

OPEN SOLUTIONS INC  
Form 10-Q  
November 12, 2004

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**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 September 30, 2004**

**OR**

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

**For the transition period of \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 000-02333**

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**Open Solutions Inc.**

*(Exact name of registrant as specified in its charter)*

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**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**22-3173050**  
*(I.R.S. Employer  
Identification No.)*

**300 Winding Brook Drive, Glastonbury, CT**  
*(Address of principal executive offices)*

**06033**  
*(Zip Code)*

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**(860) 652-3155**

*(Registrant's telephone number, including area code)*

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes (X) No ( )

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). ( )

As of November 10, 2004, 19,295,315 shares of common stock, \$0.01 par value per share, were outstanding.

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**OPEN SOLUTIONS INC.  
QUARTERLY REPORT ON FORM 10-Q  
FOR THE FISCAL QUARTER ENDED SEPTEMBER 30, 2004**

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1: FINANCIAL STATEMENTS****OPEN SOLUTIONS INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(unaudited)**

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	<b>(In thousands, except share and per share data)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 86,455	\$ 84,953
Investments in marketable securities	13,036	
Accounts receivable, net	18,880	10,267
Deferred costs	1,316	1,563
Prepaid expenses and other current assets	3,175	2,188
	<hr/>	<hr/>
Total current assets	122,862	98,971
Fixed assets, net	8,833	5,500
Investments in marketable securities		8,028
Capitalized software costs, net	4,300	2,964
Other intangible assets, net	20,059	6,421
Goodwill	34,860	11,187
	<hr/>	<hr/>
Total assets	\$190,914	\$133,071
	<hr/>	<hr/>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,193	\$ 1,800
Accrued expenses	11,164	8,368
Deferred revenue, current portion	21,113	15,324
Capital lease obligations, current portion	202	395
	<hr/>	<hr/>
Total current liabilities	35,672	25,887
	<hr/>	<hr/>
Capital lease obligations, less current portion	21	64

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Deferred revenue, less current portion	1,202	1,479
Other long-term liabilities	292	222
	<u>          </u>	<u>          </u>
Total liabilities	37,187	27,652
	<u>          </u>	<u>          </u>
Commitments and contingencies (Note 5)		
Stockholders' Equity		
Preferred stock, \$0.01 par value; 5,000,000 shares authorized; no shares issued and outstanding at September 30, 2004 and December 31, 2003		
Common stock, \$0.01 par value; 95,000,000 shares authorized; 19,206,847 and 16,786,329 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively		
	192	168
Additional paid-in capital	189,974	152,274
Accumulated other comprehensive loss	(56)	(28)
Accumulated deficit	(36,383)	(46,995)
	<u>          </u>	<u>          </u>
Total stockholders' equity	153,727	105,419
	<u>          </u>	<u>          </u>
Total liabilities and stockholders' equity	\$190,914	\$133,071
	<u>          </u>	<u>          </u>

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

Table of Contents**OPEN SOLUTIONS INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>(In thousands, except share and per share data)</b>			
Revenues:				
Software license	\$ 9,412	\$ 4,688	\$ 22,768	\$ 13,926
Service, maintenance and hardware	18,920	12,739	48,334	29,442
Total revenues	28,332	17,427	71,102	43,368
Cost of revenues:				
Software license	2,008	1,278	4,552	3,602
Service, maintenance and hardware	9,503	7,126	25,100	16,512
Total cost of revenues	11,511	8,404	29,652	20,114
Gross profit	16,821	9,023	41,450	23,254
Operating expenses:				
Sales and marketing	3,755	2,590	10,053	7,604
Product development	3,228	1,825	7,410	5,021
General and administrative	5,476	3,693	13,692	8,755
Total operating expenses	12,459	8,108	31,155	21,380
Income from operations	4,362	915	10,295	1,874
Interest income (expense), net	363	(53)	885	(18)

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Income before income taxes	4,725	862	11,180	1,856
Income tax provision	(255)	(56)	(567)	(183)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net income	\$ 4,470	\$ 806	\$ 10,613	\$ 1,673
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net income per common share:				
Basic	\$ 0.23	\$ 0.00	\$ 0.59	\$ 0.00
Diluted	0.21	0.00	0.53	0.00
Weighted average common shares used to compute net income per common share:				
Basic	19,107,201	2,497,933	17,980,593	2,487,816
Diluted	20,867,976	2,846,363	19,895,660	2,836,246

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



Table of Contents**OPEN SOLUTIONS INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

	<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>
	<b>(In thousands)</b>	
<b>Cash flows from operating activities</b>		
Net income	\$ 10,613	\$ 1,673
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,127	2,830
Compensation expense related to stock and options granted	298	360
Provision for doubtful accounts	44	(17)
Changes in operating assets and liabilities, excluding effects from acquisitions:		
Accounts receivable	(6,971)	(534)
Prepaid expenses and other current assets	194	(514)
Accounts payable and accrued expenses	(65)	842
Deferred revenue	2,654	(1,937)
	<u>10,894</u>	<u>2,703</u>
<b>Cash flows from investing activities</b>		
Purchases of fixed assets	(3,511)	(871)
Purchase of developed software		(20)
Purchases of marketable securities	(5,036)	
Business acquisitions, net of cash received	(37,244)	(8,000)
	<u>(45,791)</u>	<u>(8,891)</u>
<b>Cash flows from financing activities</b>		
Proceeds from exercise of stock options	2,977	4
Proceeds from issuance of common stock from employee stock purchase plan	332	
Proceeds from issuance of long-term debt		1,661
Repayment of long-term debt		(221)
Repayment of capital lease obligations	(349)	(104)
Net proceeds from sale of common stock	33,439	

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Net cash provided by financing activities	36,399	1,340
	<u>          </u>	<u>          </u>
Net increase (decrease) in cash and cash equivalents	1,502	(4,848)
Cash and cash equivalents, beginning of period	84,953	11,414
	<u>          </u>	<u>          </u>
Cash and cash equivalents, end of period	\$ 86,455	\$ 6,566
<b>Supplemental disclosures</b>		
Cash paid for interest	\$ 55	\$ 40
Cash paid for income taxes	394	161

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

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**OPEN SOLUTIONS INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)**

**1. The Company**

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

**2. Summary of Significant Accounting Policies**

***Basis of Presentation and Principles of Consolidation***

The accompanying condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States. These accounting principles were applied on a basis consistent with those of the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003 filed with the Securities and Exchange Commission (the "SEC"). The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments (consisting only of normal, recurring adjustments) necessary for a fair presentation. The operating results for the three and nine month periods ended September 30, 2004 may not be indicative of the results expected for any succeeding quarter or for the entire fiscal year ending December 31, 2004.

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

***Use of Estimates***

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

***Segment Reporting***

The Company applies the provisions of Statement of Financial Accounting Standards ("SFAS") No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company views its operations and manages its business as one segment, the development and marketing of computer software and related services. Factors used to identify the Company's single operating segment include the organizational structure of the Company and the financial information available for evaluation by the chief operating decision-maker in making decisions about how to allocate resources and assess performance. The Company operates primarily in one geographical area, the United States of

America. The Company provides the following disclosures of revenues from products and services:

Table of Contents**OPEN SOLUTIONS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(unaudited)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Software license	\$ 9,412,000	\$ 4,688,000	\$22,768,000	\$13,926,000
Installation, training and professional services	4,695,000	2,676,000	12,688,000	7,055,000
Maintenance, support and data center services	13,209,000	8,300,000	31,938,000	19,803,000
Hardware	1,016,000	1,763,000	3,708,000	2,584,000
Service, maintenance and hardware	18,920,000	12,739,000	48,334,000	29,442,000
Total revenues	\$28,332,000	\$17,427,000	\$71,102,000	\$43,368,000

***Net Income and Loss Per Share***

The Company reports net income or loss per share in accordance with SFAS No. 128, *Earnings per Share*. Under SFAS No. 128, basic earnings per share ( EPS ), which excludes dilution, is computed by dividing income or loss available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Diluted EPS includes in-the-money stock options and warrants using the treasury stock method and also includes the assumed conversion of preferred stock using the if-converted method. During a loss period, the assumed exercise of in-the-money stock options and warrants and the conversion of convertible preferred stock has an anti-dilutive effect, and therefore, these instruments would be excluded from the computation of dilutive EPS.

In April 2004, the EITF issued Statement No. 03-06, Participating Securities and the Two-Class Method Under FASB Statement No. 128, *Earnings Per Share* ( EITF 03-06 ). EITF 03-06 addressed a number of questions regarding the computation of EPS by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the Company when, and if, it declares dividends on its common stock and provided guidance on application of the two-class method. The two-class method is an earnings allocation formula that determines EPS for common stock and participating securities based upon an allocation of earnings as if all of the earnings for the period had been distributed in accordance with participation rights on undistributed earnings. EITF 03-06 is effective for fiscal periods beginning after March 31, 2004 and requires retroactive restatement of previously presented EPS amounts. The adoption of this standard in the second quarter of 2004

required retroactive restatement of EPS for the three and nine month periods ended September 30, 2003. Since the Company's initial public offering in the fourth quarter of 2003, there is only one class of stock outstanding and accordingly there is no impact on EPS reported in 2004.

Table of Contents**OPEN SOLUTIONS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(unaudited)**

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Net income	\$ 4,470,000	\$ 806,000	\$ 10,613,000	\$ 1,673,000
Amount allocated to participating preferred stockholders		(801,000)		(1,673,000)
Income available to common stockholders	\$ 4,470,000	\$ 5,000	\$ 10,613,000	\$
Basic net income per share				
weighted average common shares outstanding	19,107,201	2,497,933	17,980,593	2,487,816
Dilutive effect of stock options and warrants	1,760,775	348,430	1,915,067	348,430
Dilutive effect of preferred stock conversion				
Diluted net income per share				
weighted average common shares outstanding	20,867,976	2,846,363	19,895,660	2,836,246

Weighted average common share equivalents of 75,101 and 2,802,563 related to out-of-the-money stock options were excluded from the computation of diluted EPS for the three month periods ended September 30, 2004 and 2003 as they would have been anti-dilutive. Weighted average common shares of 27,818 and 2,579,260 related to out-of-the-money stock options were excluded from the computation of diluted EPS for the nine month periods ended September 30, 2004 and 2003 as they would have been anti-dilutive. Common share equivalents of 8,052,939 related to preferred stock were excluded from the computation of diluted EPS for three and nine month periods ended September 30, 2003 as they would have been antidilutive.

***Comprehensive Income***

SFAS No. 130, *Reporting Comprehensive Income*, requires that items defined as comprehensive income or loss be separately classified in the financial statements and that the accumulated balance of other comprehensive income or loss be reported separately from accumulated deficit and additional paid-in capital in the equity section of the balance

sheet.

