EMBARCADERO TECHNOLOGIES INC
Form 10-Q
August 09, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2004.

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

For the transition period from ______ to ______

Commission File Number 000-30293

EMBARCADERO TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**68-0310015**

(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

100 CALIFORNIA STREET, SUITE 1200

SAN FRANCISCO, CA 94111

(415) 834-3131

(Address of principal executive offices)

Indicate by check mark whether the registrant (1) 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 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. x Yes ¨ No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2 of the Act). x Yes ¨ No

The number of shares outstanding of the Registrant s Common Stock as of July 31, 2004 was 27,512,533.

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PART I- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EMBARCADERO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value)

(unaudited)

	June 30, 2004	December 31, 2003
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 51,152	$ 45,066
Short-term investments	14,592	12,901
Trade accounts receivable, net	8,135	8,237
Prepaid expenses and other current assets	2,026	1,670
Deferred income taxes	465	465
Total current assets	76,370	68,339
Property and equipment, net	3,132	3,259
Goodwill	10,337	10,337
Other intangible assets, net	288	692
Deferred income taxes	3,711	3,711
Other assets, net	2,689	3,692
Total assets	$ 96,527	$ 90,030
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 180	$ 1,011
Accrued liabilities	5,451	5,098
Capital lease obligations	176	
Deferred revenue	14,005	13,219
Total current liabilities	19,812	19,328
Long-term deferred revenue	252	251
Long-term capital lease obligations	309	
Long-term restructuring accrual	2,067	203
Total liabilities	22,440	19,782

Stockholders Equity:		
Common stock at $0.001 par value	28	28
Treasury stock	(6,875)	(6,287)
Additional paid-in capital	84,631	80,145
Accumulated other comprehensive income	304	374
Deferred stock-based compensation	(2,880)	(1,519)
Accumulated deficit	(1,121)	(2,493)
Total stockholders equity	74,087	70,248
Total liabilities and stockholders equity	$ 96,527	$ 90,030

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

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EMBARCADERO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2004	**2003**	**2004**	**2003**
Revenues:				
License	$ 6,730	$ 6,421	$ 14,109	$ 12,768
Maintenance	7,123	6,024	14,169	11,885
Total revenues	13,853	12,445	28,278	24,653
Cost of revenues:				
License	213	105	422	205
Amortization of acquired technology	556	556	1,111	1,111
Maintenance	620	565	1,242	1,153
Total cost of revenues	1,389	1,226	2,775	2,469
Gross profit	12,464	11,219	25,503	22,184
Operating expenses:				
Research and development	3,906	4,016	7,680	7,806
Sales and marketing	5,096	4,844	10,207	9,739
General and administrative	1,543	1,308	2,756	2,610
Restructuring and impairment charges	4,068		4,068	
Total operating expenses	14,613	10,168	24,711	20,155
Income (loss) from operations	(2,149)	1,051	792	2,029
Other income, net	168	159	319	285
Income (loss) before provision for income taxes	(1,981)	1,210	1,111	2,314
Benefit from (provision for) income taxes	1,127	(463)	261	(671)
Net income (loss)	$ (854)	$ 747	$ 1,372	$ 1,643
Net income (loss) per share:				
Basic	$ (0.03)	$ 0.03	$ 0.05	$ 0.06
Diluted	$ (0.03)	$ 0.03	$ 0.05	$ 0.06

Shares used in per share calculation:				
Basic	27,394	26,488	27,260	26,569
Diluted	27,394	28,212	29,184	28,244
Non-cash stock-based compensation included in the above expenses:				
Cost of revenues	$ 2	$	$ 2	$
Research and development	55	3	55	6
Sales and marketing	181	77	330	182
General and administrative	171	97	317	247
	$ 409	$ 177	$ 704	$ 435

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

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EMBARCADERO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
Cash from Operating Activities:		
Net income	$ 1,372	$ 1,643
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	940	1,065
Recovery of doubtful accounts	(24)	(57)
Impairment charges	680	
Amortization of developed technology	977	735
Amortization of other intangible assets	404	404
Amortization of deferred stock-based compensation	646	435
Issuance of options in exchange for services	58	
Changes in assets and liabilities:		
Trade accounts receivable	162	191
Prepaid expenses and other assets	(538)	(199)
Restructuring accrual	3,789	
Accounts payable and accrued liabilities	(2,305)	641
Deferred revenue	507	1,706
Net cash provided by operating activities	6,668	6,564
Cash from Investing Activities:		
Purchase of investments	(11,393)	(11,396)
Maturities of investments	9,702	10,200
Sales of investments		15,617
Purchase of property and equipment	(870)	(592)
Technology acquired and developed	(15)	(275)
Net cash provided by (used in) investing activities	(2,576)	13,554
Cash from Financing Activities:		
Payments for repurchase of common stock	(588)	(1,171)
Payments of principal under capital lease obligation	(15)	
Proceeds from exercise of stock options	2,422	25
Net cash provided by (used in) financing activities	1,819	(1,146)
Effect of exchange rate changes on cash and cash equivalents	175	53

