EPICOR SOFTWARE CORP
Form 10-Q
May 09, 2008
Table of Contents

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 March 31, 2008

OR

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

For the transition period from ______ to ______

Commission File No. 000-20740

EPICOR SOFTWARE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**33-0277592**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

18200 Von Karman Avenue

Suite 1000

Irvine, California 92612

(Address of principal executive offices, zip code)

Registrant s telephone number, including area code: (949) 585-4000

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 ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

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

As of May 1, 2008, there were 59,316,743 shares of common stock outstanding.

FORM 10-Q INDEX

Table of Contents

PART I

FINANCIAL INFORMATION

Item 1 - Financial Statements:

EPICOR SOFTWARE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	March 31, 2008 *(Unaudited)*	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 103,463	$ 75,158
Short-term investments	1,428	1,371
Accounts receivable, net of allowance for doubtful accounts of $8,647 and $6,464 as of 2008 and 2007, respectively	102,166	98,533
Deferred income taxes	7,403	7,060
Inventory, net	8,344	4,539
Prepaid expenses and other current assets	18,312	9,184
Total current assets	241,116	195,845
Property and equipment, net	26,460	14,762
Deferred income taxes	49,776	45,025
Intangible assets, net	141,431	46,524
Goodwill	354,228	169,267
Cash designated for acquisition		161,000
Other assets	17,398	12,958
Total assets	$ 830,409	$ 645,381
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 21,153	$ 14,640
Accrued compensation and benefits	19,197	27,555
Other accrued expenses	24,492	27,372
Current portion of long-term debt	6,289	145
Current portion of accrued restructuring costs	8,860	614
Current portion of deferred revenue	90,139	70,378
Total current liabilities	170,130	140,704
Long-term debt, less current portion	382,807	230,491
Accrued restructuring costs	5,611	356
Deferred revenue	696	823
Deferred income taxes and other income taxes	10,083	10,082
Other long-term liabilities	2,260	
Total long-term liabilities	401,457	241,752

Commitments and contingencies (Note 11)

Stockholders equity:		
Common stock	61	60
Additional paid-in capital	371,651	366,737
Less: treasury stock at cost	(17,028)	(13,883)
Accumulated other comprehensive income	1,179	61
Accumulated deficit	(97,041)	(90,050)
Total stockholders equity	258,822	262,925
Total liabilities and stockholders equity	$ 830,409	$ 645,381

See accompanying notes to unaudited condensed consolidated financial statements.

3

Table of Contents

EPICOR SOFTWARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME (LOSS)

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Revenues:		
License	$ 18,504	$ 22,032
Consulting	31,402	32,723
Maintenance	46,156	39,053
Hardware and other	6,162	7,521
Total revenues	102,224	101,329
Cost of revenues	53,545	47,179
Amortization of intangible assets	7,066	4,181
Total cost of revenues	60,611	51,360
Gross profit	41,613	49,969
Operating expenses:		
Sales and marketing	21,378	18,629
Software development	13,026	8,680
General and administrative	11,952	15,408
In-process research and development	200	
Restructuring charges	4,083	221
Total operating expenses	50,639	42,938
Income (loss) from operations	(9,026)	7,031
Interest expense	(2,898)	(2,127)
Gain on sale of non-strategic asset		1,579
Interest and other income, net	847	570
Income (loss) before income taxes	(11,077)	7,053
Provision (benefit) for income taxes	(4,086)	2,620
Net income (loss)	$ (6,991)	$ 4,433
Comprehensive income (loss):		
Net income (loss)	$ (6,991)	$ 4,433
Unrealized foreign currency translation gain	1,118	33
Comprehensive income (loss)	$ (5,873)	$ 4,466

Net income (loss) per share:		
Basic	$ (0.12)	$ 0.08
Diluted	$ (0.12)	$ 0.08
Weighted average common shares outstanding:		
Basic	57,898	56,642
Diluted	57,898	57,703

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

EPICOR SOFTWARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(*Unaudited*)

	Three Months Ended March 31, 2008	2007
Operating activities		
Net income (loss)	$ (6,991)	$ 4,433
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,939	5,742
Stock-based compensation expense	2,488	3,393
Provision for doubtful accounts	(357)	828
Provision for excess and obsolete inventory	122	
Restructuring charges	4,083	221
Excess tax benefits from share-based payment arrangements	(617)	(468)
In-process research and development charge	200	
Gain on sale of non-strategic asset		(1,579)
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:		
Accounts receivable	15,153	6,131
Inventory	(2,730)	(2,450)
Prepaid expenses and other current assets	2,245	(600)
Other assets	1,222	108
Deferred income taxes	(7,096)	2,937
Accounts payable	(556)	2,757
Accrued expenses	(15,119)	(13,184)
Accrued restructuring costs	(2,601)	(789)
Deferred revenue	1,750	(1,456)
Other long-term liabilities	(50)	
Net cash provided by operating activities	85	6,024
Investing activities		
Purchases of property and equipment	(1,419)	(1,162)
Proceeds from sale of non-strategic asset		2,500
Cash paid for acquisitions, net of cash designated for acquisition of $161,000 and cash acquired	(123,128)	(41)
Net cash (used in) provided by investing activities	(124,547)	1,297
Financing activities		
Proceeds from long-term debt	160,000	
Principal payments on long-term debt	(1,538)	(285)
Debt issuance fees	(4,949)	(690)
Proceeds from exercise of stock options	1,009	478
Proceeds from employee stock purchase plan	326	399
Excess tax benefits from share-based payment arrangements	617	468
Purchase of treasury stock	(3,144)	(2,462)
Net cash provided by (used in) financing activities	152,321	(2,092)

Effect of exchange rate changes on cash	446	95
Net increase in cash and cash equivalents	28,305	5,324
Cash and cash equivalents at beginning of period	75,158	70,178
Cash and cash equivalents at end of period	$ 103,463	$ 75,502

See accompanying notes to unaudited condensed consolidated financial statements.

