

INTERVOICE INC  
Form 10-Q  
July 06, 2007

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

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED  
May 31, 2007

OR

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

Commission file number: 1-15045

INTERVOICE, INC.

(Exact name of registrant as specified in its charter)

TEXAS

(State or other jurisdiction of  
incorporation or organization)

75-1927578

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

17811 WATERVIEW PARKWAY, DALLAS, TX

(Address of principal executive offices)

75252

(Zip Code)

972-454-8000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-Accelerated Filer

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

Yes  No

The Registrant had 38,907,646 shares of common stock, no par value per share, outstanding as of June 25, 2007.

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Certification of CFO Pursuant to Rule 13a-14(b)

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**INTERVOICE, INC.  
CONSOLIDATED BALANCE SHEETS

|   | (In Thousands, Except Share and Per<br>Share Data) |                      |
|---|--|----------------------|
|   | May 31, 2007<br>(Unaudited)                        | February 28,<br>2007 |
| <b>ASSETS</b>   |  |                      |
| Current Assets  |  |                      |
| Cash and cash equivalents   | \$ 40,754  | \$ 28,215            |
| Trade accounts receivable, net of allowance for doubtful accounts of<br>\$1,345 in fiscal 2008 and \$1,476 in fiscal 2007 | 28,508   | 36,837               |
| Inventory   | 16,892   | 13,751               |
| Prepaid expenses and other current assets   | 3,662  | 3,909                |
| Income taxes receivable   | 624  | 1,098                |
| Deferred income taxes   | 4,480  | 3,880                |
|   | 94,920   | 87,690               |
| Property and Equipment, net of accumulated depreciation of \$64,753<br>in fiscal 2008 and \$62,419 in fiscal 2007         | 34,162   | 34,429               |
| Other Assets  |  |                      |
| Intangible assets, net of accumulated amortization of \$20,789 in<br>fiscal 2008 and \$20,040 in fiscal 2007              | 8,924  | 9,505                |
| Goodwill  | 32,193   | 32,193               |
| Long term deferred income taxes   | 2,688  | 4,613                |
| Other assets  | 142  | 135                  |
|   | \$ 173,029   | \$ 168,565           |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |  |                      |
| Current Liabilities   |  |                      |
| Accounts payable  | \$ 15,762  | \$ 12,881            |
| Accrued expenses  | 13,176   | 15,571               |
| Customer deposits   | 4,306  | 4,365                |
| Deferred income   | 37,951   | 32,368               |
| Deferred income taxes   | 322  | 196                  |
|   | 71,517   | 65,381               |
| Stockholders Equity   |  |                      |

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Preferred stock, \$100 par value 2,000,000 shares authorized: none issued

Common stock, no par value, at nominal assigned value 62,000,000 shares authorized: 38,866,893 issued and outstanding in fiscal 2008 and 38,727,628 issued and outstanding in fiscal 2007

|                                      |            |            |
|--------------------------------------|------------|------------|
|                                      | 19         | 19         |
| Additional capital                   | 103,217    | 101,608    |
| Retained earnings (deficit)          | (1,559)    | 1,861      |
| Accumulated other comprehensive loss | (165)      | (304)      |
|                                      | 101,512    | 103,184    |
|                                      | \$ 173,029 | \$ 168,565 |

See notes to consolidated financial statements.

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INTERVOICE, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

|   | (In Thousands, Except Per Share<br>Data) |                 |
|---|--|-----------------|
|   | Three Months Ended                       |                 |
|   | May 31,<br>2007                          | May 31,<br>2006 |
| Sales   |  |                 |
| Solutions   | \$ 21,702                                | \$ 19,469       |
| Recurring services                                    | 26,029                                   | 26,199          |
|   | 47,731                                   | 45,668          |
| Cost of goods sold                                    |  |                 |
| Solutions   | 15,182                                   | 12,304          |
| Recurring services                                    | 7,291                                    | 7,474           |
|   | 22,473                                   | 19,778          |
| Gross margin  |  |                 |
| Solutions   | 6,520                                    | 7,165           |
| Recurring services                                    | 18,738                                   | 18,725          |
|   | 25,258                                   | 25,890          |
| Research and development expenses                     | 5,317                                    | 5,782           |
| Selling, general and administrative expenses          | 20,693                                   | 20,800          |
| Amortization of acquisition related intangible assets | 695                                      | 581             |
| Income (loss) from operations                         | (1,447)                                  | (1,273)         |
| Interest income                                       | 590                                      | 499             |
| Other income (expense)                                | (144)                                    | 207             |
| Income (loss) before taxes                            | (1,001)                                  | (567)           |
| Income taxes (benefit)                                | (128)                                    | (162)           |
| Net income (loss)                                     | \$ (873)                                 | \$ (405)        |
| Net income (loss) per share basic                     | \$ (0.02)                                | \$ (0.01)       |

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|  |           |           |
|--|-----------|-----------|
| Shares used in basic per share computation   | 38,807    | 38,504    |
| Net income (loss) per share diluted          | \$ (0.02) | \$ (0.01) |
| Shares used in diluted per share computation | 38,807    | 38,504    |

See notes to consolidated financial statements.

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INTERVOICE, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|  | (In Thousands)     |              |
|--|--------------------|--------------|
|  | Three Months Ended |              |
|  | May 31,<br>2007    | May 31, 2006 |
| Operating activities   |                    |              |
| Net income (loss)  | \$ (873)           | \$ (405)     |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                    |              |
| Depreciation and amortization  | 3,035              | 2,678        |
| Non-cash compensation expense  | 1,008              | 1,381        |
| Change in accounts receivable  | 8,337              | 59           |
| Other changes in operating activities  | 2,573              | 314          |
| Net cash provided by operating activities  | 14,080             | 4,027        |
| Investing activities   |                    |              |
| Purchases of property and equipment  | (2,142)            | (4,407)      |
| Purchase of Edify Corporation  |                    | (836)        |
| Net cash used in investing activities  | (2,142)            | (5,243)      |
| Financing activities   |                    |              |
| Exercise of stock options  | 601                | 149          |
| Net cash provided by financing activities  | 601                | 149          |
| Effect of exchange rates on cash   |                    | 453          |
| Increase (decrease) in cash and cash equivalents   | 12,539             | (614)        |
| Cash and cash equivalents, beginning of period   | 28,215             | 42,076       |
| Cash and cash equivalents, end of period   | \$ 40,754          | \$ 41,462    |

See notes to consolidated financial statements.



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INTERVOICE, INC.  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
(Unaudited)  
(In Thousands, Except Share Data)

|  | Common Stock |        | Additional<br>Capital | Retained<br>Earnings<br>(Deficit) | Accumulated<br>Other<br>Comprehensive | Total      |
|--|--------------|--------|-----------------------|-----------------------------------|---------------------------------------|------------|
|  | Shares       | Amount |                       |                                   | Loss                                  |            |
| Balance at February 28,<br>2007            | 38,727,628   | \$ 19  | \$ 101,608            | \$ 1,861                          | \$ (304)                              | \$ 103,184 |
| Net income (loss)                          |              |        |                       | (873)                             |                                       | (873)      |
| Foreign currency<br>translation adjustment |              |        |                       |                                   | 139                                   | 139        |
| Comprehensive income                       |              |        |                       |                                   |                                       | (734)      |
| Cumulative effect of<br>adopting FIN48     |              |        |                       | (2,547)                           |                                       | (2,547)    |
| Exercise of stock<br>options               | 139,265      |        | 601                   |                                   |                                       | 601        |
| Non-cash compensation                      |              |        | 1,008                 |                                   |                                       | 1,008      |
| Balance at May 31,<br>2007                 | 38,866,893   | \$ 19  | \$ 103,217            | \$ (1,559)                        | \$ (165)                              | \$ 101,512 |

See notes to consolidated financial statements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**THREE MONTHS ENDED MAY 31, 2007**

**Note A Basis of Presentation**

We have prepared the accompanying consolidated financial statements in accordance with generally accepted accounting principles for interim financial information. The consolidated balance sheet at February 28, 2007 has been derived from audited financial statements at that date. We believe we have included all adjustments necessary for a fair presentation of the unaudited May 31, 2007 and 2006 consolidated financial statements. Such adjustments are of a normal recurring nature. These financial statements should be read in conjunction with our audited financial statements and related notes for the three years ended February 28, 2007 included in our Annual Report on Form 10-K. Our Annual Report is available on our website at [www.intervoice.com](http://www.intervoice.com). Our operating results for the three-month period ended May 31, 2007 are not necessarily indicative of the results that may be expected for our fiscal year ending February 29, 2008, as our results may be affected by a number of factors including the timing and ultimate receipt of orders from significant customers which continue to constitute a large portion of our sales, the sales channel mix of products and services sold, and changes in general economic conditions, any of which could have an adverse effect on our operations.

Our consolidated financial statements include the accounts of Intervoice, Inc. and our subsidiaries, all of which are directly or indirectly 100% owned by Intervoice, Inc. All significant intercompany transactions and accounts have been eliminated in consolidation. Financial statements of our foreign subsidiaries have been translated into U.S. dollars at current and average exchange rates. Resulting translation adjustments are recorded in stockholders' equity as a part of accumulated other comprehensive loss. Any foreign currency transaction gains and losses are included in the accompanying consolidated statements of operations. Our total comprehensive loss for the first quarter of fiscal 2008 was \$0.7 million and our total comprehensive income for the first quarter of fiscal 2007 was \$0.5 million. Total comprehensive income/loss is comprised of net income/loss and foreign currency translation adjustments.