The following table summarizes the Company's comprehensive income:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Net income	\$4,470,000	\$806,000	\$10,613,000	\$1,673,000
Unrealized gain (loss) on marketable securities	33,000		(28,000)	
Total comprehensive income	\$4,503,000	\$806,000	\$10,585,000	\$1,673,000

### ***Concentration of Credit Risk***

Financial instruments that potentially expose the Company to concentrations of credit risk are limited to accounts receivable. One individual customer accounted for 12% of total revenues for both the three and nine month periods ended September 30, 2004. One individual customer accounted for 11% of total revenues for the three month period ended September 30, 2003. No one individual customer accounted 10% or more of total revenues for the nine month period ended September 30, 2003.



Table of Contents**OPEN SOLUTIONS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(unaudited)**

At September 30, 2004 and December 31, 2003, no customer accounted for 10% or more of the total accounts receivable balance. The Company maintains allowances for potential credit risks and otherwise controls this risk through monitoring procedures.

***Stock Compensation***

The Company applies the intrinsic value recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations and complies with the disclosure provisions of SFAS No. 123, as amended by SFAS No. 148. Under APB 25, compensation expense is recognized over the vesting period to the extent that the fair market value of the underlying stock on the date of grant exceeds the exercise price of the employee stock option.

The following table illustrates the effect on net income if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock options granted to employees and shares purchased under the 2003 Employee Stock Purchase Plan ( ESPP ). The ESPP program went into effect as of January 1, 2004.

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Net income, as reported	\$ 4,470,000	\$ 806,000	\$10,613,000	\$ 1,673,000
Add: Stock compensation expense included in reported net income	98,000	215,000	298,000	360,000
Subtract: Total stock compensation expense determined under fair value method	<u>(1,275,000)</u>	<u>(897,000)</u>	<u>(3,475,000)</u>	<u>(1,844,000)</u>
Pro forma net income	<u>\$ 3,293,000</u>	<u>\$ 124,000</u>	<u>\$ 7,436,000</u>	<u>\$ 189,000</u>
Reported net income per share				
Basic	\$ 0.23	\$ 0.00	\$ 0.59	\$ 0.00
Diluted	0.21	0.00	0.53	0.00
Pro forma net income per share				
Basic	\$ 0.17	\$ 0.00	\$ 0.41	\$ 0.00
Diluted	0.16	0.00	0.37	0.00

The above pro forma results are not necessarily indicative of future pro forma results. The fair value of each option grant or ESPP share purchase is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions used for options or purchase rights granted during the nine month periods ended September 30, 2004 and 2003, respectively:

	<b>ESPP</b>	<b>Stock Options</b>	
	<b>2004</b>	<b>2004</b>	<b>2003</b>
Risk free interest rate	1.02%	3.26%	3.96%
Expected dividend yield	None	None	None
Expected life of award	6 months	5 years	6 years
Expected volatility	73%	69%	74%
Weighted average fair value	\$6.52	\$13.07	\$4.45

The fair value method requires the input of highly subjective assumptions, including expected stock price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate.

Table of Contents**OPEN SOLUTIONS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(unaudited)****3. Acquisitions***Omega Systems of North America*

On July 23, 2004, the Company acquired substantially all of the outstanding operating assets and assumed certain liabilities of Omega Systems of North America LLC, a company specializing in remittance and lock box solutions, for cash consideration of approximately \$2,410,000 and acquisition-related costs of approximately \$49,000. This acquisition was recorded under the purchase method with the total consideration allocated to the fair value of assets acquired and goodwill. Pro forma information related to the combined results of operations of the Company and Omega were not material for the nine months ended September 30, 2004 and 2003, respectively.

*re:Member Data Services, Inc.*

On July 8, 2004, the Company acquired all of the outstanding stock of re:Member Data Services, Inc. ( RDS ), a provider of core processing software and related services for credit unions, for cash consideration of approximately \$21,869,000 and employee stock options valued at approximately \$789,000. In connection with the acquisition, the Company incurred approximately \$96,000 of acquisition-related costs. This acquisition was recorded under the purchase method of accounting with the total consideration allocated to the assets acquired and liabilities assumed based on estimates of fair value. Acquired liabilities include approximately \$1.0 million related to estimated losses on a lease obligation (see Note 5). The fair value of purchased technology was determined by an independent valuation firm based primarily on management's best estimate of future cash flows expected to be generated by such technology. The excess of the purchase price over the fair value of the net assets acquired has been allocated to goodwill. The operating results of this acquisition have been included in the Company's consolidated financial statements from the date of acquisition. The purchased technology related to this acquisition is being amortized over its estimated useful life of five years. The other intangible assets, comprised of customer relationships, tradenames and a non-compete agreement are being amortized over their estimated useful lives of sixteen, five and five years, respectively. Purchase accounting for this acquisition is preliminary, primarily with respect to the identification and valuation of intangibles, and is expected to be finalized during 2004.

The financial information in the table below summarizes the combined results of operations of the Company and RDS on a pro forma basis, as though the companies had been combined as of the beginning of the periods being presented below. This pro forma financial information is not necessarily indicative of the results of operations that would have been achieved had the acquisition actually taken place as of the beginning of the period being presented below.

		<b>Nine Months Ended September 30,</b>	
		<b>2004</b>	<b>2003</b>
Pro forma revenues		\$77,414,000	\$53,194,000
Pro forma net income		9,499,000	896,000
Pro forma net income per share	basic	\$ 0.53	\$ 0.00
Pro forma net income per share	diluted	0.48	0.00

***Eastpoint Technologies, LLC***

On June 18, 2004, the Company acquired substantially all of the outstanding operating assets and assumed certain liabilities of Eastpoint Technologies, LLC ( "Eastpoint" ), a provider of core processing software and related services for banks, for cash consideration of approximately \$7,000,000. Subsequent to the acquisition date, the Company received \$206,000 from amounts paid to escrow as a contractual adjustment of the original purchase price. In connection with the acquisition, the Company incurred approximately \$83,000 of acquisition-related costs. This acquisition was recorded under the purchase method of accounting with the total consideration allocated to the assets acquired and liabilities assumed based on estimates of fair value. The fair value of purchased technology was determined by an independent valuation firm based primarily on management's best estimate of future cash flows expected to be generated by such technology. The excess of the purchase price over the fair value of the net assets acquired has been allocated to goodwill. The operating results of this acquisition have been included in the Company's consolidated financial statements from the date of acquisition. The purchased technology related to this acquisition is being amortized over its estimated useful life of five years. The other intangible assets, comprised of tradenames and customer relationships are being amortized over their estimated useful lives of five and eleven years, respectively. Purchase accounting for this acquisition is preliminary, primarily with respect to the identification and valuation of intangibles, and is expected to be finalized during 2004.

Table of Contents**OPEN SOLUTIONS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(unaudited)**

The financial information in the table below summarizes the combined results of operations of the Company and Eastpoint on a pro forma basis, as though the companies had been combined as of the beginning of the periods being presented below. This pro forma financial information is not necessarily indicative of the results of operations that would have been achieved had the acquisition actually taken place as of the beginning of the period being presented below.

		<b>Nine Months Ended September 30,</b>	
		<b>2004</b>	<b>2003</b>
Pro forma revenues		\$74,061,000	\$49,014,000
Pro forma net income		9,550,000	1,144,000
Pro forma net income per share	basic	\$ 0.53	\$ 0.00
Pro forma net income per share	diluted	0.48	0.00

***Maxxar Corporation***

On February 24, 2004, the Company acquired all of the outstanding capital stock of Maxxar Corporation ( Maxxar ) for cash consideration of approximately \$6,500,000. Subsequent to the acquisition date, the Company paid an additional \$190,000 as a contractual adjustment of the original purchase price. In connection with the acquisition, the Company incurred approximately \$185,000 of acquisition-related costs. This acquisition expanded the Company's complementary product offerings to include a comprehensive suite of interactive voice solutions and computer telephony integration products. This acquisition was recorded under the purchase method of accounting with the total consideration allocated to the assets acquired and liabilities assumed based on estimates of fair value. The fair value of purchased technology was determined by an independent valuation firm based primarily on management's best estimate of future cash flows expected to be generated by such technology. The excess of the purchase price over the fair value of the net assets acquired has been allocated to goodwill. The operating results of this acquisition have been included in the Company's consolidated financial statements from the date of acquisition. The purchased technology related to this acquisition is being amortized over its estimated useful life of seven years. The other intangible assets, comprised of tradenames and customer relationships are being amortized over their estimated useful lives of ten to twenty years.

The financial information in the table below summarizes the combined results of operations of the Company and Maxxar on a pro forma basis, as though the companies had been combined as of the beginning of the periods being presented below. This pro forma financial information is not necessarily indicative of the results of operations that would have been achieved had the acquisition actually taken place as of the beginning of the period being presented below.

<b>Nine Months Ended September 30,</b>	
<b>2004</b>	<b>2003</b>

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Pro forma revenues		\$71,882,000		\$46,809,000
Pro forma net income		10,783,000		1,636,000
Pro forma net income per share	basic	\$ 0.60		\$ 0.00
Pro forma net income per share	diluted	0.54		0.00

Table of Contents**OPEN SOLUTIONS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(unaudited)**

The allocation of purchase price for each of the 2004 acquisitions is summarized below:

	<b>Omega</b>	<b>RDS</b>	<b>Eastpoint</b>	<b>Maxxar</b>
Tangible assets acquired	\$ 477,000	\$ 2,670,000	\$ 1,272,000	\$ 1,814,000
Purchased technology	250,000	750,000	290,000	760,000
Goodwill	2,004,000	12,100,000	5,322,000	4,243,000
Other intangible assets	200,000	11,440,000	1,990,000	700,000
Liabilities assumed	(472,000)	(4,206,000)	(1,997,000)	(642,000)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Purchase price	\$ 2,459,000	\$ 22,754,000	\$ 6,877,000	\$ 6,875,000
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

**4. Long-Term Debt*****Line of Credit and Equipment Term Loan***

On April 29, 2003, the Company secured a credit facility upon which it was able to draw an aggregate amount of \$4,000,000. The facility provided for funding of up to \$2,000,000 for an Equipment Term Loan and \$2,000,000 for a Working Capital Line. The Equipment Term Loan bore interest at the greater of the prime rate plus 1% or 5.75%. The Working Capital Line bore interest at the greater of the prime rate plus 0.5% or 5.25%. The Company borrowed \$1.7 million against the equipment portion of the facility, which was paid in full in December 2003 from the proceeds of the Company's initial public offering. The Company terminated the facility in February 2004.

**5. Commitments and Contingencies*****Lease Obligation***

On May 4, 2004, the Company entered into a lease agreement for a new corporate headquarters facility. The term of this lease commences on August 1, 2005 or on an earlier date by mutual written consent of the Company and lessor. Minimum future lease payments total approximately \$6.5 million over the seven year term.

In connection with the acquisition of RDS, the Company assumed a lease obligation for its primary operating facility that extends through December 2010. Minimum future lease payments total approximately \$6.9 million over the remaining term.

***Legal Proceedings***

The Company is from time to time a party to legal proceedings which arise in the normal course of business. The Company is not currently involved in any material litigation, the outcome of which would, in management's judgment based on information currently available, have a material adverse effect on the Company's results of operations or

financial condition, nor is management aware of any such litigation.

## **6. Related Party**

Until his retirement in April 2004, a director of the Company was a member of management at one of the Company's clients. For the nine month periods ended September 30, 2004 and 2003, revenues from the client were \$2,258,000 and \$460,000, respectively. As of September 30, 2004 and December 31, 2003, \$511,000 and \$0 was due from this client, respectively. Additionally, the Company holds its main operating bank account with this client.



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**OPEN SOLUTIONS INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(unaudited)**

**7. Capital Stock**

On May 17, 2004, the Company completed a public offering of 4,436,442 shares of its common stock at a price of \$21.50 per share. Of the 4,436,442 shares offered, 1,000,000 shares were offered by Open Solutions and 3,436,442 shares were offered by certain of the Company's existing stockholders. On June 8, 2004, the underwriters exercised their option to purchase 665,466 additional shares of common stock from the Company at a price of \$21.50 per share. The aggregate net proceeds to the Company from the offering were \$33,423,000.

**8. Subsequent Events**

***Acquisition of Datawest Corporation***

On August 25, 2004, the Company reached an agreement to acquire all of the outstanding stock of Datawest Corporation (Datawest), a provider of core data processing and payment technology solutions in Canada. On October 21, 2004, the shareholders of Datawest approved the sale of Datawest to the Company and on October 29, 2004, the acquisition was completed for cash consideration of CDN \$1.16 (approximately US\$0.95 at the exchange rate as of October 29, 2004) per common share for 29,824,126 common shares and CDN \$2.60 (approximately US\$2.13 at the exchange rate as of October 29, 2004) per preferred share for 5,000,000 preferred shares, for a total aggregate consideration of CDN\$47,595,986 (approximately US\$38.9 million at the exchange rate as of October 29, 2004). Additionally, the Company repaid US\$8.3 million of outstanding debt and has incurred approximately US\$286,000 of acquisition costs through October 31, 2004 for a total purchase price of US\$47.5 million. This acquisition will be recorded under the purchase method with the total consideration allocated to the fair value of assets acquired and goodwill.

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

*We use the terms Open Solutions, we, us and our to refer to the business of Open Solutions Inc. and our subsidiaries. All references to years, unless otherwise noted, refer to our fiscal years, which end on December 31.*

**Overview**

We are a provider of software and services that allow financial institutions to compete and service their customers more effectively. We develop, market, license and support an enterprise-wide suite of software and services that perform a financial institution's data processing and information management functions, including account, transaction, lending, operations, back office, client information and reporting. Our complementary products and services supplement our core software to provide our clients with fully-integrated business intelligence, customer relationship management, or CRM, check imaging, Internet banking and cash management, general ledger and profitability, loan origination, interactive voice solutions and check and item processing functions. Our software can be operated either by the financial institution itself, on an outsourced basis in one of our outsourcing centers or through an outsourcing center hosted by one of our resellers. Substantially all of our historical revenue has been generated through the licensing of our core software and our complementary products and the provision of related services and maintenance to small and mid-size commercial banks and thrifts and credit unions of all sizes.

We derive revenues from two primary sources:

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

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

Our revenues have grown from approximately \$14.1 million in 1999 to approximately \$63.9 million in 2003. Our revenues for the three and nine months ended September 30, 2004 were \$28.3 million and \$71.1 million, respectively. This growth has resulted from internal expansion and strategic acquisitions, through which we have developed and acquired new products and services.

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

We generate service and maintenance fees by converting clients to our core software suite, installing our software, assisting our clients in operating the applications, supporting the software and providing outsourcing services. Our software license agreements typically provide for five years of support services and maintenance. We perform outsourcing services through our four outsourcing centers and our check and item processing centers. Revenues from

outsourcing center services and the check and item processing centers are derived from monthly service fees, typically under three to five-year service contracts with our clients.

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

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

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We have recorded a full valuation allowance against our deferred tax assets due to the uncertainty of their utilization. Currently, we charge against income for certain state taxes and federal alternative minimum taxes. If we determine that the deferred tax assets will be utilized and the valuation allowance is reversed, we will report a significant income tax benefit in that period and, for subsequent periods, will record a tax provision against income at the effective statutory rate. However, we do not expect to incur significant tax payments until all anticipated net operating loss carry forwards and research and development tax credits are utilized. The reversal of the tax valuation allowance could occur in the near term, possibly in the next three to six months, should we continue to be profitable and sufficient positive evidence exists to support its reversal.

## **Application of Critical Accounting Policies**

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, which require that management make numerous estimates and assumptions. Actual results could differ from those estimates and assumptions, impacting our reported results of operations and financial position. The application of our critical accounting policies is described in our Annual Report on Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission. These critical accounting policies include:

*Revenue Recognition*

*Allowance for Doubtful Accounts*

*Stock Compensation*

*Software Development Costs*

*Accounting for Purchase Business Combinations*

*Long-Lived Assets, Intangible Assets and Goodwill*

There were no material changes to the application of our critical accounting policies for the nine months ended September 30, 2004.

## **Acquisitions**

Since June 2000, we have expanded our product offerings and client base through the acquisition of nine businesses. The operating results of each business acquired have been included in our financial statements from the respective dates of acquisition.

On July 1, 2003, we acquired substantially all of the assets of Liberty FiTech Systems, Inc. and assumed certain liabilities and the related future software maintenance and support obligations for consideration of approximately \$11.7 million, consisting of \$8.0 million in cash, a \$1.9 million promissory note and 133,195 shares of our common stock subject to a put and call feature. On December 2, 2003, we purchased these 133,195 shares at a price of \$13.51 per share, or an aggregate of approximately \$1.8 million. The note was paid in full in December 2003 with the proceeds from our initial public offering. The acquisition was recorded under the purchase method with the total consideration allocated to the fair value of assets acquired, including purchased technology of \$530,000, goodwill of \$4.8 million and other intangible assets of \$6.7 million. This acquisition has increased our core data processing client base among credit unions and increased the recurring revenue component of our revenues.

On February 24, 2004, we acquired Maxxar Corporation for cash consideration of approximately \$6.5 million. Subsequent to the acquisition date, we paid an additional \$190,000 as a contractual adjustment of the original purchase price. In connection with the acquisition, we incurred approximately \$185,000 of acquisition related costs. This acquisition was recorded under the purchase method of accounting with the total consideration allocated to the fair value of assets acquired, including purchased technology of approximately \$760,000 and other intangibles of approximately \$700,000. The excess of the purchase price over the fair value of the net assets acquired of \$4.2 million has been allocated to goodwill. This acquisition expanded our complementary product offerings to include a comprehensive suite of interactive voice information solutions and computer telephony integration products.

On June 18, 2004, we acquired substantially all of the outstanding operating assets and assumed certain liabilities of Eastpoint Technologies, LLC, a provider of core processing software and related services for banks, for cash consideration of approximately \$7.0 million. Subsequent to the acquisition date, we received \$206,000 from amounts paid to escrow as a contractual adjustment of the original purchase price. In connection with the acquisition, we incurred approximately \$83,000 of acquisition-related costs. This acquisition was recorded under the purchase method of accounting with the total consideration allocated to the fair value of the assets acquired, including purchased technology of \$290,000 and other intangibles of approximately \$1,990,000 and liabilities assumed based on estimates of fair value. The excess of the purchase price over the fair value of the net assets acquired of \$5.3 million has been

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allocated to goodwill. Purchase accounting for this acquisition is preliminary, primarily with respect to the identification and valuation of intangibles, and is expected to be finalized during 2004. This acquisition increased our core data processing client base among banks and increased the recurring revenue component of our revenues.

On July 9, 2004, we acquired the stock of re:Member Data Services, Inc., a provider of core processing solutions for credit unions, for cash consideration of approximately \$21.9 million and employee stock options valued at approximately \$789,000. In connection with the acquisition, the Company incurred approximately \$96,000 of acquisition-related costs. This acquisition was recorded under the purchase method of accounting with the total consideration allocated to the fair value of the assets acquired, including purchased technology of \$750,000 and other intangibles of approximately \$11.4 million and liabilities assumed based on estimates of fair value. The excess of the purchase price over the fair value of the net assets acquired of \$12.1 million has been allocated to goodwill. Purchase accounting for this acquisition is preliminary, primarily with respect to the identification and valuation of intangibles, and is expected to be finalized during 2004. This acquisition increased our core data processing client base among credit unions and increased the recurring revenue component of our revenues.

On July 23, 2004, we acquired substantially all of the outstanding operating assets and assumed certain liabilities of Omega Systems of North America LLC, a company specializing in remittance and lock box solutions, for cash consideration of approximately \$2.4 million and acquisition-related costs of approximately \$49,000.

On August 25, 2004, we reached an agreement to acquire all of the outstanding stock of Datawest Corporation (Datawest), a provider of core data processing and payment technology solutions in Canada. On October 21, 2004, the shareholders of Datawest approved the sale of Datawest to Open Solutions and on October 29, 2004, the acquisition was completed for cash consideration of CDN \$1.16 (approximately US\$0.95 at the exchange rate as of October 29, 2004) per common share for 29,824,126 common shares and CDN \$2.60 (approximately US\$2.13 at the exchange rate as of October 29, 2004) per preferred share for 5,000,000 preferred shares, for a total aggregate consideration of CDN\$47,595,986 (approximately US\$38.9 million at the exchange rate as of October 29, 2004). Additionally, we repaid US\$8.3 million of outstanding debt and have incurred approximately US\$286,000 of acquisition costs through October 31, 2004 for a total purchase price of US\$47.5 million. This acquisition will be recorded under the purchase method with the total consideration allocated to the fair value of assets acquired and goodwill. We view this acquisition as an opportunity to increase our core data processing base internationally into Canada, to increase the recurring revenue component of our revenues and to expand our product offerings to include electronic payment products and services.