Net increase in cash and cash equivalents	6,086	19,025
Cash and cash equivalents at the beginning of the period	45,066	15,870
Cash and cash equivalents at the end of the period	$ 51,152	$ 34,895

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

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EMBARCADERO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1 THE COMPANY AND BASIS OF PRESENTATION

Embarcadero Technologies, Inc. (with its subsidiaries, collectively referred to as the Company) was incorporated in California on July 23, 1993, and reincorporated in Delaware on February 15, 2000. The Company provides software products that enable organizations to effectively manage their database infrastructure and manage the underlying data housed within that infrastructure. The Company is headquartered in San Francisco, California and has international operations in Toronto, Canada, Maidenhead, United Kingdom and Melbourne, Australia.

The Company markets its software and related maintenance services directly through telesales and field sales organizations in North America, the United Kingdom and Australia, and indirectly through original equipment manufacturers (OEMs) and independent distributors worldwide.

The accompanying unaudited condensed consolidated financial statements reflect all adjustments, which, in the opinion of the Company, are necessary for a fair presentation of the results for the interim periods presented. All such adjustments are normal recurring adjustments. These financial statements have been prepared in accordance with generally accepted accounting principles related to interim financial statements and the applicable rules of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The balance sheet at December 31, 2003 was derived from the audited financial statements, but it does not include all disclosures required by generally accepted accounting principles.

The financial statements and related disclosures have been prepared with the presumption that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these financial statements should be read in conjunction with the audited financial statements and the related notes thereto contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2003, filed on March 12, 2004.

Operating results for the three and six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2004, or for any future period. Further, the preparation of condensed consolidated financial statements requires management to make estimates and assumptions that affect the recorded amounts reported therein. A change in facts or circumstances surrounding the estimates could result in a change to the estimates and impact future operating results.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of Embarcadero Technologies, Inc. and its wholly-owned subsidiaries, Embarcadero Europe Ltd., Embarcadero Canada Ltd. and Embarcadero Australia Ltd. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles (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 amount of revenues and expenses during the reporting period. In addition, the Company analyzes its current accounts receivable for a reserve for doubtful accounts based on the customers historical data and their credit-worthiness as well as the current business and economic environment. The allowance includes specific reserves for accounts where collection is no longer probable. The Company also regularly reviews its long-term assets for possible impairment loss, in accordance with GAAP requirements, and provides estimates for such losses if needed. Actual results could differ from such estimates.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less at the time of purchase. Embarcadero s cash and cash equivalents at June 30, 2004 and December 31, 2003 consisted of deposits in banks, money market funds and short-term securities.

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of cash and cash equivalents and trade accounts receivable. The Company maintains its cash and cash equivalents with high quality financial institutions and invests in highly rated short-term securities. Sales returns have not been material as of this date, and as such, the Company does not maintain any allowances for estimated future sales returns. Actual credit losses to date have been within management s expectations. As of June 30, 2004 and December 31, 2003, there were no customers with balances due to Embarcadero in excess of 10% of aggregate accounts receivable.

Property and Equipment

Property and equipments are stated at cost less accumulated depreciation, computed using the straight-line method based on the estimated useful lives of the assets, generally ranging from three to five years. Depreciation commences upon placing the asset in service. Capital leases are recorded at the lesser of the fair value of the leased asset at the inception of the lease or the present value of the minimum lease payments as of the beginning of the lease term. Leased assets are amortized on a straight-line basis over the estimated useful life of the asset or the lease term. Leasehold improvements are amortized over the shorter of the useful life or the remaining lease term. The Company reviews its property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable or that the useful lives of the assets are no longer appropriate. Factors considered important which could trigger an impairment review include, but are not limited to, significant underperformance relative to expected historical or projected future operating results and significant changes in the manner of use of the acquired assets or the strategy for the Company s overall business. When the Company determines that the carrying value of long-lived assets may not be recoverable based upon the existence of one or more of the above indicators of impairment, then it measures any impairment based on a projected discounted cash flow method using a discount rate commensurate with the risk inherent in the Company s current business model.