**Note B Inventory**

Our inventory consists of the following (in thousands):

|                  | May 31,<br>2007 | February 28,<br>2007 |
|------------------|-----------------|----------------------|
| Purchased parts  | \$ 4,424        | \$ 4,475             |
| Work in progress | 12,468          | 9,276                |
|                  | \$ 16,892       | \$ 13,751            |

**Note C Property & Equipment**

Our property and equipment consisted of the following (in thousands):

|   | May 31,<br>2007 | February 28,<br>2007 |
|---|-----------------|----------------------|
| Land and buildings                          | \$ 17,411       | \$ 17,385            |
| Computer equipment and software             | 53,925          | 52,364               |
| Furniture and fixtures                      | 3,438           | 3,344                |
| Managed services equipment                  | 16,998          | 16,481               |
| Maintenance services equipment              | 7,143           | 7,274                |
|   | 98,915          | 96,848               |
| Less allowance for accumulated depreciation | 64,753          | 62,419               |
| Property and equipment, net                 | \$ 34,162       | \$ 34,429            |



**Table of Contents****Note D Stock-based Compensation**

Our stock-based employee compensation plans are fully described in Note J in our 2007 Annual Report on Form 10-K. The following is the effect of adopting SFAS 123R as of March 1, 2006 (in thousands):

|                                     | Three Months<br>Ended<br>May 31, 2007 | Three Months<br>Ended<br>May 31, 2006 |
|-------------------------------------|---------------------------------------|---------------------------------------|
| Cost of Goods Sold                  | \$ 201                                | \$ 263                                |
| R&D                                 | 130                                   | 150                                   |
| SG&A                                | 677                                   | 926                                   |
| Total                               | \$ 1,008                              | \$ 1,339                              |
| Related deferred income tax benefit | 342                                   | 389                                   |
| Decrease in net income              | \$ 666                                | \$ 950                                |
| Decrease in earning per share basic | \$ 0.02                               | \$ 0.02                               |

**Note E Special Charges***Fiscal 2008*

During the first quarter of fiscal 2008, we incurred approximately \$1.8 million associated with severance and organizational changes affecting approximately 45 positions. In addition, we reversed a facilities related charge of approximately \$0.3 million. The following table summarizes the effect on reported operating results by financial statement category of this restructuring charge activity for fiscal 2008 (in thousands):

|   | Cost of<br>Goods<br>Sold | Research<br>and<br>Development | Selling,<br>General<br>and<br>Administrative | Total    |
|---|--------------------------|--------------------------------|--|----------|
| Severance payments and related benefits | \$ 396                   | \$ 451                         | \$ 957                                       | \$ 1,804 |

Of the severance and related benefits, \$1.7 million remained accrued at May 31, 2007.

*Fiscal 2007*

Accrued expenses at February 28, 2007 included amounts associated with three severance and organizational changes affecting approximately 55 positions as well as special charges incurred in connection with the elimination of redundant office leases. Activity during the first quarter of fiscal 2008 related to such accruals was as follows (in thousands):

|   | Accrued<br>Balance<br>February 28,<br>2007 | Payments | Accrued<br>Balance<br>May 31, 2007 |
|---|--|----------|------------------------------------|
| Severance payments and related benefits | \$ 886                                     | \$ (469) | \$ 417                             |
| Facility costs                          | 134  |          | 134                                |
| Total                                   | \$ 1,020                                   | \$ (469) | \$ 551                             |

**Note F Income Taxes**

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For the three months ended May 31, 2007 our quarterly effective tax rate of 13% varies from the U.S. federal statutory rate primarily due to certain non-deductible expenditures, an increase in the valuation allowance associated with our U.K. deferred tax assets and the effect of non-U.S. income tax rates. Our U.K. deferred tax assets remain fully reserved accordingly, we did not recognize the tax benefit associated with our first quarter U.K. loss.

For the three months ended May 31, 2006, our quarterly effective tax rate differed from the U.S. federal statutory rate primarily due to expected benefits to be realized from the use of state net operating losses and certain foreign deferred tax assets for which we had not previously realized a benefit due to our uncertainty related to the utilization of those tax assets, and the effect of non-U.S. income tax rates.

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In June 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in enterprises' financial statements in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ( SFAS 109 ). The interpretation 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. Also, the interpretation provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, and we adopted the interpretation in the first quarter of fiscal 2008.

As a result of our adoption of FIN 48, we recognized a cumulative effect adjustment of \$2.5 million, increasing our liability for unrecognized tax benefits and related penalties and interest by \$0.3 million, decreasing our non-current deferred tax assets by \$2.2 million, and reducing the March 1, 2007 balance of retained earnings by \$2.5 million. As of the date of adoption, our unrecognized tax benefits totaled \$3.6 million, of which \$0.7 million, if recognized, would affect our effective tax rate. We do not anticipate a significant change to the total amount of unrecognized tax benefits over the next twelve months.

We conduct business globally and, as a result, we, or one or more of our subsidiaries, files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. In the normal course of business, we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the U.K., Germany, Canada and the United States. Although we believe our tax estimates and our tax positions are reasonable, the final outcome of tax audits could be materially different, both favorable and unfavorable. With few exceptions, we are no longer subject to U.S. federal income tax examinations for years before fiscal 2005, and state and local income tax examinations for years before fiscal 2004. With respect to our U.S. federal, state and local net operating loss ( NOL ) carryforwards, we have years open under statutes of limitations back to fiscal year 2002, where tax authorities may not adjust income tax liabilities for these years, but can reduce NOL carryforwards and other tax attribute carryforwards to future open tax years.

We recognize potential interest and penalties related to unrecognized tax benefits as interest expense and penalties expense, respectively. As of May 31, 2007, we have accrued less than \$0.1 million for the potential payment of interest and penalties related to uncertain tax positions.

**Note G Earnings Per Share**

| (in thousands, except per share data)      | Three Months Ended May |             |
|--|------------------------|-------------|
|  | 2007                   | 31,<br>2006 |
| Numerator:                                 |                        |             |
| Net income (loss)                          | \$ (873)               | \$ (405)    |
| Denominator:                               |                        |             |
| Denominator for basic earnings per share   | 38,807                 | 38,504      |
| Dilutive potential common shares:          |                        |             |
| Employee stock options                     |                        |             |
| Denominator for diluted earnings per share | 38,807                 | 38,504      |
| Net income per share:                      |                        |             |

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|         |           |           |
|---------|-----------|-----------|
| Basic   | \$ (0.02) | \$ (0.01) |
| Diluted | \$ (0.02) | \$ (0.01) |

Options to purchase 7,532,240 and 4,611,008 shares of common stock at an average exercise price of \$8.19 and \$10.04 per share were outstanding at May 31, 2007 and 2006, respectively, but were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive given our loss for the quarters.

**Table of Contents****Note H Operating Segment Information and Major Customers**

We operate as a single, integrated business unit. Our chief operating decision maker assesses performance and allocates resources on an enterprise wide basis. Our product line includes voice portal solutions, messaging solutions, payment solutions, maintenance and related services, and hosted solutions provided for customers on an outsourced or hosted solutions provider basis. We believe that product line distinction provides the most meaningful breakdown of quarterly and annual sales activity. Our net sales by product line for the three months ended May 31, 2007 and 2006 were as follows (in thousands):

|   | Three Months Ended May<br>31, |           |
|---|-------------------------------|-----------|
|   | 2007                          | 2006      |
| Voice portal solution sales               | \$ 13,249                     | \$ 13,744 |
| Messaging solution sales                  | 6,526                         | 3,718     |
| Payment solution sales                    | 1,927                         | 2,007     |
| Total solution sales                      | 21,702                        | 19,469    |
| Maintenance and related services revenues | 21,275                        | 20,185    |
| Hosted solutions revenues                 | 4,754                         | 6,014     |
| Total recurring services revenues         | 26,029                        | 26,199    |
| Total sales                               | \$ 47,731                     | \$ 45,668 |

**Geographic Operations**

We assign revenues to geographic areas based on the locations of our customers. Our net sales by geographic area for the three-month periods ended May 31, 2007 and 2006 were as follows (in thousands):

|                           | Three Months Ended May<br>31, |           |
|---------------------------|-------------------------------|-----------|
|                           | 2007                          | 2006      |
| North America             | \$ 31,164                     | \$ 27,041 |
| Europe                    | 8,251                         | 8,736     |
| Middle East and Africa    | 4,931                         | 3,077     |
| Central and South America | 1,036                         | 4,726     |
| Pacific Rim               | 2,349                         | 2,088     |
| Total                     | \$ 47,731                     | \$ 45,668 |

**Concentration of Revenue**

No customer accounted for 10% or more of our revenue for the quarter ended May 31, 2007. One customer, O2, accounted for approximately 10% of our revenue for the quarter ended May 31, 2006.

