

EVOLVING SYSTEMS INC

Form 10-Q

November 03, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from to

Commission File Number: 0-24081

EVOLVING SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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Delaware

(State or other jurisdiction of incorporation or organization)

84-1010843

(I.R.S. Employer Identification No.)

9777 Pyramid Court, Suite 100 Englewood, Colorado

(Address of principal executive offices)

80112

(Zip Code)

(303) 802-1000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☒

(Do not check if a 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 ☒

As of October 29, 2009 there were 9,920,893 shares outstanding of Registrant's Common Stock (par value \$0.001 per share).

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EVOLVING SYSTEMS, INC.

Quarterly Report on Form 10-Q

September 30, 2009

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Signature

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(in thousands except share data)

(unaudited)

	September 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,153	\$ 5,783
Contract receivables, net of allowance for doubtful accounts of \$534 at September 30, 2009 and December 31, 2008	8,266	11,484
Unbilled work-in-progress	2,195	1,910
Deferred income taxes	5	5
Prepaid and other current assets	1,594	1,304
Total current assets	17,213	20,486
Property and equipment, net	1,264	1,277
Amortizable intangible assets, net	2,042	2,374
Goodwill	22,288	20,811
Long-term restricted cash	50	100
Long-term deferred income taxes		56
Other long-term assets	130	307
Total assets	\$ 42,987	\$ 45,411
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of capital lease obligations	\$ 24	\$ 21
Current portion of long-term debt	833	2,000
Accounts payable and accrued liabilities	4,862	5,198
Deferred income taxes	23	20
Unearned revenue	7,431	11,445
Total current liabilities	13,173	18,684
Long-term liabilities:		
Capital lease obligations, net of current portion	41	59
Other long-term obligations	333	1,402
Long-term debt, net of current portion	2,977	4,883
Deferred income taxes	330	441
Total liabilities	16,854	25,469
Commitments and contingencies (Note 10)		
Stockholders' equity:		

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Preferred stock, \$0.001 par value; 2,000,000 shares authorized; no shares issued and outstanding as of September 30, 2009 and December 31, 2008

Common stock, \$0.001 par value; 40,000,000 shares authorized; 9,818,357 and 9,753,393

shares issued and outstanding as of September 30, 2009 and December 31, 2008, respectively

	10	10
Additional paid-in capital	82,684	81,824
Accumulated other comprehensive loss	(3,338)	(5,270)
Accumulated deficit	(53,223)	(56,622)
Total stockholders' equity	26,133	19,942
Total liabilities and stockholders' equity	\$ 42,987	\$ 45,411

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

Table of Contents**EVOLVING SYSTEMS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands except per share data)****(unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
REVENUE				
License fees and services	\$ 5,836	\$ 4,539	\$ 15,940	\$ 14,713
Customer support	4,077	4,490	12,445	13,088
Total revenue	9,913	9,029	28,385	27,801
COSTS OF REVENUE AND OPERATING EXPENSES				
Costs of license fees and services, excluding depreciation and amortization	1,984	1,977	5,726	6,103
Costs of customer support, excluding depreciation and amortization	1,452	1,581	4,286	4,706
Sales and marketing	2,032	2,004	5,861	6,385
General and administrative	1,546	1,281	4,378	3,942
Product development	919	792	2,300	2,810
Depreciation	160	189	474	671
Amortization	194	371	548	1,130
Total costs of revenue and operating expenses	8,287	8,195	23,573	25,747
Income from operations	1,626	834	4,812	2,054
Other income (expense)				
Interest income	1	29	24	146
Interest expense	(145)	(278)	(563)	(897)
Loss on extinguishment of debt				(290)
Foreign currency exchange gain (loss)	226	130	(436)	272
Other income (expense), net	82	(119)	(975)	(769)
Income before income taxes	1,708	715	3,837	1,285
Income tax expense	380	122	438	161
Net income	\$ 1,328	\$ 593	\$ 3,399	\$ 1,124
Basic income per common share	\$ 0.14	\$ 0.06	\$ 0.35	\$ 0.12
Diluted income per common share	\$ 0.13	\$ 0.06	\$ 0.34	\$ 0.11
Weighted average basic shares outstanding	9,797	9,693	9,780	9,687
Weighted average diluted shares outstanding	10,249	9,873	10,024	9,904

