

CSG SYSTEMS INTERNATIONAL INC  
Form 10-Q  
May 12, 2008  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended March 31, 2008

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-27512

**CSG SYSTEMS INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

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

**47-0783182**  
(I.R.S. Employer

Identification No.)

**9555 Maroon Circle**

**Englewood, Colorado 80112**

(Address of principal executive offices, including zip code)

**(303) 200-2000**

(Registrant's telephone number, including area code)

## Edgar Filing: CSG SYSTEMS INTERNATIONAL INC - Form 10-Q

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

YES ☒ NO ☐

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

Large accelerated filer ☒

Accelerated filer ☐

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

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ☐ NO ☒

Shares of common stock outstanding at May 7, 2008: 34,925,287

**Table of Contents**

**CSG SYSTEMS INTERNATIONAL, INC.**

**FORM 10-Q For the Quarter Ended March 31, 2008**

**INDEX**

	<b>Page No.</b>
Part I - <u>FINANCIAL INFORMATION</u>	
Item 1. <u>Condensed Consolidated Balance Sheets as March 31, 2008 and December 31, 2007 (Unaudited)</u>	3
<u>Condensed Consolidated Statements of Income for the Quarter Ended March 31, 2008 and 2007 (Unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Quarter Ended March 31, 2008 and 2007 (Unaudited)</u>	5
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	23
Item 4. <u>Controls and Procedures</u>	24
Part II - <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	25
Item 1A. <u>Risk Factors</u>	25
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	29
Item 6. <u>Exhibits</u>	30
<u>Signatures</u>	31
<u>Index to Exhibits</u>	32

**Table of Contents****CSG SYSTEMS INTERNATIONAL, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share amounts)**

	March 31, 2008	December 31, 2007
	(unaudited)	
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 140,449	\$ 123,416
Short-term investments	6,157	9,416
Total cash, cash equivalents and short-term investments	146,606	132,832
Trade accounts receivable-		
Billed, net of allowance of \$1,476 and \$1,487	124,586	114,132
Unbilled and other	6,857	6,038
Deferred income taxes	8,828	10,657
Income taxes receivable	954	2,128
Other current assets	7,269	6,399
Total current assets	295,100	272,186
Property and equipment, net of depreciation of \$72,879 and \$69,565	32,970	32,656
Software, net of amortization of \$34,877 and \$34,445	8,217	8,649
Goodwill	61,094	60,745
Client contracts, net of amortization of \$103,168 and \$98,822	29,274	31,526
Deferred income taxes	5,071	9,453
Other assets	9,219	7,173
Total assets	\$ 440,945	\$ 422,388
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Current liabilities:		
Client deposits	\$ 27,628	\$ 26,657
Trade accounts payable	20,662	18,429
Accrued employee compensation	15,380	21,042
Deferred revenue	20,013	17,480
Income taxes payable	2,936	
Other current liabilities	8,556	7,595
Total current liabilities	95,175	91,203
Non-current liabilities:		
Long-term debt	230,000	230,000
Deferred revenue	8,977	9,790
Income taxes payable	5,013	4,918
Other non-current liabilities	3,927	3,953
Total non-current liabilities	247,917	248,661
Total liabilities	343,092	339,864

## Edgar Filing: CSG SYSTEMS INTERNATIONAL INC - Form 10-Q

### Stockholders' equity:

Preferred stock, par value \$.01 per share; 10,000,000 shares authorized; zero shares issued and outstanding		
Common stock, par value \$.01 per share; 100,000,000 shares authorized; 34,915,004 and 34,275,280 shares outstanding	629	622
Additional paid-in capital	350,744	350,272
Treasury stock, at cost, 27,956,808 and 27,956,808 shares	(667,858)	(667,858)
Accumulated other comprehensive income (loss):		
Unrealized gain on short-term investments, net of tax	26	15
Unrecognized pension plan losses and prior service costs, net of tax	(435)	(435)
Accumulated earnings	414,747	399,908
<b>Total stockholders' equity</b>	<b>97,853</b>	<b>82,524</b>
 Total liabilities and stockholders' equity	 \$ 440,945	 \$ 422,388

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

**Table of Contents****CSG SYSTEMS INTERNATIONAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(in thousands, except per share amounts)**

	<b>Quarter Ended</b>	
	<b>March 31,</b>	<b>March 31,</b>
	<b>2008</b>	<b>2007</b>
	<b>(unaudited)</b>	
Revenues:		
Processing and related services	\$ 104,169	\$ 89,609
Software, maintenance and services	9,427	9,135
Total revenues	113,596	98,744
Cost of revenues:		
Processing and related services	53,137	44,625
Software, maintenance and services	5,215	5,951
Total cost of revenues	58,352	50,576
Gross margin (exclusive of depreciation)	55,244	48,168
Operating expenses:		
Research and development	15,872	13,712
Selling, general and administrative	12,422	11,028
Depreciation	3,637	2,868
Restructuring charges	56	106
Total operating expenses	31,987	27,714
Operating income	23,257	20,454
Other income (expense):		
Interest expense	(1,808)	(1,786)
Interest and investment income, net	1,579	5,539
Other, net	14	62
Total other	(215)	3,815
Income from continuing operations before income taxes	23,042	24,269
Income tax provision	(8,203)	(8,494)
Income from continuing operations	14,839	15,775
Discontinued operations:		
Income from discontinued operations		
Income tax benefit		269
Discontinued operations, net of tax		269

# Edgar Filing: CSG SYSTEMS INTERNATIONAL INC - Form 10-Q

Net income	\$ 14,839	\$ 16,044
Basic earnings per common share:		
Income from continuing operations	\$ 0.45	\$ 0.35
Discontinued operations, net of tax		0.01
Net income	\$ 0.45	\$ 0.36
Diluted earnings per common share:		
Income from continuing operations	\$ 0.45	\$ 0.35
Discontinued operations, net of tax		0.01
Net income	\$ 0.45	\$ 0.36
Weighted-average shares outstanding:		
Basic	33,084	44,385
Diluted	33,189	44,715

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

**Table of Contents****CSG SYSTEMS INTERNATIONAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)**

	<b>Quarter Ended</b>	
	<b>March 31,</b>	<b>March 31,</b>
	<b>2008</b>	<b>2007</b>
	<b>(unaudited)</b>	
Cash flows from operating activities:		
Net income	\$ 14,839	\$ 16,044
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation	3,637	2,868
Amortization	5,058	4,534
Restructuring charge for abandonment of facilities		133
Gain on short-term investments	(62)	(1,438)
Deferred income taxes	5,623	3,543
Excess tax benefit of stock-based compensation awards	(143)	(460)
Stock-based employee compensation	2,586	1,975
Changes in operating assets and liabilities:		
Trade accounts and other receivables, net	(11,332)	6,549
Other current and non-current assets	(3,168)	(443)
Income taxes payable/receivable	3,133	5,385
Trade accounts payable and accrued liabilities	(1,039)	(4,727)
Deferred revenue	1,720	1,700
Net cash provided by operating activities	20,852	35,663
Cash flows from investing activities:		
Purchases of property and equipment	(3,951)	(4,290)
Purchases of short-term investments	(5,818)	(78,146)
Proceeds from sale/maturity of short-term investments	9,150	95,500
Acquisition of businesses, net of cash acquired	(843)	(700)
Acquisition of and investments in client contracts	(1,465)	(2,781)
Net cash provided by (used in) investing activities	(2,927)	9,583
Cash flows from financing activities:		
Proceeds from issuance of common stock	246	420
Repurchase of common stock	(1,281)	(78,110)
Excess tax benefit of stock-based compensation awards	143	460
Net cash used in financing activities	(892)	(77,230)
Net increase (decrease) in cash and cash equivalents	17,033	(31,984)
Cash and cash equivalents, beginning of period	123,416	240,687
Cash and cash equivalents, end of period	\$ 140,449	\$ 208,703
Supplemental disclosures of cash flow information:		
Net cash paid (received) during the period for-		
Interest	\$ 96	\$ 95
Income taxes	(546)	(705)



## Edgar Filing: CSG SYSTEMS INTERNATIONAL INC - Form 10-Q

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

**Table of Contents**

**CSG SYSTEMS INTERNATIONAL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. GENERAL**

We have prepared the accompanying unaudited condensed consolidated financial statements as of March 31, 2008 and December 31, 2007, and for the first quarter of 2008 and 2007, in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information, and pursuant to the instructions to Form 10-Q and the rules and regulations of the Securities and Exchange Commission (the SEC ). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of our management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of our financial position and operating results have been included. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in our Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC. The results of operations for the first quarter of 2008, are not necessarily indicative of the expected results for the entire year ending December 31, 2008.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Use of Estimates in Preparation of Condensed Consolidated Financial Statements.* The preparation of the accompanying Condensed Consolidated Financial Statements in conformity with GAAP 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 periods. Actual results could differ from those estimates.

*Postage.* We pass through to our clients the cost of postage that is incurred on behalf of those clients, and typically require an advance payment on expected postage costs. These advance payments are included in client deposits in the accompanying Condensed Consolidated Balance Sheets and are classified as current liabilities regardless of the contract period. We net the cost of postage against the postage reimbursements, and include the net amount in processing and related services revenues. The cost of postage that has been shown net of the postage reimbursements from our clients for the first quarter of 2008 and 2007 was \$60.2 million and \$48.6 million, respectively.

*Accounting Pronouncements Adopted.* Effective January 1, 2008 we adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. In addition, effective January 1, 2008, we adopted SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115 ( SFAS 159 ), which permits an entity to choose to measure various financial instruments and certain other items at fair value, with changes in fair value recognized in earnings each reporting period. Upon adoption of SFAS 159, we did not elect to measure any additional assets or liabilities at fair value.

*Short-term Investments and Other Financial Instruments.* Our financial instruments as of March 31, 2008 and December 31, 2007 include cash and cash equivalents, short-term investments, accounts receivable, accounts payable, and long-term debt. Because of their short maturities, the carrying amounts of cash equivalents, accounts receivable, and accounts payable approximate their fair value.