**Note I Contingencies****Intellectual Property Matters**

We generally provide our customers a qualified indemnity against the infringement of third party intellectual property rights. From time to time, various owners of patents and copyrighted works send us or our customers letters



alleging that our products do or might infringe upon the owner's intellectual property rights, and/or suggesting that we or our customers should negotiate a license or cross-license agreement with the owner. Our policy is to never knowingly infringe upon any third party's intellectual property rights. Accordingly, we forward any such allegation or licensing request to our outside legal counsel for their review, analysis and, where appropriate, opinion. We generally attempt to resolve any such matter by informing the owner of our position concerning non-infringement or invalidity, and/or, if appropriate, negotiating a license or cross-license agreement. Even though we attempt to resolve these matters without litigation, it is always possible that the owner of a patent or copyrighted work will sue us. Other than the current litigation with a patent holder discussed in "Pending Litigation" in this Note I, no such litigation is currently pending against us. We currently have a portfolio of 86 United States patents, and we have applied for and will continue to apply for and receive

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a number of additional patents to protect our technological innovations. We believe our patent portfolio could allow us to assert counterclaims for infringement against certain owners of intellectual property rights if those owners were to sue us for infringement.

From time to time Ronald A. Katz Technology Licensing L.P. ( RAKTL ) has sent letters to certain of our customers suggesting that the customer should negotiate a license agreement to cover the practice of certain patents owned by RAKTL. In the letters, RAKTL has alleged that certain of its patents pertain to certain enhanced services offered by network providers, including prepaid card and wireless services and postpaid card services. RAKTL has further alleged that certain of its patents pertain to certain call processing applications, including applications for call centers that route calls using a called party's DNIS identification number. As a result of the correspondence, many of Intervoice's customers have had discussions, or are in discussions, with RAKTL.

We offer certain products that can be programmed and configured to provide enhanced services to network providers and call processing applications for call centers. Our contracts with customers usually include a qualified obligation to indemnify and defend customers against claims that products as delivered by Intervoice infringe a third party's patent. None of our customers has notified us that RAKTL has claimed that any specific product provided by us infringes any claims of any RAKTL patent. Accordingly, we have not been required to defend any customers against a claim of infringement under a RAKTL patent. We have, however, received letters from customers notifying us of the efforts by RAKTL to license its patent portfolio and reminding us of our potential obligations under the indemnification provisions of our agreements in the event that a claim is asserted.

Some of our customers have licensed certain rights under the RAKTL patent portfolio. Two such customers who had previously attempted to tender the defense of their products to us informed us that they had entered into agreements to license certain rights under the RAKTL patents and demanded we indemnify them for unspecified amounts, including attorney's fees, paid in connection with the license agreements. We notified these customers that we believe we do not have any indemnity obligation in connection with the license agreements. We have received no further response from either customer.

A number of customers, including customers of ours and our Edify Corporation subsidiary ( Edify ) have been sued as defendants in several lawsuits brought by RAKTL in the United States District Court for the Eastern District of Texas and the United States District Court for the District of Delaware. Several of these defendants who are also customers have notified us or Edify of the lawsuits pursuant to the indemnity paragraphs of their respective sales agreements and have indicated to us that the lawsuits could potentially impact the defense and indemnity paragraphs of their respective sales agreements. Neither we nor Edify believe that we have a current obligation to defend or indemnify these customers in connection with the current allegations made in the RAKTL lawsuits and when contacted we have requested that the customers provide additional information concerning the assertions made by RAKTL.

In response to the correspondence from, and litigation initiated by, RAKTL, a few of our customers and customers of Edify have attempted to tender to us the defense of our products under contractual indemnity provisions. We have informed these customers that, while we fully intend to honor any contractual indemnity provisions, we do not believe we currently have any obligation to provide such a defense because RAKTL does not appear to have made a claim, either in the correspondence or litigation, that any Intervoice product infringes a RAKTL patent. Some of these customers have disagreed with us and stated that they believe that the statements and allegations contained within correspondence and/or litigation pleadings filed by RAKTL can be construed as a claim against Intervoice products.

Even though no claims have been made by RAKTL that a specific product offered by Intervoice infringes any claim under the RAKTL patent portfolio, we have received opinions from our outside patent counsel that certain products and applications we offer do not infringe certain claims of the RAKTL patents. We have also received opinions from our outside counsel that certain claims under the RAKTL patent portfolio are invalid or unenforceable. Furthermore, based on the reviews by outside counsel, we are not aware of any valid and enforceable claims under the RAKTL portfolio that are infringed by our products. If we do become involved in litigation in connection with the RAKTL patent portfolio, under a contractual indemnity or any other legal theory, we intend to vigorously contest the claims and to assert appropriate defenses.

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We have received letters from Webley Systems ( Webley ), a division of Parus Holdings, Inc. ( Parus ), and its counsel alleging that certain Webley patents cover one or more of our products and services. In the letters, Parus offers a license to the Webley patents. As a result of the correspondence, we conducted

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discussions with Parus. We have not had any recent discussions with Parus. Based on reviews by our outside counsel, we are not aware of any valid and enforceable claims under the Webley patents that are infringed by our products or services.

**Pending Litigation**

*David Barrie, et al., on Behalf of Themselves and All Others Similarly Situated v. InterVoice-Brite, Inc., et al.*, No. 3-01CV1071-D, pending in the United States District Court, Northern District of Texas, Dallas Division:

Several related class action lawsuits were filed in the United States District Court for the Northern District of Texas on behalf of purchasers of common stock of Intervoice during the period from October 12, 1999 through June 6, 2000 (the Class Period). Plaintiffs have filed claims, which were consolidated into one proceeding, under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the Exchange Act) and Securities and Exchange Commission (SEC) Rule 10b-5 against us as well as certain named current and former officers and directors of Intervoice on behalf of the alleged class members. In the complaint, Plaintiffs claim that we and the named current and former officers and directors issued false and misleading statements during the Class Period concerning the financial condition of Intervoice, the results of the merger with Brite and the alleged future business projections of Intervoice. Plaintiffs have asserted that these alleged statements resulted in artificially inflated stock prices.

The District Court dismissed the Plaintiffs' complaint because it lacked the degree of specificity and factual support to meet the pleading standards applicable to federal securities litigation. The Plaintiffs' appealed the dismissal to the United States Court of Appeals for the Fifth Circuit, which affirmed the dismissal in part and reversed in part. The Fifth Circuit remanded a limited number of issues for further proceedings in the District Court.

On September 26, 2006, the District Court granted the Plaintiffs' motion to certify a class of people who purchased Intervoice stock during the Class Period. On November 14, 2006, the Fifth Circuit granted our petition to appeal the District Court's decision to grant Plaintiffs' motion to certify a class. The briefing on the merits of our appeal is now complete, and we are currently waiting for the Fifth Circuit to either schedule oral argument or issue a ruling on the merits. We filed a motion to stay further discovery pending the Fifth Circuit's decision on the merits of our appeal, but the District Court denied our motion. We are in the process of continuing to produce documents in response to the Plaintiffs' requests for production. We believe that we and our officers and directors complied with the applicable securities laws and will continue to vigorously defend the case.

*Phoenix Solutions, Inc. vs. Sony Electronics, Inc.*, Case No. C07-2112 (EMC), pending in the United States District Court for the Northern District of California, San Francisco Division: On December 13, 2006, Phoenix Solutions, Inc. (Phoenix) filed suit against Sony Electronics, Inc. (Sony) in the United States District Court for the Central District of California for infringement of U.S. Patent Nos. 6,615,172, 6,633,846, 6,665,640 and 7,050,977. On February 9, 2007, Sony filed its answer to Phoenix's claims of infringement, denied any liability and filed a counterclaim alleging that the patents were neither valid nor infringed by Sony. On February 26, 2007, Sony filed a third party complaint against the Company for alleged breach of warranty of title and the warranty against infringement related to the claims of infringement made by Phoenix against Sony. In its third party complaint, Sony seeks to recover actual damages suffered by it in the event a final judgment is entered against Sony or it is otherwise liable for any damages, fees or costs arising out of the claims of patent infringement made by Phoenix against the Sony interactive voice response system. On April 9, 2007, the Company filed its motion to dismiss the third party complaint. The trial court recently transferred the case to the United States District Court for the Northern District of California, San Francisco Division, and the case is now styled *Phoenix Solutions, Inc. vs. Sony Electronics, Inc.*, Case No. C07-2112 (EMC). The Court will hold a hearing on September 10, 2007 with respect to our motion. In the event that the court does not grant the pending motion to dismiss, the Company intends to vigorously defend itself against any and all claims made against it.

**Audit Committee Investigation**

During fiscal 2005, our Audit Committee conducted an investigation of certain transactions that occurred during our fiscal years 2000 through 2002. The Audit Committee was assisted in its investigation by separate independent legal counsel and a national accounting firm. The Audit Committee reported the results of its investigation to the SEC, and we are cooperating with the SEC in its own investigation regarding the transactions. We have provided documents to the SEC in response to a subpoena and informal requests for



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information about the transactions, and several of our current and former officers and non-officer employees have provided testimony to the SEC. Our Audit Committee and its counsel are continuing to monitor our response to the SEC, and they also have conducted a review of certain documents provided to the SEC which we located after the Audit Committee's original investigation. Intervoice is presently in discussions with the SEC about a possible settlement of the matters covered by the Audit Committee investigation, but there is no assurance that agreement on any settlement will be reached. Based upon the current status of such settlement discussions, we recorded expense of approximately \$0.9 million during the fourth quarter of fiscal 2007. We are also honoring our obligation to indemnify, to the extent appropriate, certain current and former officers and other employees of Intervoice, including our Chief Executive Officer, who received subpoenas to produce documents and provide testimony to the SEC in connection with the investigation. Furthermore, we are honoring our obligation to reimburse legal fees incurred by certain recipients of the subpoenas. We understand that one of our former officers recently entered into an agreement in connection with this investigation pursuant to which he agreed to pay certain amounts in settlement of claims asserted by the SEC. We have not, and do not, intend to pay or reimburse any amounts paid in settlement by this officer.