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

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EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)

(in thousands, except share data)

(unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated (Deficit)	Total Stockholders Equity
Balance at December 31, 2008	9,753,393	\$ 10	\$ 81,824	\$ (5,270)	\$ (56,622)	\$ 19,942
Stock option exercises	33,279		160			160
Common Stock issued pursuant to the Employee Stock Purchase Plan	31,685		51			51
Stock-based compensation expense			649			649
Comprehensive income:						
Net income					3,399	
Foreign currency translation adjustment				1,932		
Comprehensive income						5,331
Balance at September 30, 2009	9,818,357	\$ 10	\$ 82,684	\$ (3,338)	\$ (53,223)	\$ 26,133

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

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EVOLVING SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 3,399	\$ 1,124
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	474	671
Amortization of intangible assets	548	1,130
Amortization of debt issuance costs	101	112
Stock based compensation	649	645
Loss on extinguishment of debt		290
Unrealized foreign currency transaction (gains) and losses, net	436	(272)
Benefit from foreign deferred income taxes	(89)	(186)
Change in operating assets and liabilities:		
Contract receivables	3,022	6,494
Unbilled work-in-progress	(142)	(1,067)
Prepaid and other assets	(188)	(450)
Accounts payable and accrued liabilities	(573)	(517)
Unearned revenue	(4,381)	(4,158)
Other long-term obligations	(1,069)	(255)
Net cash provided by operating activities	2,187	3,561
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(439)	(755)
Net cash used in investing activities	(439)	(755)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Capital lease payments	(15)	(15)
Principal payments on long-term debt	(3,073)	(7,798)
Proceeds from issuance of long-term debt		4,000
Payments for debt issuance costs		(347)
Proceeds from the issuance of stock	211	56
Net cash used in financing activities	(2,877)	(4,104)
Effect of exchange rate changes on cash	499	(344)
Net decrease in cash and cash equivalents	(630)	(1,642)
Cash and cash equivalents at beginning of period	5,783	7,271
Cash and cash equivalents at end of period	\$ 5,153	\$ 5,629
Supplemental disclosure of other cash and non-cash financing transactions:		
Interest paid	\$ 1,542	\$ 1,070
Income taxes paid	681	354
Conversion of preferred stock into common stock		5,587

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

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EVOLVING SYSTEMS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

Organization - We are a provider of software solutions and services to the wireless, wireline and IP carrier markets. We maintain long-standing relationships with many of the largest wireline, wireless and cable companies worldwide. Our customers rely on us to develop, deploy, enhance, maintain and integrate complex, highly reliable software solutions for a range of Operations Support Systems (OSS). We offer software products and solutions in four core areas: service activation solutions used to activate complex bundles of voice, video and data services for traditional and next generation wireless and wireline networks; numbering solutions that enable carriers to comply with government-mandated requirements regarding number portability as well as providing phone number management and assignment capabilities; SIM card activation solutions used to dynamically allocate and assign resources to a wireless device when it is first used, and mediation solutions supporting data collection for both service assurance and billing applications.

Interim Consolidated Financial Statements The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X and the related rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, we believe that the disclosures included in these financial statements are adequate to make the information presented not misleading. The unaudited condensed consolidated financial statements included in this document have been prepared on the same basis as the annual consolidated financial statements, and in our opinion, reflect all adjustments, which include normal recurring adjustments necessary for a fair presentation in accordance with GAAP and SEC regulations for interim financial statements. The results for the nine months ended September 30, 2009 are not necessarily indicative of the results that we will have for any subsequent period. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes to those statements for the year ended December 31, 2008 included in our Annual Report on Form 10-K.