Short-term investments are considered available-for-sale in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, and thus are reported at fair value in our accompanying Condensed Consolidated Balance Sheets, with unrealized gains and losses excluded from earnings and reported in a separate component of stockholders' equity. The fair value measurements are derived using quoted prices in active markets for identical assets and liabilities.

## **Table of Contents**

As of March 31, 2008 and December 31, 2007, the fair value of our Convertible Debt Securities, based upon quoted market prices, was approximately \$187 million and \$201 million, respectively.

*Income Taxes.* We follow the provisions of Financial Accounting Standards Board ( FASB ) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ). This interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure. There was not a significant change in our liability for unrecognized income tax benefits during the first quarter of 2008, and we do not anticipate a significant change within the next twelve months.

*Accounting Pronouncement Issued But Not Yet Effective.* In December 2007, the FASB issued SFAS 141 (revised 2007), *Business Combinations* ( SFAS 141(R) ), which significantly changes the accounting for business combinations. Under SFAS 141(R), an acquiring entity is required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS 141(R) further changes the accounting treatment for certain items, including: (i) acquisition costs will be generally expensed as incurred; (ii) noncontrolling interests (formerly known as minority interests) will be valued at fair value at the acquisition date; (iii) acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies; (iv) in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; (v) restructuring costs associated with a business combination will be expensed subsequent to the acquisition date; and (vi) changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. SFAS 141(R) also includes a substantial number of new disclosure requirements. The provisions of SFAS 141(R) are effective for us for all business combinations for which the acquisition date is on or after January 1, 2009, with early adoption prohibited. We are currently evaluating the future impacts, if any, of this standard.

In May 2008, the FASB issued FASB Staff Position ( FSP ) No. APB 14-a, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. This FSP clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement), which would include our Convertible Debt Securities, are not addressed by paragraph 12 of Accounting Principles Board ( APB ) Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, and requires that instruments within its scope be separated into their liability and equity components at initial recognition by: (i) recording the liability component at the fair value of a similar liability that does not have an associated equity component; and (ii) attributing the remaining proceeds from the issuance to the equity component. The FSP also requires that discounts on the liability component of instruments within its scope be amortized using the interest method over the expected life of a similar liability that does not have an associated equity component (considering the effects of prepayment features other than the conversion option).

The new model for accounting for convertible debt instruments that may be settled in cash is required to be applied retrospectively to all periods presented and is first applicable to our consolidated financial statements that will be included in our March 31, 2009 Form 10-Q. We are currently in the process of quantifying the impact of this FSP. While we have not completed such quantification, the application of this FSP is expected to have a material impact on our consolidated balance sheet, decreasing the amounts we report and have previously reported for long-term debt and increasing the amounts we report and have previously reported for total deferred income tax assets and stockholders' equity. The FSP is expected to have a material impact on our consolidated statement of income, increasing the amounts we report and have previously reported for interest expense and reducing the amounts we report and have previously reported for earnings per common share. The FSP is not expected to have an impact on our consolidated statement of cash flows as the recognition of the additional interest expense will be a non-cash expense.

**Table of Contents****3. STOCKHOLDERS EQUITY AND EQUITY COMPENSATION PLANS**

*Stock Repurchase Program.* We currently have a stock repurchase program, approved by our Board of Directors, authorizing us to repurchase up to 30 million shares of our common stock from time-to-time as market and business conditions warrant (the "Stock Repurchase Program").

We did not repurchase any shares during the first quarter of 2008 under our Stock Repurchase Program. During the first quarter of 2007, we repurchased 3.0 million shares of our common stock under the Stock Repurchase Program for \$75.4 million (weighted-average price of \$25.11 per share).

As of March 31, 2008, the shares repurchased under the Stock Repurchase Program since its inception in August 1999 totaled 28.8 million shares, at a total repurchase price of \$696.5 million (a weighted-average price of \$24.19 per share). As of March 31, 2008, the total remaining number of shares available for repurchase under the Stock Repurchase Program totaled 1.2 million shares.

*Stock Repurchases for Tax Withholdings.* In addition to the above mentioned stock repurchases, a summary of shares repurchased from our employees and then cancelled during the first quarter of 2008 and 2007 in connection with minimum tax withholding requirements resulting from the vesting of restricted stock under our stock incentive plans is as follows (in thousands):

	<b>Quarter Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Shares repurchased	104	106
Total amount paid	\$ 1,281	\$ 2,742

*Stock-Based Awards.* A summary of our unvested restricted stock activity during the first quarter of 2008 is as follows:

	<b>Quarter Ended March 31, 2008</b>	
	<b>Shares</b>	<b>Weighted-Average Grant Date Fair Value</b>
Unvested awards, beginning	1,303,955	\$ 23.60
Awards granted	734,500	11.79
Awards forfeited/cancelled	(15,000)	20.86
Awards vested	(301,660)	22.97
Unvested awards, ending	1,721,795	\$ 18.70

Included in the awards granted during the first quarter of 2008, are Performance-Based Awards for 118,750 restricted stock shares issued to key members of management (primarily members of executive management), which vest in equal installments over three years upon meeting either pre-established financial performance objectives or pre-established stock price objectives. The Performance-Based Awards become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment.

All other unvested restricted stock shares granted during the first quarter of 2008 are Time-Based Awards, which vest annually over four years with no restrictions other than the passage of time. Certain shares of the restricted stock become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment.

We recorded stock-based compensation expense of \$2.6 million and \$2.0 million for the first quarter of 2008 and 2007, respectively.

**Table of Contents****4. EARNINGS PER COMMON SHARE**

*Calculation of Earnings Per Common Share.* Earnings per common share ( EPS ) have been computed in accordance with SFAS No. 128, Earnings Per Share. Basic EPS is computed by dividing net income (the numerator) by the weighted-average number of common shares outstanding during the period (the denominator). Diluted EPS is consistent with the calculation of basic EPS while considering the effect of potentially dilutive common shares outstanding during the period. Unvested shares of restricted stock are not included in the basic EPS calculation. Basic and diluted EPS are presented on the face of our Condensed Consolidated Statements of Income.

No reconciliation of the basic and diluted EPS numerators is necessary for the first quarter of 2008 and 2007, as net income is used as the numerator for each period. The reconciliation of the EPS denominators is included in the following table (in thousands):

	Quarter Ended March 31,	
	2008	2007
Basic common shares outstanding	33,084	44,385
Dilutive effect of stock options	23	90
Dilutive effect of unvested restricted stock	82	240
Dilutive effect of Convertible Debt Securities		
Diluted common shares outstanding	33,189	44,715

For each of the quarters ended March 31, 2008 and 2007, 1.3 million and 0.3 million, respectively, of potentially dilutive common shares related to stock options and unvested shares of restricted stock were excluded from the computation of diluted EPS as their effect was antidilutive.

Upon conversion, we will settle the \$230 million principal amount of our Convertible Debt Securities in cash, and have the option to settle our conversion obligation, to the extent it exceeds the principal amount, in our common stock, cash or any combination of our common stock and cash. As a result, the Convertible Debt Securities have a dilutive effect only in those quarterly periods in which our average stock price exceeds the current effective conversion price of \$26.77 per share. The current effective conversion price of \$26.77 per share may be adjusted in the future for certain events, to include stock dividends, stock splits/reverse splits, the issuance of warrants to purchase our stock at a price below the then-current market price, cash dividends, and certain purchases by us of our common stock pursuant to a self-tender offer or exchange offer.

**5. COMPREHENSIVE INCOME**

The components of our comprehensive income were as follows (in thousands):

	Quarter Ended March 31,	
	2008	2007
Net income	\$ 14,839	\$ 16,044
Other comprehensive income (loss), net of tax, if any:		
Unrealized gain (loss) on short-term investments	11	(4)
Comprehensive income	\$ 14,850	\$ 16,040

**6. ACQUISITIONS**

In August 2007, we acquired 100% of the voting equity interests of Prairie Voice Services, Inc., which we subsequently renamed Prairie Interactive Messaging, Inc. ( Prairie ), for \$40.6 million in cash (net of \$3.7 million in acquired cash), plus \$0.4 million in acquisition costs. During the first quarter of 2008, we made a minor change to the estimated fair value of an acquired asset as of the date of the Prairie acquisition, resulting in a \$0.3 million decrease in the amount of goodwill related to the Prairie acquisition.



## **Table of Contents**

In July 2007, we acquired 100% of the voting equity interests of ComTec, Inc. ( ComTec ) for \$21.7 million in cash (net of \$1.9 million in acquired cash) at closing, plus \$0.5 million in acquisition costs. In March 2008, we accrued a working capital adjustment of \$0.7 million upon completion of a balance sheet audit. The working capital adjustment, along with minor changes to the estimated fair values of the assets acquired and liabilities assumed as of the date of acquisition, resulted in a \$0.7 million increase in the amount of goodwill related to the ComTec acquisition during the first quarter of 2008.

In addition to the cash paid at closing for past acquisitions, we have the following contingent purchase price payments open as of March 31, 2008 that have not been reflected as liabilities due to the uncertainty of payment:

The Prairie stock purchase agreement included contingent purchase price payments (related to the achievement of certain operating criteria) of up to \$6 million. The rights to the contingent purchase price payments go through December 31, 2009.

The ComTec stock purchase agreement included a contingent purchase price payment (related to the achievement of certain operating criteria) of up to \$2.5 million. The rights to this contingent purchase price payment go through June 30, 2008.

The Telution stock purchase agreement included contingent purchase price payments (related to revenue earn outs) of up to \$3 million. The rights to these contingent purchase price payments go through December 31, 2008.

The contingent payments will be recorded as additional purchase price if and when the events associated with the contingencies are resolved or the outcomes of the contingencies are determinable beyond a reasonable doubt.