The Audit Committee investigation found that we accounted for certain transactions incorrectly during our fiscal years 2000 through 2002. The Audit Committee investigation concluded that a \$0.9 million payment made by Intervoice to a publicly held supplier purportedly for certain prepaid licenses was linked to an agreement to amend a 1997 warrant issued to us by the supplier to permit our cashless exercise of the warrant. As a result, we believe the \$0.9 million payment should have been recorded as a reduction in the \$21.4 million gain we recognized on the sale of the shares underlying the warrant during the fourth quarter of fiscal 2001 and should not have been recorded as prepaid license inventory. Our payment to the supplier may have rendered unavailable a nonexclusive registration exemption for the sale of the shares underlying the warrant. The Audit Committee investigation also found that we intentionally provided the same supplier false or misleading documents for such supplier to use to support such supplier's improper recognition of revenue in calendar 2001.

The Audit Committee investigation and review further found that six of the seven customer sales transactions the Committee investigated were accounted for incorrectly and that there was intentional misconduct in at least one of those sales transactions. These six transactions occurred at the end of quarters in which we just met analysts' expectations with respect to earnings per share. The Audit Committee found that we improperly recognized revenue in a quarter-end barter transaction involving approximately 0.4% of annual revenues for fiscal 2000, and that we improperly accelerated the recognition of revenue in five quarter-end transactions totaling approximately 0.4% and 0.3% of annual revenues in fiscal 2000 and fiscal 2002, respectively. We, and certain of our current and former officers and the SEC have agreed that Intervoice and the officers will not assert any defenses based on a statute of limitations with respect to any action or proceeding against us or such officers brought, by or on behalf of the SEC arising out of the SEC investigation for the time periods set forth in the agreements. As a result of work performed in responding to the SEC subpoena, the Audit Committee has concluded that Intervoice also improperly recognized approximately \$5.4 million of revenue in two sales transactions during the second and third quarters of fiscal 2002 because the transactions were subject to oral side agreements that gave our customer expanded rights of return. We subsequently reversed the \$5.4 million of revenue during the fourth quarter of fiscal 2002 in connection with a return of the related systems. We also provided documents to the SEC concerning these two additional sales transactions pursuant to a separate subpoena. Separately, the Audit Committee determined that in September 2001 one of our current executive officers improperly communicated Intervoice information to a shareholder.

Our management has concluded, with the concurrence of the Audit Committee and our external auditors, that restatement of our prior period financial statements to adjust for the findings of the Audit Committee investigation and review is not necessary. In reaching this conclusion, we considered the impact of the incorrect accounting on each of the periods affected, the ages of the affected financial statements and the lack of any material changes in prior period trends as a result of the incorrect accounting. In addition, we noted that since the date of the most recent transaction reviewed in the investigation, we have restructured our business, made significant management changes, consolidated our physical operations, significantly reduced our fixed operating costs and refinanced and repaid all of our major debt obligations. We cannot predict whether we may have future losses relating to the matters investigated by the Audit Committee as a result of future claims, if any, including any claims by the government.

**Other Matters**

We are a defendant from time to time in lawsuits incidental to our business. Based on currently available information, we believe that resolution of the lawsuits and other matters described above, is uncertain, and

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there can be no assurance that future costs related to such matters would not be material to our financial position or results of operations.

We are a party to many routine contracts in which we provide general indemnities and warranties in the normal course of business to third parties for various risks. These indemnities and warranties are discussed in the following paragraphs. Except in specific circumstances where we have determined that the likelihood of loss is probable and the amount of the loss quantifiable, we have not recorded a liability for any of these indemnities. In general, we are not able to estimate the potential amount of any liability relating to these indemnities and warranties.

Many of our contracts, particularly for hosted solutions, foreign contracts and contracts with telecommunication companies, include provisions for the assessment of damages for delayed project completion and/or for our failure to achieve certain minimum service levels. We have had to pay damages in the past and may have to pay additional damages in the future. Any such future damages could be significant.

Our contracts with our customers generally contain qualified indemnifications against third party claims relating to the infringement of intellectual property as described in *Intellectual Property Matters* above.

Our contracts with our customers also generally contain warranties and, in some cases, general indemnifications against other unspecified third party and general liability claims. We have liability insurance protecting us against certain obligations, primarily certain claims related to property damage, that result from these indemnities.

We are obligated under letters of credit totaling approximately \$0.5 million issued by a bank to guarantee our performance under a long-term international managed services contract and related proposals. These letters of credit expire during fiscal 2008 and fiscal 2009.

We had employment agreements with our three most senior executive officers (President and Chief Executive Officer, Executive Vice President and Chief Financial Officer and Executive Vice President and Chief Operating Officer), three other officers and eight senior vice presidents at May 31, 2007. One agreement with a senior executive officer requires us to make termination payments to the officer of one and one-half times the officer's annual base compensation in the event the officer's services are terminated without cause or payments of up to 2.99 times the officer's annual compensation including bonuses in connection with a termination of the officer's services within a two year period following a change in ownership of Intervoice, as defined in the agreement. If the officer with such agreement were terminated for one of the preceding reasons during fiscal 2008, we would incur costs ranging from \$0.6 million to \$1.2 million. The agreements with two other senior executive officers require us to make termination payments of one and one-half times the officer's annual base compensation in the event the officer's services are terminated without cause or payments of up to two times the officer's annual base compensation including bonuses in connection with a termination of the officer's services within an 18 month period following a change in ownership of Intervoice, as defined in the agreements. If both of these officers were terminated for one of the preceding reasons during fiscal 2008, we would incur costs ranging from \$0.9 million to \$1.2 million. The remaining agreements with other officers provide for their employment through December 2007 for one of the officers and through August 2008 with respect to the remaining two officers. If we terminated these officers prior to the expiration of their contracts, we would owe them the greater of their compensation for the unexpired term of the contracts or one-half of their annual compensation under the contract. If these three other officers were terminated during fiscal 2008, we would incur costs ranging from \$0.5 million to \$0.6 million. The eight agreements with senior vice presidents were effective March 1, 2007 with two year initial terms. In the event of a Corporate Change as defined in the agreement, for any executive that has less than one year remaining in the employment term, the employment term would be automatically be extended to be effective through the date that is one year following the effective date of the Corporate Change. In the event that these agreements were terminated without cause, the executive would be entitled to his or her base salary for a period of 12 months following the termination date. One such senior vice president was terminated without cause on April 26, 2007 with an effective termination date of July 27, 2007. We incurred costs of \$0.2 million related to this termination during the first quarter of fiscal 2008. If the remaining seven senior vice presidents were terminated during fiscal 2008, we would incur costs of approximately \$1.5 million.

Under the terms of our Articles of Incorporation, we indemnify our directors, officers, employees or agents or any other person serving at our request as a director, officer, employee or agent of another corporation in connection with a derivative suit if he or she (1) is successful on the merits or otherwise or (2) acted in good faith, and in a manner he



or she reasonably believed to be in or not opposed to the best interests of the corporation. We will not provide indemnification, however, for any claim as to which the person was adjudged liable for negligence or misconduct unless the court determines that under the circumstances the person is fairly and reasonably entitled to indemnification. We provide the same category of persons with indemnification in a non-derivative suit only if such person (1) is successful on the merits or otherwise or (2) acted in good faith, and in a manner he or she reasonably believed to be in or not opposed to the best interests of the corporation,

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and with respect to any criminal action or proceeding, had no reason to believe his or her conduct was unlawful. Under the terms of our Bylaws, we also indemnify our current and former officers and directors to the fullest extent permitted or required under Article 2.02-1 of the Texas Business Corporation Act ( Article 2.02-1 ).

In connection with certain lawsuits filed against us and certain of our present and former officers and directors (see Pending Litigation above), we have agreed to pay in advance any expenses, including attorneys' fees, incurred by such present and former officers and directors in defending such litigation, in accordance with Article 2.02-1 and our Articles of Incorporation and Bylaws. Each of these parties has provided us with a written undertaking to repay us the expenses advanced if the person is ultimately not entitled to indemnification.

We have a qualified obligation to indemnify certain current and former officers and other employees of Intervoice in connection with activities resulting from the Audit Committee investigation and related SEC inquiries described in Audit Committee Investigation above.

Texas corporations are authorized to obtain insurance to protect officers and directors from certain liabilities, including liabilities against which the corporation cannot indemnify its officers and directors. We have obtained liability insurance for our officers and directors as permitted by Article 2.02-1. Our insurance policies provide coverage for losses and expenses incurred by us and our current and former directors and officers in connection with claims made under the federal securities laws. These policies, however, exclude losses and expenses related to the Barrie class action lawsuit, or to other litigation based on claims that are substantially the same as those in the Barrie class action, and contain other customary provisions to limit or exclude coverage for certain losses and expenses.

**Note J Subsequent Event (Unaudited)**

On May 31, 2007, we became aware of the intention of a shareholder to solicit proxies to elect an alternate slate of nominees to the seven-member Intervoice Board of Directors. Following a series of negotiations, effective June 22, 2007, three existing board members resigned at the request of the Company to accommodate resolution of the proxy contest, and these vacancies on the Board were filled by the election of three of the nominees from the alternate slate put forth by the shareholder. We have agreed to reimburse the shareholder up to \$0.5 million for expenses incurred. In addition, we expect to incur additional expense related to this proxy action totaling up to another \$0.5 million.

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

**Critical Accounting Policies.** In preparing our consolidated financial statements in conformity with accounting principles generally accepted in the United States, we use estimates and projections that affect the reported amounts and related disclosures and that may vary from actual results. Our critical accounting policies are discussed fully in the Annual Report on Form 10-K for the year ended February 28, 2007.

**Sales.** We operate as a single, integrated business unit. Our chief operating decision maker assesses performance and allocates resources on an enterprise wide basis. Our product line includes voice portal solutions, messaging solutions, payment solutions, maintenance and related services, and hosted solutions provided for customers on an outsourced or hosted solution provider basis. We believe that product line distinction provides the most meaningful breakdown of quarterly and annual sales activity. Our net sales by product line for the three months ended May 31, 2007 and 2006 were as follows (in thousands):

|   | Three Months Ended May 31, |                  |                  |
|---|----------------------------|------------------|------------------|
|   |                            | % Change<br>From |                  |
|   | 2007                       | Prior Year       | 2006             |
| Voice portal solution sales               | \$ 13,249                  | (3.6)%           | \$ 13,744        |
| Messaging solution sales                  | 6,526                      | 75.5%            | 3,718            |
| Payment solution sales                    | 1,927                      | (4.0)%           | 2,007            |
| <b>Total solution sales</b>               | <b>21,702</b>              | <b>11.5%</b>     | <b>19,469</b>    |
| Maintenance and related services revenues | 21,275                     | 5.4%             | 20,185           |
| Hosted solutions revenues                 | 4,754                      | (21.0)%          | 6,014            |
| <b>Total recurring services revenues</b>  | <b>26,029</b>              | <b>(0.6)%</b>    | <b>26,199</b>    |
| <b>Total Sales</b>                        | <b>\$ 47,731</b>           | <b>4.5%</b>      | <b>\$ 45,668</b> |

We assign revenues to geographic areas based on the locations of our customers. Our net sales by geographic area for the three-month periods ended May 31, 2007 and 2006 were as follows (in thousands):

|                           | Three Months Ended May 31, |                  |                  |
|---------------------------|----------------------------|------------------|------------------|
|                           |                            | % Change<br>From |                  |
|                           | 2007                       | Prior Year       | 2006             |
| North America             | \$ 31,164                  | 15.2%            | \$ 27,041        |
| Europe                    | 8,251                      | (5.6)%           | 8,736            |
| Middle East and Africa    | 4,931                      | 60.3%            | 3,077            |
| Central and South America | 1,036                      | (78.1)%          | 4,726            |
| Pacific Rim               | 2,349                      | 12.5%            | 2,088            |
| <b>Total</b>              | <b>\$ 47,731</b>           | <b>4.5%</b>      | <b>\$ 45,668</b> |

International sales comprised 35% of our total sales during the first quarter of fiscal 2008, down from 40% during the first quarter of fiscal 2007.

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Total sales for the first quarter of fiscal 2008 increased 4.5% as compared to the first quarter of fiscal 2007. Messaging solution sales increased 75.5% as we began to recognize revenue on the significant projects booked at the end of fiscal 2007 including \$3.3 million recognized under one \$10.3 million media exchange contract entered into in February 2007. Messaging solution sales for the first quarter of fiscal 2007 included approximately \$0.7 million of revenue under the first two contracts for our new media exchange product. Our sales of payment solutions continue to primarily reflect sales of capacity upgrades to existing customers.

The increase in our maintenance and related services revenues in the first quarter of fiscal 2008 as compared to the first quarter of fiscal 2007 is comprised of increases of \$0.8 million (4.4%) in maintenance

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revenues on voice automation/IVR solutions and \$0.3 million (28.0%) in maintenance revenues on messaging solutions.

The 21.0% decrease in hosted solutions revenue in the first quarter of fiscal 2008 compared to the first quarter of fiscal 2007 resulted primarily from the July 2006 expiration of one international long term hosted solutions contract. Revenue under this contract totaled approximately \$1.9 million during the first quarter of fiscal 2007. This decline was partially offset by growth in our voice portal hosted solutions sales.

No customer accounted for 10% or more of our revenue during the first quarter of fiscal 2008. One customer, O2, accounted for approximately 10% of our revenue during the quarter ended May 31, 2006.

We are prone to quarterly fluctuations. Some of our transactions are completed in the same fiscal quarter as ordered. The quantity and size of large sales (sales valued at approximately \$2.0 million or more) during any quarter can cause wide variations in our quarterly sales and earnings, as such sales are unevenly distributed throughout the fiscal year. We use a system combining estimated sales from our recurring services contracts, our backlog of committed solutions orders and our pipeline of solutions sales opportunities to estimate sales and trends in our business. For the quarters ended May 31, 2007 and 2006, sales were sourced as follows:

|   | Three Months Ended May |      |
|---|------------------------|------|
|   | 2007                   | 2006 |
| Sales from recurring services and support contracts, including contracts for hosted solutions | 55%                    | 58%  |
| Sales from beginning solutions backlog  | 33%                    | 29%  |
| Sales from the quarter's pipeline   | 12%                    | 13%  |
|   | 100%                   | 100% |

Our service and support contracts range in original duration from one month to five years, with most hosted solutions contracts having initial terms of two to three years and most maintenance and related contracts having initial terms of one year. Because many of the longer duration contracts give customers early cancellation privileges, we do not consider our book of services contracts to be reportable backlog, as a portion of the potential revenue reflected in the contract values may never be realized. Nevertheless, it is easier for us to estimate service and support revenues than to estimate solutions sales for the next quarter because the service and support contracts generally span multiple quarters and revenues recognized under each contract are generally similar from one quarter to the next.

Our backlog is made up of customer orders for solutions for which we have received complete purchase orders. Backlog as of the end of our last five fiscal quarters was as follows (in thousands):

| Quarter Ended     | Backlog  |
|-------------------|----------|
| May 31, 2007      | \$60,411 |
| February 28, 2007 | \$54,115 |
| November 30, 2006 | \$46,345 |
| August 31, 2006   | \$41,639 |
| May 31, 2006      | \$41,221 |

We generally expect all projects in our existing backlog to be initiated within the next twelve months and most of such backlog to be recognized as revenue within twelve months. Approximately 20% of such backlog could convert to revenue subsequent to twelve months. The accuracy of any estimate of future sales is dependent, in part, on our ability to project the amount of revenue to be contributed from beginning solutions backlog during any fiscal quarter. Our ability to estimate the amount of backlog that will be converted to revenue in any fiscal quarter can be affected by factors outside our control, including changes in project timing requested by our customers and cash collections from certain international customers. Approximately 30% of our solutions backlog at May 31, 2007 is associated with customers for which revenue is recognized on a cash basis which impacts the time between project completion and

revenue recognition.

Our pipeline of opportunities for solutions sales is the aggregation of our sales opportunities for which we have not received a purchase order, with each opportunity evaluated for the date the potential customer will make a purchase decision, competitive risks, and the potential amount of any resulting sale. No matter how promising a pipeline opportunity may appear, there is no assurance it will ever result in a sale. Accordingly, upward or downward trends in our total pipeline are not considered meaningful from a financial analysis

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perspective. While we incorporate an estimate of sales from pipeline into our business planning and budgeting, pipeline estimates are necessarily speculative and may not consistently correlate to solutions sales in a particular quarter or over a longer period of time. While we know the amount of solutions backlog available at the beginning of a quarter, we must speculate on our pipeline of solutions opportunities for the quarter. Our accuracy in estimating total solutions sales for the next fiscal quarter is, therefore, highly dependent upon our ability to successfully estimate which pipeline opportunities will close during the quarter.

**Cost of Goods Sold.** Cost of goods sold was comprised of the following for the quarters ended May 31, 2007 and 2006 (in thousands):

|                                    | Three Months Ended May 31, |           |
|------------------------------------|----------------------------|-----------|
|                                    | 2007                       | 2006      |
| Solutions COGS                     | \$ 15,182                  | \$ 12,304 |
| As percentage of solutions sales   | 70.0%                      | 63.2%     |
| Services COGS                      | \$ 7,291                   | \$ 7,474  |
| As percentage of services revenues | 28.0%                      | 28.5%     |
| Total COGS                         | \$ 22,473                  | \$ 19,778 |
| As percentage of total sales       | 47.1%                      | 43.3%     |

The increase in solutions cost of goods sold as a percentage of solutions sales in the first quarter of fiscal 2008 as compared to the first quarter of fiscal 2007 was negatively impacted by the work performed during the first quarter of fiscal 2008 on the \$10.3 million media exchange contract entered into in February 2007. We realized no net margin on approximately \$3.3 million of revenue recognized under this contract and provided an additional loss provision of approximately \$0.2 million during the first quarter of fiscal 2008.