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

Earnings Per Share - On July 1, 2009, we announced that our Board of Directors approved a one-for-two reverse split of our common stock, as previously authorized and approved by our stockholders at the June 9, 2009 annual meeting, which took effect at 11:59 p.m. (Eastern time) on July 20, 2009 (the Effective Time). Our common stock began trading on a post-split basis on July 21, 2009. As a result of the reverse stock split, every two shares of our common stock was combined into one share of common stock. The reverse stock split affected all of our common stock outstanding immediately prior to the Effective Time of the reverse stock split as well as the number of shares of common stock available for issuance under our equity incentive plans. In addition, the reverse stock split reduced the number of shares of common stock issuable upon the exercise of stock options. Our common stock outstanding at June 30, 2009 was approximately 19.6 million shares. Adjusting for the reverse

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stock split, the common stock outstanding at June 30, 2009 was reduced to approximately 9.8 million shares. The number of authorized shares of common stock remains at 40.0 million. The reverse split did not affect the par value of our common stock which remains at \$0.001. As a result of the reverse stock split, the stated capital on our balance sheet attributable to our common stock was reduced in proportion to the size of the reverse stock split. Common stock and additional paid-in capital balances, all share amounts, stock option amounts and per share/option prices appearing in this Quarterly Report on Form 10-Q reflect the reverse stock split for all periods presented.

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

Principles of Consolidation - The consolidated financial statements include the accounts of Evolving Systems, Inc. and

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subsidiaries, all of which are wholly owned. All significant intercompany transactions and balances have been eliminated in consolidation.

Goodwill - Goodwill is the excess of acquisition cost of an acquired entity over the fair value of the identifiable net assets acquired. Goodwill is not amortized, but tested for impairment annually or whenever indicators of impairment exist. These indicators may include a significant change in the business climate, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business or other factors. For purposes of the goodwill evaluation, we compare the fair value of each of our reporting units to its respective carrying amount. If the carrying value of a reporting unit were to exceed its fair value, we would then compare the fair value of the reporting unit's goodwill to its carrying amount, and any excess of the carrying amount over the fair value would be charged to operations as an impairment loss.

Intangible Assets - Amortizable intangible assets consist primarily of purchased software and licenses, customer contracts and relationships, trademarks and tradenames, and business partnerships acquired in conjunction with our purchases of CMS Communications, Inc. (CMS), Telecom Software Enterprises, LLC (TSE) and Tertio Telecoms Ltd. (Evolving Systems U.K.). These definite life assets are amortized using the straight-line method over their estimated lives.

We assess the impairment of identifiable intangibles if events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. Factors that we consider significant which could trigger an impairment analysis include the following:

- Significant under-performance relative to historical or projected future operating results;
- Significant changes in the manner of use of the acquired assets or the strategy of the overall business;
- Significant negative industry or economic trends; and/or
- Significant decline in our stock price for a sustained period.

If, as a result of the existence of one or more of the above indicators of impairment, we determine that the carrying value of intangibles and/or long-lived assets may not be recoverable, we compare the estimated undiscounted cash flows expected to result from the use of the asset and its eventual disposition to the asset's carrying amount. If an amortizable intangible or long-lived asset is not deemed to be recoverable, we recognize an impairment loss representing the excess of the asset's carrying value over its estimated fair value.

Fair Value of Financial Instruments - The carrying amounts for certain financial instruments, including cash and cash equivalents, contract receivables and accounts payable, approximate fair value due to their short maturities. We estimate the fair value of our debt based on current rates offered to us for debt of the same remaining maturities, if available, or if not available, based on discounted future cash flows using current

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market interest rates. As of September 30, 2009, we estimated the fair value of our fixed rate senior term loan and subordinated notes was \$0.9 million and \$3.4 million, respectively. As of December 31, 2008, we estimated the fair value of our fixed rate senior term loan and subordinated notes was \$2.4 million and \$6.0 million, respectively.

Revenue Recognition - We generally recognize revenue when an agreement is signed, the fee is fixed or determinable and collectability is reasonably assured. We recognize revenue from two primary sources: license fees and services, and customer support. The majority of our license fees and services revenue is generated from fixed-price contracts, which provide for licenses to our software products and services to customize such software to meet our customers' use. When the services are determined to be essential to the functionality of the delivered software, we recognize revenue using the percentage-of-completion method of accounting. We estimate the percentage-of-completion for each contract based on the ratio of direct labor hours incurred to total estimated direct labor hours and recognize revenue based on the percent complete multiplied by the contract amount. Since estimated direct labor hours, and changes thereto, can have a significant impact on revenue recognition, these estimates are critical and we review them regularly. We record amounts billed in advance of services being performed as unearned revenue. Unbilled work-in-progress represents revenue earned but not yet billable under the terms of the fixed-price contracts. All such amounts are expected to be billed and collected within 12 months.