The results of operations of ComTec and Prairie are included in the accompanying Condensed Consolidated Statements of Income for the periods subsequent to the acquisition dates. Pro forma information on our historical results of operations to reflect the acquisitions of ComTec and Prairie is not presented as ComTec's and Prairie's results of operations during prior periods are not material to our results of operations.

## **7. DEBT**

Our long-term debt as of March 31, 2008 and December 31, 2007 consists of our Convertible Debt Securities. As of March 31, 2008: (i) none of the contingent conversion features have been achieved, and thus, the Convertible Debt Securities are not convertible by the holders; and (ii) we are in compliance with the provisions of the bond indenture related to the Convertible Debt Securities.

We have made no borrowings on our \$100 million 2004 Revolving Credit Facility. As of March 31, 2008, we: (i) are in compliance with the financial ratios and other covenants; and (ii) have \$99.5 million available to us.

## **8. LONG-LIVED ASSETS**

*Goodwill.* The changes in the carrying amount of goodwill for the first quarter of 2008, to include goodwill resulting from the ComTec and Prairie acquisitions (see Note 6), were as follows (in thousands):

January 1, 2008, balance	\$ 60,745
Adjustment to ComTec acquired goodwill	675
Adjustment to Prairie acquired goodwill	(326)
March 31, 2008, balance	\$ 61,094





**Table of Contents**

*Other Intangible Assets.* Our intangible assets subject to ongoing amortization consist primarily of client contracts and software. As of March 31, 2008 and December 31, 2007, the carrying values of these assets were as follows (in thousands):

	March 31, 2008			December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Client contracts	\$ 132,442	\$ (103,168)	\$ 29,274	\$ 130,348	\$ (98,822)	\$ 31,526
Software	43,094	(34,877)	8,217	43,094	(34,445)	8,649
Total	\$ 175,536	\$ (138,045)	\$ 37,491	\$ 173,442	\$ (133,267)	\$ 40,175

The total amortization expense related to intangible assets for the first quarter of 2008 and 2007 was \$4.8 million and \$4.2 million, respectively. Based on the March 31, 2008 net carrying value of our intangible assets, the estimated total amortization expense for each of the five succeeding fiscal years ending December 31 are: 2008 \$19.8 million; 2009 \$6.3 million; 2010 \$6.3 million; 2011 \$5.6 million; and 2012 \$4.9 million.

## 9. COMMITMENTS, GUARANTEES AND CONTINGENCIES

*Product and Services Warranties.* We generally warrant that our products and related offerings will conform to published specifications, or to specifications provided in an individual client arrangement, as applicable. The typical product warranty period is 90 days from delivery of the product or offering. For certain service offerings we provide a limited warranty for the duration of the services provided. We generally warrant that services will be performed in a professional and workmanlike manner. The typical remedy for breach of warranty is to correct or replace any defective deliverable, and if not possible or practical, we will accept the return of the defective deliverable and refund the amount paid under the client arrangement that is allocable to the defective deliverable. Our contracts also generally contain limitation of damages provisions in an effort to reduce our exposure to monetary damages arising from breach of warranty claims. Historically, we have incurred minimal warranty costs, and as a result, do not maintain a warranty reserve.

*Product and Services Indemnifications.* Our arrangements with our clients generally include an indemnification provision that will indemnify and defend a client in actions brought against the client that claim our products and/or services infringe upon a copyright, trade secret, or valid patent. Historically, we have not incurred any significant costs related to such indemnification claims, and as a result, do not maintain a reserve for such exposure.

*Claims for Company Non-performance.* Our arrangements with our clients typically cap our liability for breach to a specified amount of the direct damages incurred by the client resulting from the breach. From time-to-time, these arrangements may also include provisions for possible liquidated damages or other financial remedies for our non-performance, or in the case of certain of our outsourced customer care and billing solutions, provisions for damages related to service level performance requirements. The service level performance requirements typically relate to system availability and timeliness of service delivery. As of March 31, 2008, we believe we have adequate reserves, based on our historical experience, to cover any reasonably anticipated exposure as a result of our nonperformance for any past or current arrangements with our clients. The amount of the reserve maintained for this purpose is not material.

*Indemnifications Related to Sold Businesses.* In conjunction with the sale of the GSS business in December 2005, we provided certain indemnifications to the buyer of this business which are considered routine in nature (such as employee, tax, or litigation matters that occurred while these businesses were under our ownership). Under the provisions of this indemnification agreement, payment by us is conditioned on the other party making a claim pursuant to the procedures in the indemnification agreement, and we are typically allowed to challenge the other party's claims. In addition, certain of our obligations under this indemnification agreement are limited in terms of time and/or amounts, and in some cases, we may have recourse against a third party if we are required to make certain indemnification payments.

We estimated the fair value of these indemnifications at \$2.8 million as of the closing date for the sale of the GSS business. Since the sale of the GSS business, we have made an indemnification payment of \$0.1 million, and as of March 31, 2008, the indemnification liability was \$2.3 million. It is not possible to predict the maximum potential amount of future payments we may be required to make under this indemnification agreement due to the conditional nature of our obligations and the unique facts and circumstances



## **Table of Contents**

associated with each indemnification provision. We believe that if we were required to make payments in excess of the indemnification liability we have recorded, the resulting loss would not have a material effect on our financial condition or results of operations. If any amounts required to be paid by us would differ from the amounts initially recorded as indemnification liabilities as of the closing dates for the sale of the GSS business, the difference would be reflected in the discontinued operations section of our Condensed Consolidated Statements of Income.

*Indemnifications Related to Officers and the Board of Directors.* We have agreed to indemnify certain of our officers and members of our Board of Directors if they are named or threatened to be named as a party to any proceeding by reason of the fact that they acted in such capacity. We maintain directors' and officers' (D&O) insurance coverage to protect against such losses. We have not historically incurred any losses related to these types of indemnifications, and are not aware of any pending or threatened actions or claims against any officer or member of our Board of Directors. As a result, we have not recorded any liabilities related to such indemnifications as of March 31, 2008. In addition, as a result of the insurance policy coverage, we believe these indemnification agreements are not significant to our results of operations.

*Legal Proceedings.* From time-to-time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. We are not presently a party to any material pending or threatened legal proceedings.

## **10. SUBSEQUENT EVENT**

On April 30, 2008, we acquired 100% of the voting equity interests of DataProse, Inc., ( "DataProse" ) for approximately \$39 million in cash. DataProse is a privately-held provider of statement presentment and direct mail services headquartered in Oxnard, California. DataProse assists over 500 clients across the United States to market through improved billing statements and personalized direct mail. We acquired DataProse to further our objective of helping our clients maximize every customer interaction by both strengthening and broadening our portfolio of output solutions capabilities. Additionally, this acquisition allows us to diversify our client base into the utilities, financial services, and telecommunications markets, and add clients in the non-profit sectors of healthcare and higher education.

We are in the early stages of the DataProse purchase accounting, but estimate a significant portion of the purchase price will be allocated to amortizable intangible assets and to goodwill. The results of DataProse will be included in our results of operations for the period subsequent to the acquisition date. Pro forma information on our historical results of operations to reflect the acquisition of DataProse will not be presented as DataProse's results of operations during the prior periods are not material to our results of operations.

## **Table of Contents**

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

The information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto (the Financial Statements ) included in this Form 10-Q and the audited consolidated financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2007 (our 2007 10-K ).

### **Forward-Looking Statements**

This report contains a number of forward-looking statements relative to our future plans and our expectations concerning the North American customer care and billing industry, as well as the communications industry it serves, and similar matters. These forward-looking statements are based on assumptions about a number of important factors, and involve risks and uncertainties that could cause actual results to differ materially from estimates contained in the forward-looking statements. Some of the risks that are foreseen by management are outlined within Part II Item 1A., Risk Factors . Item 1A. constitutes an integral part of this report, and readers are strongly encouraged to review this section closely in conjunction with MD&A.

### **Management Overview of Quarterly Results**

*Our Company.* We are a leading provider of outsourced solutions that facilitate customer interaction management on the behalf of our clients, generating a very large percentage of our revenues from the North American cable and Direct Broadcast satellite ( DBS ) communications markets. Our solutions also support an increasing number of other industries such as financial services, utilities, telecommunications, and home security.

Our solutions manage key customer interactions such as set-up and activation of customer accounts, sales support and marketing, order processing, invoice calculation (i.e., customer billing), production and mailing of monthly customer invoices, management reporting, electronic presentment and payment of invoices, automated and interactive messaging, and deployment and management of the client's field technicians to the customer's home. Our unique combination of solutions, services, and expertise ensure that our clients can rapidly launch new service offerings, improve operational efficiencies, and deliver a high-quality customer experience in a competitive and ever-changing marketplace.

The North American communications industry has experienced significant consolidation over the last few years, resulting in a large percentage of the market being served by a fewer number of services providers with greater size and scale. Consistent with this market concentration, a large percentage of our revenues are generated from a limited number of clients, with approximately two-thirds of our revenues for the first quarter of 2008 and for 2007 being generated from our four largest clients, which are Comcast Corporation ( Comcast ), DISH Network Corporation ( DISH ), Time Warner Inc. ( Time Warner ), and Charter Communications ( Charter ).

A summary of our results of operations for the first quarter of 2008 is as follows:

Our revenues for the first quarter of 2008 were \$113.6 million, up 15.0% when compared to \$98.7 million for the same period in 2007, and relatively consistent when compared to \$113.5 million for the fourth quarter of 2007.

The year-over-year increase in revenues is primarily due to: (i) revenues generated from the acquired ComTec and Prairie businesses; and, to a slightly lesser degree (ii) continued growth in the use of various ancillary products and services we offer.

Our operating expenses for the first quarter of 2008 were \$90.3 million, up 15.4% when compared to \$78.3 million for the same period in 2007, and down 2.6% when compared to \$92.8 million for the fourth quarter of 2007.

The year-over-year increase in operating expenses relates primarily to the impact of the acquisitions of the ComTec and Prairie businesses.