Impairment of Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in business combination. In July 2001, the FASB approved the issuance of SFAS No. 142, Goodwill and Other Intangible Assets . SFAS No. 142 provides guidance on how to account for goodwill and certain intangible assets after an acquisition is completed. The most substantive change is that goodwill and other indefinite life intangible assets can no longer be amortized but instead should be periodically tested for impairment. Embarcadero adopted SFAS No. 142 on January 1, 2002 and has ceased amortization of goodwill and will evaluate it for impairment in accordance with its policies.

Revenue Recognition

The Company s revenues are primarily derived from software license fees and related maintenance and support contracts. Revenues from software license fees are recognized upon shipment, when terms of the contracts are Freight on Board (F.O.B.) shipping point, provided that evidence of an arrangement exists, the fee is fixed or determinable and collection of the resulting receivable is probable. Maintenance and support contracts generally cover a one-year term and are paid for in advance. Revenues from maintenance and support contracts are recognized ratably over the term of the contract. License revenues include the nominal shipping and handling charges associated with most of the license orders. The actual shipping costs that we incur are included in the cost of revenue.

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The Company uses purchase orders, signed contracts and pre-payments via check, wire or credit card as persuasive evidence for substantiation of an arrangement. For arrangements with multiple obligations (e.g., undelivered maintenance and support contracts and consulting and training services bundled with licenses), the Company allocates revenues to the delivered elements of the arrangement using the residual value method based on the vendor specific objective evidence (VSOE) for the undelivered items. The VSOE for post contract services (PCS) is determined based upon prices paid by the customers for the separate renewal or sale of such services. If the Company cannot determine the VSOE for PCS, then the entire arrangement fee is recognized ratably over the contractual PCS period (explicit rights to PCS) or the period during which PCS is expected to be provided (implicit rights to PCS).

The Company typically grants its customers net 30 payment terms, but some payments are collected in advance via check, wire or credit card upon receipt of an order.

Products may be sold through resellers and distributors in the United States and certain international markets. Revenues from software license fees sold through resellers or distributors are recognized on the sell-through basis. Maintenance obligations to distributors commence when agreement is signed. Distributors purchase products to fulfill specific customer orders and generally do not hold inventory of our products.

The Company also enters into arrangements with OEMs that provide for license fees based on inclusion of the Company s products in their OEM products. These arrangements often provide for non-refundable and upfront minimum royalty payments which are recognized as revenue either immediately or on a sell-through basis when due, assuming all other revenue recognition criteria are met. The OEM arrangements usually include maintenance and support contracts. The Company allocates revenues to the delivered elements of the arrangements using the residual value method based on the VSOE for undelivered items.

The Company sells its software and related maintenance services directly through our telesales and field sales organizations in North America, the United Kingdom and Australia and indirectly through our distribution partners worldwide.

Foreign Currency Translation

The functional currencies of the Company s foreign subsidiaries are their respective local currencies. The Company translates the assets and liabilities of international subsidiaries into U.S. Dollars at the current rates of exchange in effect during each period. Revenues and expenses are translated using rates that approximate the average of those in effect during the period. Gains and losses from translation adjustments are included in stockholders equity in the consolidated balance sheet caption Accumulated other comprehensive income (loss) .

Deferred Revenue

Deferred revenue represents amounts received from customers under certain maintenance and service contracts for which the revenue earnings process has not been completed. The revenue will be recognized ratably over the life of the contract or when the service is rendered.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes based on Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts and the tax basis of existing assets and liabilities. The Company records a valuation allowance to reduce tax assets to an amount for which realization is more likely than not. There are certain charges that are not deductible for tax purposes. The Company recorded a restructuring charge of $4.1 million during the three months ended June 30, 2004, a significant portion of this amount will not be deductible for tax purposes in the current year. Thus, the statutory income tax rate used for determination of tax liability will likely differ from the effective income tax rate used for the calculation of income tax provision for financial reporting purposes.

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Stock-Based Compensation

The Company has adopted stock-based compensation plans that provide for the grant of options and restricted stock to employees and directors of the Company. All options granted under these plans typically vest over terms of three to four years. The restricted stock is subject to transfer restrictions that lapse over time, typically one to two years.