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

In arrangements where the services are not essential to the functionality of the delivered software, we recognize license revenue when a license agreement has been signed, delivery has occurred, the fee is fixed or determinable and collectability is reasonably assured. Where applicable, we unbundle and record as revenue fees from multiple element arrangements as the elements are delivered to the extent that vendor specific objective evidence (VSOE) of fair value of the undelivered elements exist. If VSOE for the undelivered elements

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does not exist, we defer fees from such arrangements until the earlier of the date that VSOE does exist on the undelivered elements or all of the elements have been delivered.

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

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

Stock-based Compensation - We account for stock-based compensation by applying a fair-value-based measurement method to account for share-based payment transactions with employees and directors and record compensation cost for all stock awards granted after January 1, 2006 and awards modified, repurchased, or cancelled after that date. We record compensation costs associated with the vesting of unvested options on a straight-line basis over the vesting period. Stock-based compensation is a non-cash expense because we settle these obligations by issuing shares of our common stock instead of settling such obligations with cash payments. We use the Black-Scholes model to estimate the fair value of each option grant on the date of grant. This model requires the use of estimates for expected term of the options and expected volatility of the price of our common stock.

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

Effective January 1, 2007, we adopted a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more likely than not to be sustained upon examination by taxing authorities. There was no material impact on the company's consolidated financial position and results of operations as a result of this adoption.

As of September 30, 2009 and December 31, 2008, we had no liability for unrecognized tax benefits. We do not believe there will be any material changes to our unrecognized tax positions over the next twelve months.

Recent Accounting Pronouncements - In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05, Measuring Liabilities at Fair Value, to amend FASB Accounting Standards Codification™ (ASC) 820, Fair Value Measurements and Disclosures, to clarify how entities should estimate the fair value of liabilities. ASC 820, as amended, includes clarifying guidance for circumstances in which a quoted price in an active market is not available, the effect of the existence of liability transfer restrictions, and the effect of quoted prices for the identical liability, including when the identical liability is traded as an asset. The amended

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guidance in ASC 820 on measuring liabilities at fair value is effective for the first interim or annual reporting period beginning after August 28, 2009, with earlier application permitted. We do not believe that the adoption of the amended guidance in ASC 820 will have a significant effect on our consolidated financial statements.

In October 2009, the FASB issued ASU 2009-13, Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force, to amend certain guidance in FASB ASC 605, Revenue Recognition, 25, Multiple-Element Arrangements . The amended guidance in ASC 605-25 (1) modifies the separation criteria by eliminating the criterion that requires objective and reliable evidence of fair value for the undelivered item(s), and (2) eliminates the use of the residual method of allocation and instead requires that arrangement consideration be allocated, at the inception of the arrangement, to all deliverables based on their relative selling price. The amended guidance in ASC 605-25 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early application and retrospective application permitted. The Company expects to prospectively apply the amended guidance in ASC 605-25 beginning January 1, 2010. The Company does not believe that the adoption of the amendments to ASC 605-25 will have a significant effect on its consolidated financial statements.

In October 2009, the FASB issued ASU 2009-14, Certain Revenue Arrangements That Include Software Elements a consensus of the FASB Emerging Issues Task Force, to amend the scope of arrangements under ASC 985, Software, 605, Revenue Recognition to exclude tangible products containing software components and non-software components that function together to deliver a product s essential functionality. The amended guidance in ASC 605-25 and ASC 985-605 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early application and retrospective application permitted. The Company expects to prospectively apply the amended guidance in ASC 985-605, concurrently with the amended guidance in ASC 605-25, beginning on January 1, 2010. The Company does not believe that the

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adoption of the amended guidance in ASC 605-25 and ASC 985-605 will have a significant effect on its consolidated financial statements.