**Table of Contents****Results of Operations**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>(in thousands)</b>			
<b>Statement of Operations Data:</b>				
Revenues:				
Software license	\$ 9,412	\$ 4,688	\$22,768	\$13,926
Service, maintenance and hardware	18,920	12,739	48,334	29,442
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total revenues	28,332	17,427	71,102	43,368
Cost of revenues:				
Software license	2,008	1,278	4,552	3,602
Service, maintenance and hardware	9,503	7,126	25,100	16,512
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total cost of revenues	11,511	8,404	29,652	20,114
Operating expenses:				
Sales and marketing	3,755	2,590	10,053	7,604
Product development	3,228	1,825	7,410	5,021
General and administrative	5,476	3,693	13,692	8,755
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total operating expenses	12,459	8,108	31,155	21,380
Income from operations	4,362	915	10,295	1,874
Interest income (expense), net	363	(53)	885	(18)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Income before income taxes	4,725	862	11,180	1,856
Income tax provision	(255)	(56)	(567)	(183)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net income	\$ 4,470	\$ 806	\$10,613	\$ 1,673
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

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	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
<b>As a Percentage of Revenues:</b>				
Revenues:				
Software license	33.2%	26.9%	32.0%	32.1%
Service, maintenance and hardware	66.8	73.1	68.0	67.9
Total revenues	100.0	100.0	100.0	100.0
Cost of revenues:				
Software license	7.1	7.3	6.4	8.3
Service, maintenance and hardware	33.5	40.9	35.3	38.1
Total cost of revenues	40.6	48.2	41.7	46.4
Operating expenses:				
Sales and marketing	13.3	14.8	14.1	17.5
Product development	11.4	10.5	10.4	11.6
General and administrative	19.3	21.2	19.3	20.2
Total operating expenses	44.0	46.5	43.8	49.3
Income from operations	15.4	5.3	14.5	4.3
Interest income (expense), net	1.3	(0.3)	1.2	0.0
Income before income taxes	16.7	5.0	15.7	4.3
Income tax provision	(0.9)	(0.3)	(0.8)	(0.4)
Net income	15.8	4.7	14.9	3.9



**Table of Contents*****Three Months Ended September 30, 2004 Compared to Three Months Ended September 30, 2003***

**Revenues.** We generate revenues from licensing the rights to use our software products and certain third-party software products to clients. We also generate revenues from installation, training, maintenance and support services provided to clients, from outsourcing center services and from hardware sales related to our check imaging and telephony businesses. Revenues increased 62.6% from \$17.4 million for the three months ended September 30, 2003 to \$28.3 million for the three months ended September 30, 2004. This increase was attributable to a \$4.7 million increase in licensing revenue from our core and complementary products attributable to sales to new clients, including those clients of our acquired entities, sales of additional products to existing clients and an increase in license fees from BISYS. Of the \$4.7 million increase in licensing revenues, \$960,000 related to revenue from those acquisitions completed subsequent to September 30, 2003, which were Maxxar Corporation, Eastpoint Technologies, LLC, re:Member Data Services, Inc and Omega Systems of North America. The increase in revenues was also attributable to an increase of \$2.0 million in our implementation and other professional services, \$945,000 of which was from acquired businesses. We also realized an increase of \$2.4 million in our maintenance revenue, \$1.8 million of which was from acquired businesses, and an increase of \$2.5 million in our outsourcing revenues, \$2.4 million of which was from acquired businesses. The increases in implementation, professional services and maintenance revenues are also directly related to the increase in sales of licenses to new clients and sales of additional products to existing clients. Additionally, revenues associated with hardware and other revenues decreased by \$747,000 as compared to the three months ended September 30, 2003 due to one large transaction in 2003. The acquired businesses provided \$513,000 of hardware and other revenues.

**Cost of Revenues.** Cost of revenues includes third party license fees and the direct expenses associated with providing our services such as systems operations, customer support, installations, professional services and other related expenses. Cost of revenues increased 37.0% from \$8.4 million for the three months ended September 30, 2003 to \$11.5 million for the three months ended September 30, 2004. The increase was due primarily to a \$1.1 million increase in costs associated with implementation and other professional services, \$404,000 of which is from acquired businesses, a \$616,000 increase in costs associated with maintenance, all of which is from the acquired businesses and a \$1.1 million increase in costs associated with the growth of our outsourcing business, \$839,000 of which is from the acquired businesses. Additionally, the costs associated with hardware and other revenues decreased by \$393,000. The acquired businesses provided \$464,000 of costs related to hardware and other revenues. Cost of revenues represented 48.2% of revenues for the three months ended Sept 30, 2003 as opposed to 40.6% of revenues for the three months ended September 30, 2004. Cost of revenues increased on an absolute basis primarily as a result of the acquisitions completed since September 30, 2003, but also from increased third party license costs and costs of professional services associated with our revenue growth. Cost of revenues as a percentage of revenues decreased primarily because certain of our costs are fixed and our revenues (particularly maintenance, support and data center revenue) grew at a faster rate than our costs.

***Operating Expenses***

**Sales and Marketing.** Sales and marketing expenses include salaries and commissions paid to sales and marketing personnel and other costs incurred in marketing our products and services. Sales and marketing expenses increased 45.0% from \$2.6 million for the three months ended September 30, 2003 to \$3.8 million for the three months ended September 30, 2004. This increase was due primarily to \$531,000 in sales and marketing expenses from the acquired businesses and higher sales commissions due to the increase in license revenues. Sales and marketing expenses represented 14.9% of revenues for the three months ended September 30, 2003 as opposed to 13.3% of revenues for the three months ended September 30, 2004. Sales and marketing expenses as a percentage of revenues decreased primarily because sales and marketing expenses did not increase proportionally to our revenue growth. In the event that we acquire product lines or businesses in the future, we would anticipate that, based on the nature and magnitude of those acquisitions, our sales and marketing expenses would increase as a result of those acquisitions.

*Product Development.* Product development expenses include salaries of personnel in our product development department, consulting fees and other related expenses. Product development expenses increased 76.9% from \$1.8 million for the three months ended September 30, 2003 to \$3.2 million for the three months ended September 30, 2004. This increase was due primarily to a \$1.2 million in product development expenses from the acquired businesses. Product development expenses represented 10.5% of revenues for the three months ended September 30, 2003 as opposed to 11.4% of revenues for the three months ended September 30, 2004. Product development expenses as a percentage of revenues increased primarily as a result of higher development costs at certain of our recently acquired businesses. Product development expenses as a percentage of revenue for our non-acquired businesses is lower than that of our acquired businesses because our major product lines are largely developed and therefore did not require significant incremental investment. In the event that we acquire product lines or businesses in the future, we would anticipate that, based on the nature and magnitude of those acquisitions, our product development expenses would increase as a result of those acquisitions. As we increase our international operations, including the business acquired in the Datawest transaction, we expect to increase our product development expenses in order to modify our current product offerings to perform in non-U.S. banking systems.

*General and Administrative.* General and administrative expenses consist of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance and depreciation. General and administrative expenses increased 48.3% from \$3.7 million for the three months ended September 30, 2003 to \$5.5 million for the three months

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ended September 30, 2004. The increase was due primarily to \$1.4 million of expense from the acquired businesses and professional fees and other costs related to the requirements of being a public company, including the costs of compliance with Section 404 of Sarbanes-Oxley. General and administrative expenses represented 21.2% of revenues for the three months ended September 30, 2003 as opposed to 19.3% of revenues for the three months ended September 30, 2004. In the event that we acquire product lines or businesses in the future, we would anticipate that, based on the nature and magnitude of those acquisitions, our general and administrative expenses would increase as a result of those acquisitions.

*Interest Income, net.* Interest income, net, increased from net interest expense of \$53,000 for the three months ended September 30, 2003 to net interest income of \$363,000 for the three months ended September 30, 2004. This increase was due primarily to increased interest income from the investment of the proceeds of our initial public offering in the fourth quarter of 2003 and our follow-on offering in the second quarter of 2004.

*Income Tax Provision.* Income tax provision increased from \$56,000 for the three months ended September 30, 2003 to \$255,000 for the three months ended September 30, 2004. The increase was the result of increased profitability resulting in higher federal alternative minimum tax, higher state income tax expense and deferred federal tax expense related to the tax amortization of goodwill from the Liberty FiTech Systems, Inc. and Eastpoint Technologies, LLC acquisitions.

### ***Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003***

*Revenues.* Revenues increased 64.0% from \$43.4 million for the nine months ended September 30, 2003 to \$71.1 million for the nine months ended September 30, 2004. This increase was attributable to an \$8.8 million increase in licensing revenue from our core and complementary products attributable to sales to new clients, sales of additional products to existing clients, including those clients of our acquired entities and an increase in license fees from BISYS. Of the \$8.8 million increase in licensing revenues, \$1.9 million related to revenue from those acquisitions completed subsequent to January 1, 2003, which were Liberty FiTech Systems, Inc., Maxxar Corporation, Eastpoint Technologies, LLC, re:Member Data Services, Inc and Omega Systems of North America. The increase in revenues was also attributable to an increase of \$5.6 million in our implementation and other professional services, \$1.6 million of which was from acquired businesses. We also realized an increase of \$6.5 million in our maintenance revenue, \$4.4 million of which was from acquired businesses, and an increase of \$5.6 million in our outsourcing revenues, \$5.1 million of which was from acquired businesses. The increases in implementation, professional services and maintenance revenues is also directly related to the increase in sales of licenses to new clients and sales of additional products to existing clients. Additionally, revenues associated with hardware and other revenues increased by \$1.1 million, \$990,000 of which was from acquired businesses.

*Cost of Revenues.* Cost of revenues increased 47.4% from \$20.1 million for the nine months ended September 30, 2003 to \$29.7 million for the nine months ended September 30, 2004. The increase was due primarily to a \$3.0 million increase in costs associated with implementation and other professional services, \$1.1 million of which is from acquired businesses, a \$2.2 million increase in costs associated with maintenance, \$2.0 million of which is from the acquired businesses and a \$2.6 million increase in costs associated with the growth of our outsourcing business, \$2.1 million of which is from the acquired businesses. Cost of revenues represented 46.4% of revenues for the nine months ended September 30, 2003 as opposed to 41.7% of revenues for the nine months ended September 30, 2004. Cost of revenues increased on an absolute basis primarily as a result of the acquisitions completed since January 1, 2003, but also from increased third party license costs and costs of professional services associated with our revenue growth. Cost of revenues as a percentage of revenues decreased primarily because certain of our costs are fixed and our revenues (particularly maintenance, support and data center revenue) grew at a faster rate than our costs.

### ***Operating Expenses***

*Sales and Marketing.* Sales and marketing expenses increased 32.2% from \$7.6 million for the nine months ended September 30, 2003 to \$10.1 million for the nine months ended September 30, 2004. This increase was due primarily to \$844,000 in sales and marketing expenses from the acquired businesses and higher sales commissions due to the increase in license revenues. Sales and marketing expenses represented 17.5% of revenues for the nine months ended September 30, 2003 as opposed to 14.1% of revenues for the nine months ended September 30, 2004. Sales and marketing expenses as a percentage of revenues decreased because sales and marketing expenses did not increase proportionally to our revenue growth. In the event that we acquire product lines or businesses in the future, we would anticipate that, based on the nature and magnitude of those acquisitions, our sales and marketing expenses would increase as a result of those acquisitions.