## **Table of Contents**

The decrease in operating expenses between the fourth quarter of 2007 and the first quarter of 2008 is primarily due to retirement benefits for our former Chief Executive Officer recorded in the fourth quarter of 2007.

Our diluted earnings per common share from continuing operations for the first quarter of 2008 was \$0.45, an increase of 28.6% when compared to \$0.35 per diluted share for the first quarter of 2007, and an increase of 12.5% when compared to \$0.40 per diluted share for the fourth quarter of 2007.

The year-over-year increase in our diluted earnings per common share is primarily due to a decrease of approximately 26% in diluted shares outstanding as a result of significant share repurchases made under our stock repurchase program during 2007.

The sequential quarterly increase in our diluted earnings per common share is primarily due to nonrecurring operating expenses of approximately \$2 million in the fourth quarter of 2007 related to the retirement of our former CEO in December 2007, with no comparable amounts in the first quarter of 2008.

Income from continuing operations for the first quarter of 2008 includes non-cash charges related to depreciation, amortization and stock-based compensation expense totaling \$11.0 million (pretax impact), or \$0.21 per diluted share impact, as compared to non-cash charges for the first quarter of 2007 of \$9.1 million (pretax impact), or \$0.13 per diluted share.

We continue to generate strong cash flows from operations. As of March 31, 2008, we had cash, cash equivalents, and short-term investments of \$146.6 million, as compared to \$132.8 million as of December 31, 2007.

Cash flows from operating activities for the first quarter of 2008 were \$20.9 million, compared to \$35.7 million for the first quarter of 2007, and \$19.5 million for the fourth quarter of 2007, with the year-over-year fluctuation between periods related primarily to changes in trade accounts receivables. See the Liquidity section below for further discussion.

Other key matters for the quarter were as follows:

During the first quarter of 2008, we invested \$15.9 million, or approximately 14% of our revenues, in research and development ( R&D ) activities. We continue to invest heavily in R&D to ensure that we stay ahead of our clients' needs and advance our clients' business as well as our own. Our clients are seeing heightened competitive pressures from the traditional telephone companies and other new entrants in an increasing number of markets. At the same time, our clients are deploying new services at a faster pace than ever before, to include expanding their offerings to serve a growing number of business customers, thus dramatically increasing the complexity of their business operations. We recognize these challenges and believe our value proposition is to provide solutions that help our clients ensure that each interaction they have with their customers is an opportunity to create value and deepen the business relationship. As a result of our R&D efforts, we have broadened our footprint within our client base with many innovative product offerings.

Our current processing agreements with Comcast and DISH run through December 31, 2008. See our Significant Client Relationships Section below for further discussion.

Total customer accounts processed on our systems as of March 31, 2008 were 45.6 million, compared to 45.4 million as of March 31, 2007, and 45.1 million as of December 31, 2007. The increase in the total customer accounts processed on our systems in the first quarter of 2008 is primarily due to additional customers Comcast converted to our systems following the dissolution of its partnership with Insight Communications Company, Inc. ( Insight ).



## Table of Contents

### Acquisition of DataProse, Inc.

On April 30, 2008, we acquired 100% of the voting equity interests of DataProse, Inc. ( DataProse ), a privately-held provider of statement presentment and direct mail services headquartered in Oxnard, California for approximately \$39 million in cash. DataProse assists over 500 clients across the United States to market through improved billing statements and personalized direct mail. We acquired DataProse to further our objective of helping our clients maximize every customer interaction by both strengthening and broadening our portfolio of output solutions capabilities. Additionally, this acquisition allows us to diversify our client base into the utilities, financial services, and telecommunications markets, and add clients in the non-profit sectors of healthcare and higher education.

We expect that DataProse will: (i) contribute approximately \$15 million to our full year 2008 revenues; (ii) have a slightly dilutive impact to our results of operations in 2008; and (iii) be slightly accretive on an operating cash flow basis. The expected impact of the DataProse acquisition includes estimates for certain acquisition-related expenses, associated primarily with our planned integration efforts, and estimates for the amortization of acquired intangible assets. Because of the inherent uncertainties in making such estimates, the actual impact of DataProse on our financial performance for 2008 may vary from our current expectations as we work through our integration efforts and complete the purchase accounting during the remainder of the year.

### Significant Client Relationships

*Client Concentration.* Approximately two-thirds of our total revenues are generated from our four largest clients, which include Comcast, DISH, Time Warner, and Charter. Revenues from these clients represented the following percentages of our total revenues for the first quarter of 2008, the fourth quarter of 2007, and the first quarter of 2007:

	March 31, 2008	Quarter Ended December 31, 2007	March 31, 2007
Comcast (1)(2)	27%	26%	29%
DISH (1)	19%	19%	21%
Time Warner	13%	14%	12%
Charter	8%	8%	9%

- (1) The slight decrease in our percentage of revenues generated from Comcast and DISH for the first quarter of 2008 when compared to the first quarter of 2007, is primarily due to greater revenue diversification resulting from our acquisitions of the ComTec and Prairie businesses in 2007.
- (2) The slight increase in our percentage of revenues generated from Comcast for the first quarter of 2008 when compared to the fourth quarter of 2007 is primarily due to (i) an increase in the usage of our ancillary products and services; and (ii) an increase in the number of Comcast subscriber accounts on our processing systems due to the conversion of the former Insight subscribers during the quarter, as noted above. As of March 31, 2008, December 31, 2007, and March 31, 2007, the percentages of net billed accounts receivable balances attributable to our largest clients were as follows:

	March 31, 2008	As of December 31, 2007	March 31, 2007
Comcast	30%	32%	28%
DISH	26%	22%	25%
Time Warner	8%	11%	9%
Charter	8%	9%	13%

*Comcast.* Our processing agreement with Comcast runs through December 31, 2008. We are currently engaged in discussions with Comcast regarding contract renewal terms. Although we believe our operating relationship with Comcast is good, there can be no assurances around the timing and/or the terms of any renewal arrangement at this time. The Comcast processing agreement and related material amendments are

## Edgar Filing: CSG SYSTEMS INTERNATIONAL INC - Form 10-Q

included in the exhibits to our periodic filings with the Securities and Exchange Commission ( SEC ), and we encourage readers to review these documents for further details.



**Table of Contents**

*DISH.* Our processing agreement with DISH runs through December 31, 2008, and provides DISH with the option to extend the term of the agreement for either one or two years beyond the end of December 2008. We are currently engaged in discussions with DISH regarding contract renewal options. Although we believe our operating relationship with DISH is good, there can be no assurances around the timing and/or the terms of any contract extension or renewal arrangement at this time. The DISH processing agreement includes certain annual financial commitments that we expect DISH to exceed based on the number of DISH customers currently on our systems. The DISH processing agreement and related material amendments are included in the exhibits to our periodic filings with the SEC, and we encourage readers to review these documents for further details.

See our 2007 10-K for additional discussion of our business relationships and contractual terms with the above mentioned significant clients.

*Risk of Client Concentration.* In the near term, we expect to continue to generate a large percentage of our total revenues from our four largest clients, Comcast, DISH, Time Warner, and Charter. There are inherent risks whenever a large percentage of total revenues are concentrated with a limited number of clients. One such risk is that, should a significant client: (i) terminate or fail to renew its contract with us, in whole or in part, for any reason; (ii) significantly reduce the number of customer accounts processed on our systems, the price paid for our services, or the scope of services that we provide; or (iii) experience significant financial or operating difficulties, it could have a material adverse effect on our financial condition and results of operations (including possible impairment or significant acceleration of the amortization of intangible assets).

**Stock-Based Compensation Expense**

Stock-based compensation expense is included in the following captions in the accompanying Condensed Consolidated Statements of Income (in thousands):

	March 31, 2008	Quarter Ended December 31, 2007	March 31, 2007
Cost of processing and related services	\$ 803	\$ 880	\$ 593
Cost of software, maintenance and services	159	205	148
Research and development	336	347	186
Selling, general and administrative	1,288	1,544	1,048
Total stock-based compensation expense	\$ 2,586	\$ 2,976	\$ 1,975

**Critical Accounting Policies**

The preparation of our Financial Statements in conformity with accounting principles generally accepted in the U.S. requires us to select appropriate accounting policies, and to make judgments and estimates affecting the application of those accounting policies. In applying our accounting policies, different business conditions or the use of different assumptions may result in materially different amounts reported in our Financial Statements.

We have identified the most critical accounting policies that affect our financial condition and the results of our business continuing operations. Those critical accounting policies were determined by considering the accounting policies that involve the most complex or subjective decisions or assessments. The most critical accounting policies identified relate to: (i) revenue recognition; (ii) allowance for doubtful accounts receivable; (iii) impairment assessments of long-lived assets; (iv) loss contingencies; (v) income taxes; and (vi) business combinations and asset purchases. These critical accounting policies, as well as our other significant accounting policies, are discussed in greater detail in our 2007 10-K.

## **Table of Contents**

### **Results of Operations**

*Total Revenues.* Total revenues for the first quarter of 2008 increased 15.0% to \$113.6 million, from \$98.7 million for the first quarter of 2007. The components of total revenues are discussed in more detail below.

*Processing and related services revenues.* Processing and related services revenues for the first quarter of 2008 increased \$14.6 million or 16.2% to \$104.2 million, from \$89.6 million for the first quarter of 2007. The increase in processing and related services revenues between periods is primarily due to: (i) the acquisition of the ComTec and Prairie businesses; and to a slightly lesser degree (ii) increased utilization of new and existing products and services by our clients, to include such things as higher usage of marketing services and various ancillary customer care solutions. All ComTec and Prairie revenues fall within this revenue classification.

Additional information related to processing and related services revenues is as follows:

Amortization of our client contracts intangible assets (reflected as a reduction of processing and related services revenues) for the first quarter of 2008 and 2007 was \$3.6 million in each quarter.

Total customer accounts processed on our systems as of March 31, 2008 were 45.6 million, up slightly compared to 45.4 million as of March 31, 2007, and compared to 45.1 million as of December 31, 2007. The increase in the total customer accounts processed on our systems in the first quarter of 2008 is primarily due to additional customers Comcast converted to our systems following the dissolution of its partnership with Insight.

*Software, Maintenance and Services Revenues.* Software, maintenance and services revenues for the first quarter of 2008 were \$9.4 million, relatively consistent with \$9.1 million for the first quarter of 2007.

*Cost of Revenues.* See our 2007 10-K for a description of the types of costs that are included in the individual line items for cost of revenues.

*Cost of Processing and Related Services.* The cost of processing and related services for the first quarter of 2008 increased \$8.5 million or 19.1% to \$53.1 million, from \$44.6 million for the first quarter of 2007, with this expense increase primarily due to: (i) the acquisitions of the ComTec and Prairie businesses, as all of the ComTec and Prairie cost of revenues fall within this expense classification; and (ii) an increase in variable costs related to the delivery of ancillary products and services (e.g., print costs, etc.), which directly correlate with the increase in revenues related to ancillary products and services.

The gross margin percentage for processing and related services was 49.0% for the first quarter of 2008, as compared to 50.2% for the first quarter of 2007, with the decrease in gross margin percentages between periods primarily due to the acquisition of the ComTec and Prairie businesses. These acquired businesses operate at a lower gross margin percentage level than our historical business operations.

*Cost of Software, Maintenance and Services.* The cost of software, maintenance and services for the first quarter of 2008 decreased 12.4% to \$5.2 million, from \$6.0 million for the first quarter of 2007. The decrease between periods is primarily due to a decrease in personnel assigned internally to software maintenance projects.

The gross margin percentage for software, maintenance and services was 44.7% for the first quarter of 2008, as compared to 34.9% for the first quarter of 2007. The increase in gross margin percentage is primarily attributed to: (i) the change in mix of these revenues between periods; and (ii) a decrease in personnel assigned internally to software maintenance projects. Variability in quarterly revenues and operating results are inherent characteristics of companies that sell software licenses, and perform professional services. Our quarterly revenues for software licenses and professional services may fluctuate, depending on various factors, including the timing of executed contracts and revenue recognition, and the delivery of contracted services or products. However, the costs associated with software and professional services revenues are not subject to the same degree of variability (e.g., these costs are generally fixed in nature within a relatively short period of time), and thus, fluctuations in our software and maintenance, professional services, and overall gross margins, will likely occur between periods.

## **Table of Contents**

*Gross Margin (Exclusive of Depreciation).* The overall gross margin percentage (exclusive of depreciation) for the first quarter of 2008 was 48.6%, relatively consistent when compared to 48.8% for the first quarter of 2007.

*R&D Expense.* R&D expense for the first quarter of 2008 increased 15.8% to \$15.9 million, from \$13.7 million for the first quarter of 2007. The increase between periods is primarily due to an increase in personnel on R&D projects, reflective of our increased focus on product development and enhancement efforts. As a percentage of total revenues, R&D expense was 14.0% for the first quarter of 2008, compared to 13.9% for the first quarter of 2007. We did not capitalize any internal software development costs during the first quarter of 2008 and 2007.

Our R&D efforts have been focused on the continued evolution of our ACP product, both functionally and architecturally, in response to market demands that our products have certain functional features and capabilities, as well as architectural flexibilities (such as service oriented architecture, or SOA). This product evolution will result in the modularization of certain product functionality that historically has been tightly integrated with the ACP platform, which will allow us to respond more quickly to required changes to our products and provide greater interoperability with other computer systems. Although our primary value proposition to our clients will continue to be the breadth and depth of our fully pre-integrated solution, these R&D efforts will also allow us to separate certain software components so as to allow such components to be marketed on a stand-alone basis where a specific client requirement and/or business need dictates, including the use of certain products across non-CSG customer care and billing systems.

At this time, we expect our future R&D efforts to continue to focus on similar tasks as noted above. In the near term, we expect that the percentage of our total revenues spent on R&D to be relatively consistent with the first quarter of 2008 (i.e., approximately 14%), with the level of our R&D spend highly dependent upon the opportunities that we see in our markets.

*Selling, General and Administrative ( SG&A ) Expense.* SG&A expense for the first quarter of 2008 increased 12.6% to \$12.4 million, from \$11.0 million for the first quarter of 2007. The increase in SG&A expense is primarily due to the impact of the ComTec and Prairie sales and marketing costs. As a percentage of total revenues, SG&A expense was 10.9% for the first quarter of 2008, compared to 11.2% for the first quarter of 2007.

*Depreciation Expense.* Depreciation expense for the first quarter of 2008 increased 26.8% to \$3.6 million, compared to \$2.9 million for the first quarter of 2007. The increase in depreciation expense is primarily due to the increased capital expenditures made over the last five quarters, to include the acquired property and equipment from our acquisition activities. Depreciation expense for all property and equipment is reflected separately in the aggregate and is not included in the cost of revenues or the other components of operating expenses.

*Operating Income.* Operating income for the first quarter of 2008 was \$23.3 million, or 20.5% of total revenues, compared to \$20.5 million, or 20.7% of total revenues for the first quarter of 2007. The slight decrease in operating income margin between years is primarily due to the impact of the ComTec and Prairie acquisitions.

At this time, we expect our operating income margin to trend down over the remainder of the year, with our full year 2008 operating margin expected to be approximately 18%. The decrease in our expected operating income margin for the remainder of 2008 is primarily due to: (i) an expected upward trend in expenses primarily as a result of our commitment to further advance our products and solutions through continued R&D and support efforts; and (ii) the expected dilutive effect of the DataProse acquisition on a GAAP basis, with DataProse expected to decrease our full year operating income margin by approximately 100 basis points.

Total non-cash charges related to depreciation, amortization, and stock-based compensation expense included in the determination of operating income for the first quarter of 2008 and 2007 were \$11.0 million and \$9.1 million, respectively.

*Interest and Investment Income, net.* Interest and investment income for the first quarter of 2008 decreased \$3.9 million, to \$1.6 million, from \$5.5 million for the first quarter of 2007, primarily due to the following: (i) a significant decrease in our cash and short-term investment balances between years primarily due to our stock repurchase activity in 2007, and to a lesser degree, the purchase of the ComTec and Prairie businesses in 2007; and (ii) a decrease in the overall rate of return realized on investments between periods.

## Table of Contents

We expect our interest and investment income to trend down slightly for the remainder of 2008 primarily due to a deterioration in the interest rate environment.

*Income Tax Provision.* The effective income tax rates for the first quarter of 2008 and 2007 were 36% and 35%, respectively. At this time, we estimate that our overall effective income tax rate for the full year 2008 will range between 35% and 36%.

As of March 31, 2008, our \$13.9 million of net deferred income tax assets represented approximately 3% of total assets. We continue to believe that sufficient taxable income will be generated in the future in order to realize the benefit of these net deferred income tax assets. Our assumptions of future profitable operations are supported by our strong operating performances over the last several years.

## Liquidity

### Cash and Liquidity

As of March 31, 2008 our principal sources of liquidity included cash, cash equivalents, and short-term investments of \$146.6 million, compared to \$132.8 million as of December 31, 2007. We generally invest our excess cash balances in low-risk, short-term investments to limit our exposure to market risks. We have ready access to all of our cash, cash equivalents, and short-term investment balances.

In addition to the above sources of liquidity, we also have a five-year, \$100 million senior secured revolving credit facility (the 2004 Revolving Credit Facility ) with a syndicate of U.S. financial institutions that expires in September 2009. The 2004 Revolving Credit Facility has a \$40 million sub-facility for standby and commercial letters of credit and a \$10 million sub-facility for same day advances. We have made no borrowings under the 2004 Revolving Credit Facility. Our ability to borrow under the 2004 Revolving Credit Facility is subject to a limitation of total indebtedness based upon the results of consolidated leverage and interest coverage ratio calculations, and a minimum liquidity requirement. As of March 31, 2008, we were in compliance with the financial ratios and other covenants of the 2004 Revolving Credit Facility, and had \$99.5 million available to us.

### Cash Flows From Operating Activities

We calculate our cash flows from operating activities in accordance with GAAP, beginning with net income, adding back the impact of non-cash items (e.g., depreciation, amortization, stock-based compensation, etc.), and then factoring in the impact of changes in working capital items. See our 2007 10-K for a description of the primary uses and sources of our cash flows from operating activities.

Our net cash flows from operating activities, broken out between operations and changes in working capital assets and liabilities, for the indicated periods are as follows (in thousands):

	Operations	Changes in Working Capital Assets and Liabilities	Net Cash Provided by Operating Activities Quarter Totals
Cash Flows from Operating Activities:			
2007:			
March 31 (1)	\$ 27,199	\$ 8,464	\$ 35,663
June 30	28,217	(3,719)	24,498
September 30 (2)	28,404	7,266	35,670
December 31 (3)	30,355	(10,807)	19,548
2008:			
March 31 (4)	31,538	(10,686)	20,852

**Table of Contents**

- (1) Cash flows from operating activities for the first quarter of 2007 were positively impacted by approximately \$10 million as we received an additional monthly processing invoice payment from a key client before quarter end. As a result, we received four monthly processing invoice payments from this key client during the first quarter of 2007, as compared to three monthly processing invoice payments in a typical quarter.
- (2) Cash flows from operating activities for the third quarter of 2007 were positively impacted by normal timing changes in certain operating assets and liabilities for the quarter.
- (3) Cash flows from operating activities for the fourth quarter of 2007 were negatively impacted by normal changes in working capital items, primarily related to the timing of payments for accrued payables and the collections on outstanding accounts receivable at quarter end.
- (4) Cash flows from operating activities for the first quarter of 2008 were negatively impacted by approximately \$10 million as the result of a delay in the receipt of a monthly processing invoice payment from a key client. This payment was received during the first week of April 2008. As a result, we received two monthly processing invoice payments from this key client during the first quarter of 2008, as compared to three monthly processing invoice payments in a typical quarter.