**Research and Development Expenses.** Research and development expenses for the quarters ended May 31, 2007 and 2006 were as follows (in thousands):

|                                   | Three Months Ended May 31, |          |
|-----------------------------------|----------------------------|----------|
|                                   | 2007                       | 2006     |
| Research and development expenses | \$ 5,317                   | \$ 5,782 |
| As percentage of total sales      | 11.1%                      | 12.7%    |

Research and development expenses are lower during the first quarter of fiscal 2008 because the development effort of approximately \$1.2 million related to the large media exchange contract we entered into during the fourth quarter of fiscal 2007 is charged to cost of goods sold rather than research and development expenses. This reduction is offset, in part, by increased resources required to support the technology acquired from Nuasis during the third quarter of fiscal 2007. Research and development expenses include the design of new products and the enhancement of existing products.

Our research and development spending is focused in six key areas. First, we are developing software tools to aid in the development and deployment of customer applications incorporating speech recognition, text-to-speech, and other rich media technologies for enterprises and wireless and wireline providers. Next, we are developing server-based application software platforms for operations and management of contact center, speech and call completion applications. These software platforms are branded under the name Media Exchange. We will use these software platforms for deployment and management of enterprise, wireless and wireline network operator applications, which are designed to operate in both J2EE and Microsoft ®.NET enterprise computing environments. Third, we are developing media servers, voice browsers, and call processing infrastructure based on open standards such as VoiceXML, CCXML, SCXML and SALT. These media servers are VoIP enabled, allowing operation in soft-switch and hybrid PSTN and VoIP networks. Fourth, we are developing packaged, speech enabled applications for the network operator and enterprise markets. These include a range of vertical and horizontal applications that are designed to greatly enhance customer return-on-investment by providing many commonly used configurable functions

that can be deployed more quickly than custom applications. Fifth, we are developing software and tools designed to provide integration of live agent positions in a customer contact center setting. This software covers a broad range of functions including agent call-screen transfer, workflow management, full call recording, agent and supervisor management systems and reporting and various integration functions. Finally, we are developing modular productivity and communications applications for wireless and wireline applications



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including speech driven voice mail, voice activated dialing, and enhanced personal information management. The network products are also branded under the product name Media Exchange.

We expect to maintain a strong commitment to research and development so that we can remain at the forefront of technology development in our markets.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses for the quarters ended May 31, 2007 and 2006 were as follows (in thousands):

|  | Three Months Ended May 31, |          |
|--|----------------------------|----------|
|  | 2007                       | 2006     |
| Selling, general and administrative expenses | \$20,693                   | \$20,800 |
| As percentage of total sales                 | 43.4%                      | 45.5%    |

Selling, general and administrative expenses for the first quarter of fiscal 2008 are down slightly from fiscal 2007 levels. Stock compensation expense was \$0.7 million in fiscal 2008 as compared to \$0.9 million in fiscal 2007.

**Amortization of Acquired Intangible Assets.** We incurred expenses of approximately \$0.7 million related to the amortization of acquisition related intangibles in the first quarter of fiscal 2008. Such amortization related to intangible assets acquired in the purchase of certain assets from Nuasis, the acquisition of Edify and the merger with Brite Voice Systems.

**Other Income/Expense.** Other expense during the first quarter of fiscal 2008 was comprised primarily of foreign currency transaction losses. Other income during the first quarter of fiscal 2007 was comprised of approximately \$0.6 million primarily resulting from the sale of MetLife common stock acquired as a result of MetLife's demutualization. This income was offset by approximately \$0.4 million of foreign currency transaction losses.

**Income Taxes.** For the three months ended May 31, 2007 our quarterly effective tax rate of 13% varies from the U.S. federal statutory rate primarily due to certain non-deductible expenditures, an increase in the valuation allowance associated with our U.K. deferred tax assets and the effect of non-U.S. income tax rates. Our U.K. deferred tax assets remain fully reserved accordingly, we did not recognize the tax benefit associated with our first quarter U.K. loss.

For the three months ended May 31, 2006, our quarterly effective tax rate differed from the U.S. federal statutory rate primarily due to expected benefits to be realized from the use of state NOLs and certain foreign deferred tax assets for which we had not previously realized a benefit due to our uncertainty related to the utilization of those tax assets, and the effect of non-U.S. income tax rates.

In June 2006, the Financial Accounting Standards Board issued FIN 48 which clarifies the accounting for uncertainty in income taxes recognized in enterprises' financial statements in accordance with SFAS 109. The interpretation 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. Also, the interpretation provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, and we adopted the interpretation in the first quarter of fiscal 2008.

As a result of our adoption of FIN 48, we recognized a cumulative effect adjustment of \$2.5 million, increasing our liability for unrecognized tax benefits and related penalties and interest by \$0.3 million, decreasing our non-current deferred tax assets by \$2.2 million, and reducing the March 1, 2007 balance of retained earnings by \$2.5 million. As of the date of adoption, our unrecognized tax benefits totaled \$3.6 million, of which \$0.7 million, if recognized, would affect our effective tax rate. We do not anticipate a significant change to the total amount of unrecognized tax benefits over the next twelve months.

We conduct business globally and, as a result, we or one or more of our subsidiaries files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. In the normal course of business, we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the U.K., Germany, Canada and the United States. Although we believe our tax estimates and our tax positions are reasonable, the final outcome of tax audits could be materially different, both favorable and unfavorable. With few exceptions, we are no longer subject to U.S. federal income tax examinations for



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years before fiscal 2005, and state and local income tax examinations for years before fiscal 2004. With respect to our U.S. federal, state and local NOL carryforwards, we have years open under statutes of limitations back to fiscal year 2002, where tax authorities may not adjust income tax liabilities for these years, but can reduce NOL carryforwards and other tax attribute carryforwards to future open tax years.

We recognize potential interest and penalties related to unrecognized tax benefits as interest expense and penalties expense, respectively. As of May 31, 2007, we have accrued less than \$0.1 million for the potential payment of interest and penalties related to uncertain tax positions.

**Loss from Operations and Net Loss.** We generated an operating loss of \$1.4 million and a net loss of \$0.9 million during the first quarter of fiscal 2008. During the first quarter of fiscal 2007, we generated an operating loss of \$1.2 million and a net loss of \$0.4 million.

**Liquidity and Capital Resources.** We had approximately \$40.8 million in cash and cash equivalents at May 31, 2007. Our cash reserves increased \$12.6 million during the three months ended May 31, 2007, with operating activities providing \$14.1 million of cash, net investing activities using \$2.1 million of cash and net financing activities providing \$0.6 million of cash.

Operating cash flow for the quarter ended May 31, 2007 resulted from our continuing focus on balance sheet management and collections related to annual maintenance renewals. We improved our days sales outstanding of accounts receivable to 54 days, down from 70 days at February 28, 2007. In addition, deferred revenue increased \$5.6 million due to the timing of annual maintenance contract renewals, which are paid in advance.

For sales of certain of our more complex, customized systems (generally ones with a sales price of \$500,000 or more), we recognize revenue based on a percentage of completion methodology. Unbilled receivables accrued under this methodology totaled \$6.7 million (23.4% of total net receivables) at May 31, 2007, down \$0.6 million from February 28, 2007. We expect to bill and collect unbilled receivables as of May 31, 2007 within the next twelve months.

While we continue to focus on the level of our investment in accounts receivable, we generate a significant percentage of our sales, particularly sales of enhanced telecommunications services systems, outside the United States. Customers in certain countries are subject to significant economic and political challenges that affect their cash flow, and many customers outside the United States are generally accustomed to vendor financing in the form of extended payment terms. To remain competitive in markets outside the United States, we may offer selected customers such payment terms. In all cases, however, we only recognize revenue at such time as our system or service fee is fixed or determinable, collectibility is probable and all other criteria for revenue recognition have been met. In some limited cases, this policy may result in recognizing revenue on a cash basis, limiting revenue recognition on certain sales of systems and/or services to the actual cash received to date from the customer, provided that all other revenue recognition criteria have been satisfied.

We used \$2.1 million of cash on investing activities during the first quarter of fiscal 2008. Of this amount, we used \$0.4 million for costs in connection with our SAP implementation, \$0.5 million to purchase equipment to expand our hosted solutions business and \$1.2 million for replacement and expansion of our computing infrastructure and other capital purchases.

During the quarter ended May 31, 2007, our financing activities provided \$0.6 million in net cash flow. Our option holders exercised options for approximately 0.1 million shares of common stock and, in so doing, provided us with \$0.6 million in cash.

**Adequacy of Cash Reserves**

We believe our cash reserves and internally generated cash flow will be sufficient to meet our cash requirements for at least the next twelve months.

**Impact of Inflation**

We do not expect any significant short-term impact of inflation on our financial condition. We presently are not bound by long-term fixed price sales contracts. The absence of such contracts reduces our exposure to inflationary effects.

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**Item 4. Controls and Procedures**

**Evaluation of disclosure controls and procedures.** Our disclosure controls and procedures are designed to provide reasonable, but not absolute, assurance that the objectives of our disclosure control system are met. A control system, no matter how well conceived and operated, is subject to inherent limitations. These limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more persons or by management override of the control. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Based on the evaluation by our management (with the participation of our Chief Executive Officer and Chief Financial Officer), as of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) are effective to provide reasonable assurance that material information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. Such officers also have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, to allow timely decisions regarding required disclosure.

**Changes in internal control.** There has been no change in our internal control over financial reporting identified in connection with the evaluation that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

See Pending Litigation and Audit Committee Investigation in Note I in Item 1 of Part I of this quarterly report on Form 10-Q.

**Item 1A. Risk Factors**

This report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this Form 10-Q, including, without limitation, statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes to Consolidated Financial Statements located elsewhere in this report regarding our financial position, business strategy, plans and objectives of management for future operations, future sales and industry conditions, are forward-looking statements. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. In addition to important factors described elsewhere in this report, we caution current and potential investors that the following important risk factors, among others, sometimes have affected, and in the future could affect, our actual results and could cause such results during fiscal 2008, and beyond, to differ materially from those expressed in any forward-looking statements made by or on behalf of Intervoice:

*Our operating results may fluctuate significantly from period to period, and this may cause our stock price to decline.* Our revenue and operating results have fluctuated in the past and we expect further fluctuations in the future. Given these fluctuations, we believe that quarter to quarter comparisons of our revenue and operating results are not necessarily meaningful or an accurate indicator of our future performance. As a result, our results of operations may not meet the expectations of securities analysts or investors in the future, which could cause our stock price to decline. Factors that contribute to fluctuations in our operating results and can preclude our ability to accurately forecast our results include the following:

- § variability in the time periods necessary to complete projects and achieve project milestones in order to recognize revenue, which may be influenced by volume, size, timing, contractual terms of new licenses and renewals of existing licenses and cash basis revenues;
- § the components of our revenue that are deferred, including our subscription-based hosted solutions and that portion of our software licenses attributable to support and maintenance;
- § volume, timing and fulfillment of customer orders, particularly with respect to large orders (sales of approximately \$2.0 million or more), some of which are completed in the same quarter in which they are ordered and some of which are completed over several quarters, and fluctuations in demand for our products and services;
- § our ability to complete orders from our solutions backlog, subject to timing changes requested by our customers, and projects accounted for on a percentage of completion basis, including estimates based on a variety of factors and subject to revision;
- § the use of low pricing to win important customers, and the possible recognition of loss contingencies for certain projects that we estimate will be delivered at a negative gross margin;
- § the lengthy sales cycle for our products, which typically involve comprehensive solutions that may require detailed customer evaluations;
- § the performance of our international business, which accounts for a significant portion of our consolidated revenues, and fluctuations in foreign currency exchange rates;

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- § the mix of products we sell and services we offer and whether our products are sold through our direct sales force or through an intermediary;
- § introduction of new products, product upgrades or updates by us or our competitors, and any resulting customer delays in purchasing products;
- § any increased price sensitivity by our customers, particularly due to increased competition including open source or free software;
- § periodic difficult economic conditions, particularly affecting the technology industry, as well as economic uncertainties;
- § higher than anticipated costs related to fixed-price contracts with our customers;
- § our ability to effectively manage our operating expense levels;

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- § timing of significant marketing and sales promotions, and expenses incurred pursuing new product or market opportunities;
- § stock-based compensation expense, which we began recognizing for our stock-based compensation plans in the first quarter of fiscal 2007;
- § costs and charges related to certain events, including Sarbanes-Oxley compliance efforts, matters relating to our Audit Committee investigation and litigation;
- § the structure, timing and integration of acquisitions of businesses, products and technologies and related disruption of our current business;
- § factors that lead to substantial declines in estimated values of long-lived assets below their carrying value; and
- § changes in generally accepted accounting principles.

Due to these and other factors, our revenue and operating results are difficult to forecast and are prone to fluctuate, which may cause a decline in our stock price. Our expense levels are based in significant part on our expectations of future revenue, and we may not be able to reduce our expenses quickly to respond to a shortfall in projected revenue. Therefore, our failure to meet revenue expectations could seriously harm our business, operating results and financial condition. See the discussion entitled "Sales" in Item 2 of Part I for a discussion of our system for estimating sales and tracking sales trends in our business.

*We are subject to potential and pending lawsuits and other claims.* We are subject to certain potential and pending lawsuits and other claims discussed in Note I in Item 1 of Part I of this quarterly report on Form 10-Q. Furthermore, we may become subject to claims, including claims by the government, or other adverse consequences arising from the findings of the Audit Committee investigation and related SEC investigation discussed in Note I. We and certain of our current and former officers and non-officer employees have responded to SEC subpoenas to produce documents and provide testimony about the transactions that were the subject of the investigation. Any adverse judgment, penalty or settlement related to any lawsuit or other such claim could have consequences that would be material to our financial position or results of operations. We may be required to indemnify certain of our current and former directors and officers under existing arrangements in connection with the defense, or advancement of defense-related expenses, we are currently providing to certain individuals in connection with the class action lawsuit and the SEC investigation. Our insurance policies provide coverage for certain losses and expenses incurred by us and our current and former directors and officers in connection with claims made under the federal securities laws. These policies, however, exclude losses and expenses related to the Barrie class action lawsuit discussed in Note I or to other litigation based on claims that are substantially the same as the claims in the Barrie class action and contain other customary provisions to limit or exclude coverage for certain losses and expenses.

*We face intense competition based on product capabilities and we experience ever increasing demands from our actual and prospective customers for our products to be compatible with a variety of rapidly proliferating computing, telephony and computer networking technologies and standards.* Our success is dependent, to a large degree, on our effectiveness in allocating resources to developing and improving products compatible with those technologies, standards and functionalities that ultimately become widely accepted by our current and prospective customers. Our success is also dependent, to a large degree, on our ability to implement arrangements with vendors of complementary product offerings so that we can provide our current and prospective customers greater functionality. Our principal competitors include Avaya, Nortel, Nuance Communications, Comverse Technology, Unisys and Alcatel/Lucent. Many of our competitors have greater

financial, technological and marketing resources than we have, as well as greater name recognition. Although we have committed substantial resources to enhance our existing products and to develop and market new products, there is no assurance we will be successful. In addition, it is possible that new entrants to the market and strategic acquisitions and partnerships between existing companies could increase the competition in the markets in which we participate. An increase in such competition could materially adversely affect our ability to sell our products, thereby adversely affecting our business, operating results and financial condition.

*We may not be successful in selling and implementing our products and services in the face of the new, standards-based market.* Intervoice has historically provided complete, bundled hardware and



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software solutions using internally developed components to address our customers' total business needs. The markets for our products have required a shift to the development of products and services based on an open, standards-based architecture such as the J2EE and Microsoft's .NET environments utilizing VoiceXML and/or SALT standards. Such an open, standards-based approach allows customers to independently purchase and combine hardware components, standardized software modules, and customization, installation and integration services from individual vendors deemed to offer the best value in the particular class of product or service. In such an environment, we believe we may sell less hardware and fewer bundled systems and may become increasingly dependent on our development and sale of software application packages, customized software and consulting and integration services. This shift places new challenges on us to hire and retain the mix of personnel necessary to respond to this business environment, to adapt to the changing expense structure that the new environment may tend to foster, to respond to potentially different competitors, and to increase sales of services, customized software and application packages to offset reduced sales of hardware and bundled solutions. Failure to develop, enhance, acquire and introduce new products and services to respond to continually changing market conditions or customer requirements, or lack of customer acceptance of our products or services will materially adversely affect the value of our intellectual property, barriers to entry to our business, customer retention, gross margins, and the results of operations and financial condition.

*We may not be able to retain our customer base, and, in particular, our more significant customers. Our success is heavily dependent on our ability to retain our significant customers. The loss of one of our significant customers could negatively impact our operating results. Our installed base of customers generally is not contractually obligated to place further solutions orders with us or to extend their services contracts with us at the expiration of their current contracts.*

*We will be harmed if we lose key business and technical personnel. We rely upon the services of a relatively small number of key technical, project management and senior management personnel, most of whom do not have employment contracts. If we were to lose any of our key personnel, replacing them could be difficult and costly. If we were unable to successfully and promptly replace such personnel, our business could be materially harmed.*

*Our reliance on significant vendor relationships could result in significant expense or an inability to serve our customers if we lose these relationships. Although we generally use standard parts and components in our products, some of our hardware components are available only from a small number of vendors. Likewise, we license speech recognition technology primarily from Nuance Communications, Inc., the dominant vendor for this technology. As we continue to migrate to open, standards-based systems, we will become increasingly dependent on our component suppliers and software vendors. To date, we have been able to obtain adequate supplies of needed components and licenses in a timely manner, and we expect to continue to be able to do so. Nevertheless, if our significant vendors are unable to supply components or licenses at current levels, we may not be able to obtain these items from another source or at historical prices. In such instances, we would be unable to provide products and services to our customers or generate historical operating margins, and our business and operating results would suffer.*

*If third parties assert claims that our products or services infringe on their technology and related intellectual property rights, whether the claims are made directly against us or against our customers, we could incur substantial costs. We believe software and technology companies, including us and others in our industry, increasingly may become subject to infringement claims. Such claims may require us to enter into costly license agreements or result in even more costly litigation. To the extent a licensing arrangement is required, the arrangement may not be available at all, or, if available, may be very expensive or even prohibitively expensive. As with any legal proceeding, there is no guarantee we will prevail in any litigation instituted against us asserting infringement of intellectual property rights. To the extent we suffer an adverse judgment,*

we might have to pay substantial damages, discontinue the use and sale of infringing products, repurchase infringing products from our customers in accordance with indemnity obligations, expend significant resources to acquire non-infringing alternatives, and/or obtain licenses to the intellectual property that has been infringed upon. As with licensing arrangements, non-infringing substitute technologies may not be available and, if available, may be very expensive, or even prohibitively expensive, to implement. Accordingly, for all of the foregoing reasons, a claim of infringement could ultimately have a material adverse effect on our business, financial condition and results of operations.