NOTE 2 GOODWILL AND INTANGIBLE ASSETS

We recorded goodwill as a result of three acquisitions which occurred over the period from November 2003 to November 2004. We acquired CMS in November 2003, TSE in October 2004 and Evolving Systems U.K. in November 2004.

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

	License and Services		Customer Support		Total
	US	UK	US	UK	Goodwill
Balance as of December 31, 2008	\$	\$ 6,611	\$ 6,033	\$ 8,167	\$ 20,811
Effects of changes in foreign currency exchange rates		661		816	1,477
Balance as of September 30, 2009	\$	\$ 7,272	\$ 6,033	\$ 8,983	\$ 22,288

We conducted our annual goodwill impairment test as of July 31, 2009, and we determined that goodwill was not impaired as of the test date. From July 31, 2009 through September 30, 2009, no events have occurred that we believe may have impaired goodwill.

We amortized identifiable intangible assets on a straight-line basis over estimated lives ranging from one to seven years and include the cumulative effects of foreign currency exchange rates. As of September 30, 2009 and December 31, 2008, identifiable intangibles were as follows (in thousands):

	September 30, 2009			December 31, 2008			Weighted-Average
	(1) Gross Amount	Accumulated Amortization	Net Carrying Amount	(1) Gross Amount	Accumulated Amortization	Net Carrying Amount	Amortization Period
Purchased software	\$ 1,712	\$ 1,214	\$ 498	\$ 1,583	\$ 902	\$ 681	4.6 yrs
Purchased licenses	227	227		227	227		2.3 yrs
Trademarks and tradenames	714	332	382	649	232	417	7.0 yrs
Business partnerships	117	76	41	106	53	53	5.0 yrs
Customer relationships	3,176	2,055	1,121	2,986	1,763	1,223	5.3 yrs
	\$ 5,946	\$ 3,904	\$ 2,042	\$ 5,551	\$ 3,177	\$ 2,374	5.2 yrs

(1) Changes in intangible gross values as of September 30, 2009 compared to December 31, 2008 are the direct result of changes in foreign currency exchange rates for the periods then ended.

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Amortization expense of identifiable intangible assets was \$0.2 and \$0.5 million for the three and nine months ended September 30, 2009, respectively, and \$0.4 and \$1.1 million for the three and nine months ended September 30, 2008, respectively. As Evolving Systems U.K. uses the British Pound Sterling as its functional currency, the amount of future amortization actually recorded will be based upon exchange rates in effect at that time. Expected future amortization expense related to identifiable intangibles based on our carrying amount as of September 30, 2009 was as follows (in thousands):

Twelve months ending September 30,

2010	\$	710
2011		631
2012		401
2013		300
	\$	2,042

NOTE 3 EARNINGS PER COMMON SHARE

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

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On January 1, 2009, we adopted a policy providing that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are participating securities and shall be included in the computation of both basic and diluted earnings per share. Upon adoption, both basic and diluted income per share for 2009 and 2008 remained unchanged.

The following is the reconciliation of the denominator of the basic and diluted EPS computations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Basic income per common and preferred share:				
Net income available to common and preferred stockholders	\$ 1,328	\$ 593	\$ 3,399	\$ 1,124
Weighted average common shares outstanding	9,797	9,693	9,780	9,522
Participating securities				165
Basic weighted average shares outstanding	9,797	9,693	9,780	9,687
Basic income per common and preferred share	\$ 0.14	\$ 0.06	\$ 0.35	\$ 0.12
Diluted income per common and preferred share:				
Net income available to common and preferred stockholders	\$ 1,328	\$ 593	\$ 3,399	\$ 1,124
Weighted average common shares outstanding	9,797	9,693	9,780	9,522
Participating securities				165
Effect of dilutive securities options	452	180	244	217
Diluted weighted average shares outstanding	10,249	9,873	10,024	9,904
Diluted income per common and preferred share	\$ 0.13	\$ 0.06	\$ 0.34	\$ 0.11

For the three months ended September 30, 2009 and 2008, 0.9 million and 1.9 million shares of common stock were excluded from the dilutive stock calculation because their exercise prices were greater than the average fair value of our common stock for the period. For each of the nine month periods ended September 30, 2009 and 2008, 1.8 million shares of common stock were excluded from the dilutive stock calculation because their exercise prices were greater than the average fair value of our common stock for the period.