We believe the table presented above demonstrates our ability to consistently generate strong cash flows and the importance of managing our working capital items. As the table above illustrates, the operations portion of our cash flows from operating activities remains relatively consistent between periods. The variations in our net cash provided by operating activities are primarily the result of the changes in our working capital assets and liabilities related to our operations, and generally over longer periods of time, do not significantly impact our cash flows from operations.

Significant fluctuations in key working capital items between March 31, 2008 and December 31, 2007 that impacted our cash flows from operating activities are as follows:

**Billed Trade Accounts Receivable**

Management of our billed trade accounts receivable is important in maintaining strong quarterly cash flows from operating activities. Our billed trade accounts receivable balance includes billings for several non-revenue items (primarily postage, sales tax, and deferred revenue items). As a result, we evaluate our performance in collecting our accounts receivable through our calculation of days billings outstanding ( DBO ) rather than a typical days sales outstanding ( DSO ) calculation. DBO is calculated based on the billings for the period (including non-revenue items) divided by the average monthly net trade accounts receivable balance for the period.

Our gross and net billed trade accounts receivable and related allowance for doubtful accounts receivable ( Allowance ) as of the end of the indicated periods, and our DBO for the quarters then ended, are as follows (in thousands, except DBO):

<b>Quarter Ended</b>	<b>Gross</b>	<b>Allowance</b>	<b>Net Billed</b>	<b>DBO</b>
<b>2007:</b>				
March 31	104,677	(1,577)	103,100	63
June 30	104,254	(1,619)	102,635	61
September 30 (1)	111,541	(1,589)	109,952	60
December 31(2)	115,619	(1,487)	114,132	59
<b>2008:</b>				
March 31 (3)	126,062	(1,476)	124,586	59

- (1) The \$7.3 million increase in gross and net billed trade accounts receivable at September 30, 2007 is primarily due to the acquisitions of the ComTec and Prairie businesses.

(2)

## Edgar Filing: CSG SYSTEMS INTERNATIONAL INC - Form 10-Q

The \$4.1 million increase in gross and net billed trade accounts receivable at December 31, 2007 is primarily due to the timing of client payments at quarter end.

- (3) The \$10.4 million increase in gross and net billed trade accounts receivable at March 31, 2008 is primarily due to a delay in the receipt of a monthly processing invoice payment from a key client. This payment was received during the first week of April 2008.

## **Table of Contents**

### **Deferred Income Taxes**

The net decrease of \$6.2 million in total deferred income tax assets from \$20.1 million as of December 31, 2007 to \$13.9 million as of March 31, 2008 primarily relates to: (i) the reversal of deferred tax assets upon vesting of restricted stock awards; (ii) the utilization of net operating loss (NOL) carryforwards; and (iii) the increase in deferred tax liabilities related to our Convertible Debt Securities.

### **Accrued Employee Compensation**

Accrued employee compensation decreased \$5.6 million, from \$21.0 million as of December 31, 2007 to \$15.4 million as of March 31, 2008 primarily as a result of the payment of the 2007 management bonuses in March 2008.

### **Income Taxes Payable**

The \$3.1 million of cash flows from operating activities related to income taxes payable/receivable for the first quarter of 2008, is primarily due to the timing of our estimated Federal and state income tax payments.

### ***Cash Flows From Investing Activities***

Our typical investing activities consist of purchases/sales of short-term investments, purchases of property and equipment, and investments in client contracts, which are discussed below.

*Purchases/Sales of Short-term Investments.* We generally invest our excess cash balances in low-risk, cash equivalents or short-term investments to limit our exposure to market risks. These cash equivalents and short-term investments are readily convertible back into cash. During the first quarter of 2008, we purchased \$5.8 million and sold (or had mature) \$9.2 million of short-term investments. We continually evaluate the appropriate mix of our investment of excess cash balances between cash equivalents and short-term investments in order to maximize our investment returns and will likely purchase and sell additional short-term investments in the future.

*Property and Equipment/Client Contracts.* Our capital expenditures for the first quarter of 2008 and 2007 for property and equipment, and investments in client contracts, excluding the acquisitions of ComTec and Prairie in 2007, were as follows (in thousands):

	<b>Quarter Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Property and equipment	\$ 3,951	\$ 4,290
Client contracts	1,465	2,781

The property and equipment expenditures during the first quarter of 2008 consisted principally of computer hardware and related equipment, statement production equipment, and facilities and internal infrastructure items.

The investments in client contracts for the first quarter of 2008 and 2007 relate primarily to client incentive payments (\$0.7 million and \$2.5 million respectively) and the deferral of costs related to conversion/set-up services provided under long-term processing contracts (\$0.8 million and \$0.3 million, respectively).

### ***Cash Flows From Financing Activities***

Our financing activities typically consist of activities with our common stock.

*Repurchase of Common Stock.* During the first quarter of 2007, we repurchased shares of our common stock under the guidelines of the Stock Repurchase Program for \$75.4 million. We made no comparable share repurchases in the first quarter of

## **Table of Contents**

2008. In addition, outside of the Stock Repurchase Program, during the first quarter of 2008 and 2007, we repurchased from our employees and then cancelled approximately 104,000 shares and 106,000 shares of our common stock for \$1.3 million and \$2.7 million, respectively, in connection with minimum tax withholding requirements resulting from the vesting of restricted stock under our stock incentive plans.

### **Capital Resources**

As of March 31, 2008, we had \$146.6 million of cash and short-term investments available to fund our operations, and we expect to generate material amounts of additional cash during the remainder of 2008. The following are the key items to consider in assessing our sources and uses of capital resources:

*Acquisitions.* On April 30, 2008, we acquired 100% of the voting equity interests of DataProse, a privately-held provider of statement processing and direct mail services headquartered in Oxnard, California for approximately \$39 million in cash. The acquisition was funded from currently available cash.

As discussed in Note 6 to the Financial Statements, we have the following contingent purchase price payments open as of March 31, 2008 that have not been reflected because of the uncertainty of payment:

The Prairie stock purchase agreement included contingent purchase price payments (related to the achievement of certain operating criteria) of up to \$6 million. The rights to the contingent purchase price payments go through December 31, 2009.

The ComTec stock purchase agreement included a contingent purchase price payment (related to the achievement of certain operating criteria) of up to \$2.5 million. The rights to this contingent purchase price payment go through June 30, 2008.

The Telution stock purchase agreement included contingent purchase price payments (related to revenue earn outs) of up to \$3 million. The rights to these contingent purchase price payments go through December 31, 2008.

*Stock Repurchase Program.* As of March 31, 2008, we have 1.2 million remaining shares authorized for repurchase under the Stock Repurchase Program. During the first quarter of 2008, we did not repurchase any shares of our common stock under our Stock Repurchase Program.

*Purchases of Property and Equipment.* During the first quarter of 2008, we spent \$4.0 million on property and equipment. At this time, we expect our 2008 capital expenditures to be approximately \$20 million to \$25 million, with the actual spend highly dependent upon certain revenue opportunities we are pursuing. As of March 31, 2008, we have made no significant capital expenditure commitments.

*Convertible Debt Securities.* Our Convertible Debt Securities bear interest at a rate of 2.5% per annum, which is payable semiannually in arrears on June 15 and December 15 of each year. Refer to our 2007 10-K for additional disclosures related to the Convertible Debt Securities, to include the call and put features beginning in June 2011, and the contingent conversion features under which the holders of the Convertible Debt Securities can convert their securities. As of March 31, 2008, none of the contingent conversion features have been achieved, and thus, the Convertible Debt Securities are not convertible by the holders.

Upon conversion of the Convertible Debt Securities, we will settle our conversion obligation as follows: (i) we will pay cash for 100% of the \$230 million principal amount of the Convertible Debt Securities; and (ii) to the extent our conversion obligation exceeds the principal amount, we will satisfy the remaining conversion obligation in our common stock, cash or any combination of our common stock and cash.

We do not expect any of the conversion triggers to occur during the next 12 months. As a result, in the near-term, we expect our annual debt service costs related to the Convertible Debt Securities to be limited to the annual interest payments of \$5.8 million.





## **Table of Contents**

*2004 Revolving Credit Facility.* As of March 31, 2008, we had made no borrowings under the 2004 Revolving Credit Facility. Refer to our 2007 10-K for additional disclosures related to the 2004 Revolving Credit Facility, to include the requirement to maintain certain financial ratios and the interest rates for borrowings. We pay a quarterly commitment fee on the unused portion of the 2004 Revolving Credit Facility. This commitment fee rate is dependent on our leverage ratio and ranges from 25 to 50 basis points per annum. As of March 31, 2008, the commitment fee rate was 37.5 basis points per annum, resulting in minimum commitment fee payments totaling \$0.4 million per year. The 2004 Revolving Credit Facility expires in September 2009. As of March 31, 2008, due to an outstanding irrevocable letter of credit of \$0.5 million, we had \$99.5 million of the 2004 Revolving Credit Facility available to us.

In summary, we expect to continue to make investments in client contracts, capital equipment, and R&D. Although we do not have any plans to repurchase significant amounts of our outstanding common stock under our Stock Repurchase Program at this time, we expect to continually evaluate the possibility of stock repurchases in the future. In addition, as part of our growth strategy, we are continually evaluating potential business and asset acquisitions, and investments in market share expansion with our existing and potential new clients. We believe that: (i) our current cash and short-term investments balance, together with cash expected to be generated from future operating activities; (ii) the amount available under the 2004 Revolving Credit Facility; and (iii) other possible sources of additional debt that are available to us, will be sufficient to meet our anticipated cash requirements for at least the next 12 months.

### **Ratio of Earnings to Fixed Charges**

The ratio of earnings to fixed charges is computed by dividing fixed charges into earnings. Earnings is defined as income before income taxes, plus fixed charges. Fixed charges consist of interest expense (including the amortization of deferred financing costs) and the estimated interest component of rental expense. Our consolidated ratio of earnings to fixed charges for the first quarter of 2008, was 9.66:1.00. See Exhibit 12.10 to this document for information regarding the calculation of our ratio of earnings to fixed charges.