The Company accounts for stock-based employee compensation using the intrinsic value method in accordance with Accounting Principles Board (APB)Opinion No. 25 and related interpretations, which generally requires that the amount of compensation cost that must be recognized, if any, is the quoted market price of the stock at the measurement date, which is generally the grant date, less the amount the grantee is required to pay to acquire the stock.

Alternatively, Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, employs fair value-based measurement and generally results in the recognition of compensation expense for all stock-based awards to employees. SFAS No. 123 does not require an entity to adopt those provisions, but rather, permits continued application of APB Opinion No. 25. The Company has elected not to adopt the recognition and measurement provisions of SFAS No. 123 and continues to account for its stock-based employee compensation plans under APB Opinion No. 25 and related interpretations. In accordance with APB Opinion No. 25, deferred compensation is generally recorded for stock-based employee compensation grants based on the excess of the market value of the common stock on the measurement date over the exercise price. The deferred compensation is amortized to expense over the vesting period of each unit of stock-based employee compensation granted. If the exercise price of the stock-based compensation is equal to or exceeds the market price of the Company s common stock on the date of grant, no compensation expense is recorded.

For the six months ended June 30, 2004, the Company issued restricted stock grants with an associated deferred compensation expense of $2.8 million. There were no restricted stock grants issued in the six months ended June 30, 2003. This deferred compensation expense will be amortized to expense over the period that the transfer restrictions are in effect. For the three months ended June 30, 2004, the Company recorded compensation expense of approximately $400,000 related to restricted stock grants. For the six months ended June 30, 2004, the Company recorded compensation expense of approximately $700,000 related to restricted stock grants. No comparable expense was recorded in the six months ended June 30, 2003.

The compensation expense recorded for restricted stock grants under the intrinsic value method is consistent with the expense that would be recorded under the fair value-based method. Had the compensation cost for the Company s employee stock option grants been determined based on the grant date fair values of awards estimated using the Black-Scholes option pricing model, which is consistent with the method described in SFAS No. 123, the Company s reported net income (loss) and income (loss) per share would have been reduced to the following pro forma amounts (in thousands, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
	(unaudited)		(unaudited)	
Net income (loss), as reported	$ (854)	$ 747	$ 1,372	$ 1,643
	242	147	383	364

Employee stock-based compensation expense included in reported net income (loss), net of tax				
Total employee stock-based compensation expense determined under fair value	(930)	(849)	(1,598)	(1,542)
Pro forma net income (loss)	$ (1,542)	$ 45	157	$ 465
Basic net income (loss):				
As reported	$ (0.03)	$ 0.03	$ 0.05	$ 0.06
Pro forma	$ (0.06)	$ 0.00	$ 0.01	$ 0.02
Diluted net income (loss):				
As reported	$ (0.03)	$ 0.03	$ 0.05	$ 0.06
Pro forma	$ (0.06)	$ 0.00	$ 0.01	$ 0.02

The fair value of each option grant is estimated on the date of grant using the fair value method with the following weighted average assumptions:

	Three months ended June 30,		Six months ended June 30,	
	2004	**2003**	**2004**	**2003**
	(unaudited)		**(unaudited)**	
Risk free interest rate	3.02-3.78%	2.33-6.65%	2.40-3.78%	2.33-6.65%
Expected life	4	4	4	4
Expected dividends	$	$	$	$
Volatality	99%	113%	99%	113%

Recent Accounting Pronouncements

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. In November 2003, the FASB issued FASB Staff Position No. FASB 150-3 which deferred the measurement provisions of SFAS No. 150 indefinitely for certain mandatory and redeemable non-controlling interests that were issued before November 5, 2003. The FASB plans to reconsider implementation issues and, perhaps, classification or measurement guidance for those non-controlling interests during the deferral period. To date, the effective provisions of SFAS No. 150 did not have an impact on the Company s results of operations, financial position or cash flows since we do not currently have any financial instruments affected by the standard. While the effective date of certain elements of SFAS No. 150 have been deferred, the adoption of SFAS No. 150 when finalized is not expected to have an impact on the Company s financial position, results of operations or cash flows, since we do not currently have any financial instrument effected by the standard.

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In March 2004, the EITF reached consensus on Issue 03-01 (EITF 03-01), The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments , EITF 03-01 includes new guidance for evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. The accounting guidance of EITF 03-01 is effective for fiscal years beginning after June 15, 2004, while the disclosure requirements are effective for fiscal years ending after June 15, 2004. The Company does not believe that the adoption of EITF 03-01 will have a material effect on its financial position or results of operations.