NOTE 4 SHARE-BASED COMPENSATION

We account for stock-based compensation by applying a fair-value-based measurement method to account for share-based payment transactions with employees and directors and record compensation cost for all stock awards granted after January 1, 2006 and awards modified, repurchased, or cancelled after that date, using the modified prospective method. We record compensation costs associated with the vesting of unvested options on a straight-line basis over the vesting period. We recognized \$0.2 million for each of the three months ended September 30, 2009 and 2008 and \$0.6 million for each of the nine months ended September 30, 2009 and 2008, respectively, of compensation expense in the consolidated statements of operations, with respect to our stock-based compensation plans. The following table summarizes stock-based compensation expenses recorded in the statement of operations (in thousands):

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Cost of license fees and services, excluding depreciation and amortization	\$ 16	\$ 16	\$ 51	\$ 46
Cost of customer support, excluding depreciation and amortization	2	1	6	5
Sales and marketing	36	18	107	101
General and administrative	146	133	417	431
Product development	23	21	68	62
	\$ 223	\$ 189	\$ 649	\$ 645

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Stock Incentive Plans

In January 1996, our stockholders approved an Amended and Restated Stock Option Plan (the "Option Plan"). Under the Option Plan, as amended, and after the reverse stock split, 4,175,000 shares were reserved for issuance. Options issued under the Option Plan were at the discretion of the Board of Directors, including the vesting provisions of each stock option granted. Options were granted with an exercise price equal to the closing price of our common stock on the date of grant, generally vest over four years and expire no more than ten years from the date of grant. The Option Plan terminated on January 18, 2006; options granted before that date were not affected by the plan termination. At September 30, 2009 and 2008, 1.8 million and 1.9 million options remained outstanding under the Option Plan, respectively.

In March 2007, upon the hiring of our Vice President of World Wide Sales and Marketing, in accordance with NASDAQ Marketplace Rule 4350(i)(1)(a)(iv), the Board of Directors approved an inducement award under a stand-alone equity incentive plan. We granted 50,000 non-qualified options to purchase shares of our common stock at an exercise price equal to the closing price of our common stock on the date of grant. The options vest over four years and expire ten years from the date of grant. At September 30, 2009 and 2008, 50,000 options remained outstanding under this plan.

In June 2007, our stockholders approved the 2007 Stock Incentive Plan (the "2007 Stock Plan"). As a result of the reverse stock split on July 21, 2009, a maximum of 1,000,000 shares can be issued under the 2007 Stock Plan. Awards permitted under the 2007 Stock Plan include: Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Awards and Other Stock-Based Awards. Awards issued under the 2007 Stock Plan are at the discretion of the Board of Directors. As applicable, awards are granted with an exercise price equal to the closing price of our common stock on the date of grant, generally vest over four years and expire no more than ten years from the date of grant. At September 30, 2009 and 2008, 0.5 million and 0.3 million options remained outstanding under the 2007 Stock Plan, respectively.

In December 2008, under the 2007 Stock Plan, we awarded a total of 52,500 shares of restricted stock to members of our Board of Directors and senior management. There were no issuances of restricted stock during either of three or nine months ended September 30, 2009 or 2008. During the three months ended September 30, 2009 and 2008, 10,000 and 7,000 shares of restricted stock vested, respectively. During the nine months ended September 30, 2009 and 2008, 31,000 and 21,000 shares of restricted stock vested, respectively. There were no forfeitures of restricted stock during the either of the three or nine months ended September 30, 2009 and 2008. The fair market value for share-based compensation expensing is equal to the closing price of our common stock on the date of grant. The restrictions on the stock award are released generally over four years for senior management and over one year for board members.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Expected term (years)	*	*	5.3	6.2
Risk-free interest rate	*	*	2.4%	2.7%

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Expected volatility	*	*	78.0%	101.9%
Expected dividend yield	*	*	0%	0%

* - None granted

The following is a summary of stock option activity under the plans for the nine months ended September 30, 2009: