

BLACKBAUD INC
Form 10-Q
August 11, 2008
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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, 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 number: 000-50600

BLACKBAUD, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

11-2617163
(I.R.S. Employer
Identification No.)

2000 Daniel Island Drive

Charleston, South Carolina 29492

(Address of principal executive offices, including zip code)

(843) 216-6200

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, 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.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

The number of shares of the registrant's Common Stock outstanding as of August 1, 2008 was 43,572,381.

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BLACKBAUD, INC.

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Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial statements****Blackbaud, Inc.****Consolidated balance sheets****(Unaudited)**

(in thousands, except share amounts)	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	\$ 9,979	\$ 14,775
Accounts receivable, net of allowance of \$1,728 and \$1,935 at June 30, 2008 and December 31, 2007, respectively	64,227	44,689
Prepaid expenses and other current assets	10,287	11,279
Deferred tax asset, current portion	2,802	2,276
Total current assets	87,295	73,019
Property and equipment, net	16,967	16,962
Deferred tax asset	48,795	51,696
Goodwill	61,175	58,275
Intangible assets, net	35,133	37,272
Other assets	490	470
Total assets	\$ 249,855	\$ 237,694
Liabilities and stockholders equity		
Current liabilities:		
Trade accounts payable	\$ 6,341	\$ 5,802
Accrued expenses and other current liabilities	18,180	20,575
Capital lease obligations, current portion	470	513
Short-term debt	24,500	-
Deferred revenue	107,000	93,106
Total current liabilities	156,491	119,996
Capital lease obligations, noncurrent	352	586
Deferred revenue, noncurrent	3,093	2,994
Other noncurrent liabilities	613	1,015
Total liabilities	160,549	124,591
Commitments and contingencies (Note 9)		
Stockholders equity:		
Preferred stock; 20,000,000 shares authorized, none outstanding	-	-
Common stock, \$0.001 par value; 180,000,000 shares authorized, 50,499,324 and 50,450,675 shares issued at June 30, 2008 and December 31, 2007, respectively	50	50

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Additional paid-in capital	110,771	105,687
Treasury stock, at cost; 6,933,667 and 5,431,852 shares at June 30, 2008 and December 31, 2007, respectively	(121,514)	(85,487)
Accumulated other comprehensive income	91	137
Retained earnings	99,908	92,716
Total stockholders equity	89,306	113,103
Total liabilities and stockholders equity	\$ 249,855	\$ 237,694

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

Table of Contents**Blackbaud, Inc.****Consolidated statements of operations****(Unaudited)**

(in thousands, except share and per share amounts)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Revenue				
License fees	\$ 9,603	\$ 11,030	\$ 19,238	\$ 19,097
Services	25,336	22,218	48,912	40,532
Maintenance	26,371	23,164	51,801	45,600
Subscriptions	9,010	5,539	17,795	10,332
Other revenue	2,182	2,094	4,192	3,629
Total revenue	72,502	64,045	141,938	119,190
Cost of revenue				
Cost of license fees	807	804	1,649	1,280
Cost of services	14,905	13,606	30,598	25,722
Cost of maintenance	4,595	4,220	9,299	8,239
Cost of subscriptions	3,824	2,190	7,480	4,114
Cost of other revenue	2,023	1,776	3,871	3,136
Total cost of revenue	26,154	22,596	52,897	42,491
Gross profit	46,348	41,449	89,041	76,699
Operating expenses				
Sales and marketing	15,672	14,223	30,911	27,140
Research and development	8,642	6,926	17,409	13,753
General and administrative	7,273	6,592	14,539	12,736
Amortization	167	98	334	182
Total operating expenses	31,754	27,839	63,193	53,811
Income from operations	14,594	13,610	25,848	22,888
Interest income	34	156	199	527
Interest expense	(148)	(379)	(218)	(746)
Other income (expense), net	49	(8)	(40)	(77)
Income before provision for income taxes	14,529	13,379	25,789	22,592
Income tax provision	5,542	5,176	9,759	8,633
Net income	\$ 8,987	\$ 8,203	\$ 16,030	\$ 13,959
Earnings per share				
Basic	\$ 0.21	\$ 0.19	\$ 0.37	\$ 0.32

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Diluted	\$ 0.21	\$ 0.19	\$ 0.36	\$ 0.31
Common shares and equivalents outstanding				
Basic weighted average shares	42,776,609	43,355,261	43,336,989	43,508,166
Diluted weighted average shares	43,457,710	44,338,741	44,064,436	44,501,949
Dividends per share	\$ 0.100	\$ 0.085	\$ 0.200	\$ 0.170

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

Table of Contents**Blackbaud, Inc.****Consolidated statements of cash flows****(Unaudited)**

(in thousands)	Six months ended June 30,	
	2008	2007
Cash flows from operating activities		
Net income	\$ 16,030	\$ 13,959
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,107	3,570
Provision for doubtful accounts and sales returns	2,199	1,271
Stock-based compensation expense	4,678	3,511
Excess tax benefit on exercise of stock options	(18)	(709)
Deferred taxes	2,363	4,028
Other non-cash adjustments	37	24
Changes in assets and liabilities, net of acquisition:		
Accounts receivable	(20,886)	(11,897)
Prepaid expenses and other assets	994	1,250
Trade accounts payable	519	(1,388)
Accrued expenses and other current liabilities	(2,773)	(3,589)
Deferred revenue	13,218	9,360
Net cash provided by operating activities	21,468	19,390
Cash flows from investing activities		
Purchase of property and equipment	(2,957)	(3,128)
Purchase of net assets of acquired companies	(2,895)	(59,243)
Net cash used in investing activities	(5,852)	(62,371)
Cash flows from financing activities		
Proceeds from issuance of debt	27,200	30,000
Proceeds from exercise of stock options	393	828
Excess tax benefit on exercise of stock options	18	709
Payments on debt	(2,708)	(16,922)
Payments of deferred financing fees	(47)	-
Payments on capital lease obligations	(276)	(204)
Purchase of treasury stock	(36,027)	(14,106)
Dividend payments to stockholders	(8,843)	(7,503)
Net cash used in financing activities	(20,290)	(7,198)
Effect of exchange rate on cash and cash equivalents	(122)	59
Net decrease in cash and cash equivalents	(4,796)	(50,120)
Cash and cash equivalents, beginning of period	14,775	67,783
Cash and cash equivalents, end of period	\$ 9,979	\$ 17,663

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

Table of Contents**Blackbaud, Inc.****Consolidated statements of stockholders' equity and comprehensive income****(Unaudited)**

(in thousands, except share amounts)	Comprehensive income	Common stock Shares	Common stock Amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income	Retained earnings	Total stockholders equity
Balance at December 31, 2006		49,205,522	\$ 49	\$ 88,409	\$ (69,630)	\$ 232	\$ 76,298	\$ 95,358
Net income	\$ 31,724	-	-	-	-	-	31,724	31,724
Payment of dividends	-	-	-	-	-	-	(15,074)	(15,074)
Purchase of 633,878 treasury shares under stock repurchase program and surrender of 54,079 shares upon restricted stock vesting	-	-	-	-	(15,857)	-	-	(15,857)
Exercise of stock options	-	776,125	1	5,450	-	-	-	5,451
Tax impact of exercise of nonqualified stock options	-	-	-	4,931	-	-	-	4,931
Cumulative effect of FIN 48 adoption	-	-	-	-	-	-	(269)	(269)
Stock-based compensation	-	-	-	6,897	-	-	37	6,934
Restricted stock grants	-	549,320	-	-	-	-	-	-
Restricted stock cancellations	-	(80,292)	-	-	-	-	-	-
Translation adjustment, net of tax	(95)	-	-	-	-	(95)	-	(95)
Comprehensive income	\$ 31,629							
Balance at December 31, 2007		50,450,675	\$ 50	\$ 105,687	\$ (85,487)	\$ 137	\$ 92,716	\$ 113,103
Net income	\$ 16,030	-	-	-	-	-	16,030	16,030
Payment of dividends	-	-	-	-	-	-	(8,843)	(8,843)
Purchase of 1,499,745 treasury shares under stock repurchase program and surrender of 2,070 shares upon restricted stock vesting	-	-	-	-	(36,027)	-	-	(36,027)
Exercise of stock options	-	63,286	-	393	-	-	-	393
Tax impact of exercise of nonqualified stock options	-	-	-	18	-	-	-	18
Stock-based compensation	-	-	-	4,673	-	-	5	4,678
Restricted stock grants	-	7,928	-	-	-	-	-	-
Restricted stock cancellations	-	(22,565)	-	-	-	-	-	-
Translation adjustment, net of tax	(46)	-	-	-	-	(46)	-	(46)
Comprehensive income	\$ 15,984							
Balance at June 30, 2008		50,499,324	\$ 50	\$ 110,771	\$ (121,514)	\$ 91	\$ 99,908	\$ 89,306

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

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Blackbaud, Inc.

Condensed notes to consolidated financial statements

(Unaudited)

1. Organization

Blackbaud, Inc. (the Company) is the leading global provider of software and related services designed specifically for nonprofit organizations, and provides products and services that enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage finances and optimize internal operations. As of June 30, 2008, the Company had approximately 19,000 active customers distributed across multiple verticals within the nonprofit market including education, foundations, health and human services, religion, arts and cultural, public and societal benefits, environment and animal welfare and international foreign affairs.

2. Summary of significant accounting policies

Unaudited interim financial statements

The interim consolidated financial statements as of June 30, 2008, and for the three and six months ended June 30, 2008 and 2007, have been prepared by the Company pursuant to the rules and regulations of the SEC for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to state fairly the consolidated balance sheets, consolidated statements of operations, consolidated statements of cash flows and consolidated statements of stockholders' equity and comprehensive income for the periods presented in accordance with accounting principles generally accepted in the United States (U.S. GAAP). The consolidated balance sheet at December 31, 2007 has been derived from the audited consolidated financial statements at that date. Operating results for the three and six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2008 or any other future period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been omitted in accordance with the rules and regulations for interim reporting of the SEC. These interim 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 and other forms filed with the SEC from time to time.