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

As discussed in our 2007 10-K, we are exposed to market risks related to changes in interest rates, and fluctuations and changes in the market value of our short-term investments. We have not historically entered into derivatives or other financial instruments for trading or speculative purposes.

#### ***Interest Rate Risk***

*Market Risk Related to Long-Term Debt.* We are exposed to interest rate risk related to long-term debt from two sources: our Convertible Debt Securities and our 2004 Revolving Credit Facility.

The interest rate on the Convertible Debt Securities is fixed, and thus, as it relates to our borrowings under the Convertible Debt Securities, we are not exposed to changes in interest rates. Commencing on June 15, 2011, in any six-month interest period where the average trading price of the Convertible Debt Securities immediately preceding that six-month interest period equals 120% or more of the principal amount of the Convertible Debt Securities, we will pay contingent interest equal to 0.25% of that average trading price.

The interest rate for borrowings under the 2004 Revolving Credit Facility, except for same day advances, is chosen at our option, and is based upon a base rate or adjusted LIBOR rate, plus an applicable margin. The base rate represents the higher of a floating prime rate and a floating rate equal to 50 basis points in excess of the Federal Funds Effective Rate. The interest rate for same day advances is based upon base rate, plus an applicable margin. The applicable margins are dependent on our leverage ratio, as defined, and range from zero to 100 basis points for base rate loans and 125 to 225 basis points for LIBOR loans. As of March 31, 2008, we had made no borrowings under the 2004 Revolving Credit Facility.

## **Table of Contents**

*Market Risk Related to Cash Equivalents and Short-term Investments.* Our cash and cash equivalents as of March 31, 2008, and December 31, 2007 were \$140.4 million and \$123.4 million, respectively. Our cash balances are typically swept into overnight money market accounts on a daily basis, and excess funds are invested in low-risk, somewhat longer term, cash equivalent instruments and short-term investments. We have minimal market risk for our cash and cash equivalents due to the relatively short maturities of the instruments.

Our short-term investments as of March 31, 2008 and December 31, 2007 were \$6.2 million and \$9.4 million, respectively. The day-to-day management of our cash equivalents and short-term investments is performed by two large financial institutions in the U.S., using strict and formal investment guidelines approved by our Board of Directors. Under these guidelines, short-term investments are limited to certain acceptable investments with: (i) a maximum maturity, (ii) a maximum concentration and diversification; and (iii) a minimum acceptable credit quality. At this time, we believe we have minimal liquidity risk associated with the short-term investments included in our portfolio.

We do not utilize any derivative financial instruments for purposes of managing our market risks related to interest rate risk.

### **Item 4.      *Controls and Procedures*** ***(a) Disclosure Controls and Procedures***

As required by Rule 13a-15(b), our management, including the Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), conducted an evaluation as of the end of the period covered by this report of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e). Based on that evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

### ***(b) Internal Control Over Financial Reporting***

As required by Rule 13a-15(d), our management, including the CEO and CFO, also conducted an evaluation of our internal control over financial reporting, as defined by Rule 13a-15(f), to determine whether any changes occurred during the quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, the CEO and CFO concluded that there has been no such change during the quarter covered by this report.

**Table of Contents**

**CSG SYSTEMS INTERNATIONAL, INC.**

**PART II. OTHER INFORMATION**

**Item 1. *Legal Proceedings***

From time-to-time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. We are not presently a party to any material pending or threatened legal proceedings.

**Item 1A. *Risk Factors***

We or our representatives from time-to-time may make or may have made certain forward-looking statements, whether orally or in writing, including without limitation, any such statements made or to be made in MD&A contained in our various SEC filings or orally in conferences or teleconferences. We wish to ensure that such statements are accompanied by meaningful cautionary statements, so as to ensure, to the fullest extent possible, the protections of the safe harbor established in the Private Securities Litigation Reform Act of 1995.

Accordingly, the forward-looking statements are qualified in their entirety by reference to and are accompanied by the following meaningful cautionary statements identifying certain important risk factors that could cause actual results to differ materially from those in such forward-looking statements. This list of risk factors is likely not exhaustive. We operate in a rapidly changing and evolving market involving the North American communications industry (e.g., bundled multi-channel video, Internet, voice and IP-based services), and new risk factors will likely emerge. Management cannot predict all of the important risk factors, nor can it assess the impact, if any, of such risk factors on our business or the extent to which any risk factor, or combination of risk factors, may cause actual results to differ materially from those in any forward-looking statements. Accordingly, there can be no assurance that forward-looking statements will be accurate indicators of future actual results, and it is likely that actual results will differ from results projected in forward-looking statements and that such differences may be material.

**We Derive a Significant Portion of Our Revenues From a Limited Number of Clients, and the Loss of the Business of a Significant Client Would Materially Adversely Affect Our Financial Condition and Results of Operations.**

The North American communications industry has experienced significant consolidation over the last few years, resulting in a large percentage of the market being served by a limited number of service providers with greater size and scale. Consistent with this market concentration, a large percentage of our revenues are generated from a limited number of clients, with approximately two-thirds of our revenues being generated from our four largest clients, which are (in order of size) Comcast, DISH, Time Warner, and Charter. See the Significant Client Relationships section of MD&A for key renewal dates and a brief summary of our business relationship with these clients.

There are inherent risks whenever a large percentage of total revenues are concentrated with a limited number of clients. One such risk is that, should a significant client: (i) terminate or fail to renew their contracts with us, in whole or in part for any reason; (ii) significantly reduce the number of customer accounts processed on our systems, the price paid for our services, or the scope of services that we provide; or (iii) experience significant financial or operating difficulties, it could have a material adverse effect on our financial condition and results of operations.

Our industry is highly competitive, and the possibility that a major client may move all or a portion of its customers to a competitor has increased. While our clients may incur some costs in switching to our competitors, they may do so for a variety of reasons, including: (i) if we do not maintain favorable relationships; (ii) if we do not provide satisfactory services and products; or (iii) for reasons associated with price.

## **Table of Contents**

### **A Reduction in Demand for Our Key Customer Care and Billing Products and Services Could Have a Material Adverse Effect on Our Financial Condition and Results of Operations.**

Historically, a substantial percentage of our total revenues have been generated from our core outsourced processing product, ACP, and related services. These products and services are expected to continue to provide a large percentage of our total revenues in the foreseeable future. Any significant reduction in demand for ACP and related services could have a material adverse effect on our financial condition and results of operations.

### **We May Not Be Able to Respond to the Rapid Technological Changes in Our Industry.**

The market for customer care and billing systems is characterized by rapid changes in technology and is highly competitive with respect to the need for timely product innovations and new product introductions. As a result, we believe that our future success in sustaining and growing our revenues depends upon the continued market acceptance of our products, especially ACP, and our ability to continuously adapt, modify, maintain, and operate our products to address the increasingly complex and evolving needs of our clients, without sacrificing the reliability or quality of the products. In addition, the market is demanding that our products have greater architectural flexibility and interoperability with other computer systems, and that we are able to meet the demands for technological advancements to our products and services at a greater pace. Attempts to meet these demands subjects our R&D efforts to greater risks.

As a result, substantial R&D will be required to maintain the competitiveness of our products and services in the market. Technical problems may arise in developing, maintaining and operating our products and services as the complexities are increased. Development projects can be lengthy and costly, and may be subject to changing requirements, programming difficulties, a shortage of qualified personnel, and/or unforeseen factors which can result in delays. In addition, we may be responsible for the implementation of new products and/or the migration of clients to new products, and depending upon the specific product, we may also be responsible for operations of the product.

There is an inherent risk in the successful development, implementation, migration, and operations of our products and services as the technological complexities, and the pace at which we must deliver these products and services to market, continue to increase. The risk of making an error that causes significant operational disruption to a client increases proportionately with the frequency and complexity of changes to our products and services. There can be no assurance: (i) of continued market acceptance of our products and services; (ii) that we will be successful in the development of product enhancements or new products that respond to technological advances or changing client needs at the pace the market demands; or (iii) that we will be successful in supporting the implementation, migration and/or operations of product enhancements or new products.

### **Our Business is Dependent on the North American Cable and DBS Industries.**

We have historically generated a significant portion of our revenues by providing products and services to clients in the North American cable and DBS industries. A decrease in the number of customers served by our clients, an adverse change in the economic condition of these industries, and/or changing consumer demand for services could have a material adverse effect on our results of operations. Additionally, a significant portion of our historical growth has come from our support of clients' expansion into new lines of business, such as HSI and VoIP. There can be no assurance that our current and potential clients will be successful in expanding into new segments of the converging communications industry. Even if major forays into new markets by our current or potential clients are successful, we may be unable to meet the special billing and customer interaction management needs of those markets.

Our clients operate in a highly competitive environment. It is widely anticipated that traditional wireline and wireless telephone service providers, and others, will continue their aggressive pursuit of providing convergent services, including residential video, a market historically dominated by our clients. Should these alternative service providers be successful in their video strategies, it could threaten our clients' market share, and thus our source of revenues, as generally speaking these companies do not use our core products and services and there can be no assurance that new entrants will become our clients.

## **Table of Contents**

### **The Consolidation of the North American Cable and DBS Industry May Have a Material Adverse Effect on Our Results of Operations.**

The North American cable and DBS industry may continue to be subject to significant ownership changes. One facet of these changes is that consolidation by and among our core client base, the cable and DBS providers, as well as new entrants such as the traditional wireline and wireless carriers, will decrease the potential number of buyers for our products and services. Should these consolidations result in a concentration of customer accounts being owned by companies with whom we do not have a relationship, or with whom competitors are entrenched, we could be subject to the inherent risk that subscribers will be moved off of us and onto a competitor's system, thereby having a material adverse effect on our results of operations. Furthermore, movement of our clients' customers from our systems to a competitor's system as a result of regionalization strategies by our clients could have a material adverse effect on our operations. Finally, as the result of the consolidations, our current and potential clients may choose to use their size and scale to exercise more severe pressure on pricing negotiations.