*Product Development.* Product development expenses increased 47.6% from \$5.0 million for the nine months ended September 30, 2003 to \$7.4 million for the nine months ended September 30, 2004. This increase was due primarily to a \$2.0 million increase in product development expenses from the acquired businesses. Product development expenses represented 11.6% of revenues for the nine months ended September 30, 2003 as opposed to 10.4% of revenues for the nine months ended September 30, 2004. Product development expenses as a percentage of revenues decreased primarily because our major product lines are largely developed and therefore did not require incremental investment. In the event that we acquire product lines or businesses in the future, we would anticipate that, based on the nature and magnitude of those acquisitions, our product development expenses would increase as a result of those acquisitions. As we increase our international operations, including the business acquired in the Datawest transaction, we expect to increase our product development expenses in order to modify our current product offerings to perform in non-U.S. banking

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systems.

*General and Administrative.* General and administrative expenses increased 56.4% from \$8.8 million for the nine months ended September 30, 2003 to \$13.7 million for the nine months ended September 30, 2004. The increase was due primarily to \$2.9 million of expense from the acquired businesses, professional fees and other costs related to the requirements of being a public company, including the costs of compliance with Section 404 of Sarbanes-Oxley and capital based taxes of approximately \$210,000. General and administrative expenses represented 20.2% of revenues for the nine months ended September 30, 2003 as opposed to 19.3% of revenues for the nine months ended September 30, 2004. In the event that we acquire product lines or businesses in the future, we would anticipate that, based on the nature and magnitude of those acquisitions, our general and administrative expenses would increase as a result of those acquisitions.

*Interest Income, net.* Interest income, net, increased from a net interest expense of \$18,000 for the nine months ended September 30, 2003 to net interest income of \$885,000 for the nine months ended September 30, 2004. This increase was due primarily to increased interest income from the investment of the proceeds of our initial public offering in the fourth quarter of 2003 and our follow-on public offering in the second quarter of 2004.

*Income Tax Provision.* Income tax provision increased from \$183,000 for the nine months ended September 30, 2003 to \$567,000 for the nine months ended September 30, 2004. The increase was the result of increased profitability resulting in higher federal alternative minimum tax, higher state income tax expense and deferred federal tax expense related to the tax amortization of goodwill from the Liberty FiTech Systems Inc. and Eastpoint Technologies LLC acquisitions.

**Liquidity and Capital Resources**

At September 30, 2004 and December 31, 2003, we had cash and cash equivalents totaling \$86.5 million and \$85.0 million, respectively.

The following table sets forth the elements of our cash flow statement for the following periods:

	<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>
	<b>(in thousands)</b>	
Net cash provided by operating activities	\$ 10,894	\$ 2,703
Net cash used in investing activities	(45,791)	(8,891)
Net cash provided by financing activities	36,399	1,340

***Cash from Operating Activities***

Cash provided by operations in the nine months ended September 30, 2004 was attributable to net income of \$10.6 million, depreciation and amortization and other non-cash items of \$4.5 million partially offset by an increase in working capital of \$4.2 million, primarily due to an increase in accounts receivable. The increase in accounts receivable was partially offset by an increase in deferred revenue. Cash provided by operations in the three months

ended September 30, 2003 was attributable to net income of \$1.7 million, depreciation and amortization and other non-cash items of \$3.2 million partially offset by an increase in working capital of \$2.1 million.

***Cash from Investing Activities***

Cash from investing activities consists primarily of purchases of fixed assets, investments in marketable securities and business acquisitions. Total capital expenditures for the nine months ended September 30, 2004 and 2003 were \$3.5 million and \$891,000, respectively, and were primarily related to the purchase of computer equipment, computer software, software development services, furniture and fixtures and leasehold improvements at our new lease facility. During the final three months of 2004, we expect to spend approximately \$700,000 and \$450,000, respectively, on the build out of our new lease facility and the implementation of a new enterprise software system. We currently have no other significant capital spending or purchase commitments, but expect to continue to engage in capital spending in the ordinary course of business.

In the nine months ended September 30, 2004, we purchased \$5.0 million in marketable securities.

Additionally, net cash used in investing activities for the nine months ended September 30, 2004 included \$6.8 million, \$6.6 million, \$21.4 million and \$2.4 million used for the acquisitions of Maxxar Corporation, Eastpoint Technologies, Inc., re:Member Data Services, Inc. and Omega Systems of North America, respectively, net of cash received. Net cash used in investing activities for the nine months ended September 30, 2003 included \$8.0 million used for the acquisition of Liberty FiTech Systems, Inc.

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### ***Cash from Financing Activities***

On May 17, 2004, we completed a follow-on offering of 4,436,442 shares of our common stock at a price of \$21.50 per share. Of the 4,436,442 shares offered, 1,000,000 shares were offered by Open Solutions and 3,436,442 shares were offered by certain of our existing stockholders. On June 8, 2004, the underwriters exercised their option to purchase 665,466 additional shares of our common stock at a price of \$21.50 per share. The aggregate net proceeds from the offering were \$33.4 million.

During the nine months ended September 30, 2004, we also received approximately \$3.0 million of proceeds from the exercise of stock options and \$332,000 from the issuance of common stock in connection with our employee stock purchase program.

We currently anticipate that our current cash balance and cash flow from operations will be sufficient to meet our presently anticipated capital needs for the next twelve months, but may be insufficient to provide funds necessary for any future acquisitions we may make during that time. To the extent we require additional funds, whether for acquisitions or otherwise, we may seek additional equity or debt financing. Such financing may not be available to us on terms that are acceptable to us, if at all, and any equity financing may be dilutive to our stockholders. To the extent we obtain additional debt financing, our debt service obligations will increase and the relevant debt instruments may, among other things, impose additional restrictions on our operations, require us to comply with additional financial covenants or require us to pledge assets to secure our borrowings.

As defined in Section 382 of the Internal Revenue Code, certain ownership changes limit the annual utilization of federal net operating losses and tax credit carry forwards. We experienced such an ownership change in 1995. The follow-on offering has resulted in a second ownership change. This limitation of the utilization of federal net operating losses imposed by Section 382 is applied annually and is equal to a published long term exempt rate multiplied by the aggregate fair value of the company immediately prior to the ownership change. This resulting limitation may also be increased by imputed tax deductions of certain intangibles resulting from built-in gains, as defined. We do not believe that the Section 382 limitation with respect to the 1995 ownership change nor the change that resulted from the follow-on offering will result in the loss of any net operating losses or tax credit carry forwards prior to their expiration. As a result of future issuance of, sales of, and other transactions involving our common stock, we may experience an ownership change in the future, which could cause such federal net operating losses and tax credit carryforwards to be subject to limitation under Section 382.

### ***Recent Developments***

On August 25, 2004, we reached an agreement to acquire all of the outstanding stock of Datawest Corporation (Datawest), a provider of core data processing and payment technology solutions in Canada. On October 21, 2004, the shareholders of Datawest approved the sale of Datawest to Open Solutions and on October 29, 2004, the acquisition was completed for cash consideration of CDN \$1.16 (approximately US\$0.95 at the exchange rate as of October 29, 2004) per common share for 29,824,126 common shares and CDN \$2.60 (approximately US\$2.13 at the exchange rate as of October 29, 2004) per preferred share for 5,000,000 preferred shares, for a total aggregate consideration of CDN\$47,595,986 (approximately US\$38.9 million at the exchange rate as of October 29, 2004). Additionally, we repaid US\$8.3 million of outstanding debt and have incurred approximately US\$286,000 of acquisition costs through October 31, 2004 for a total purchase price of US\$47.5 million. This acquisition will be recorded under the purchase method with the total consideration allocated to the fair value of assets acquired and goodwill.

### ***Off-Balance Sheet Arrangements***

We do not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

### Contractual Obligations as of September 30, 2004

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Capital Lease Obligations	\$ 254,000	\$ 237,000	\$ 17,000	\$	\$
Operating Leases	15,887,000	2,933,000	4,996,000	4,151,000	3,807,000
Total Contractual Obligations	\$16,141,000	\$3,170,000	\$5,013,000	\$4,151,000	\$3,807,000



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**Factors That May Affect Future Results**

The risks and uncertainties described below are not the only risks we face. Additional risks and uncertainties not presently known to us or that are currently deemed immaterial may also impair our business operations. If any of the following risks actually occur, our financial condition and operating results could be materially adversely affected.

**We are dependent on the banking and credit union industry, and changes within that industry could reduce demand for our products and services.**

The large majority of our revenues are derived from financial institutions in the banking and credit union industry, primarily small to mid-size banks and thrifts and credit unions of all sizes, and we expect to continue to derive substantially all of our revenues from these institutions for the foreseeable future. Unfavorable economic conditions adversely impacting the banking and credit union industry could have a material adverse effect on our business, financial condition and results of operations. For example, financial institutions in the banking and credit union industry have experienced, and may continue to experience, cyclical fluctuations in profitability as well as increasing challenges to improve their operating efficiencies. Due to the entrance of non-traditional competitors and the current environment of low interest rates, the profit margins of commercial banks, thrifts and credit unions have narrowed. As a result, some banks have slowed, and may continue to slow, their capital spending, including spending on computer software and hardware, which can negatively impact license sales of our core and complementary products to new and existing clients. Decreases in or reallocation of capital expenditures by our current and potential clients, unfavorable economic conditions and new or persisting competitive pressures could adversely affect our business, financial condition and results of operations.

**Consolidation in the banking and financial services industry could adversely impact our business by eliminating a number of our existing and potential clients.**

There has been and continues to be merger, acquisition and consolidation activity in the banking and financial services industry. Mergers or consolidations of banks and financial institutions in the future could reduce the number of our clients and potential clients. A smaller market for our services could have a material adverse impact on our business and results of operations. In addition, it is possible that the larger banks or financial institutions which result from mergers or consolidations could decide to perform themselves some or all of the services which we currently provide or could provide. If that were to occur, it could have a material adverse impact on our business and results of operations.

**Our success depends on decisions by potential clients to replace their legacy computer systems, and their failure to do so would adversely affect demand for our products and services.**

We primarily derive our revenues from two sources: license fees for software products and fees for a full range of services complementing our products, including outsourcing, installation, training, maintenance and support services. A large portion of these fees are either directly attributable to licenses of our core software system or are generated over time by clients using our core software. Banks and credit unions historically have been slow to adapt to and accept new technologies. Many of these financial institutions have traditionally met their information technology needs through legacy computer systems, in which they have often invested significant resources. As a result, these financial institutions may be inclined to resist replacing their legacy systems with our core software system. Our future financial performance will depend in part on the successful development, introduction and client acceptance of new and enhanced versions of our core software system and our other complementary products. A decline in demand for, or failure to achieve broad market acceptance of, our core software system or any enhanced version as a result of competition, technological change or otherwise, will have a material adverse effect on our business, financial condition and results of operations.

**If we fail to expand our outsourcing business and other sources of recurring revenue, we may be unable to successfully implement our business strategy.**

We can host a financial institution's data processing functions at our outsourcing centers. Our outsourcing centers currently serve clients using our core software and our Internet banking, ATM, cView, cash management, collections, automated clearing house, or ACH, processing, check and item processing and telephony products. In the future, we plan to offer all of our products in our outsourcing centers and continue to market our outsourcing services aggressively.

Our outsourcing services provide a source of recurring revenue which can grow as the number of accounts processed for a client increases. We also seek to generate recurring revenue through our licensing model, which generates additional fees for us as a client's business grows or it adds more software applications, as well as through the provision of maintenance, support and other professional services. Our maintenance revenues are the largest of these revenue components, and we expect that these revenues will continue to be a significant portion of our total revenues as our client base grows due to their recurring nature. We anticipate that the revenue from outsourcing centers hosted by resellers will comprise a greater proportion of total revenues in future periods due to the amendment and restatement of our agreement with BISYS, Inc., which became effective as of September 1, 2003. To the extent we fail to persuade new or existing clients to purchase our outsourcing services or we are unable to offer some or all of our products to clients on an outsourced basis, we will be unable to implement our strategy and our revenue may be less predictable.

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### **We have had few profitable quarters, and may never achieve sustained profitability.**

We were incorporated in May 1992 and did not release our first product until 1995. Accordingly, our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies with limited operating histories. Although we have been profitable for the year ended December 31, 2003 and for the past eight quarters, we may not be profitable in future periods, either on a short or long-term basis. As of September 30, 2004, we had an accumulated deficit of approximately \$36.4 million. There can be no assurance that operating losses will not recur in the future, that we will ever sustain profitability on a quarterly or annual basis or that our actual results will meet our projections, expectations or announced guidance. To the extent that revenues do not grow at anticipated rates, increases in operating expenses precede or are not subsequently followed by commensurate increases in revenues or we are unable to adjust operating expense levels accordingly, our business, financial condition and results of operations will be materially adversely affected.

### **If we fail to adapt our products and services to changes in technology or in the marketplace, we could lose existing clients and be unable to attract new business.**

The markets for our software products and services are characterized by technological change, frequent new product introductions and evolving industry standards. The introduction of products embodying new technologies and the emergence of new industry standards can render our existing products obsolete and unmarketable in short periods of time. We expect new products and services, and enhancements to existing products and services, to continue to be developed and introduced by others, which will compete with, and reduce the demand for, our products and services. Our products' life cycles are difficult to estimate. Our future success will depend, in part, on our ability to enhance our current products and to develop and introduce new products that keep pace with technological developments and emerging industry standards and to address the increasingly sophisticated needs of our clients. There can be no assurance that we will be successful in developing, marketing, licensing and selling new products or product enhancements that meet these changing demands, that we will not experience difficulties that could delay or prevent the successful development, introduction and marketing of these products or that our new products and product enhancements will adequately meet the demands of the marketplace and achieve market acceptance.

### **We encounter a long sales and implementation cycle requiring significant capital commitments by our clients which they may be unwilling or unable to make.**

The implementation of our core software system involves significant capital commitments by our clients. Potential clients generally commit significant resources to an evaluation of available software and require us to expend substantial time, effort and money educating them as to the value of our software. Sales of our core processing software products require an extensive education and marketing effort throughout a client's organization because decisions relating to licensing our core processing software generally involve the evaluation of the software by senior management and a significant number of client personnel in various functional areas, each having specific and often conflicting requirements.

We may expend significant funds and management resources during the sales cycle and ultimately fail to close the sale. Our core software product sales cycle generally ranges between six to nine months, and our implementation cycle for our core software generally ranges between six to nine months. Our sales cycle for all of our products and services is subject to significant risks and delays over which we have little or no control, including:

- our clients' budgetary constraints,

- the timing of our clients' budget cycles and approval processes,

our clients' willingness to replace their core software solution vendor,

the success and continued support of our strategic marketing partners' sales efforts, and

the timing and expiration of our clients' current license agreements or outsourcing agreements for similar services.

If we are unsuccessful in closing sales after expending significant funds and management resources or if we experience delays as discussed above, it could have a material adverse effect on our business, financial condition and results of operations.

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**We utilize certain key technologies from third parties, and may be unable to replace those technologies if they become obsolete or incompatible with our products.**

Our proprietary software is designed to work in conjunction with certain third-party software products, including Microsoft and Oracle relational databases. Although we believe that there are alternatives to these products generally available to us, any significant interruption in the supply of such third-party software could have a material adverse effect on our sales unless and until we can replace the functionality provided by these products. In addition, we are dependent upon these third parties' abilities to enhance their current products, to develop new products on a timely and cost-effective basis and to respond to emerging industry standards and other technological changes. There can be no assurance that we would be able to replace the functionality provided by the third-party software currently offered in conjunction with our products in the event that such software becomes obsolete or incompatible with future versions of our products or is otherwise not adequately maintained or updated. The absence of, or any significant delay in, the replacement of that functionality could have a material adverse effect on our business, financial condition and results of operations. Furthermore, delays in the release of new and upgraded versions of third-party software products, particularly the Oracle relational database management system, could have a material adverse effect on our revenues and results of operations. Because of the complexities inherent in developing sophisticated software products and the lengthy testing periods associated with these products, no assurance can be given that our future product introductions will not be delayed.

**We operate in a competitive business environment, and if we are unable to compete effectively, we may face price reductions and decreased demand for our products.**

The market for our products and services is intensely competitive and subject to technological change. Competitors vary in size and in the scope and breadth of the products and services they offer. We encounter competition from a number of sources, all of which offer core software systems to the banking and credit union industry. We expect additional competition from other established and emerging companies as the market for core processing software solutions and complementary products continues to develop and expand.

We also expect that competition will increase as a result of software industry consolidation, including particularly the acquisition of any of our competitors or any of the retail banking system providers by one of the larger service providers to the banking industry. We encounter competition in the United States from a number of sources, including Fiserv, Inc., Jack Henry & Associates, Inc., Fidelity National Financial Corporation and John H. Harland Company, all of which offer core processing systems or outsourcing alternatives to banks, thrifts and credit unions. Some of our current, and many of our potential, competitors have longer operating histories, greater name recognition, larger client bases and significantly greater financial, engineering, technical, marketing and other resources than we do. As a result, these companies may be able to respond more quickly to new or emerging technologies and changes in client demands or to devote greater resources to the development, promotion and sale of their products than we can.

In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address the needs of our prospective clients. Accordingly, it is possible that new competitors or alliances among competitors may emerge and acquire significant market share. We expect that the banking and credit union software market will continue to attract new competitors and new technologies, possibly involving alternative technologies that are more sophisticated and cost-effective than our technology. There can be no assurance that we will be able to compete successfully against current or future competitors or that competitive pressures faced by us will not materially adversely affect our business, financial condition and results of operations.

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**Our quarterly revenues, operating results and profitability will vary from quarter to quarter, which may result in volatility in our stock price.**

Our quarterly revenues, operating results and profitability have varied in the past and are likely to continue to vary significantly from quarter to quarter. This may lead to volatility in our stock price. These fluctuations are due to several factors relating to the license and sale of our products, including:

- the timing, size and nature of our licensing transactions,
- lengthy and unpredictable sales cycles,
- the timing of introduction and market acceptance of new products or product enhancements by us or our competitors,
- the timing of acquisitions by us of businesses and products,
- product and price competition,
- the relative proportions of revenues derived from license fees and services,
- changes in our operating expenses,
- software bugs or other product quality problems, and
- personnel changes and fluctuations in economic and financial market conditions.

We believe that period-to-period comparisons of our results of operations are not necessarily meaningful. There can be no assurance that future revenues and results of operations will not vary substantially. It is also possible that in future quarters, our results of operations will be below the expectations of public market analysts or investors or our announced guidance. In either case, the price of our common stock could be materially adversely affected.

**We face a lengthy sales cycle for our core software, which may cause fluctuations in our revenues from quarter to quarter.**

We may not be able to increase revenue or decrease expenses to meet expectations for a given quarter. We recognize software license revenues upon delivery and, if required by the underlying agreement, upon client acceptance, if such criteria is other than perfunctory, which does not always occur in the same quarter in which the software license agreement for the system is signed. As a result, we are constrained in our ability to increase our software license revenue in any quarter if there are unexpected delays in delivery or required acceptance of systems for which software licenses were signed in previous quarters. Implementation of our core software system typically occurs over six to nine months. Delays in the delivery, implementation or any required acceptance of our products could materially adversely affect our quarterly results of operations. Revenues from software license sales accounted for 32.0% of revenues for the nine months ended September 30, 2004, 33.5% of revenues for the year ended December 31, 2003, 30.3% of revenues for the year ended December 31, 2002 and 36.6% of revenues for the year ended December 31, 2001. We expect that revenues from software license sales will continue to provide a significant percentage of our revenues in future periods, and our ability to close license sales, as well as the timing of those sales, may have a material impact on our quarterly results. In addition, increased sales and marketing expenses for any given quarter may negatively impact operating results of that quarter due to lack of recognition of associated revenues until the delivery of the product in a subsequent quarter.

**Our level of fixed expenses may cause us to incur operating losses if we are unsuccessful in maintaining our current revenue levels.**

Our expense levels are based, in significant part, on our expectations as to future revenues and are largely fixed in the short term. As a result, we may be unable to adjust spending in a timely manner to compensate for any unexpected shortfall in revenues. Accordingly, any significant shortfall of revenues in relation to our expectations would have an immediate and materially adverse effect on our business, financial condition and results of operations. In addition, as we expand we would anticipate increasing our operating expenses to expand our installation, product development, sales and marketing and administrative organizations. The time of such expansion and the rate at which new personnel become productive could cause material losses to the extent we do not generate additional revenue.

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**We rely on our direct sales force to generate revenue, and may be unable to hire additional sales personnel in a timely manner.**

We rely primarily on our direct sales force to sell licenses of our core software system. We may need to hire additional sales, client care and implementation personnel in the near-term and beyond if we are to achieve revenue growth in the future. Competition for such personnel is intense, and there can be no assurance that we will be able to retain our existing sales, customer service and implementation personnel or will be able to attract, assimilate or retain additional highly qualified personnel in the future. If we are unable to hire or retain qualified sales personnel on a timely basis, our business, financial condition and results of operations could be materially adversely affected.

**We receive a portion of our revenues from relationships with strategic marketing partners, and if we lose one or more of these marketing partners or fail to add new ones it could have a negative impact on our business.**

We expect that revenues generated from the sale of our products and services by our strategic marketing partners will account for a meaningful portion of our revenues for the foreseeable future. In particular, we expect that one major national outsourcing center, will account for a meaningful portion of our revenues over time. During the nine months ended September 30, 2004, this outsourcing center represented approximately \$8.3 million, or 11.7%, of our total revenues. During the fiscal year ended December 31, 2003, this outsourcing center represented approximately \$5.8 million, or 9.1%, of our total revenues. On September 30, 2003, we amended and restated our software license agreement with this outsourcing center, effective as of September 1, 2003.

Our strategic marketing partners pay us license fees based on the volume of products and services that they sell. If we lose one or more of our major strategic marketing partners, we may be unable in a timely manner, or at all, to replace them with another entity with comparable client bases and user demographics, which would adversely affect our business, financial condition and results of operations. In addition, we plan to supplement our existing distribution partners with other national and regional outsourcing centers. If we are unable to identify appropriate resellers and enter into arrangements with them for the outsourcing of our products and services to financial institutions, we may not be able to sustain or grow our business.

**If we do not retain our senior management and other key employees, we may not be able to successfully implement our business strategy.**

We have grown significantly in recent years, and our management remains concentrated in a small number of key employees. Our future success depends to a significant extent on our executive officers and key employees, including our sales force and software professionals, particularly project managers, software engineers and other senior technical personnel. The loss of the services of any of these individuals or group of individuals could have a material adverse effect on our business, financial condition and results of operations. Competition for qualified personnel in the software industry is intense and we compete for these personnel with other software companies that have greater financial and other resources than we do. Our future success will depend in large part on our ability to attract, retain and motivate highly qualified personnel, and there can be no assurance that we will be able to do so. Any difficulty in hiring needed personnel could have a material adverse effect on our business, financial condition and results of operations.

**We rely on internally developed software and systems as well as third-party products, any of which may contain errors and bugs.**

Our software may contain undetected errors, defects or bugs. Although we have not suffered significant harm from any errors or defects to date, we may discover significant errors or defects in the future that we may or may not be able to correct. Our products involve integration with products and systems developed by third parties. Complex



software programs of third parties may contain undetected errors or bugs when they are first introduced or as new versions are released. There can be no assurance that errors will not be found in our existing or future products or third-party products upon which our products are dependent, with the possible result of delays in or loss of market acceptance of our products, diversion of our resources, injury to our reputation and increased service and warranty expenses and/or payment of damages.

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**We could be sued for contract or product liability claims and lawsuits may disrupt our business, divert management's attention or have an adverse effect on our financial results.**

Failures in a client's system could result in an increase in service and warranty costs or a claim for substantial damages against us. There can be no assurance that the limitations of liability set forth in our contracts would be enforceable or would otherwise protect us from liability for damages. We maintain general liability insurance coverage, including coverage for errors and omissions in excess of the applicable deductible amount. There can be no assurance that this coverage will continue to be available on acceptable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not deny coverage as to any future claim. The successful assertion of one or more large claims against us that exceeds available insurance coverage, or the occurrence of changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business, financial condition and results of operations. Furthermore, litigation, regardless of its outcome, could result in substantial cost to us and divert management's attention from our operations. Any contract liability claim or litigation against us could, therefore, have a material adverse effect on our business, financial condition and results of operations. In addition, because many of our projects are business-critical projects for financial institutions, a failure or inability to meet a client's expectations could seriously damage our reputation and affect our ability to attract new business.

**Government regulation of our business could cause us to incur significant expenses, and failure to comply with applicable regulations could make our business less efficient or impossible.**

The financial services industry is subject to extensive and complex federal and state regulation. Financial institutions, including banks, thrifts and credit unions, operate under high levels of governmental supervision. Our clients must ensure that our products and services work within the extensive and evolving regulatory requirements applicable to them, including those under federal and state truth-in-lending and truth-in-deposit rules, usury laws, the Equal Credit Opportunity Act, the Fair Housing Act, the Electronic Fund Transfer Act, the Fair Credit Reporting Act, the Bank Secrecy Act, the Community Reinvestment Act, the Gramm-Leach-Bliley Act of 1999, the USA Patriot Act and other state and local laws and regulations. The compliance of our products and services with these requirements may depend on a variety of factors, including the product at issue and whether the client is a bank, thrift, credit union or other type of financial institution.

Neither federal depository institution regulators nor other federal or state regulators of financial services require us to obtain any licenses. We are subject to examination by federal depository institution regulators under the Bank Service Company Act.

Although we believe we are not subject to direct supervision by federal and state banking agencies relating to other regulations, we have from time to time agreed to examinations of our business and operations by these agencies. These regulators have broad supervisory authority to remedy any shortcomings identified in any such examination.

Federal, state or foreign authorities could also adopt laws, rules or regulations relating to the financial services industry that affect our business, such as requiring us or our clients to comply with data, record keeping and processing and other requirements. It is possible that laws and regulations may be enacted or modified with respect to the Internet, covering issues such as end-user privacy, pricing, content, characteristics, taxation and quality of services and products. Adoption of these laws, rules or regulations could render our business or operations more costly and burdensome or less efficient and could require us to modify our current or future products or services.

**Our limited ability to protect our proprietary technology and other rights may adversely affect our ability to compete.**

We rely on a combination of copyright, trademark and trade secret laws, as well as licensing agreements, third-party nondisclosure agreements and other contractual provisions and technical measures to protect our intellectual property rights. There can be no assurance that these protections will be adequate to prevent our competitors from copying or reverse-engineering our products, or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology. To protect our trade secrets and other proprietary information, we require employees, consultants, advisors and collaborators to enter into confidentiality agreements. We cannot assure you that these agreements will provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information. We do not include in our products any mechanism to prevent unauthorized copying and any such unauthorized copying could have a material adverse effect on our business, financial condition and results of operations. We have no patents, and existing copyright laws afford only limited protection for our intellectual property rights and may not protect such rights in the event competitors independently develop products similar to ours. In addition, the laws of certain countries in which our products are or may be licensed do not protect our products and intellectual property rights to the same extent as the laws of the United States.

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**If we are found to infringe the proprietary rights of others, we could be required to redesign our products, pay royalties or enter into license agreements with third parties.**

Although we have never been the subject of a material intellectual property dispute, there can be no assurance that a third party will not assert that our technology violates its intellectual property rights in the future. As the number of software products in our target market increases and the functionality of these products further overlap, we believe that software developers may become increasingly subject to infringement claims. Any claims, whether with or without merit, could:

be expensive and time consuming to defend,

cause us to cease making, licensing or using products that incorporate the challenged intellectual property,

require us to redesign our products, if feasible,

divert management's attention and resources, and

require us to enter into royalty or licensing agreements in order to obtain the right to use necessary technologies. There can be no assurance that third parties will not assert infringement claims against us in the future with respect to our current or future products or that any such assertion will not require us to enter into royalty arrangements (if available) or litigation that could be costly to us.

**We have entered into and may continue to enter into or seek to enter into business combinations and acquisitions which may be difficult to integrate, disrupt our business, dilute stockholder value or divert management attention.**

Since 2000, we have acquired nine businesses. As part of our business strategy, we may enter into additional business combinations and acquisitions in the future. We have limited experience in making acquisitions. In addition, acquisitions are typically accompanied by a number of risks, including:

the difficulty of integrating the operations and personnel of the acquired companies,

the maintenance of acceptable standards, controls, procedures and policies,

the potential disruption of our ongoing business and distraction of management,

the impairment of relationships with employees and clients as a result of any integration of new management and other personnel,

the inability to maintain relationships with clients of the acquired business,

the difficulty of incorporating acquired technology and rights into our products and services,

the failure to achieve the expected benefits of the combination or acquisition,

expenses related to the acquisition,

potential unknown liabilities associated with acquired businesses, and

unanticipated expenses related to acquired technology and its integration into existing technology.

If we are not successful in completing acquisitions that we may pursue in the future, we would be required to reevaluate our growth strategy and we may have incurred substantial expenses and devoted significant management time and resources in seeking to complete the acquisitions. In addition, with future acquisitions, we could use substantial portions of our available cash as all or a portion of the purchase price. We could also issue additional securities as consideration for these acquisitions, which could cause our stockholders to suffer significant dilution. Any future acquisitions may not generate additional revenue for us.

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**We face risks associated with our Canadian operations that could harm our financial condition and results of operations.**

On October 29, 2004, we completed the acquisition of Datawest Corporation, a provider of banking and payment technology solutions located in Vancouver, Canada. Although historically we have not generated significant revenues from operations outside the United States, we expect that the portion of our revenues generated by our international operations will increase as a result of our acquisition of Datawest. As is the case with most international operations, the success and profitability of such operations are subject to numerous risks and uncertainties that include, in addition to the risks our business as a whole faces, the following:

difficulties and costs of staffing and managing foreign operations,

differing regulatory and industry standards and certification requirements,

the complexities of foreign tax jurisdictions,

currency exchange rate fluctuations, and

import or export licensing requirements.

**If we fail to effectively manage our growth, our financial results could be adversely affected.**

We have expanded our operations rapidly in recent years. For example, our aggregate revenues increased from approximately \$27.3 million in 2001 to approximately \$44.3 million in 2002 and approximately \$63.9 million in 2003. As of September 30, 2004, we had 577 employees, up from 278 as of December 31, 2002. In addition, we continue to explore ways to extend our target markets, including to larger financial institutions, international clients, and clients in the payroll services, insurance and brokerage industries. Our growth may place a strain on our management systems, information systems and resources. Our ability to successfully offer products and services and implement our business plan requires adequate information systems and resources and oversight from our senior management. We will need to continue to improve our financial and managerial controls, reporting systems and procedures as we continue to grow and expand our business. As we grow, we must also continue to hire, train, supervise and manage new employees. We may not be able to hire, train, supervise and manage sufficient personnel or develop management and operating systems to manage our expansion effectively. If we are unable to manage our growth, our operations and financial results could be adversely affected.

**The requirements of being a public company may strain our resources and distract management.**

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934 and the Sarbanes-Oxley Act of 2002. These requirements may place a strain on our systems and resources. The Securities Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and financial condition. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal controls for financial reporting. We currently do not have an internal audit group. In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting, significant resources and management oversight will be required. As a result, management's attention may be diverted from other business concerns, which could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, we may need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge and we cannot assure you that we will be able to do so in a timely fashion.

**Under new regulations required by the Sarbanes-Oxley Act of 2002, an adverse opinion on internal controls could be issued by our auditors, and this could have a negative impact on our stock price.**

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we establish and maintain an adequate internal control structure and procedures for financial reporting and assess on an on-going basis the design and operating effectiveness of our internal control structure and procedures for financial reporting. Our auditors are required to audit both the design and operating effectiveness of our internal controls and management's assessment of the design and the effectiveness of its internal controls. Although no known material weaknesses exist at this time, this will be the first year that we have undergone an audit of our internal controls and procedures, and it is possible that material weaknesses could be found through our own evaluation, or that of our auditors. If such weaknesses are found, we may not be able to remediate such weaknesses in time to meet the deadlines imposed by the Sarbanes-Oxley Act for compliance with the requirements of Section 404. If we do not effectively complete our assessment or if our internal controls are not designed or operating effectively, our external auditors may either disclaim an opinion as it relates to management's assessment of the effectiveness of our internal controls or may issue a qualified opinion on the effectiveness of our internal controls. Any such disclaimer or qualified opinion could have a material adverse effect on our stock price.