Basis of consolidation

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

Reclassifications

Certain amounts in the 2007 statement of cash flows have been reclassified to conform to the 2008 presentation. Under the current presentation, the excess tax benefit on the exercise of stock options is shown as a separate adjustment to reconcile net income to net cash provided by operating activities; in prior periods the change was included in accrued expenses and other current liabilities in 2007.

Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Areas of the financial statements where estimates may have the most significant effect include revenue recognition, the allowance for sales returns and doubtful accounts, valuation of long-lived and intangible assets and goodwill, stock-based compensation and provision for income taxes and valuation of deferred tax assets. Changes in the facts or circumstances underlying these estimates could result in material changes and actual results could differ from these estimates.

Revenue recognition

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The Company's revenue is generated primarily by selling perpetual licenses or charging for the use of its software products and providing support, training, consulting, technical and other professional services for those products. The Company makes available certain of its software products for use in hosted application arrangements without licensing perpetual rights to the software (hosted applications). Additionally, the Company provides hosting services to customers

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Blackbaud, Inc.

Condensed notes to consolidated financial statements (continued)

(Unaudited)

who have purchased perpetual rights to certain of its software products (hosting services). The Company recognizes revenue in accordance with:

The American Institute of Certified Public Accountants Statements of Position (SOP) 97-2, Software Revenue Recognition, as modified by SOPs 98-4 and 98-9, as well as Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants;

The SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition in Financial Statements;

The Emerging Issues Task Force (EITF) Issue No. 00-03, Application of AICPA Statement of Position 97-2 to Arrangements that Include the Right to Use Software Stored on Another Entity s Hardware;

The EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables; and

The SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts.

The Company recognizes revenue from the sale of perpetual software license rights when persuasive evidence of an arrangement exists, the product has been delivered, title and risk of loss have transferred to the customers, the fee is fixed or determinable and collection of the resulting receivable is probable. The Company deems acceptance of an agreement to be evidence of an arrangement. Delivery occurs when the product is shipped or transmitted. The Company s typical license agreement does not include customer acceptance provisions; if acceptance provisions are provided, delivery is deemed to occur upon acceptance. The Company considers the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within the Company s standard payment terms. The Company considers payment terms greater than 90 days to be beyond its customary payment terms. The Company deems collection probable if the Company expects that the customer will be able to pay amounts under the arrangement as they become due. If the Company determines that collection is not probable, the Company postpones recognition of the revenue until collection. The Company sells software licenses with maintenance and, often times, professional services. The Company allocates revenue to delivered components, normally the license component of the arrangement, using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to the Company. Fair value for the maintenance services associated with the Company s software licenses is based upon renewal rates stated in the Company s agreements, which vary according to the level of the maintenance program. Fair value of professional services and other products and services is based on sales of these products and services to other customers when sold on a stand-alone basis.

The Company s consulting, installation and implementation services are generally billed based on hourly rates plus reimbursable travel-related expenses. For small service engagements, less than approximately \$10,000, the Company frequently contracts for and bills based on a fixed fee plus reimbursable travel-related expenses. The Company recognizes this revenue upon completion of the work performed. When the Company s services include software customization, these services are provided to support customer requests for assistance in creating special reports and other minor enhancements that will assist with efforts to improve operational efficiency and/or to support business process improvements. These services are not essential to the functionality of the Company s software and rarely exceed three months in duration. The Company recognizes revenue as these services are performed. When the Company enters into larger fixed price contracts, the Company recognizes revenue on a percent-complete basis.

The Company recognizes analytic services revenue from donor prospect research engagements, the sale of lists of potential donors, benchmarking studies and data modeling service engagements upon delivery.

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The Company sells training at a fixed rate for each specific class, at a per attendee price, or at a packaged price for several attendees, and revenue is recognized only upon the customer attending and completing training. Additionally, the Company sells a fixed-rate program, which permits customers to attend unlimited training over a specified contract period, typically one year, subject to certain restrictions, and revenue is recognized ratably over this contract period.

The Company recognizes revenue from maintenance services ratably over the contract term, which is principally one year. Maintenance contracts also include the right to unspecified product upgrades on an if-and-when available basis. Certain support services are sold in prepaid units of time and recognized as revenue upon their usage.

Subscription revenue includes revenue associated with hosted applications, hosting services, data enrichment services, data management services and online training programs. Subscription-based revenue and any related set-up fees are recognized ratably over the service period of the contract.

Table of Contents**Blackbaud, Inc.****Condensed notes to consolidated financial statements (continued)****(Unaudited)**

To the extent that the Company's customers are billed and/or pay for the above described services in advance of delivery, the amounts are recorded in deferred revenue.

Stock-based compensation

Stock-based compensation is accounted for in accordance with the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)). Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is the vesting period. The provisions of SFAS No. 123(R) apply to grants made after the adoption date, awards modified, repurchased or cancelled after the adoption date and existing grants that were partially unvested at that date. Compensation expense for grants outstanding on the date of adoption is recognized over the remaining service period using the grant date fair values and amortization methods determined previously for the SFAS No. 123, Accounting for Stock-Based Compensation, pro forma disclosures.

The Company did not grant any new stock options in the six months ended June 30, 2008. During the six months ended June 30, 2008, the Company granted 7,928 shares of restricted stock and 99,690 stock appreciation rights. The aggregate grant date fair value of awards issued during the period was \$1,049,000, which will be recognized as expense over the requisite service period of the awards.

The Company allocates stock-based compensation to expense categories on the statements of operations. The following table summarizes stock-based compensation expense for the three and six months ended June 30, 2008 and 2007.

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Included in cost of revenue:				
Cost of services	\$ 302	\$ 182	\$ 652	\$ 339
Cost of maintenance	119	52	231	99
Cost of subscriptions	58	11	85	21
Total included in cost of revenue	479	245	968	459
Included in operating expenses:				
Sales and marketing	295	261	581	521
Research and development	508	266	1,028	535
General and administrative	1,037	1,027	2,101	1,996
Total included in operating expenses	1,840	1,554	3,710	3,052
Total	\$ 2,319	\$ 1,799	\$ 4,678	\$ 3,511

The Company, upon the approval of its stockholders in June 2008, adopted the Blackbaud, Inc. 2008 Equity Incentive Plan. There are 7,126,520 shares reserved for issuance under the 2008 Equity Incentive Plan and all other stock plans of the Company, including the 2004 Stock Plan, 2001 Stock Option Plan and 1999 Stock Option Plan, are terminated as to future grants. Employees, directors and consultants are eligible to receive stock awards under the 2008 Equity Incentive Plan. The Company may grant incentive stock options, nonstatutory stock options, restricted stock awards, restricted stock unit awards, stock appreciation rights, performance stock awards and other stock awards under this plan.

Table of Contents**Blackbaud, Inc.****Condensed notes to consolidated financial statements (continued)****(Unaudited)****Amortization expense**

Amortization expense related to intangible assets acquired in business combinations is allocated to cost of revenue on the statements of operations based on the revenue stream to which the asset contributes. The following table summarizes amortization expense for the three and six months ended June 30, 2008 and 2007.

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Included in cost of revenue:				
Cost of license fees	\$ 43	\$ 43	\$ 86	\$ 67
Cost of services	334	312	668	533
Cost of maintenance	98	103	196	181
Cost of subscriptions	409	214	818	403
Cost of other revenue	19	21	38	37
Total included in cost of revenue	903	693	1,806	1,221
Included in operating expenses	167	98	334	182
Total	\$ 1,070	\$ 791	\$ 2,140	\$ 1,403

Income taxes

Prior to October 13, 1999, the Company was organized as an S corporation under the Internal Revenue Code and, therefore, was not subject to federal income taxes. The Company historically made distributions to its stockholders to cover the stockholders' anticipated tax liability. In connection with its 1999 recapitalization, the Company converted its U.S. taxable status from an S corporation to a C corporation and, accordingly, since October 14, 1999 has been subject to federal and state income taxes. Upon this conversion and as a result of the recapitalization, the Company recorded a one-time benefit of \$107,000,000 to establish a deferred tax asset. This amount was recorded as a direct increase to equity in the statements of stockholders' equity. The Company did not record a valuation allowance against this item in its deferred tax asset as of June 30, 2008 or December 31, 2007, as the Company believed at those dates it was more likely than not that it would be able to utilize this benefit, which is dependent upon the Company's ability to generate future taxable income.

The Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109, Accounting for Income Taxes, (FIN 48) on January 1, 2007. Under FIN 48 the tax benefit from an uncertain tax position must be recognized only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. Penalties and interest accrued related to unrecognized tax benefits are recognized in the provision for income taxes.

Significant judgment is required in determining the provision for income taxes. The Company records its tax provision at the anticipated tax rates based on estimates of annual pretax income. To the extent that the final results differ from these estimated amounts that were initially recorded, the differences impact the income tax provision in the period in which the determination is made and could have an impact on the deferred tax asset. The Company's deferred tax assets and liabilities are recorded at an amount based upon a U.S. federal income tax rate of 35.0% and appropriate statutory rates of various foreign, state and local jurisdictions in which the Company operates. If the Company's tax rates change, the deferred tax assets and liabilities may be adjusted to an amount reflecting those income tax rates. If such change is determined to be appropriate, it will affect the provision for income taxes during the period that the determination is made.