NOTE 3 OTHER COMPREHENSIVE INCOME (LOSS)

Other comprehensive income consists of unrealized gain (loss) on available-for-sale investments and foreign currency translation adjustments during the period.

The components of comprehensive income (loss) are as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
	(unaudited)		(unaudited)	
Net income (loss), as reported	$ (854)	$ 747	$ 1,372	$ 1,643
Unrealized loss on available-for-sale investments	(11)		(7)	(112)
Foreign currency translation adjustments	(72)	48	(66)	30
Comprehensive income (loss)	$ (937)	$ 795	$ 1,299	$ 1,561

NOTE 4 EARNINGS PER SHARE

Basic net income per share excludes the effect of the potentially dilutive securities and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution of securities by adding dilutive stock options and shares subject to repurchase to the weighted average number of common shares outstanding for the period.

A reconciliation of the numerator and denominator used in the calculation of basic and diluted net income per share is as follows (in thousands, except per share data):

	Three months ended June 30,		Six months ended June 30,	
	2004	**2003**	**2004**	**2003**
	(unaudited)		**(unaudited)**	
Calculation of basic net income (loss) per share:				
Net income (loss)	$ (854)	$ 747	$ 1,372	$ 1,643
Weighted average common shares outstanding	27,394	26,488	$ 27,260	26,569
Net income (loss) per share, basic	$ (.03)	$ 0.03	$ .05	$ 0.06
Calculation of diluted net income (loss) per share:				
Net income (loss)	$ (854)	$ 747	$ 1,372	$ 1,643
Weighted average - common shares outstanding	27,394	26,488	27,260	26,569
Dilutive securities - common stock options and non vested stock		1,724	1,924	1,675
Weighted average - common and common equivalent shares outstanding	27,394	28,212	29,184	28,244
Net income (loss) per share, diluted	$ (.03)	$ 0.03	$ .05	$ 0.06
Anti-dilutive common stock options and non-vested common sock not included in net income (loss) per share calculation	4,408	1,605	695	1,581
Average stock price used in earnings per share calculation	$ 12.62	$ 6.90	$ 13.08	$ 6.63

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NOTE 5 ACCOUNTING FOR GOODWILL AND OTHER INTANGIBLE ASSETS

Between January 1, 2004 and June 30, 2004, there were no changes to the Company s goodwill balance of $10.3 million. There can be no assurance, however, that a material impairment charge will not be recorded in the future.

Other intangible assets subject to amortization consist of purchased technology that is being amortized over a period of four years as follows (in thousands):

	As of June 30, 2004			As of December 31, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
		(unaudited)			(unaudited)	
Other intangible assets:						
Purchased technology	$ 3,230	$ 2,942	$ 288	$ 3,230	$ 2,538	$ 692

The other intangible assets will be fully amortized in 2004.

NOTE 6- CAPITALIZED SOFTWARE

The Company accounts for certain software development costs, including purchased software, in accordance with SFAS No. 86, Accounting for Costs of Computer Software to be Sold, Leased or Otherwise Marketed. For the three and six months ended June 30, 2004, the Company capitalized $15,000. For the comparable periods in 2003, the Company capitalized $170,000 and $275,000, respectively. Capitalized software costs subject to amortization consist of technology that is being amortized over a period of 36 months. The remaining lives of the capitalized software at June 30, 2004 are between 1.25 and 2.25 years. The software development costs are as follows (in thousands):

	As of June 30, 2004			As of December 31, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
		(unaudited)			(unaudited)	
Capitalized software	$ 6,238	$ 3,760	$ 2,478	$ 6,223	$ 2,783	$ 3,440

The net capitalized software costs are classified as Other assets on the Company s balance sheet.

NOTE 7 RESTRUCTURING AND IMPAIRMENT LOSS

During the three months ended June 30, 2004, the Company recorded a restructuring and impairment charge of $4.1 million related to the restructuring and consolidation of our office leases in San Francisco. The restructuring charge is based on the net present value of the Company s future contractual lease obligations net of contractual sublease income, as well as incidental costs related to the restructuring.

In, addition to the restructuring provision, the Company abandoned approximately $680,000 of leasehold improvements and excess furniture and fixtures.

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A summary of the restructuring accrual is as follows (in thousands):

	Facility Leases, Net of Sublease Income	Write Down of Leasehold Improvements	Other Restructuring Expenses	Total
		(unaudited)		
Balance as of December 31, 2003	$ 413	$	$	$ 413
Net cash payments in the six months ended June 30, 2004	(265)		(200)	(465)
Restructuring and impairment charges	2,822	680		