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**The design of other core vendors' software or their use of financial incentives may make it more difficult for clients to use our complementary products.**

Currently, some core software vendors design their software so that it is difficult or infeasible to use third-party complementary products, including ours. Some core software vendors use financial incentives to encourage their core software clients to purchase their proprietary complementary products. For example, in the past a core software vendor has charged disproportionately high fees to integrate third-party complementary products such as ours, thereby providing a financial incentive for clients of that vendor's core software to use its complementary products. We have responded to this practice by emphasizing to prospective clients the features and functionality of our products, lowering our price or offering to perform the relevant integration services ourselves. We cannot assure you that these competitors, or other vendors of core software, will not begin or continue to construct technical, or implement financial, obstacles to the purchase of our products. These obstacles could make it more difficult for us to sell our complementary products and could have a material adverse effect on our business and results of operations.

**Operational failures in our outsourcing centers could cause us to lose clients.**

Damage or destruction that interrupts our provision of outsourcing services could damage our relationship with our clients and may cause us to incur substantial additional expense to repair or replace damaged equipment. Although we have installed back-up systems and procedures to prevent or reduce disruption, we cannot assure you that we will not suffer a prolonged interruption of our data processing services. In the event that an interruption of our network extends for more than several hours, we may experience data loss or a reduction in revenues by reason of such interruption. In addition, a significant interruption of service could have a negative impact on our reputation and could lead our present and potential clients to choose service providers other than us.

**Unauthorized disclosure of data, whether through breach of our computer systems or otherwise, could expose us to protracted and costly litigation or cause us to lose clients.**

In our outsourcing centers, we collect and store sensitive data, including names, addresses, social security numbers, checking and savings account numbers and payment history records, such as account closures and returned checks. If a person penetrates our network security or otherwise misappropriates sensitive data, we could be subject to liability or our business could be interrupted. Penetration of the network security of our outsourcing centers could have a negative impact on our reputation and could lead our present and potential clients to choose service providers other than us.

**We may need additional capital in the future, which may not be available to us, and if we raise additional capital, it may dilute your ownership in us.**

We may need to raise additional funds through public or private debt or equity financings in order to meet various objectives, such as:

- taking advantage of growth opportunities, including more rapid expansion,
- acquiring businesses and products,
- making capital improvements to increase our servicing capacity,
- developing new services or products, and
- responding to competitive pressures.



In addition, we may need additional financing if we decide to undertake new sales and/or marketing initiatives, if we are required to defend or enforce our intellectual property rights, or if sales of our products do not meet our expectations.

Any debt incurred by us could impair our ability to obtain additional financing for working capital, capital expenditures or further acquisitions. Covenants governing any indebtedness we incur would likely restrict our ability to take specific actions, including our ability to pay dividends or distributions on, or redeem or repurchase, our capital stock, enter into transactions with affiliates, merge, consolidate or sell our assets or make capital expenditure investments. In addition, the use of a substantial portion of the cash generated by our operations to cover debt service obligations and any security interests we grant on our assets could limit our financial and business flexibility.

Any additional capital raised through the sale of equity or convertible debt securities may dilute your ownership percentage in us. Furthermore, any additional debt or equity financing we may need may not be available on terms favorable to us, or at all. If future financing is not available or is not available on acceptable terms, we may not be able to raise additional capital, which could significantly limit our ability to implement our business plan. In addition, we may have to issue securities, including debt securities, that may have rights, preferences and privileges senior to our common stock.

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**The price of our common stock may be volatile.**

In the past three years, technology stocks listed on the Nasdaq National Market have experienced high levels of volatility and significant declines in value from their historic highs. The trading price of our common stock following this offering may fluctuate substantially. The price of the common stock that will prevail in the market after this offering may be higher or lower than the price you pay, depending on many factors, some of which are beyond our control and may not be related to our operating performance. The fluctuations could cause you to lose part or all of your investment in our shares of common stock. The factors that could cause fluctuations in the trading price of our common stock include, but are not limited to, the following:

price and volume fluctuations in the overall stock market from time to time,

significant volatility in the market price and trading volume of financial services companies,

actual or anticipated changes in our earnings or fluctuations in our operating results or in the expectations of securities analysts,

general economic conditions and trends,

major catastrophic events,

loss of a significant client or clients,

sales of large blocks of our stock, or

departures of key personnel.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been brought against that company. Due to the potential volatility of our stock price, we may therefore be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business.

**If a substantial number of shares of our common stock become available for sale and are sold in a short period of time, the market price of our common stock could decline significantly.**

If our stockholders sell substantial amounts of our common stock in the public market, the market price of our common stock could decrease significantly. The perception in the public market that our stockholders might sell shares of common stock could also depress the market price of our common stock.

In addition, as of September 30, 2004, we had options to purchase a total of 2,948,672 shares of our common stock outstanding under our 1994 Stock Incentive Plan, 2000 Stock Incentive Plan and 2003 Stock Incentive Plan, of which 1,484,951 were vested. We have filed Form S-8 registration statements to register all of the shares of our common stock issuable under these plans. The market price of shares of our common stock may drop significantly when the restrictions on resale by our existing stockholders lapse and our stockholders are able to sell shares of our common stock into the market. A decline in the price of shares of our common stock might impede our ability to raise capital through the issuance of additional shares of our common stock or other equity securities, and may cause you to lose part or all of your investment in our shares of common stock.

**Some provisions in our certificate of incorporation and by-laws may deter third parties from acquiring us.**

Our restated certificate of incorporation and our amended and restated by-laws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors, including the following:

our board of directors is classified into three classes, each of which serves for a staggered three year term,

only our board of directors, the chairman of our board of directors or our president may call special meetings of our stockholders,

our stockholders may take action only at a meeting of our stockholders and not by written consent,

we have authorized undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval,

our stockholders have only limited rights to amend our by-laws, and

we require advance notice requirements for stockholder proposals.

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These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and cause us to take other corporate actions you desire.

**Section 203 of the Delaware General Corporation Law may delay, defer or prevent a change in control that our stockholders might consider to be in their best interest.**

We are subject to Section 203 of the Delaware General Corporation Law which, subject to certain exceptions, prohibits business combinations between a publicly-held Delaware corporation and an interested stockholder, which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation's voting stock for a three-year period following the date that such stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring or preventing a change in control of our company that our stockholders might consider to be in their best interests.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We transact business with clients almost exclusively in the United States and receive payment for our services exclusively in United States dollars. As a result, our financial results are unlikely to be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets.

Our interest income is generally not sensitive to changes in the general level of interest rates in the United States. A 10% increase or decrease in interest rates would not have a material adverse effect on our financial condition.

We do not hold derivative financial or commodity instruments, nor engage in any foreign currency transactions, and all of our cash and cash equivalents are held on deposit with banks and highly liquid marketable securities with maturities of three months or less.

**Item 4. Controls and Procedures**

*(a) Evaluation of Disclosure Controls and Procedures.*

Our management, with the participation of our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act) as of September 30, 2004. In designing and evaluating our disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and our management necessarily applied its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our CEO and CFO concluded that, as of September 30, 2004, our disclosure controls and procedures were (1) designed to ensure that material information relating to us, including our consolidated subsidiaries, is made known to our CEO and CFO by others within those entities, particularly during the period in which this report was being prepared and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

*(b) Changes in Internal Control over Financial Reporting.*

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act) occurred during the fiscal quarter ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

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

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

*Initial Public Offering and Use of Proceeds from Sales of Registered Securities*

On December 2, 2003, we completed an initial public offering of 5,750,000 shares of our common stock, par value \$.01 per share, at a price to the public of \$17.00 per share. Of the shares sold in the IPO,

5,570,000 shares were sold by us, including 750,000 shares purchased by the underwriters upon exercise of their over-allotment option, and

180,000 shares were sold by selling stockholders.

The offer and sale of all of the shares in the IPO were registered under the Securities Act pursuant to a Registration Statement on Form S-1 (File No. 333-108293), which was declared effective by the Securities and Exchange Commission on November 25, 2003. In addition to expenses incurred in connection with the IPO and previously disclosed in our Form 10-K for the year ended December 31, 2003, from the effective date of the registration statement through September 30, 2004, we have spent an additional \$6.8 million, \$21.9 million, \$6.9 million, and \$2.4 million of the \$86.4 million of net proceeds from the IPO on the purchase of all of the capital stock of Maxxar Corporation and re:Member Data Services, Inc. and substantially all of the outstanding operating assets of Eastpoint Technologies, LLC and Omega Systems of North America LLC, respectively. Payments of proceeds were to persons other than our directors or officers (or their associates), persons owning 10% or more of our equity securities, or our affiliates.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OPEN SOLUTIONS INC.

Date: November 12, 2004

/s/ Louis Hernandez, Jr.  
Louis Hernandez, Jr.  
Chairman of the Board and Chief  
Executive Officer  
(Principal Executive Officer)

November 12, 2004

/s/ Carl D. Blandino  
Date: Carl D. Blandino  
Senior Vice President, Chief Financial  
Officer, Treasurer and Secretary  
(Principal Financial Officer and Principal  
Accounting Officer)  
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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
2.1	Acquisition Agreement dated as of August 25, 2004, between 6259936 Canada Inc. and Open Solutions, Inc. and Datawest Solutions Inc. (Incorporated by reference to the Registrant's Current Report on Form 8-K dated August 25, 2004 (File No. 0-02333-56)).
2.2	Stock Purchase Agreement, dated as of July 8, 2004, by and among David B. Becker, John E. Taylor, as Trustee of the David B. Becker Family Trust and David B. Becker, as Trustee of the David B. Becker Charitable Remainder Unitrust, as shareholders of re:Member Data Services, Inc., and RD Acquisition Corp. (Incorporated by reference to the Registrant's Current Report on Form 8-K dated July 8, 2004 (File No. 0-02333-56)).
2.3	Asset Purchase Agreement, dated as of July 23, 2004, among Omega Systems of North America LLC, Evan P. Lewis, as sole trustee of Omega Systems of North America Voting Trust, Evan P. Lewis, as sole trustee of Omega Systems of North America Holding Trust, Tri-Core Systems Enterprises, LLC, Evan P. Lewis, as sole trustee of Tri-Core Holding Trust, Evan P. Lewis and Open Solutions Inc. (Incorporated by reference to Registrant's Current Report on Form 8-K dated July 23, 2004 (File No. 0-02333-56)).
31.1	Certification of Louis Hernandez, Jr., Chairman of the Board and Chief Executive Officer, pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Carl D. Blandino, Senior Vice President, Chief Financial Officer, Treasurer and Secretary, pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Louis Hernandez, Jr., Chairman of the Board and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Carl D. Blandino, Senior Vice President, Chief Financial Officer, Treasurer and Secretary, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.