New accounting pronouncements

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In June 2008, the FASB issued FASB Staff Position (FSP) No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1), which clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends before vesting should be considered participating securities. As participating securities, these instruments should be included in the calculation of basic earnings per share using the two-class method. Under FSP EITF 03-6-1, restricted stock issued by the Company is considered to be participating and would need to be included in the calculation of basic earnings per share at adoption. The

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Blackbaud, Inc.

Condensed notes to consolidated financial statements (continued)

(Unaudited)

Company is currently evaluating the impact that FSP EITF 03-6-1 will have on its financial statements. FSP EITF 03-6-1 will be effective for the Company on January 1, 2009.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). This standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles in the United States for non-governmental entities. SFAS No. 162 will be effective 60 days following approval by the U.S. Securities and Exchange Commission of the Public Company Accounting Oversight Board's amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Company does not expect SFAS No. 162 to have a material impact on the preparation of its consolidated financial statements.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 removes the requirement of SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142) for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. FSP FAS 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity consider its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. FSP FAS 142-3 will be effective for the Company on January 1, 2009. The Company is currently evaluating the potential impact of adopting FSP FAS 142-3.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 is intended to improve financial standards for derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. SFAS No. 161 requires enhanced disclosures of: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedged items are accounted for under FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS No. 133); and (c) its related interpretations and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS No. 161 must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under FAS No. 133 for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is currently evaluating the impact that FAS No. 161 will have on its financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141R). SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS No. 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141R will be effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact of adoption of SFAS No. 141R on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160 *Noncontrolling Interests in Consolidated Financial Statements- an Amendment of ARB No. 51* (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards pertaining to ownership interests in subsidiaries held by parties other than the parent, the amount of net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of any retained noncontrolling equity investment when a subsidiary is deconsolidated. This statement also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 will be effective for fiscal years beginning on or after December 15, 2008. The Company is currently evaluating the potential impact of adoption of SFAS No. 160 on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, (SFAS No. 157) which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective

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for fiscal years beginning after November 15, 2007. On February 12, 2008, the FASB issued FSP SFAS No. 157-2 (FSP 157-2), which delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair

Table of Contents**Blackbaud, Inc.****Condensed notes to consolidated financial statements (continued)****(Unaudited)**

value in the financial statements on a recurring basis (at least annually). FSP 157-2 partially defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of FSP 157-2. In addition, FASB issued a staff position, FSP SFAS No. 157-1, to clarify that SFAS No. 157 does not apply under SFAS No. 13, Accounting for Leases (SFAS No. 13), and other accounting pronouncements that address fair value measurements for purposes of lease classifications under SFAS No. 13. The Company adopted SFAS No. 157 on January 1, 2008, except as it applies to those non-financial assets and non-financial liabilities as noted in FSP 157-2. The major categories of assets and liabilities that are measured at fair value, for which the Company has not yet applied the provisions of SFAS No. 157 include goodwill and long-lived assets subject to impairment tests under SFAS No. 142 and SFAS No. 144. As it applies to non-financial assets and non-financial liabilities, the Company does not expect the adoption of SFAS No. 157, to have a material impact on its consolidated financial position, results of operations or cash flows.

3. Business combinationseTapestry

On August 1, 2007, the Company acquired eTapestry.com, Inc. (eTapestry), a privately owned company based near Indianapolis, Indiana. eTapestry is the provider of an on-demand fundraising solution. The Company believes that the acquisition of eTapestry will allow it to address a broader market opportunity by providing an on-demand solution that is suited for smaller organizations interested in a relatively low-cost offering and mid-sized nonprofits interested in a stand-alone fundraising solution deployed in an on-demand model. The Company acquired all of the outstanding capital stock of eTapestry for approximately \$25,429,000 in a cash transaction financed by a combination of cash on hand and borrowings under the Company's revolving credit facility. An additional amount of up to \$1,500,000 is contingently payable to certain eTapestry employees under a stock-based incentive arrangement based upon performance of the acquired business over the two years subsequent to the acquisition date ending on September 30, 2008 and 2009. Amounts paid, if any, under this arrangement will be accounted for as expense when incurred. The results of operations of eTapestry are included in the consolidated financial statements of the Company from the date of acquisition.

Target Companies

On January 16, 2007, the Company acquired Target Software, Inc. and Target Analysis Group, Inc., or the Target Companies, privately owned affiliated companies based in Cambridge, Massachusetts. The two acquired companies provide solutions that help organizations analyze, plan, forecast, execute, and manage high-volume fundraising campaigns while simultaneously helping them maintain long-term constituent relationships. The acquisition of the Target Companies is expected to significantly advance the Company's strategic goal of providing a complete solution that will meet the fundraising and direct marketing needs of the nonprofit sector. The Company acquired all of the outstanding capital stock of the Target Companies for approximately \$58,733,000, including direct acquisition-related costs, in an all cash transaction that was financed by a combination of cash on hand and borrowings under the Company's revolving credit facility. An additional amount of up to \$2,400,000 was contingently payable to the sellers under an earn-out arrangement based upon performance of the acquired businesses over the year subsequent to the acquisition. The results of operations of the Target Companies are included in the consolidated financial statements of the Company from the date of acquisition.

During the six months ended June 30, 2008, the Company paid \$2,327,000 of contingent consideration in connection with the acquisition of the Target Companies on January 16, 2007. The payment was recorded as additional cost of the acquired entity and increased the balance of goodwill. There is no further obligation in connection with the acquisition of the Target Companies.

Table of Contents**Blackbaud, Inc.****Condensed notes to consolidated financial statements (continued)****(Unaudited)**

The following unaudited pro forma information presents the consolidated results of operations of the Company as if the acquisition of the Target Companies had taken place at the beginning of 2007. The pro forma information includes the business combination effect of the amortization charges from acquired intangible assets, adjustments to interest income and related tax effects. The pro forma information does not necessarily reflect the actual results that would have occurred nor is it necessarily indicative of future results of operations.

	Six months ended
(in thousands, except per share amounts)	June 30, 2007
Revenue	\$ 119,971
Net income	13,707
Earnings per share, basic	\$ 0.32
Earnings per share, diluted	0.31

On April 21, 2008, the Company made the final payment of contingent consideration in connection with the 2006 acquisition of Campagne Associates, Ltd. (Campagne). The Company recorded the entire payment of \$569,000 as an increase in goodwill. Cumulatively, the Company paid a total of \$1,563,000 of the potential \$2,500,000 of contingent consideration, there is no further obligation in connection with the acquisition of Campagne.

4. Earnings per share

The Company computes earnings per common share in accordance with SFAS Statement No. 128, Earnings per Share (SFAS No. 128). Under the provisions of SFAS No. 128, basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares and dilutive potential common shares then outstanding. Diluted earnings per share reflect the assumed conversion of all dilutive securities, using the treasury stock method. Dilutive potential common shares consist of shares issuable upon the exercise of stock options, shares of non-vested restricted stock and settlement of stock appreciation rights.

Diluted earnings per share for the three months ended June 30, 2008 and 2007 include the effect of 681,101 and 983,480 potential common shares, respectively and for the six months ended June 30, 2008 and 2007 include the effect of 727,447 and 993,783 potential common shares, respectively. There were no anti-dilutive potential common shares outstanding for the three and six months ended June 30, 2008 and 2007.

The following table sets forth the computation of basic and diluted earnings per share:

(in thousands, except share and per share amounts)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Numerator:				
Net income, as reported	\$ 8,987	\$ 8,203	\$ 16,030	\$ 13,959
Denominator:				
Weighted average common shares	42,776,609	43,355,261	43,336,989	43,508,166
Add effect of dilutive securities:				
Employee stock options and restricted stock	681,101	983,480	727,447	993,783

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Weighted average common shares assuming dilution	43,457,710	44,338,741	44,064,436	44,501,949
Earnings per share:				
Basic	\$ 0.21	\$ 0.19	\$ 0.37	\$ 0.32
Diluted	\$ 0.21	\$ 0.19	\$ 0.36	\$ 0.31

Table of Contents**Blackbaud, Inc.****Condensed notes to consolidated financial statements (continued)****(Unaudited)****5. Comprehensive Income**

Total comprehensive income for the three and six months ended June 30, 2008 and 2007 was as follows:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Net income	\$ 8,987	\$ 8,203	\$ 16,030	\$ 13,959
Foreign currency translation adjustment, net of tax	(54)	45	(46)	(27)
Comprehensive income	\$ 8,933	\$ 8,248	\$ 15,984	\$ 13,932

For the three months ended June 30, 2008 and 2007, the amount of income tax expense allocated to foreign currency translation adjustments was benefit of \$35,000 and expense of \$29,000, respectively. For the six months ended June 30, 2008 and 2007, the amount of income tax benefit allocated to foreign currency translation adjustments was \$29,000 and \$17,000, respectively.

6. Prepaid expenses and other current assets

Prepaid expenses and other current assets consisted of the following as of June 30, 2008 and December 31, 2007:

(in thousands)	June 30, 2008	December 31, 2007
Taxes, prepaid and receivable	\$ 1,344	\$ 5,547
Prepaid software maintenance and royalties	3,336	2,131
Deferred sales commissions	2,697	1,903
Other	2,910	1,698
Total prepaid expenses and other current assets	\$ 10,287	\$ 11,279

7. Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following as of June 30, 2008 and December 31, 2007:

(in thousands)	June 30, 2008	December 31, 2007
Accrued bonuses	\$ 4,608	\$ 6,566
Taxes payable	4,713	3,306
Accrued commissions and salaries	2,470	2,967
Accrued accounting and legal fees	1,345	1,766
Customer credit balances	1,825	1,588
Accrued health care costs	612	1,094
Other	2,607	3,288
Total accrued expenses and other current liabilities	\$ 18,180	\$ 20,575

8. Revolving credit facility

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On July 25, 2007, the Company entered into a new \$75,000,000 revolving credit facility. The new revolving credit facility has a term of five years, is guaranteed by the material domestic subsidiaries and is collateralized with the stock of all of the Company's subsidiaries. Amounts borrowed under the revolving credit facility bear interest, at the Company's option, at a variable rate based (a) on the higher of the prime rate plus a margin of up to 0.5% or federal funds rate plus a margin of 0.5% to 1.0% or (b) LIBOR plus a margin of 1.0% to 1.5%. The exact amount of any margin depends on the nature of the loan and the leverage ratio at the time of the borrowing. The Company also pays a quarterly commitment fee of 0.2% to 0.3% per annum on the unused portion of the revolving credit facility, depending on the leverage ratio of the Company. The outstanding balance of the previous credit facility on July 25, 2007 of \$10,000,000 was transferred upon its termination on that date to the new credit facility.

Table of Contents**Blackbaud, Inc.****Condensed notes to consolidated financial statements (continued)****(Unaudited)**

Also under the terms of the credit agreement, the Company may elect not more than two times to increase the amount available under the facility for an aggregate amount of up to \$50,000,000, subject to certain terms and conditions. On June 23, 2008, the Company exercised one of its two options to increase the existing credit facility by \$15,000,000 to an aggregate available amount of \$90,000,000. Subsequent to exercising this increase, all principal covenants or the financial terms of the facility, noted above, remained unchanged.

During the six months ended June 30, 2008, the Company borrowed \$27,200,000 under its credit agreement and repaid \$2,700,000. There was \$24,500,000 principal outstanding under the credit facility as of June 30, 2008.

9. Commitments and contingencies

The Company currently leases various office space and equipment under operating leases. In addition to operating leases, the Company, through its acquisitions of the Target Companies and eTapestry, has various non-cancellable capital leases for computer equipment and furniture. As of June 30, 2008, the future minimum lease commitments related to these lease agreements, as well as the lease agreements discussed below, net of related sublease commitments, were as follows:

Year ending December 31,

(in thousands)	Operating leases	Capital leases
2008 - remaining	\$ 3,684	\$ 296
2009	7,556	405
2010	4,571	167
2011	847	40
2012	650	2
2013 and thereafter	205	-
Total minimum lease payments	\$ 17,513	910
Less: portion representing interest		88
Present value of net minimum lease payments		822
Less: current maturities		470
Long-term maturities		\$ 352

Lease agreement

On October 13, 1999, the Company entered into a lease agreement for office space with Duck Pond Creek, LLC, which is partially owned by certain current executive officers of the Company. The term of the lease is for ten years with two five-year renewal options by the Company. The current annual base rent of the lease is \$4,854,000 payable in equal monthly installments. The base rate escalates annually at a rate equal to the change in the consumer price index, as defined in the agreement.

The Company has subleased a portion of its headquarters facility under various agreements extending through 2008. Under these agreements, rent expense was reduced by \$65,000 and \$93,000 for the three months ended June 30, 2008 and 2007, respectively and \$131,000 and \$201,000 for the six months ended June 30, 2008 and 2007, respectively. The operating lease commitments will be reduced by minimum aggregate sublease commitments of \$377,000 through 2010. The Company has also received and expects to receive through 2015, quarterly South Carolina state incentive payments as a result of locating its headquarters facility in Berkeley County, South Carolina. These amounts are recorded as a reduction of rent expense and were \$703,000 and \$482,000 for the three months ended June 30, 2008 and 2007, respectively and \$1,100,000 and \$846,000 for the six months ended June 30, 2008 and 2007, respectively.

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Blackbaud, Inc.

Condensed notes to consolidated financial statements (continued)

(Unaudited)

Contingent consideration

As discussed in Note 3, Business combinations, the Company has amounts up to \$1,500,000 contingently payable to certain eTapestry employees based on the performance of the acquired business over the two years subsequent to the acquisition date.

Other commitments

The Company has a commitment of \$200,000 payable annually through 2009 for certain naming rights on a stadium in Charleston, South Carolina. The Company incurred expense under this agreement of \$50,000 for each of the three-month periods ended June 30, 2008 and 2007 and \$100,000 for each of the six-month periods ended June 30, 2008 and 2007.

The Company utilizes third-party relationships in conjunction with its products. The contractual arrangements vary in length from one to three years. In certain cases, these arrangements require a minimum annual purchase commitment. The aggregate minimum purchase commitment under these arrangements is approximately \$555,000 through 2010. The Company incurred expense under these arrangements of \$22,000 and \$231,000 for the three months ended June 30, 2008 and 2007, respectively and \$206,000 and \$426,000 for the six months ended June 30, 2008 and 2007, respectively.

Legal contingencies

The Company is subject to legal proceedings and claims that have arisen in the ordinary course of business. In accordance with SFAS No. 5, Accounting for Contingencies, the Company records an accrual for a contingency when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The Company does not believe the amount of potential liability with respect to these actions will have a material adverse effect upon the Company's financial position, results of operations or cash flows.

10. Income taxes

The Company calculated its income taxes for the six-month period ended June 30, 2008 using the projected effective tax rate for fiscal 2008 in accordance with SFAS No. 109. The 2008 estimated annual effective tax rate of 39.7%, which excludes period-specific items, was applied as the effective rate for the quarter ended June 30, 2008. The Company's effective tax rate for the three-month periods ended June 30, 2008 and 2007, including the effects of period-specific events, was 38.1% and 38.7%, respectively. As of June 30, 2008, the Company had state tax credits of \$10,470,000, \$6,805,000 net of federal tax effect, which will expire between 2009 and 2021, if unused. These tax credits had a valuation reserve of approximately \$5,987,000, \$3,891,000 net of federal tax effect, as of June 30, 2008. The valuation allowance was unchanged during the three and six months ended June 30, 2008.

The Company recorded excess tax benefits on stock option exercises of approximately \$18,000 and \$709,000 in stockholders' equity in the six months ended June 30, 2008 and 2007, respectively.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result, the Company recognized a \$269,000 reduction, including interest and penalties and net of applicable taxes, to the January 1, 2007 balance of retained earnings. During the second quarter of 2008, the Company recognized as a benefit in income tax expense \$300,000 of its unrecognized tax benefit and \$164,000 of associated interest and penalties due to a certain statute of limitation expiring during the period. The unrecognized tax benefit was \$329,000 and \$629,000 as of June 30, 2008 and December 31, 2007, respectively. The total amount of unrecognized tax benefits as of June 30, 2008 that, if recognized, would affect the effective tax rate was \$214,000. The total amounts of interest and penalties included in the consolidated balance sheets as of June 30, 2008 and December 31, 2007 was \$223,000 and \$386,000, respectively.

It is reasonably possible that the total amounts of unrecognized tax benefits the Company has recorded for positions taken in certain tax jurisdictions could significantly decrease within the next twelve months. A possible decrease could result from the finalization of state income

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tax reviews. This position relates to a state nexus issue. The reasonably possible decrease in the next twelve months is \$179,000.

Table of Contents**Blackbaud, Inc.****Condensed notes to consolidated financial statements (continued)****(Unaudited)****11. Stockholders' equity****Common stock**

The Company has authorized 180,000,000 shares of common stock with a par value of \$0.001. As of June 30, 2008 and December 31, 2007, 50,499,324 and 50,450,675 shares were issued and 43,565,657 and 45,018,823 shares were outstanding, respectively.

Preferred stock

The Company has authorized 20,000,000 shares of preferred stock. No shares were issued and outstanding at June 30, 2008 and December 31, 2007. The Company's Board of Directors may fix the relative rights and preferences of each series of preferred stock in a resolution of the Board of Directors.

Dividends

On February 5, 2008, the Company's Board of Directors approved an increase to the Company's annual dividend from \$0.34 per share to \$0.40 per share and declared its first quarter dividend of \$0.10 per share, which was paid on March 14, 2008 to stockholders of record on February 28, 2008.

On May 7, 2008, the Company's Board of Directors declared a second quarter dividend of \$0.10 per share payable on June 16, 2008 to stockholders on record on May 28, 2008.

Stock repurchase program

On May 7, 2008, the Company's Board of Directors approved a stock repurchase program that authorized the Company to purchase up to \$40,000,000 of the Company's outstanding shares of common. The prior program was terminated at that date and the remaining balance of \$6,376,383 that was authorized but not used was included in the \$40,000,000 authorized under the new plan. The new plan does not have an expiration date. The shares can be purchased from time to time on the open market or in privately negotiated transactions depending upon market conditions and other factors, all in accordance with the requirements of applicable law.

The table below shows the plans under which shares were purchased during the six months ended June 30, 2008:

	Plan date	Shares repurchased	Average price	Cost
New plan	May 7, 2008	64,000	\$23.43	1,499,711
Prior plan	June 13, 2007	1,435,745	\$24.03	34,497,520
Total		1,499,745	\$24.00	35,997,231

In addition to the Company's stock repurchase plan, 2,070 shares, valued at \$53,000, were surrendered by holders of restricted stock to the Company to satisfy their tax obligations due upon vesting of restricted stock during the six months ended June 30, 2008.

12. Segment information

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The Company has adopted SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. SFAS No. 131 establishes standards for the reporting by business enterprises of information about operating segments, products and services, geographic areas, and major customers. The method of determining what information is reported is based on the way that management organizes the operating segments within the Company for making operational decisions and assessments of financial performance. The Company has determined that its reportable segments are those that are based upon internal financial reports that disaggregate certain operating information into six reportable segments. The Company's chief operating decision maker, as defined in SFAS No. 131, is its chief executive officer, or CEO.

The CEO uses the information presented in these reports to make certain operating decisions. The CEO does not review any report presenting segment balance sheet information. The segment revenues and direct controllable costs, which

Table of Contents**Blackbaud, Inc.****Condensed notes to consolidated financial statements (continued)****(Unaudited)**

include salaries, related benefits, third-party contractors, data expense and classroom rentals, for the three and six months ended June 30, 2008 and 2007 were as follows:

(in thousands)	License fees	Consulting and education services (1)	Analytic services (2)	Maintenance	Subscriptions	Other	Total
Three months ended June 30, 2008							
Revenue	\$9,603	\$20,217	\$5,119	\$26,371	\$9,010	\$2,182	\$72,502
Direct controllable costs	764	10,529	2,136	3,582	2,961	2,001	21,973
Segment income	8,839	9,688	2,983	22,789	6,049	181	50,529
Corporate costs not allocated ⁽³⁾							4,181
Operating expenses							31,754
Interest expense, net							114
Other (income), net							(49)
Income before provision for income taxes							\$14,529
Three months ended June 30, 2007							
Revenue	\$11,030	\$18,589	\$3,629	\$23,164	\$5,539	\$2,094	\$64,045
Direct controllable costs	762	9,626	1,906	3,293	1,698	1,751	19,036
Segment income	10,268	8,963	1,723	19,871	3,841	343	45,009
Corporate costs not allocated ⁽³⁾							3,560
Operating expenses							27,839
Interest expense, net							223
Other expense, net							8
Income before provision for income taxes							\$13,379
Six months ended June 30, 2008							
Revenue	\$19,238	\$39,492	\$9,420	\$51,801	\$17,795	\$4,192	\$141,938
Direct controllable costs	1,563	21,562	4,378	7,265	5,801	3,826	44,395
Segment income	17,675	17,930	5,042	44,536	11,994	366	97,543
Corporate costs not allocated ⁽³⁾							8,502
Operating expenses							63,193
Interest expense, net							19
Other expense, net							40
Income before provision for income taxes							\$25,789

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Six months ended June 30, 2007							
Revenue	\$19,098	\$33,935	\$6,597	\$45,600	\$10,331	\$3,629	\$119,190
Direct controllable costs	1,214	18,506	3,425	6,447	3,173	3,091	35,856
Segment income	17,884	15,429	3,172	39,153	7,158	538	83,334
Corporate costs not allocated ⁽³⁾							6,635
Operating expenses							53,811
Interest expense, net							219
Other expense, net							77
Income before provision for income taxes							\$22,592

- (1) This segment consists of consulting, installation and implementation, document imaging, customer training and other educational services.
- (2) This segment consists of donor prospect research and data modeling services.
- (3) Various corporate costs, such as depreciation, facilities and IT support costs, stock-based compensation and amortization of intangibles arising from business combinations, are not allocated to the segment income because management believes that the exclusion of these costs allows the Company to better understand and manage other operating expenses and cash needs.

13. Subsequent events

On July 8, 2008, the Company acquired Kintera, Inc. (Kintera), a publicly traded company based in San Diego, California. Kintera is a leader in providing on-demand solutions to the nonprofit sector. The acquisition of Kintera adds experience in on-demand solutions and expands the Company's set of online offerings to nonprofit sector. Kintera was acquired through a tender offer, paying \$1.12 per Kintera share, for total of approximately \$46,000,000 in a tender offer of cash. The Company financed this acquisition with cash on hand and borrowing under the Company's revolving credit facility. As a result of the transaction, Kintera has become a wholly-owned subsidiary of the Company.

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Blackbaud, Inc.

Item 2. Management's discussion and analysis of financial condition and results of operations

The Company will include the operating results of Kintera in its consolidated financial statements from the date of acquisition.

On August 4, 2008, the Company's Board of Directors declared a third quarter dividend of \$0.10 per share payable on September 15, 2008 to stockholders of record on August 28, 2008.

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Blackbaud, Inc.

Item 2. Management's discussion and analysis of financial condition and results of operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements reflect our current view with respect to future events and financial performance and are subject to risks and uncertainties, including those set forth under "Cautionary statement" included in this "Management's discussion and analysis of financial condition and results of operations" and elsewhere in this report, that could cause actual results to differ materially from historical or anticipated results.

Overview

We are the leading global provider of software and related services designed specifically for nonprofit organizations. Our products and services enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage finances and optimize internal operations. We have focused solely on the nonprofit market since our incorporation in 1982 and have developed our suite of products and services based upon our extensive knowledge of the operating challenges facing nonprofit organizations. As of June 30, 2008, we had approximately 19,000 active customers. Our customers operate in multiple verticals within the nonprofit market, including education, foundations, health and human services, religion, arts and cultural, public and societal benefits, environment and animal welfare and international foreign affairs.

We derive revenue from selling perpetual licenses or charging for the use of our software products and providing a broad offering of services, including consulting, training, installation and implementation, as well as ongoing customer support and maintenance. Consulting, training and implementation are generally not essential to the functionality of our software products and are sold separately. Furthermore, we derive revenue from providing hosting services, performing donor prospect research engagements, selling lists of potential donors, and providing benchmarking studies and data modeling services.

Critical accounting policies and estimates

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (" U.S. GAAP "). The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenue and expenses during the reporting period and related disclosures of contingent assets and liabilities. The most significant estimates and assumptions relate to our revenue recognition, our allowance for sales returns and doubtful accounts, valuation of long-lived and intangible assets and goodwill, stock-based compensation and provision for income taxes, valuation of deferred tax assets and liabilities and contingencies.

We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. On an ongoing basis, we reconsider and evaluate our estimates and assumptions. We are not aware of any circumstances in the past that have caused these estimates and assumptions to be materially wrong. Furthermore, we are not currently aware of any material changes in our business that might cause these assumptions or estimates to differ significantly. In our discussion below of deferred taxes, the most significant asset subject to such assumptions and estimates, we have described the sensitivity of these assumptions or estimates to potential deviations in actual results. Actual results could differ from any of our estimates under different assumptions or conditions.

We believe the critical accounting policies listed below require the use of significant judgments and estimates in the preparation of our consolidated financial statements.

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Blackbaud, Inc.

Item 2. Management's discussion and analysis of financial condition and results of operations (continued)

Revenue recognition

Our revenue is generated primarily by selling perpetual licenses or charging for the use of our software products and providing support, training, consulting, technical and other professional services for those products. We make available certain software products for use in hosted application arrangements without licensing perpetual rights to the software (hosted applications). Additionally we provide hosting services to customers who have purchased perpetual rights to certain of our software products (hosting services). We recognize revenue in accordance with:

The American Institute of Certified Public Accountants Statements of Position (SOP) 97-2, Software Revenue Recognition, as modified by SOPs 98-4 and 98-9, as well as Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants;

The SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition in Financial Statements;

The Emerging Issues Task Force (EITF) Issue No. 00-03, Application of AICPA Statement of Position 97-2 to Arrangements that Include the Right to Use Software Stored on Another Entity's Hardware;

The EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables; and

The SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts.

We recognize revenue from the sale of perpetual license rights to software when persuasive evidence of an arrangement exists, the product has been delivered, title and risk of loss have transferred to the customers, the fee is fixed or determinable and collection of the resulting receivable is probable. We deem acceptance of an agreement to be evidence of an arrangement. Delivery occurs when the product is shipped or transmitted. Our typical license agreement does not include customer acceptance provisions; if acceptance provisions are provided, delivery is deemed to occur upon acceptance. We consider the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within our standard payment terms. We consider payment terms greater than 90 days to be beyond its customary payment terms. We deem collection probable if we expect that the customer will be able to pay amounts under the arrangement as they become due. If we determine that collection is not probable, we postpone recognition of the revenue until collection. We sell software licenses with maintenance and, often times, professional services. We allocate revenue to delivered components, normally the license component of the arrangement, using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to us. Fair value for the maintenance services associated with our software licenses is based upon renewal rates stated in our agreements, which vary according to the level of the maintenance program. Fair value of professional services and other products and services is based on sales of these products and services to other customers when sold on a stand-alone basis.

The application of SOP 97-2 requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence (VSOE) of fair value exists for those elements. As we develop new products, we could experience difficulty in determining VSOE regarding the fair value of those new products. This would result in the deferral of revenue on those transactions until all elements of the arrangement have been delivered or until VSOE is established.

Our services, which include consulting, installation and implementation services, are generally billed based on hourly rates plus reimbursable travel-related expenses. For small service engagements, less than approximately \$10,000, we frequently contract for and bill based on a fixed fee plus reimbursable travel-related expenses. We recognize this revenue upon completion of the work performed. When our services include software customization, these services are provided to support customer requests for assistance in creating special reports and other minor

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enhancements that will assist with efforts to improve operational efficiency and/or to support business process improvements. These services are not essential to the functionality of our software and rarely exceed three months in duration. We recognize revenue as these services are performed. When we enter into larger fixed price contracts, we recognize revenue on a percent-complete basis.

We recognize analytic services revenue from donor prospect research engagements, sales of lists of potential donors, benchmarking studies and data modeling service engagements upon delivery.

We sell training at a fixed rate for each specific class, at a per attendee price, or at a packaged price for several attendees, and revenue is recognized only upon the customer attending and completing training. Additionally, we sell a fixed-rate program, which permits customers to attend unlimited training over a specified contract period, typically one year, subject to certain restrictions, and revenue is recognized ratably over this contract period.

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Blackbaud, Inc.

Item 2. Management's discussion and analysis of financial condition and results of operations (continued)

We recognize revenue from maintenance services ratably over the contract term, which is principally one year. Our maintenance contracts also include the right to unspecified product upgrades on an if-and-when available basis. Certain support services are sold in prepaid units of time and recognized as revenue upon their usage.

Subscription revenue includes revenue associated with hosted applications, hosting services, data enrichment services, data management services and online training programs. Subscription-based revenue and any related set-up fees are recognized ratably over the service period of the contract.

To the extent that our customers are billed and/or pay for the above described services in advance of delivery, the amounts are recorded in deferred revenue.

Sales returns and allowance for doubtful accounts

We provide customers a 30-day right of return and maintain a reserve for returns. We estimate the amount of this reserve based on historical experience. Provisions for sales returns are charged against the related revenue items.

We maintain an allowance for doubtful accounts at an amount we estimate to be sufficient to provide adequate protection against losses resulting from extending credit to our customers. In judging the adequacy of the allowance for doubtful accounts, we consider multiple factors including historical bad debt experience, the general economic environment, the need for specific customer reserves and the aging of our receivables. Any necessary provision is reflected in general and administrative expense. A considerable amount of judgment is required in assessing these factors and if any receivables were to deteriorate, an additional provision for doubtful accounts could be required.

Valuation of long-lived and intangible assets and goodwill

We review identifiable intangible and other long-lived assets for impairment when events change or circumstances indicate the carrying amount may not be recoverable. Events or changes in circumstances that indicate the carrying amount may not be recoverable include, but are not limited to, a significant decrease in the market value of the business or asset acquired, a significant adverse change in the extent or manner in which the business or asset acquired is used or significant adverse change in the business climate. If such events or changes in circumstances occur, we use the undiscounted cash flow method to determine whether the asset is impaired. Cash flows would include the estimated terminal value of the asset and exclude any interest charges. To the extent that the carrying value of the asset exceeds the undiscounted cash flows over the estimated remaining life of the asset, we measure the impairment using discounted cash flows. The discount rate utilized would be based on our best estimate of our risks and required investment returns at the time the impairment assessment is made.

In accordance with the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), we test goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test compares the fair value of the reporting unit with its carrying amount. If the carrying amount exceeds its fair value, impairment is indicated. The impairment is measured as the excess of the recorded goodwill over its fair value, which could materially adversely impact our financial position and results of operations. Goodwill is assigned to various reporting units.

Stock-based compensation

We account for stock-based compensation in accordance the provisions of FASB's Statement No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)). Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is the vesting period.

We determine the fair value of the stock options and stock appreciation rights using an option pricing model, which requires us to use significant judgment to make estimates regarding the life of the award, volatility of our stock price, the risk-free interest rate and the dividend yield of our

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stock over the life of the award. Changes to these estimates would result in different fair values of awards.

SFAS No. 123(R) requires us to estimate the number of awards that will be forfeited and recognize expense only for those awards that ultimately vest. Significant judgment is required in determining the adjustment to compensation expense for

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Blackbaud, Inc.

Item 2. Management's discussion and analysis of financial condition and results of operations (continued)

estimated forfeitures. Compensation expense in a period could be impacted, favorably or unfavorably, by differences between forfeiture estimates and actual forfeitures.

We adopted SFAS No. 123(R) on January 1, 2006 using the modified prospective method. Under the modified prospective application method, prior periods are not revised for comparative purposes. The provisions of SFAS No. 123(R) apply to grants made after the adoption date and existing grants which were partially unvested at that date. Compensation expense for grants outstanding on the date of adoption are recognized over the remaining service period using the grant date fair values and amortization methods determined previously for the SFAS No. 123, Accounting for Stock-Based Compensation, pro forma disclosures.

Provision for income tax and valuation of deferred tax assets

We account for income taxes using the asset and liability approach as prescribed by SFAS Statement No. 109, Accounting for Income Taxes. This approach requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements or income tax returns. Using the enacted tax rates in effect for the year in which we expect the differences to reverse, we determine deferred tax assets and liabilities based on the differences between the financial reporting and the tax basis of an asset or liability. We record a valuation allowance when it is more likely than not that the deferred tax asset will not be realized.

Significant judgment is required in determining our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in a net deferred tax asset, which is included on our consolidated balance sheets. The final outcome of these matters for tax reporting purposes might be different than that which is reflected in our historical income tax provisions, benefits and accruals. Any difference could have a material effect on our income tax provision and net income in the period in which such a determination is made.

Prior to October 13, 1999, we were organized as an S corporation under the Internal Revenue Code and, therefore, were not subject to federal income taxes. In addition, as a result of our S corporation status we were not subject to income tax in many of the states in which we operated. We historically made distributions to our stockholders to cover the stockholders' anticipated tax liability. In connection with our 1999 recapitalization, we converted our U.S. taxable status from an S corporation to a C corporation. Accordingly, since October 14, 1999 we have been subject to federal and state income taxes. Upon the conversion and in connection with the recapitalization, we recorded a one-time benefit of \$107.0 million to establish a deferred tax asset.

We must assess the likelihood that the net deferred tax asset will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance, we must include an expense within the tax provision in the statements of operations. Except with respect to certain state income tax credits, we did not record a valuation allowance as of June 30, 2008 and December 31, 2007, because we expect to be able to utilize our entire net deferred tax asset. The ability to utilize our net deferred tax asset is solely dependent on our ability to generate future taxable income. Based on current estimates of revenue and expenses, we expect future taxable income will be more than sufficient to recover the annual amount of additional tax deductions permitted. Even if actual results are significantly below our current estimates, the recovery still remains likely and no valuation allowance would be necessary.

Significant judgment is required in determining the provision for income taxes. To the extent that the final results differ from these estimated amounts that were initially recorded, such differences will impact the income tax provision in the period in which such determination is made and could have an impact on the deferred tax asset. Our deferred tax assets and liabilities are recorded at an amount based upon a U.S. federal income tax rate of 35.0%. If our projected taxable income falls and our tax rate decreases, we will adjust our deferred tax assets and liabilities to an amount reflecting a reduced expected U.S. federal income tax rate. If such change is determined to be appropriate, it will affect the provision for income taxes during the period that the determination is made.

We adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109, Accounting for Income Taxes, (FIN 48) on January 1, 2007. Under FIN 48 we must recognize the tax impact from an uncertain tax position only

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if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax impact recognized in the financial statements from such a position is measured based on the largest benefit that has a greater than 50% likelihood of

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being realized upon ultimate resolution. Penalties and interest related to uncertain tax positions are recorded as tax expense. Significant judgment is required in the identification of uncertain tax positions and in the estimation of penalties and interest on uncertain tax positions.

Contingencies

We are subject to the possibility of various loss contingencies in the normal course of business. In accordance with SFAS No. 5, *Accounting for Contingencies*, we record an accrual for a contingency when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Often these issues are subject to substantial uncertainties and, therefore, the probability of loss and an estimation of damages are difficult to ascertain. These assessments can involve a series of complex judgments about future events and can rely heavily on estimates and assumptions that have been deemed reasonable by us. Although we believe we have substantial defenses in these matters, we could in the future incur judgments or enter into settlements of claims that could have a material adverse effect on our financial position, results of operations or cash flows in any particular period.

Results of operations**Comparison of the three months and six months ended June 30, 2008 and 2007**

We completed the acquisition of Target Software, Inc. and Target Analysis Group, Inc., together referred to as the Target Companies, on January 16, 2007. Additionally, we completed the acquisition of eTapestry.com, Inc., referred to as eTapestry, on August 1, 2007. The results of operations from the Target Companies and eTapestry are included in our consolidated results of operations from the dates of their respective acquisition.

On July 8, 2008, we completed the acquisition of Kintera, Inc. (Kintera). As this transaction took place outside the periods reported in this quarterly report, the results of operations for the three and six months ended June 30, do not include the activities of Kintera.

Revenue

The table below compares revenue from our statements of operations for the three and six months ended June 30, 2008 with the same periods in 2007.

(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
License fees	\$ 9.6	\$ 11.0	\$ (1.4)	(13)%	\$ 19.2	\$ 19.1	\$ 0.1	1%
Services	25.3	22.2	3.1	14%	48.9	40.6	8.3	20%
Maintenance	26.4	23.2	3.2	14%	51.8	45.6	6.2	14%
Subscriptions	9.0	5.5	3.5	64%	17.8	10.3	7.5	73%
Other	2.2	2.1	0.1	5%	4.2	3.6	0.6	17%
Total revenue	\$ 72.5	\$ 64.0	\$ 8.5	13%	\$ 141.9	\$ 119.2	\$ 22.7	19%

Total revenue increased \$8.5 million, or 13%, in the second quarter of 2008 compared to the second quarter of 2007. A total of \$2.5 million or 29% of this increase was attributable to the inclusion of eTapestry in our consolidated results of operations. The remaining increase in revenue in the second quarter of 2008 is primarily due to growth in services to new and existing customers partially due to the introduction of new product offerings. Also contributing to the growth is revenue from new maintenance contracts associated with new license agreements and annual inflationary rate adjustments associated with existing client contracts and revenue from our subscription offerings. Offsetting these increases is a \$1.4 million decrease in license fee revenue, which is principally due to fewer sales to new customers.

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Total revenue increased \$22.7 million, or 19%, in the first six months of 2008 compared to the first six months of 2007. A total of \$4.8 million or 21% of this increase was attributable to the inclusion of eTapestry in our consolidated results of operations. The remaining increase in revenue in the first six months of 2008 is primarily due to growth in services to new and existing customers partially due to the introduction of new product offerings. Also contributing to the growth is revenue from new maintenance contracts associated with new license agreements and annual inflationary rate adjustments associated with existing client contracts and revenue from our subscription offerings.

Subscription revenue grew 64% and 73% for the three and six months ended June 30, 2008, respectively, when compared to the same periods in 2007. Of the increase in subscription revenue for the three and six months ended June 30, 2008, \$1.9 million and \$3.6 million, respectively, or 54% and 48%, respectively, of the growth is attributable to the inclusion of

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eTapestry. The remaining \$1.6 million and \$3.9 million increase in subscription revenue in the three and six months ended June 30, 2008, respectively, is largely the result of growth in our hosting business and Netsolutions and other analytic offerings.

Segment results

We analyze our business according to our six operating segments as identified in Note 12, which are license fees, consulting and education services, analytic services, maintenance, subscriptions and other. The analyses provided below are presented on a non-GAAP basis before the inclusion of various allocable corporate costs such as depreciation, facilities and IT support costs, stock-based compensation and amortization of intangibles arising from business combinations because, in managing our operations, we believe that the exclusion of these costs allows us to better understand and manage other operating expenses and cash needs. These excluded costs are analyzed separately following the segment results analysis.

License fees

(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
License fee revenue	\$ 9.6	\$ 11.0	\$ (1.4)	(13)%	\$ 19.2	\$ 19.1	\$ 0.1	1%
Direct controllable cost of license fees	0.8	0.8	-	0%	1.6	1.2	0.4	33%
Segment income	\$ 8.8	\$ 10.2	\$ (1.4)	(14)%	\$ 17.6	\$ 17.9	\$ (0.3)	(2)%
Segment margin %	92%	93%			92%	94%		

Revenue from license fees is derived from the sale of our software products, under a perpetual license agreement. The decrease in license fee revenue in the second quarter of 2008 is principally attributable to a \$1.5 million decrease in sales to new clients resulting from the challenging economic environment.

Direct controllable cost of license fees includes third-party software royalties and costs of shipping software products to our customers. The cost of license fees remained flat in absolute terms in the second quarter of 2008 compared to the same period of the previous year.

License fee revenue in the first six months of 2008 was relatively constant with prior year levels, after reflecting the decrease in software sales to new clients in the second quarter (see discussion in Revenue above).

The increase in cost of license fees in the first six months of 2008 is principally due to an increase of \$0.3 million in other third-party software costs for various products.

Consulting and education services

(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
Consulting and education services revenue	\$ 20.2	\$ 18.6	\$ 1.6	9%	\$ 39.5	\$ 34.0	\$ 5.5	16%
Direct controllable cost of consulting and education services	10.5	9.6	0.9	9%	21.6	18.5	3.1	17%
Segment income	\$ 9.7	\$ 9.0	\$ 0.7	8%	\$ 17.9	\$ 15.5	\$ 2.4	15%
Segment margin %	48%	48%			45%	46%		

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Consulting and education services revenue consists of consulting, installation, implementation and education services. Consulting, installation and implementation services involve converting data from a customer's existing system, assisting in file set up and system configuration, and/or process re-engineering. Education services principally involve customer training activities.

The rates charged for our service offerings have remained relatively constant year over year and, as such, the increase in revenue in the second quarter of 2008 is principally the result of increased volume of services provided. Of the \$1.6 million increase in revenue in the second quarter of 2008, \$0.5 million was attributable to the inclusion of eTapestry. The increase in revenue is comprised of a \$1.2 million increase in consulting, installation and implementation services delivered and a \$0.4 million increase in education services delivered.

Cost of consulting and education services is principally comprised of human resource costs, third-party contractor expenses, classroom rentals and other costs incurred in providing consulting, installation and implementation services and

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customer training. During the second quarter of 2008, salary, benefit and bonus expense increased \$0.9 million compared to the second quarter of 2007 because we increased headcount over the course of 2007 to meet growing customer demand. A total of \$0.2 million, or 22% of the increase in salary, benefits and bonus expense is due to the inclusion of headcount associated with the acquisition of eTapestry.

During the first six months of 2008, consulting and education revenue increased \$5.5 million compared to the first six months of 2007, of which \$0.9 million is attributed to the inclusion of eTapestry. The increase in revenue is comprised of a \$4.0 million increase in consulting, installation and implementation services delivered and a \$1.5 million increase in education services delivered. Of this increase in education services, \$0.7 million is attributable to Training Pass, our fixed-rate program, which permits customers to attend unlimited training over a specified contract period.

During the first six months of 2008, salary, benefit and bonus expense increased \$3.0 million compared to the first six months of 2007 as we increased headcount over the course of 2007 to meet growing customer demand. A total of \$0.3 million, or 10% of the increase in salary, benefits and bonus expense is due to the inclusion of headcount associated with the acquisition of eTapestry. Travel-related expenses, training supplies and other costs increased \$0.3 million. These increases were partially offset by a decrease in recruiting and relocation costs and contracted services of \$0.2 million.

Analytic services

(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
Analytic services revenue	\$ 5.1	\$ 3.6	\$ 1.5	42%	\$ 9.4	\$ 6.6	\$ 2.8	42%
Direct controllable cost of analytic services	2.1	1.9	0.2	11%	4.4	3.4	1.0	29%
Segment income	\$ 3.0	\$ 1.7	\$ 1.3	76%	\$ 5.0	\$ 3.2	\$ 1.8	56%
Segment margin %	59%	47%			53%	48%		

Analytic services, which are comprised of donor prospect research, benchmarking studies and data modeling services, involve the assessment of current and prospective donor information of the customer. These assessments are performed using our proprietary analytical tools. The end product enables the customer to more effectively target its fundraising activities. Revenue from analytic services increased 42% in the second quarter of 2008 compared to the second quarter of 2007. The increase in analytic services is comprised of a \$1.5 million increase in donor prospect research, sales of lists of potential donors, benchmarking studies and data modeling services delivered, of which less than \$0.1 million is attributable to eTapestry.

Cost of analytic services is primarily comprised of human resource costs and data expense incurred to perform analytic services. Salary, benefits and bonus expense increased \$0.4 million in the second quarter of 2008 compared to the second quarter of 2007.

Revenue from analytic services increased 42% in the first six months of 2008 compared to the first six months of 2007. The increase in analytic services is comprised of a \$2.8 million increase in donor prospect research, sales of lists of potential donors, benchmarking studies and data modeling services delivered, of which less than \$0.2 million is attributable to eTapestry.

Salary, benefits and bonus expense increased \$1.0 million in the first six months of 2008 compared to the first six months of 2007 as we increased headcount to meet the increased customer demand.

Maintenance

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(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
Maintenance revenue	\$ 26.4	\$ 23.2	\$ 3.2	14%	\$ 51.8	\$ 45.6	\$ 6.2	14%
Direct controllable cost of maintenance	3.6	3.3	0.3	9%	7.3	6.4	0.9	14%
Segment income	\$ 22.8	\$ 19.9	\$ 2.9	15%	\$ 44.5	\$ 39.2	\$ 5.3	14%
Segment margin %	86%	86%			86%	86%		

Revenue from maintenance is comprised of annual fees derived from maintenance contracts associated with new software licenses and annual renewals of existing maintenance contracts. These contracts provide customers updates, enhancements and upgrades to our software products as well as online, telephone and email support. The maintenance revenue increase in the second quarter of 2008 compared to the second quarter of 2007 is comprised of \$3.4 million of new maintenance

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contracts associated with new license agreements and \$0.6 million from maintenance contract inflationary rate adjustments, offset by \$1.1 million of maintenance contracts that were not renewed.

Direct controllable cost of maintenance is primarily comprised of human resource costs, third-party royalty costs, and other costs incurred in providing support and related services to our customers. During the second quarter of 2008 the cost of maintenance increase is principally the result of a \$0.3 million increase in salary, benefits and bonus expense.

The maintenance revenue increase in the first six months of 2008 compared to the first six months of 2007 is comprised of \$6.7 million of new maintenance contracts associated with new license agreements, \$0.4 million from maintenance agreements associated with customers of the Target Companies and \$1.2 million from maintenance contract inflationary rate adjustments, offset by \$2.2 million of maintenance contracts that were not renewed.

During the first six months of 2008 the cost of maintenance increase is principally the result of a \$0.6 million increase in salary, benefits and bonus expense.

Subscriptions

(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
Subscriptions revenue	\$ 9.0	\$ 5.5	\$ 3.5	64%	\$ 17.8	\$ 10.3	\$ 7.5	73%
Direct controllable cost of subscriptions	3.0	1.7	1.3	76%	5.8	3.2	2.6	81%
Segment income	\$ 6.0	\$ 3.8	\$ 2.2	58%	\$ 12.0	\$ 7.1	\$ 4.9	69%
Segment margin %	67%	69%			67%	69%		

Revenue from subscriptions is principally comprised of revenue from providing access to hosted applications, providing application hosting services, and access to certain data services and our online subscription training offerings. The increase in subscriptions revenue in the second quarter of 2008 compared to the second quarter of 2007 is principally due to a \$2.6 million increase in revenue from hosted applications, of which \$1.9 million is attributable to eTapestry. Additionally, revenue from application hosting services increased \$0.5 million and revenue from our online analytics products increased \$0.4 million.

Direct controllable cost of subscriptions is primarily comprised of human resource costs, third-party royalty and data expenses, hosting expenses, and other costs incurred in providing support and services to our customers. The increase in the cost of subscriptions in the second quarter of 2008 compared to the second quarter of 2007 is principally due to an increase in salary, benefits and bonus expenses, which increased \$0.9 million, of which \$0.3 million is due to the inclusion of eTapestry. Additionally, data expense, hosting and other costs increased \$0.4 million, of which \$0.1 million is attributed to the inclusion of eTapestry.

The increase in subscriptions revenue in the first six months of 2008 compared to the first six months of 2007 is principally due to a \$5.3 million increase in revenue from hosted applications, of which \$3.6 million, or 68%, is attributable to the inclusion of eTapestry. Additionally, revenue from application hosting services increased \$1.1 million and revenue from our online analytics products increased \$1.0 million.

The increase in the cost of subscriptions in the first six months of 2008 compared to the first six months of 2007 is principally due to an increase in salary, benefits and bonus expenses, which increased \$1.9 million, of which \$0.6 million is due to the inclusion of eTapestry. Additionally, data expense, hosting and other costs increased \$0.5 million, of which \$0.1 million is attributed to the inclusion of eTapestry.

Other revenue

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(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
Other revenue	\$ 2.2	\$ 2.1	\$ 0.1	5 %	\$ 4.2	\$ 3.6	\$ 0.6	17 %
Direct controllable cost of other revenue	2.0	1.8	0.2	11 %	3.8	3.1	0.7	23 %
Segment income	\$ 0.2	\$ 0.3	\$ (0.1)	(33)%	\$ 0.4	\$ 0.5	\$ (0.1)	(20)%
Segment margin %	9%	14%			10%	14%		

Other revenue includes the sale of business forms used in conjunction with our software products; reimbursement of travel and related expenses, primarily incurred during the performance of services at customer locations; fees from user

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conferences; and sale of hardware in conjunction with The Patron Edge. Other revenue remained relatively constant with 2007 levels in the second quarter.

Direct controllable cost of other revenue includes human resource costs, costs of business forms and reimbursable expense relating to the performance of services at customer locations. The increase in the second quarter of 2008 compared to the second quarter of 2007 is due to a \$0.4 million increase in conference costs offset by a decrease of \$0.2 million in reimbursable expenses related to providing services at customer locations.

Other revenue increased in the first six months of 2008 primarily due to a \$0.3 million increase in reimbursable travel-related costs from our services businesses.

The increase in the cost of other revenue in the first six months of 2008 compared to the first six months of 2007 is due to a \$0.3 million increase in reimbursable expenses related to providing services at customer locations and a \$0.4 million increase in conference costs.

U.S. GAAP gross profit

Segment income does not include an allocation of corporate costs, stock-based compensation expense and amortization expense. The following schedule reconciles total segment income to gross profit as stated on the statements of operations.

(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
License fees	\$ 8.8	\$ 10.2	\$ (1.4)	(14)%	\$ 17.6	\$ 17.9	\$ (0.3)	(2)%
Consulting and education services	9.7	9.0	0.7	8%	17.9	15.5	2.4	15%
Analytic services	3.0	1.7	1.3	76%	5.0	3.2	1.8	56%
Maintenance	22.8	19.9	2.9	15%	44.5	39.2	5.3	14%
Subscriptions	6.0	3.8	2.2	58%	12.0	7.1	4.9	69%
Other	0.2	0.3	(0.1)	(33)%	0.4	0.5	(0.1)	(20)%
Total segment income	\$ 50.5	\$ 44.9	\$ 5.6	12%	\$ 97.4	\$ 83.4	\$ 14.0	17%
Less corporate costs not allocated to segment expenses:								
Stock-based compensation	0.5	0.2	0.3	150%	1.0	0.5	0.5	100%
Amortization of intangible assets acquired in business combinations	0.9	0.5	0.4	80%	1.8	1.2	0.6	50%
Corporate overhead costs	2.8	2.8	-	- %	5.6	5.0	0.6	12%
Gross profit as stated in statements of operations	\$ 46.3	\$ 41.4	\$ 4.9	12%	\$ 89.0	\$ 76.7	\$ 12.3	16%
Gross margin %	64%	65%			63%	64%		

Stock-based compensation expense and amortization expense are analyzed separately following the operating expenses section.

Allocated corporate overhead costs are comprised of depreciation, facilities and IT support costs. The increase in the second quarter of 2008 compared to 2007 is primarily the result of an increase in allocated depreciation expense of \$0.2 million as the result of property and equipment acquired during the interim period.

The increase in allocated corporate overhead costs in the first six months of 2008 compared to 2007 is comprised of an increase in allocated depreciation of \$0.4 million and an increase in allocated facilities costs of \$0.4 million. Depreciation increased primarily as the result of property and equipment acquired during the interim period. Allocated facilities costs increased primarily as the result of higher maintenance costs related

to hardware and software.

Operating expenses

The operating expenses analyzed below are presented on a non-GAAP basis as they exclude stock-based compensation expense. We believe that the exclusion of these costs allows us to better understand and manage other operating expenses and cash needs. Stock-based compensation expense is analyzed, in total, in the section following the operating expense analysis.

Table of Contents**Blackbaud, Inc.****Item 2. Management's discussion and analysis of financial condition and results of operations (continued)****Sales and marketing**

(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
Sales and marketing expense excluding stock-based compensation	\$ 15.4	\$ 14.0	\$ 1.4	10%	\$ 30.3	\$ 26.6	\$ 3.7	14%
Percentage of revenue	21%	22%			21%	22%		

Sales and marketing expense includes salaries and related human resource costs, travel-related expenses, sales commissions, advertising and marketing materials, public relations and an allocation of depreciation, facilities and IT support costs. The increase in sales and marketing expense in the second quarter of 2008 compared to the second quarter of 2007 is principally due to increases in the size of our sales force and the inclusion of eTapestry. During the second quarter of 2008, salaries, benefits and bonus expense increased \$1.0 million, of which \$0.5 million is due the inclusion of eTapestry. Other increases include higher advertising and marketing materials expenses of \$0.6 million. These increases were partially offset by a decrease in recruiting and relocation and travel-related costs of \$0.3 million.

The increase in sales and marketing expense in the first six months of 2008 compared to the first six months of 2007 is principally due to increases in the size of our sales force and the inclusion of eTapestry. During the first six months of 2008, salaries, benefits and bonus expense increased \$2.3 million, of which \$1.0 million is due the inclusion of headcount associated with the acquisition of eTapestry. Additionally, commission expenses increased \$0.5 million due to higher commissionable sales. Other increases include higher allocated costs of \$0.4 million and higher advertising and marketing expenses of \$0.7 million. These increases were partially offset by a decrease in recruiting and relocation and travel-related costs of \$0.2 million.

Research and development

(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
Research and development expense excluding stock-based compensation	\$ 8.1	\$ 6.7	\$ 1.4	21%	\$ 16.4	\$ 13.2	\$ 3.2	24%
Percentage of revenue	11%	10%			12%	11%		

Research and development expenses include salaries and related human resource costs, third-party contractor expenses, software development tools and other expenses related to developing new products, upgrading and enhancing existing products and an allocation of depreciation, facilities and IT support costs. During the second quarter of 2008, the increase in research and development costs is primarily due to a \$1.3 million increase in salaries, benefits and bonus expense due to an increase in headcount as we expanded our investment in our products.

During the first six months of 2008, the increase in research and development costs is primarily due to a \$2.6 million increase in salaries, benefits and bonus expense resulting from an increase in headcount and increased investment in this area of which \$0.4 million is due to the inclusion of eTapestry. Further increases of \$0.3 million are attributable to higher allocated costs and a further \$0.2 million higher contracted services, recruiting and other costs.

Research and development as a percentage of revenue increased 1% point for both the three and six months ended June 30, 2008, respectively, compared to the same period in 2007 although absolute dollar expenses increased 21% and 24%, respectively, during this period.

General and administrative

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(in millions)	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
General and administrative expense excluding stock-based compensation	\$ 6.2	\$ 5.6	\$ 0.6	11%	\$ 12.4	\$ 10.7	\$ 1.7	16%
Percentage of revenue	9%	9%			9%	9%		

General and administrative expense consists primarily of human resource costs for general corporate functions, including finance, accounting, legal, human resources, corporate development, third-party professional fees, insurance, an allocation of depreciation, facilities and IT support, and other administrative expenses. During the second quarter of 2008, general and administrative expenses increased \$0.6 million compared to the second quarter of 2007, of which \$0.2 million is

Table of Contents**Blackbaud, Inc.****Item 2. Management's discussion and analysis of financial condition and results of operations (continued)**

attributed to the inclusion of eTapestry. This increase of \$0.6 million was primarily driven by an increase in salaries, benefits and bonus expense associated with additional headcount.

During the first six months of 2008, general and administrative expenses increased \$1.7 million compared to the first six months of 2007, of which \$0.4 million is attributed to the inclusion of eTapestry. The remaining increase of \$1.3 million was primarily driven by a \$1.2 million increase in salaries, benefits and bonus expense associated with additional headcount.

Stock-based compensation

Beginning on January 1, 2006, we adopted SFAS No. 123(R), using the modified prospective transition method. SFAS No. 123(R) requires us to recognize compensation expense related to stock-based awards granted to employees.

Our consolidated statements of operations for the second quarter and first six months of 2008 and 2007 includes the amounts of stock-based compensation illustrated below:

(in thousands)	Three months ended June 30,				Six Months ended June 30,			
	2008	2007	Change	% Change	2008	2007	Change	% Change
Included in cost of revenue:								
Cost of services	\$ 302	\$ 182	\$ 120	66%	\$ 652	\$ 339	\$ 313	92%
Cost of maintenance	119	52	67	129	231	99	132	133
Cost of subscriptions	58	11	47	427	85	21	64	305
Total included in cost of revenue	479	245	234	96	968	459	509	111
Included in operating expenses:								
Sales and marketing	295	261	34	13	581	521	60	12
Research and development	508	266	242	91	1,028	535	493	92
General and administrative	1,037	1,027	10	1	2,101	1,996	105	5
Total included in operating expenses	1,840	1,554	286	18	3,710	3,052	658	22
Total	\$ 2,319	\$ 1,799	\$ 520	29%	\$ 4,678	\$ 3,511	\$ 1,167	33%

Stock-based compensation is comprised of expense from stock options, restricted stock awards and stock appreciation rights. The table below summarizes the stock-based compensation by award type for the second quarter and first six months of 2008 and 2007.

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007