### **We Face Significant Competition in Our Industry.**

The market for our products and services is highly competitive. We directly compete with both independent providers of products and services and in-house systems developed by existing and potential clients. In addition, some independent providers are entering into strategic alliances with other independent providers, resulting in either new competitors, or competitors with greater resources. Many of our current and potential competitors have significantly greater financial, marketing, technical, and other competitive resources than our company, many with significant and well-established domestic and international operations. There can be no assurance that we will be able to compete successfully with our existing competitors or with new competitors.

### **Client Bankruptcies Could Adversely Affect Our Business, and Any Accounting Reserves We Have Established May Not Be Sufficient.**

In the past, certain of our clients have filed for bankruptcy protection. Companies involved in bankruptcy proceedings pose greater financial risks to us, consisting principally of possible claims of preferential payments for certain amounts paid to us prior to the bankruptcy filing date, as well as increased collectibility risk for accounts receivable, particularly those accounts receivable that relate to periods prior to the bankruptcy filing date. We consider such risks in assessing our revenue recognition and the collectibility of accounts receivable related to our clients that have filed for bankruptcy protection, and for those clients that are seriously threatened with a possible bankruptcy filing. We establish accounting reserves for our estimated exposure on these items. However, there can be no assurance that our accounting reserves related to this exposure will be adequate. Should any of the factors considered in determining the adequacy of the overall reserves change adversely, an adjustment to the accounting reserves may be necessary. Because of the potential significance of this exposure, such an adjustment could be material.

### **We May Incur Additional Material Restructuring Charges in the Future.**

Since the third quarter of 2002, we have recorded restructuring charges related to involuntary employee terminations, various facility abandonments, and various other restructuring activities. The accounting for facility abandonments requires highly subjective judgments in determining the proper accounting treatment for such matters. We continually evaluate our assumptions, and adjust the related restructuring reserves based on the revised assumptions at that time. Moreover, we continually evaluate ways to reduce our operating expenses through new restructuring opportunities, including more effective utilization of our assets, workforce and operating facilities. As a result, there is a reasonable likelihood that we may incur additional material restructuring charges in the future.

---

## **Table of Contents**

### **Failure to Attract and Retain Our Key Management and Other Highly Skilled Personnel Could Have a Material Adverse Effect on Our Business.**

Our future success depends in large part on the continued service of our key management, sales, product development, and operational personnel. We believe that our future success also depends on our ability to attract and retain highly skilled technical, managerial, operational, and marketing personnel, including, in particular, personnel in the areas of R&D and technical support. Competition for qualified personnel at times can be intense, particularly in the areas of R&D, conversions, software implementations, and technical support. For these reasons, we may not be successful in attracting and retaining the personnel we require, which could have a material adverse effect on our ability to meet our commitments and new product delivery objectives.

### **We May Not Be Successful in the Integration of Our Acquisitions.**

As part of our growth strategy, we seek to acquire assets, technology, and businesses which will provide the technology and technical personnel to expedite our product development efforts, provide complementary products or services, or provide access to new markets and clients.

Acquisitions involve a number of risks and difficulties, including: (i) expansion into new markets and business ventures; (ii) the requirement to understand local business practices; (iii) the diversion of management's attention to the assimilation of acquired operations and personnel; and (iv) potential adverse effects on a company's operating results for various reasons, including, but not limited to, the following items: (a) the inability to achieve revenue targets; (b) the inability to achieve certain operating synergies; (c) charges related to purchased in-process R&D projects; (d) costs incurred to exit current or acquired contracts or activities; (e) costs incurred to service any acquisition debt; and (f) the amortization or impairment of intangible assets.

Due to the multiple risks and difficulties associated with any acquisition, there can be no assurance that we will be successful in achieving our expected strategic, operating, and financial goals for any such acquisition.

### **Failure to Protect Our Proprietary Intellectual Property Rights Could Have a Material Adverse Effect on Our Financial Condition and Results of Operations.**

We rely on a combination of trade secret and copyright laws, nondisclosure agreements, and other contractual and technical measures to protect our proprietary rights in our products. We also hold a limited number of patents on some of our newer products, but do not rely upon patents as a primary means of protecting our rights in our intellectual property. There can be no assurance that these provisions will be adequate to protect our proprietary rights. Although we believe that our intellectual property rights do not infringe upon the proprietary rights of third parties, there can be no assurance that third parties will not assert infringement claims against us or our clients.

We continually assess whether there are any risks to our intellectual property rights. Should these risks be improperly assessed or if for any reason should our right to develop, produce and distribute our products be successfully challenged or be significantly curtailed, it could have a material adverse effect on our financial condition and results of operations.

### **The Delivery of Our Products and Services is Dependent on a Variety of Computing Environments and Communications Networks, Which May Not Be Available or May Be Subject to Security Attacks.**

Our products and services are generally delivered through a variety of computing environments operated by us, which we will collectively refer to herein as Systems. We provide such computing environments through both outsourced arrangements, such as our data processing arrangement with FDC, as well as internally operating numerous distributed servers in geographically dispersed environments. The end users are connected to our Systems through a variety of public and private communications networks, which we will collectively refer to herein as Networks. Our products and services are generally considered to be mission critical customer management systems by our clients. As a result, our clients are highly dependent upon the availability and uncompromised security of our Networks and Systems to conduct their business operations.

Our Networks and Systems are subject to the risk of an extended interruption or outage due to many factors such as: (i) planned changes to our Systems and Networks for such things as scheduled maintenance and technology upgrades, or migrations to other technologies, service providers, or physical location of hardware; (ii) human and machine error; (iii) acts of nature; and (iv) intentional, unauthorized attacks from computer hackers. In addition, we continue to expand our use of the Internet with our

**Table of Contents**

product offerings thereby permitting, for example, our clients' customers to use the Internet to review account balances, order services or execute similar account management functions. Allowing access to our Networks and Systems via the Internet increases their vulnerability to unauthorized access and corruption, as well as increasing the dependency of our Systems' reliability on the availability and performance of the Internet and end users' infrastructure.

As a means to mitigate certain risks in this area of our business, we have done the following: (i) established policies and procedures related to planned changes to our Systems and Networks; (ii) implemented a business continuity plan, to include testing certain aspects of this plan on a periodic basis; and (iii) implemented a security and data privacy program (utilizing ISO 17799 as a guideline) designed to mitigate the risk of an unauthorized access to the Networks and Systems primarily through the use of network firewalls, procedural controls, intrusion detection systems and antivirus applications. In addition, we undergo periodic security reviews of certain aspects of our Networks and Systems by independent parties.

The method, manner, cause and timing of an extended interruption or outage in our Networks or Systems are impossible to predict. As a result, there can be no assurances that our Networks and Systems will not fail, or that our business continuity plans will adequately mitigate all damages incurred as a consequence. Should our Networks or Systems: (i) experience an extended interruption or outage, (ii) have their security breached, or (iii) have their data lost, corrupted or otherwise compromised, it would impede our ability to meet product and service delivery obligations, and likely have an immediate impact to the business operations of our clients. This would most likely result in an immediate loss to us of revenue or increase in expense, as well as damaging our reputation. Any of these events could have both an immediate, negative impact upon our financial condition and our short-term revenue and profit expectations, as well as our long-term ability to attract and retain new clients.

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

The following table presents information with respect to purchases of company common stock made during the first quarter of 2008 by CSG Systems International, Inc. or any affiliated purchaser of CSG Systems International, Inc., as defined in Rule 10b-18(a)(3) under the Exchange Act.

Period	Total Number of Shares Purchased <sup>2</sup>	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan or Programs <sup>1</sup>
January 1 – January 31	40,793	\$ 13.53		1,204,096
February 1 – February 29	43,469	11.65		1,204,096
March 1 – March 31	20,038	11.15		1,204,096
Total	104,300	\$ 12.29		

<sup>1</sup> Our Board of Directors have authorized us to repurchase up to 30 million shares of our common stock under the Stock Repurchase Program. The Stock Repurchase Program does not have an expiration date.

<sup>2</sup> The total number of shares purchased that are not part of the Stock Repurchase Program represents shares purchased and cancelled in connection with stock incentive plans.

**Item 3. Defaults Upon Senior Securities**

None





**Table of Contents**

**Item 4.**      *Submission of Matters to a Vote of Security Holders*  
None

**Item 5.**      *Other Information*  
None

**Item 6.**      *Exhibits*  
The Exhibits filed or incorporated by reference herewith are as specified in the Exhibit Index.

**Table of Contents**

**SIGNATURES**

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

Dated: May 12, 2008

CSG SYSTEMS INTERNATIONAL, INC.

/s/ Peter E. Kalan  
Peter E. Kalan  
Chief Executive Officer and President  
(Principal Executive Officer)

/s/ Randy R. Wiese  
Randy R. Wiese  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)

**Table of Contents**

**CSG SYSTEMS INTERNATIONAL, INC.**

**INDEX TO EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
10.22C*	Fourth Amendment to CSG Master Subscriber Management System Agreement between CSG Systems, Inc. and EchoStar Satellite L.L.C.
10.47C	Third Amendment to Employment Agreement with Randy R. Wiese, dated February 22, 2008
10.48D (1)	Fourth Amendment to Employment Agreement with Peter E. Kalan, dated February 22, 2008
10.49C	Third Amendment to Employment Agreement with Joseph T. Ruble, dated February 22, 2008
10.70C	Third Amendment to Employment Agreement with Robert M. Scott, dated February 22, 2008
12.10	Statement regarding computation of Ratio of Earnings to Fixed Charges
31.01	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.02	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(1)	Incorporated by reference to the exhibit of the same number to the Registrant's Current Report on Form 8-K/A for the event dated November 14, 2007, filed on February 28, 2008.
*	Portions of the exhibit have been omitted pursuant to an application for confidential treatment, and the omitted portions have been filed separately with the Commission.