EPICOR SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2008

Note 1. Basis of Presentation

The accompanying Unaudited Condensed Consolidated Financial Statements included herein have been prepared by Epicor Software Corporation (the Company) in conformity with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial information for reporting on Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These Unaudited Condensed Consolidated Financial Statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

In the opinion of management, the Unaudited Condensed Consolidated Financial Statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company s financial position, results of operations and cash flows.

The results of operations for the three months ended March 31, 2008 are not necessarily indicative of the results of operations that may be reported for any other interim period or for the entire year ending December 31, 2008. The Condensed Consolidated Balance Sheet at December 31, 2007 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements, as permitted by SEC rules and regulations for interim reporting.

Inventory is comprised solely of finished goods.

Note 2. Stock-Based Compensation

The following table sets forth the total stock-based compensation expense resulting from stock options, restricted stock awards and the employee stock purchase plan included in the Company s Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) (*in thousands*):

	Three Months Ended March 31,	
	2008	2007
Cost of consulting revenues	$ 251	$ 370
Cost of maintenance revenues	111	155
Sales and marketing	875	1,098
Software development	201	262
General and administrative	1,050	1,508
Total stock-based compensation expense	$ 2,488	$ 3,393

Net cash proceeds from the exercise of stock options were $1,009,000 and $478,000 for the three months ended March 31, 2008 and 2007, respectively. In accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123-R), the Company presents excess tax benefits from stock-based compensation awards, if any, as financing cash flows rather than operating cash flows. For the three months ended March 31, 2008 and 2007, net cash provided by operating activities decreased by, and financing activities increased by, $617,000 and $468,000, respectively, related to excess tax benefits from exercise of stock-based awards. The tax benefit related to stock-based compensation for the three months ended March 31, 2008 and 2007 was $756,000 and $1,008,000, respectively. No share-based compensation was capitalized for the three months ended March 31, 2008 and 2007.

During the first quarter of 2008, the Company granted 1,127,000 shares of performance-based restricted stock to employees for annual promotions and new hires for the 2008 and 2009 performance plan years. The shares are subject to a vesting schedule and were granted pursuant to the terms of the Company s performance-based restricted

Table of Contents

stock plan. The recipients will vest in the restricted stock, or a portion thereof, in two equal, annual installments depending upon achievement of targets with respect to the Company s annual revenue and adjusted earnings before interest, taxes, depreciation and amortization (EBITDA) for each of two performance years, 2008 and 2009. Restricted stock is held in escrow, and the Company s reacquisition right will not lapse until the shares are fully vested. Upon an employee s termination of service with the Company, shares that have not vested will be forfeited and automatically transferred to and reacquired by the Company. In addition, restricted shares that do not vest as a result of the Company s non-achievement with respect to annual revenue and adjusted EBITDA performance conditions for either performance year will be forfeited and automatically transferred to and reacquired by the Company.

The performance conditions for each year are independent of the performance condition for the preceding year. Therefore, although compensation expense for all years will be measured based on the grant date fair value of the shares, the related compensation expense will be recognized separately in each year related only to the shares potentially earned in each year, assuming that it is considered to be probable that the shares will be earned each year. In addition, the compensation expense for each year is estimated and a pro rata amount is accrued on a quarterly basis. Quarterly compensation expense may include a cumulative adjustment resulting from changes in the estimated number of shares expected to be earned during that plan year.

On February 15, 2008, the Company s reacquisition right lapsed on 659,646 shares related to the performance-based restricted stock plan for the 2007 performance year. These shares are included in restricted stock at December 31, 2007. The lapse occurred following the Company s determination of its achievement of 2007 performance year performance conditions. The compensation expense related to these shares was included in the Consolidated Statements of Operations for the year ended December 31, 2007.

The Company withholds a portion of the vested shares as consideration for the Company s payment of applicable employee income taxes. As of March 31, 2008, these repurchased shares are held in treasury and are available for future reissuance. In conjunction with the quarterly vesting of restricted stock grants and vesting of the performance-based restricted stock, during the three months ended March 31, 2008, the Company acquired 257,441 and 177,667, shares of common stock, respectively, at a value of $3,144,000 and $2,462,000, respectively.

At March 31, 2008, there was approximately $1,954,000 of total unrecognized compensation expense related to restricted stock, excluding performance-based restricted stock, and $12,210,000 related to performance-based restricted stock. These costs are expected to be recognized over a weighted-average period of approximately two years. The compensation cost related to the performance-based restricted stock depends on the estimated number of shares that will vest, based on the probable outcome of the performance conditions. Therefore, the recognized compensation could vary significantly, depending on the outcome of those conditions. The Company is required at each reporting date to assess whether achievement of any performance condition is probable. Based on the Company s current assessment, the Company has recorded stock compensation expense related to performance-based restricted stock of $1,830,000 for three months ended March 31, 2008.

At March 31, 2008, there was approximately $314,000 of total unrecognized compensation expense related to unvested stock options. This cost is expected to be recognized over a weighted-average period of approximately one year.

The fair value of restricted stock that vested during the three months ended March 31, 2008 and 2007 was $9,085,000 and $194,000, respectively.

No options were granted during the three months ended March 31, 2008 and 2007. There were 244,929 options exercised during the three months ended March 31, 2008. As of March 31, 2008, there were 1,799,000 options exercisable with a weighted average remaining contractual term, weighted average exercise price and aggregate intrinsic value of 4.6 years, $8.12 and $7,536,000, respectively. The Company issues new shares to satisfy stock option exercises and stock purchases under the Company s share-based plans.

The aggregate intrinsic value above represents the total pretax intrinsic value (the difference between the Company s closing stock price on the last trading day of the quarter and the exercise price) multiplied by the number of shares that would have been received by the option holders had all option holders exercised their options on March 31, 2008. This amount changes based on the fair market value of the Company s stock.

Table of Contents

Note 3. Revenue Recognition

The Company recognizes revenue in accordance with accounting principles generally accepted in the United States of America, principally:

Statement of Position (SOP) No. 97-2, Software Revenue Recognition, issued by the American Institute of Certified Public Accountants (AICPA) and interpretations;

AICPA SOP No. 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions;

Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements, issued by the United States Securities and Exchange Commission as amended by SAB No. 104;

Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) Issue No. 00-21 Revenue Arrangements with Multiple Deliverables; and

AICPA SOP No. 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts.

The Company enters into contractual arrangements with end-users of its products to sell software licenses, maintenance services and consulting services, either separately or various combinations thereof. For each arrangement, revenues are recognized when persuasive evidence of an arrangement exists, the fees to be paid by the customer are fixed or determinable, collection of the fees is probable, delivery of the product has occurred, vendor-specific objective evidence (VSOE) of the fair value of any undelivered elements exists and no other significant obligations on the part of the Company remain.

For multiple-element software arrangements, the Company accounts for the software license component using the residual method. The residual method generally requires recognition of software license revenue in a multiple-element arrangement once all software products have been delivered and accepted by the customer and the only undelivered elements are maintenance services and/or consulting services. The fair value of the maintenance services is determined based on VSOE of fair value and is deferred and recorded ratably over the maintenance terms. Fair value for any related consulting services is determined by VSOE of fair value and generally recognized as the services are performed. After any required fair value allocations to the undelivered maintenance and/or consulting services elements, the residual contractual consideration is allocated to the license associated with the software products in the transaction. The Company s maintenance services VSOE of fair value is determined by reference to the price the Company s customers are required to pay for the services when sold-separately (i.e. the maintenance service fees paid by the Company s customers upon renewal). VSOE of fair value for consulting services is determined by reference to the price the Company s customers are required to pay for such services when sold separately, or when sold independent of any of the Company s other product or service offerings.

In certain instances, the Company enters into arrangements that include two or more non-software products or services such as hardware and related services. Such arrangements are divided into separate units of accounting provided that the delivered item has stand-alone value and there is objective and reliable evidence of the fair value of the undelivered items. The total arrangement fee is allocated to the undelivered elements based on their fair values and to the initial delivered elements using the residual method. Revenue is recognized separately, and in accordance with the Company s revenue recognition policy, for each element.

License Revenues: Amounts allocated to software license revenues sold directly by the Company are recognized at the time of shipment of the software when fair value for any undelivered elements is determinable and all the other revenue recognition criteria discussed above have been met.

Revenues on sales made to the Company s resellers are recognized upon shipment of the Company s software to the reseller when the reseller has an identified end-user and all other revenue recognition criteria noted above are met. Under limited arrangements with certain distributors, all the revenue recognition criteria have been met upon delivery of the product to the distributor and, accordingly, revenues are recognized at that time. The Company does not offer a right of return on its products.

Consulting Service Revenues: Consulting service revenues are comprised of consulting and implementation services and, to a limited extent, training. Consulting services are generally sold on a time-and-materials basis and can include services ranging from software installation to data conversion and building non-complex interfaces to allow the software to operate in integrated environments. Consulting engagements can last anywhere from one day to several months and are based strictly on the customer s requirements and complexities and are independent of the

Table of Contents

functionality of the Company s software. The Company s software, as delivered, can generally be used by the customer for the customer s purpose upon installation. Further, implementation and integration services provided are generally not essential to the functionality of the software, as delivered, and do not result in any material changes to the underlying software code. Services are generally separable from the other elements under the same arrangement since the performance of the services are not essential to the functionality of the other elements of the transaction, the services are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services, and VSOE of fair value exists for the services based on sold separately data. If, in the services element of the arrangement the Company performs significant production, modification or customization of its software, the Company applies the provisions of SOP No. 81-1, otherwise SOP No. 97-2 applies. For services performed on a time-and-material basis, revenue is recognized when the services are performed and billed. On occasion, the Company enters into fixed fee arrangements or arrangements in which customer payments are tied to achievement of specific milestones. In fixed fee arrangements, revenue is recognized as services are performed as measured by hours incurred to date, as compared to total estimated hours to be incurred to complete the work. In milestone achievement arrangements, the Company recognizes revenue as the respective milestones are achieved.

The Company has recorded unbilled consulting revenues totaling $4,025,000 and $2,810,000 at March 31, 2008 and December 31, 2007, respectively. These unbilled revenues represent consulting services performed during the last few business days of the quarter but not billed until the following month. The Company cuts-off consulting billing prior to the end of each month. Unbilled consulting revenue is recorded in accounts receivable in the accompanying Condensed Consolidated Balance Sheets.

Maintenance Service Revenues: Maintenance service revenues consist primarily of fees for providing unspecified software upgrades on a when-and-if-available basis and technical support over a specified term, which is typically twelve months. Maintenance revenues are typically paid in advance and are recognized on a straight-line basis over the term of the contract.

Hardware Revenues: In some cases, the Company resells third party hardware systems and related peripherals as part of an end-to-end solution requested by its customers. Hardware revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection is considered probable. The Company considers delivery to occur when the product is shipped and title and risk of loss have passed to the customer.

Software License Indemnification: The Company s standard software license agreements contain an infringement indemnity clause under which the Company agrees to defend, indemnify and hold harmless our customers and business partners against liability and damages arising from third party claims that the Company s products violate or infringe the intellectual property rights of others. These clauses constitute a form of guarantee that is subject to the disclosure requirements, but not the initial recognition or measurement provisions, of FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. The Company has never lost a third party infringement claim, and, to date, the Company s costs to defend such claims and/or lawsuits have been insignificant. Although it is possible that in the future third parties may claim that the Company s current or future software solutions infringe upon their intellectual property, a maximum obligation arising out of these types of agreements is not explicitly stated and, therefore, the overall maximum amount of these obligations cannot be reasonably estimated.

Sales taxes collected from customers are recorded on a net basis.

Note 4. Basic and Diluted Net Income Per Share

Net income (loss) per share is calculated in accordance with SFAS No. 128, Earnings per Share. Under the provisions of SFAS No. 128, basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period, excluding shares of unvested restricted stock. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common and potential common shares outstanding during the period if their effect is dilutive.

For the three months ended March 31, 2008 and 2007, options to purchase 763,000 and 536,000 shares of common stock, respectively, with weighted average prices of $13.51 and $14.42, respectively, were outstanding but not included in the computation because the effect would be anti-dilutive.

Table of Contents

On May 8, 2007, the Company closed an offering of $230 million aggregate principal amount of 2.375% convertible senior notes due in 2027 (Note 8). The notes are unsecured and convertible into cash or, at the Company s option, cash and shares of the Company s common stock, at an initial conversion rate of 55.2608 shares of common stock per $1,000 principal amount of notes, which is equivalent to an initial conversion price of approximately $18.10 per share. Pursuant to the terms of the notes, the principal amount of the notes is settleable in cash and only the amount of conversion value, as defined, in excess of the principal amount of the notes is settleable in cash or shares. Therefore, the notes are only dilutive when the common stock price exceeds the conversion price, and no shares have been included in the calculation of diluted net income per share as the conversion value did not exceed the principal amount of the notes.

The following table computes basic and diluted net income (loss) per share (*in thousands, except per share amounts*):

	Three Months Ended March 31,	
	2008	**2007**
Net income (loss) applicable to common stockholders	$ (6,991)	$ 4,433
Basic:		
Weighted average common shares outstanding	60,138	59,179
Weighted average common shares of unvested restricted stock	(2,240)	(2,537)
Shares used in the computation of basic net income (loss) per share	57,898	56,642
Net income (loss) per share applicable to common stockholders basic	$ (0.12)	$ 0.08
Diluted:		
Shares used in the computation of basic net income per share	57,898	56,642
Stock options and employee stock purchase plan (ESPP) shares		757
Unvested restricted stock		304
Shares used in the computation of diluted net income per share	57,898	57,703
Net income per share applicable to common stockholders diluted	$ (0.12)	$ 0.08

Note 5. Acquisitions and Disposition

Acquisitions are accounted for under the purchase method of accounting, in accordance with SFAS No. 141, Business Combinations. Management is responsible for determining the fair value of the assets acquired and liabilities assumed. The fair value of the assets acquired and liabilities assumed represent management s estimate of fair value. The Company conducts an active mergers and acquisitions program. Acquisition candidates are determined to be viable if they meet the Company s stringent criteria which includes, but is not limited to, product and technology fit, culture, geography, revenue synergies and financial contribution. Because the software industry is consolidating, the purchase environment is competitive. Valuations are determined through a combination of earnings per share accretion models which assume certain cost synergies, internal rate of return calculations, discounted cash flow models, outside valuations and appraisals and market conditions. The results of the acquisitions are included in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) from the respective acquisition dates forward.

Acquisitions

NSB Retail Systems PLC

On February 7, 2008, the Company completed its acquisition of NSB Retail Systems PLC (NSB). NSB designs, develops, markets and supports store and merchandising solutions to retailers of apparel, footwear and specialty merchandise. The acquisition of NSB provides an expanded portfolio of products and services for large and mid-sized specialty retailers and department stores, as well as a fully hosted, managed service offering designed for smaller retailers who are interested in rapid implementation via an on-demand versus on-premise offering.

10

Table of Contents

Pursuant to the terms of the acquisition agreement, shareholders of NSB received £0.38 in cash for each NSB ordinary share. The value of the fully diluted share capital of NSB was approximately $311,845,000, not including transaction costs, based on the exchange rates in effect at the time the U.S. dollars were converted to pounds sterling for purposes of the transaction. The consideration payable under the agreement was funded by the Company with approximately $161,000,000 in existing cash balances, with the balance of the consideration being funded by drawing from funds available pursuant to the 2007 credit facility (Note 8). In addition, on February 11, 2008, the Company sold the NSB acquisition British pound sterling call options that were marked to market at December 31, 2007 at $1,802,000 back to the issuing institutions for $192,000, resulting in net foreign currency loss of $1,610,000. The loss resulted from depreciation of pounds sterling against the U.S. Dollar. The net loss is included in Interest and other income, net, in the Condensed Consolidated Statements of Operations.

The total preliminary purchase price for NSB is shown below (*in thousands*):

Cash	$ 311,845
Transaction costs	5,258
Total purchase price	$ 317,103

The acquisition of NSB is accounted for as a purchase business combination as defined in SFAS No. 141, Business Combinations. Under the purchase method of accounting, the purchase price was allocated to NSB s tangible and intangible assets acquired and liabilities assumed based on their estimated fair values as of February 7, 2008, with any excess being ascribed to goodwill. Management is primarily responsible for determining the fair values of these assets. The fair value of the assets acquired and liabilities assumed represent management estimate of fair values. The purchase price allocation and transaction costs are preliminary and will be adjusted upon completion of the final valuation of acquired assets and liabilities assumed, including income tax assets and liabilities. See Note 6 for a discussion of goodwill and intangibles acquired.

The following table summarizes the preliminary allocation of the purchase price (*in thousands*):

Fair value of tangible assets acquired:	
Cash and marketable securities	$ 33,181
Accounts receivable	17,688
Inventory	1,196
Property and equipment	11,933
Prepaid and other assets	4,587
Deferred tax asset	5,351
Total tangible assets acquired	73,936
Acquired technology	58,700
Acquired in-process research and development	200
Customer base	39,300
Trade name	3,500
Goodwill	184,007
Accounts payable and accrued expenses	(22,948)
Deferred revenue	(17,328)
Other long-term liabilities	(2,264)
Net assets acquired	$ 317,103

In connection with the acquisition, the Company formulated a restructuring plan for the NSB operations. As a result, the Company recorded a liability of $4,344,000 for the costs related to involuntary employee terminations. This liability was included in the allocation of the purchase price in accordance with SFAS No. 141, Business Combinations and EITF Issue No. 95-3 Recognition of Liabilities in Connection with a Purchase Business Combination. Execution of the restructuring plan was substantially completed as of March 31, 2008.

Included in the Company s operating results for three months ended March 31, 2008 is a charge of $200,000 for the acquired in-process research and development expenses related to the NSB acquisition. The in-process research and development expenses arose from new products that were under development at the date of the acquisition and were expected to eventually lead to new products but had not yet established technological feasibility and for which no future alternative use was identified. The valuation of the in-process research and development projects were based upon the discounted expected future cash flows of the products over the products expected life, reflecting the estimated stage of completion of the projects and the estimate of the costs to complete the projects.

Goodwill is amortizable for tax purposes when determining foreign earnings subject to tax in the U.S. A portion of the goodwill is amortizable for tax in the foreign jurisdiction.

Professional Advantage Pty Limited

On May 16, 2007, the Company acquired the assets of a division of Professional Advantage Pty Limited (PA), a privately held reseller located in Australia. The primary purpose of this acquisition was to increase the Company s presence and direct customer base in the territories covered by PA.

The purchase price was allocated to PA s tangible and intangible assets acquired and liabilities assumed based on their estimated fair values as of May 16, 2007. The Company is amortizing the acquired customer base over seven years and the acquired technology over five years. The following table summarizes the allocation of the purchase price (*in thousands*):

Cash	$ 16,000
Transaction costs	631
Total	$ 16,631
Fixed assets	$ 49
Customer base	5,728
Acquired technology	1,199
Goodwill	10,626
Accrued liabilities	(632)
Deferred revenue	(339)
Net assets acquired	$ 16,631

Goodwill is amortizable for tax purposes when determining foreign earnings subject to tax in the U.S. It is amortizable for tax in the foreign jurisdictions. The pro forma impact of this acquisition was not significant to the Company s historical results of operations.

Pro Forma Information

Actual results of operations of the companies acquired in 2008 and 2007 are included in the consolidated financial statements from their respective dates of acquisition. The unaudited pro forma statement of operations data of the Company set forth below gives effect to the acquisition by Epicor of NSB using the purchase method as if it occurred on January 1, 2007, and includes amortization of identified intangibles, interest expense on debt incurred to finance the acquisitions, elimination of amortization related to NSB intangibles not assumed in the acquisition, and the in-process research and development charge. This pro forma information is presented for illustrative purposes only and is not necessarily indicative of the combined financial results of operations for future periods or the financial results of operations that actually would have been realized had the acquisition occurred at that time (*in thousands, except per share data*).

	(Unaudited) **Three Months Ended March 31,**	
	2008	**2007**
Total revenues	$ 107,940	$ 119,603
Net income (loss)	$ (11,632)	$ 1,176

Net income (loss) per share:		
Basic	$ (0.20)	$ 0.02
Diluted	$ (0.20)	$ 0.02

12

Table of Contents

Disposition

Sale of Non-Strategic Asset

During March 2007, the Company entered into an arrangement to sell the assets of its payroll bureau operations in Russia. In connection with this asset sale arrangement, the Company also entered into an arrangement with the same party to license the iScala payroll product for resale on an exclusive basis in certain Eastern European territories. This transaction was accounted for as a multiple-element arrangement under EITF Issue No. 00-21. Based on an estimated fair value of the payroll bureau, the Company allocated $2,500,000 of the total consideration to the sale of these assets. This consideration, less the carrying amounts of $786,000 of goodwill and $113,000 of net customer base intangible assets originally recorded in connection with the 2004 acquisition of Scala and $22,000 of net tangible assets, resulted in a net gain of $1,579,000 which is included in gain on sale of non-strategic asset in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for three months ended March 31, 2007. The remaining consideration related to the iScala payroll product license is included in license revenues in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the three months ended March 31, 2007.

Note 6. Goodwill and Intangible Assets

In acquisitions accounted for using the purchase method, goodwill is recorded for the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net tangible and identified intangible assets acquired. SFAS No. 142, Goodwill and Other Intangible Assets, requires an annual review of goodwill and indefinite-lived intangibles for possible impairment. In accordance with SFAS No. 142, the Company performed an impairment review of its recorded goodwill in 2007 and determined that no impairment of goodwill existed because the estimated fair value of each reporting unit exceeded its carrying amount. The following table represents the balance and changes in goodwill by reporting unit as of and for the three months ended March 31, 2008 (*in thousands*):

	License	Consulting	Maintenance	Total
Balance as of December 31, 2007	$ 51,670	$ 39,471	$ 78,126	$ 169,267
NSB acquisition	82,111	28,866	73,030	184,007
Foreign currency translation	170	371	207	748
Other	28	24	154	206
Balance as of March 31, 2008	$ 133,979	$ 68,732	$ 151,517	$ 354,228

The following is the average amortization period for intangible assets:

	Average Amortization Periods
Acquired technology	5 years
Customer base	7 years
Trademark	5 years
Covenants not to compete	1-2 years

The following represents the change in intangible assets recorded during 2008, including intangible assets recorded as a result of the NSB acquisition and additional change due to foreign currency translation (*in thousands*):

	NSB	Foreign Currency Translation	Total Change
Acquired technology	$ 58,700	$ 58	$ 58,758
Customer base	39,300	819	40,119
Trademark	3,500	8	3,508

Covenant not to compete	57	57

Table of Contents

Intangibles assets are amortized over the estimated economic life of the assets. As of March 31, 2008, the Company has not identified any indicators of impairment associated with identified intangible assets.

The following table summarizes the components of intangible assets (*in thousands):*

	As of March 31, 2008			As of December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Acquired technology	$ 137,481	$ 59,142	$ 78,339	$ 78,723	$ 54,459	$ 24,264
Customer base	77,474	20,855	56,619	37,355	18,684	18,671
Trademark	13,808	7,335	6,473	10,300	6,711	3,589
Covenant not to compete	2,247	2,247		2,190	2,190	
Total	$ 231,010	$ 89,579	$ 141,431	$ 128,568	$ 82,044	$ 46,524

Amortization expense of the Company s intangible assets included in cost of revenues for the three months ended March 31, 2008 and 2007 was $7,066,000 and $4,181,000, respectively. Amortization expense of the Company s intangible assets included in general and administrative expense for the three months ended March 31, 2008 and 2007 was $0 and $47,000, respectively. Estimated amortization expense for the remainder of 2008, 2009, 2010, 2011, 2012 and thereafter is approximately $26,167,000, $31,170,000, $27,999,000, $21,647,000, $20,134,000 and $14,314,000, respectively.

Note 7. Restructuring Charges

During the first quarter of 2008, the Company recorded restructuring charges of $4,083,000. This charge represents severance costs related to management severance and cost reductions from the elimination of redundancies in the Company s retail business resulting from the NSB acquisition. In connection with these restructuring costs, the Company terminated 35 employees or approximately 1% of the Company s workforce at that time from all functional areas. As of March 31, 2008, all of these terminations had been completed.

In connection with the Company s acquisition of NSB, the Company formulated a restructuring plan for the NSB operations. In connection with this plan, the Company recorded a liability in purchase accounting of $4,344,000 for the separation costs associated with the NSB reduction in workforce. The Company terminated 79 NSB employees, or 10% of the NSB workforce. At March 31, 2008, 59 of these terminations had been completed and all other employees to be terminated have been notified.

During the three months ended March 31, 2008, the Company made $3,092,000 in cash payments (or otherwise settled) against reserves associated with its restructuring activities.

Note 8. Credit Facility and Debt Offering

Credit Facilities

On March 30, 2006, the Company entered into a credit agreement with several financial institutions (the 2006 credit facility), consisting of a term loan and a revolver. In May 2007, the Company completed a debt offering for $230 million convertible senior notes and used a portion of the proceeds to repay the outstanding balance of the term loan. On May 1, 2007, the credit agreement for the 2006 credit facility was amended to permit this debt offering described above.

Effective December 17, 2007, the Company voluntarily terminated the 2006 credit facility as a result of entering into the 2007 credit facility described below. There were no premiums or penalties incurred by the Company in connection with the termination of the 2006 credit facility and all amounts outstanding under 2006 credit facility were deemed paid in full on the termination date.

Table of Contents

On December 16, 2007, the Company entered into a credit agreement with several financial institutions (the 2007 credit facility), which provides for term loans in an amount up to $100 million and revolving loans in an amount up to $100 million with an option for the Company to increase the revolving loan commitments and/or the term loan commitments by an aggregate amount of up to $50 million pursuant to an accordion feature for a total secured loan facility of up to $250 million. In connection with the 2007 credit facility, the Company agreed to certain financial and other covenants. Funds available under the 2007 credit facility were allowed to be used by the Company to finance its acquisition of NSB (Note 5), to pay the fees and expenses incurred in connection with the NSB acquisition, to provide ongoing working capital and for other general corporate purposes of the Company and its subsidiaries following the NSB acquisition. The Company may also use a portion of the available borrowing capacity to repurchase outstanding shares of its common stock.

On February 11, 2008, the Company amended the 2007 credit facility to exercise the accordion feature contained in the facility and increase the total credit facility to $250 million, consisting of $100 million of term loans and $150 million of revolving loans. On February 19, 2008, the Company borrowed $100 million in term loans and $60 million of revolving loans under the 2007 credit facility and used the proceeds to finance the NSB acquisition and to pay certain fees and expenses incurred in connection with the NSB acquisition. Interest under the 2007 credit facility is based, at the option of the Company, on either (i) the base rate, which is defined as a fluctuating rate per annum equal to the higher of the average rate of the overnight federal funds and Administrative Agent s prime rate as announced from time to time, plus a margin equal to between .50% and 1.75%, depending on the Company s senior secured leverage ratio as of the fiscal quarter most recently ended or (ii) a floating per annum rate (based upon one, two, three, six or nine-month interest periods) based on BBA LIBOR plus a margin equal to between 1.50% and 2.75%, depending on the Company s senior secured leverage ratio as of the fiscal quarter most recently ended.

On March 31, 2008, the Company made a mandatory principal payment of $1.25 million against the term loan from discretionary funds. As of March 31, 2008, the Company had borrowing capacity of $90 million under the 2007 credit facility and the weighted average interest rate applicable to outstanding loans under the 2007 credit facility was 5.39%. As of March 31, 2008, the Company was in compliance with all covenants included in the terms of the 2007 credit facility.

On April 18, 2008, the Company entered into interest rate swap agreements to convert a portion of the Company s interest rate variability to a fixed rate basis as required under the 2007 credit facility. The interest rate swaps qualify for hedge accounting treatment pursuant to SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. The changes in the fair value of the interest rate swaps will be reflected in the carrying value of the interest rate swap on the balance sheet. The differential to be paid or received on the interest rate swap agreements will be accrued and recognized as an adjustment to interest expense as interest rates change. The interest rate swap agreements commence effective June 30, 2008 and have an aggregate notional amount of $20 million maturing March 31, 2009 and $30 million maturing September 30, 2009. The effective interest rate for the notional amounts covered by the swap agreements is 5.67%.

Debt Offering

On May 8, 2007, the Company closed an offering of $230 million aggregate principal amount of 2.375% convertible senior notes due in 2027. The notes are unsecured and pay interest semiannually at a rate of 2.375% per annum until May 15, 2027. The notes are convertible into cash or, at the Company s option, cash and shares of the Company s common stock, at an initial conversion rate of 55.2608 shares of common stock per $1,000 principal amount of notes, which is equivalent to an initial conversion price of approximately $18.10 per share. Pursuant to the terms of the notes, the principal amount of the notes is settleable in cash and only the amount of conversion value, as defined, in excess of the principal amount of the notes is settleable in cash or shares. The initial conversion price represents a 30% premium over the last reported sale price of the Company s common stock prior to the offering that began on May 2, 2007, which was $13.92 per share. The conversion rate will be adjusted upon the occurrence of certain events defined in the indenture. The share settlement feature upon conversion of the senior convertible notes is generally limited to the conversion value in excess of the par value of the notes. The notes do not contain any restrictive financial covenants.

The notes are convertible under the following circumstances: (1) during any fiscal quarter after the fiscal quarter ending June 30, 2007 (and only during such fiscal quarter), if the closing sale price of the Company s common stock for each of 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter exceeds 130% of the conversion price in effect on the last trading day of the immediately preceding fiscal quarter; (2) during the five consecutive business days immediately after any five consecutive trading day period (the note measurement period) in which the trading price per $1,000 principal amount of notes for each such trading day was equal to or less than 98% of the conversion value of the notes for such trading day during the note measurement period; (3) upon our calling such notes for redemption; (4) upon the occurrence of specified corporate transactions and (5) during the 30 days prior to, but excluding, any scheduled purchase date and at any time on or after May 15, 2026, and before the close of business on the business day immediately preceding the maturity date.

On or after May 15, 2014, the Company may from time to time at its option redeem the notes, in whole or in part, for cash, at a redemption price equal to 100% of the principal amount of the notes we redeem, plus any accrued and unpaid interest to, but excluding, the redemption date. On each May 15, 2014, May 15, 2017 and May 15, 2022, holders may require us to purchase all or a portion of their notes at a purchase price equal to 100% of the principal amount of the notes to be purchased, plus any accrued and unpaid interest to, but excluding, the purchase date.

The net proceeds of the offering were $222.0 million after deducting the underwriters discounts and commissions and offering expenses. On May 8, 2007, the Company used approximately $94 million of the proceeds to pay in full its term loan outstanding under the 2006 credit facility. The balance of the net proceeds of the offering will be used for working capital, capital expenditures and other general corporate purposes, which may include funding acquisitions of businesses, technologies or product lines. The Company may also use a portion of the remaining net proceeds to repurchase outstanding shares of its common stock.

Note 9. Provision for Income Taxes

The Company adopted FASB Interpretation (FIN) 48, Accounting for Uncertainty in Income Taxes (FIN 48) on January 1, 2007. At March 31, 2008, the Company had $21.4 million of gross unrecognized tax benefits, of which $2.7 million would reduce the effective tax rate if recognized. The Company s continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. As of March 31, 2008, the Company has approximately $221,000 of accrued interest and penalties related to uncertain tax positions.

The tax years 1994 to 2008 remain open to examination by the major taxing jurisdictions to which the Company is subject. The Company is currently under examination in various locations including Canada and United Kingdom. The Company does not believe the amount of unrecognized tax benefits as of March 31, 2008 will significantly increase or decrease within 12 months.

The provision for income taxes consists of provisions for federal, state and foreign income taxes. The Company operates in an international environment with significant operations in various locations outside the U.S. Accordingly, the consolidated income tax rate is a composite rate reflecting the earnings in the various locations and the applicable rates.

The Company recorded a benefit for income taxes of ($4,086,000) and a provision for income taxes of $2,620,000 for the three months ended March 31, 2008 and 2007, respectively. The effective income tax rates were (36.9%) and 37.2% for the three months ended March 31, 2008 and March 31, 2007, respectively. The effective tax rate differs from the statutory U.S. federal income tax rate of 35% primarily due to state and foreign income tax and permanent differences between GAAP pre-tax income and taxable income.

The Company has provided a valuation allowance on certain foreign deferred tax assets and intends to maintain a valuation allowance until sufficient positive evidence exists to support its reversal. In general, any realization of these deferred tax assets will reduce the Company s effective rate in future periods. Under the provisions of SFAS No. 109, Accounting for Income Taxes, and related interpretations, future period reductions to the valuation allowance related to Scala s deferred tax assets that existed as of the date of acquisition of Scala are first credited against goodwill, then to the other identifiable intangible assets existing at the date of acquisition, and then, once these assets have been reduced to zero, credited to the income tax provision. In accordance with FIN 18, Accounting for Income Taxes in Interim Periods, the Company makes its best estimate of the tax rate expected to be applicable for the full fiscal year. The rate so determined is used to provide for income taxes in an interim period. Absent a material or discrete adjustment to deferred taxes, the deferred tax accounts are adjusted at year end.

The Company regularly reviews the deferred tax assets for recoverability and the need for a valuation allowance. The Company analyzes both negative and positive evidence, and the strength of such evidence. This analysis includes assessment by jurisdiction of forecasted and historic financial performance and taxable income, performance compared to profit and revenue targets, strength or weakness of revenue generating functions, expense forecasts, and other factors. The valuation allowance will continue to be evaluated over future quarters.

Table of Contents

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires the formulation of estimates and assumptions that affect the reported amount of tax-related assets and liabilities and income tax provisions. The Company assesses the recoverability of the deferred tax assets on an ongoing basis, analyzing all available positive and negative evidence to determine whether, based on such evidence, it is more likely than not that some portion or all of the Company s net deferred assets will be realized in future periods. This assessment requires significant judgment. In addition, the Company has made estimates involving current and deferred income taxes, tax attributes relating to the interpretation of various tax laws and historical bases of tax attributes associated with certain tangible and intangible assets. Failure to achieve the Company s operating income targets may change its assessment regarding the recoverability of the net deferred tax assets and such change could result in a valuation allowance being recorded against some or all of the deferred tax assets. Any increase in a valuation allowance would result in additional income tax expense, lower stockholders equity and could have a significant impact on the Company s earnings in future periods.

U.S. income taxes were not provided for on undistributed earnings from certain non-U.S. subsidiaries. Those earnings are considered to be permanently reinvested in accordance with Accounting Principles Board (APB) Opinion 23.

Note 10. Segment Information

In accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, the Company has prepared operating segment information to report components that are evaluated regularly by the Company s chief operating decision maker in deciding how to allocate resources and in assessing performance.

The Company s reportable operating segments include licenses, consulting, maintenance and hardware and other. Currently, the Company does not separately allocate amortization of intangible assets or operating expenses to these segments, nor does it allocate specific assets to these segments. Therefore, the segment information reported includes only revenues, cost of segment revenues and segment gross profit. Excluded from the table below is amortization of intangible assets for the three months ended March 31, 2008 and 2007 of $7,066,000 and $4,181,000, respectively.

Operating segment data for the three months ended March 31, 2008 and 2007 is as follows (*in thousands*):

	Licenses	Consulting	Maintenance	Hardware and Other	Total
Three months ended March 31, 2008:					
Revenues	$ 18,504	$ 31,402	$ 46,156	$ 6,162	$ 102,224
Cost of revenues	3,578	31,957	11,590	6,420	53,545