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*We are exposed to risks related to our international operations that could increase our costs and hurt our business.* Our products are currently sold in more than 75 countries. Our international sales were 35% and 40% of total sales for the quarters ended May 31, 2007 and 2006, respectively. International sales, personnel and property are subject to certain risks, including:

- § terrorism;
- § fluctuations in currency exchange rates;
- § ability to collect on accounts receivable;
- § the difficulty and expense of maintaining foreign offices and distribution channels;
- § tariffs and other barriers to trade;
- § greater difficulty in protecting and enforcing intellectual property rights;
- § general economic and political conditions in each country, including nationalization of customers or channel partners;
- § loss of revenue, property and equipment from expropriation;
- § import and export licensing requirements; and
- § additional expenses and risks inherent in conducting operations in geographically distant locations, including risks arising from differences in language and cultural approaches to the conduct of business.

*Our inability to meet contracted performance targets could subject us to significant penalties.* Many of our contracts, particularly for hosted solutions, foreign contracts and contracts with telecommunication companies, include provisions for the assessment of damages for delayed project completion and/or for our failure to achieve certain minimum service levels. We have had to pay damages in the past and may have to pay additional damages in the future. Any such future damages could be significant.

*Increasing consolidation in the telecommunications and financial industries could adversely affect our revenues and profitability.* The majority of our largest customers are in the telecommunications and financial industries. These industries are undergoing significant consolidation as a result of merger and acquisition activity. This activity could result in a decrease in the number of customers purchasing our products and/or in delayed purchases of our products by customers that are reviewing their strategic alternatives in light of a pending merger or acquisition. If these results occur, our revenues and profitability could decline or our loss could increase.

*Our products are complex, and software defects could reduce our revenues and expose us to litigation.* The software products we offer are complex and may contain errors or defects, even after extensive testing and quality control, particularly in early versions. Furthermore, because our products increasingly are designed around an open standards based architecture incorporating elements developed by third parties, such errors or defects may be outside of our direct ability to control or correct. Any defects or errors could potentially result in loss of revenues, product returns or order cancellations, and could potentially hinder market acceptance of our products and harm our reputation. Accordingly, any defects or errors could have a material adverse effect on our business, results of operations and financial condition. Our customer license agreements typically contain provisions to limit our product warranty obligations and exposure to potential liability claims.

*We have grown, and may continue to grow, through acquisitions, which could dilute our existing shareholders and could involve substantial acquisition risks. As part of our business strategy, we have in the past acquired, and expect to continue to acquire or make investments in, other businesses and technologies. We may issue equity securities for future acquisitions, which would dilute our existing shareholders, and we may incur debt in connection with future acquisitions, which may include covenants or other restrictions that hinder our ability to operate our business. Furthermore, our prior acquisitions required substantial integration and management efforts. Acquisitions can involve a number of risks, including:*

- § difficulty in transitioning and integrating the operations, facilities and personnel of the acquired businesses, including different and complex order processing, support and accounting and financial reporting systems;
- § loss of key management, sales, research and development and other key employees of the acquired company;
- § difficulty in integrating acquired products into our product portfolio, including engineering, sales and marketing integration;
- § impairment of relationships with partners, suppliers and customers;

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- § difficulty in implementing and standardizing company-wide financial, accounting, billing, information and other systems and the internal controls surrounding those systems and processes;
- § disruption of our ongoing operations and distraction of management and other employees;
- § difficulty in incorporating acquired technology and rights into our products and technology;
- § unanticipated expenses and delays in completing acquired development projects and technology integration;
- § difficulty in management of geographically remote operations in the United States and internationally;
- § delay of sales to customers pending resolution of product integration between our existing and our newly acquired products; and

§ difficulty entering new markets or businesses in which we have limited experience.

As a result of these and other risks, we may not realize anticipated benefits from our acquisitions. Any failure to achieve these benefits or failure to successfully integrate acquired businesses and technologies could result in a material adverse affect on our business, results of operations and financial condition.

*Our stock price has been and may continue to be subject to wide fluctuations.* Our stock price historically has been volatile and may continue to be volatile in the future. Various factors contribute to the volatility of our stock price, including business developments (such as new product introductions and acquisitions or dispositions), litigation developments, quarterly variations in our financial results, our ability to meet investors expectations, and general economic and market conditions. In addition, third-party announcements by our partners and competitors may contribute to our stock price volatility. Certain types of investors may choose not to invest in stocks with this level of stock price volatility. Fluctuations in our stock price could cause increased risk of shareholder litigation, which could result in substantial costs and divert management's attention and resources.

*We are exposed to risks related to our channel program that could decrease our revenues and hurt our business.* Although we principally sell our products and services through our direct sales force, a significant amount of our sales are made through intermediaries such as distributors, system integrators and other strategic channel partners. We endeavor to increase the percentage of sales through intermediaries as we continue to focus our sales efforts through the channel and other partners. We anticipate future revenue growth to depend in large part on our success in expanding relationships, and establishing new relationships, with intermediaries. These intermediaries may sell their own products or other vendors' products that compete with our products, and may compete with our own direct sales force in certain sales opportunities. While we have instituted programs designed to increase sales of our products through intermediaries, certain intermediaries may give greater priority to products of other suppliers, including competitors. Our ability to grow sales through intermediaries depends on our investment in appropriate financial incentives, support and sales tools for intermediaries, while effectively alleviating conflict with our own sales force. Failure to effect this strategy appropriately may result in certain intermediaries choosing to cease or reduce the sales of our products, resulting in a material adverse change in our business, results of operations and financial condition.

*Unanticipated changes in our effective tax rates or exposure to additional income tax liabilities could affect our profitability or increase our loss.* We are a U.S.-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. We are generally required to account for taxes in each jurisdiction in which we operate, including making assumptions, interpretations and judgments with respect to the applicable tax

requirements. Our provision for income taxes is calculated based on a mix of earnings, statutory rates, and enacted tax rules by jurisdiction, including transfer pricing. Significant judgment is required in determining our provision for income taxes and in evaluating our tax positions on a worldwide basis. It is possible that these positions may be challenged which may have a significant impact on our effective tax rate, which could affect our results of operations and financial condition.

*Failure to maintain effective internal controls could have a material adverse effect on our business, results of operations, financial condition, and our stock price.* A failure to maintain adequate internal control procedures as required by Section 404 of the Sarbanes-Oxley Act of 2002 may preclude our management's ability to conclude that we have effective internal controls over our financial reporting. These internal controls are also required for us to produce management financial information, make

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determinations on revenue recognition and other material accounting issues, and prevent financial fraud. If we are unable to produce reliable financial reports, make appropriate determinations on revenue recognition and material accounting policies or prevent fraud, our business, operating results and financial condition could be adversely affected.

*We have sustained operating losses in the past, and may incur additional losses in the future which may require us to raise additional capital on unfavorable terms. We cannot be certain that our revenue will grow or that we will achieve or maintain profitable operations in the future. If we are unable to return to and maintain profitability, the market price for our stock may decline, perhaps substantially. If we continue to have operating losses, we may be required to raise additional capital to maintain or grow our operations. Such additional capital may only be available at unfavorable terms that could be dilutive to existing shareholders, have a high interest rate, contain restrictive covenants, or contain other unfavorable terms.*

**Item 6. Exhibits**

(a) Exhibits

- 3.1 Articles of Incorporation, as amended, of Registrant. (1)
- 3.2 Amendment to Articles of Incorporation of Registrant. (2)
- 3.3 Amendment to Articles of Incorporation of Registrant. (3)
- 3.4 Third Restated Bylaws of Registrant. (6)
- 4.1 Third Amended and Restated Rights Agreement dated as of May 1, 2001 between the Registrant and Computershare Investor Services, LLC, as Rights Agent. (4)
- 4.2 Registration Rights Agreement, dated as of May 29, 2002, between the Registrant and each of the Buyers under a Securities Purchase Agreement. (5)
- 4.3 First Amendment to Third Amended and Restated Rights Agreement dated as of May 29, 2002, between Registrant and Computershare Investor Services, LLC, as Rights Agent. (5)
- 10.1 Employment Agreements effective March 1, 2007 between Registrant and Senior Vice Presidents. (7)
- 10.2 Separation Agreement dated as of April 23, 2007 between Registrant and Marie Jackson. (8)
- 10.3 Termination of Employment Agreement between Registrant and George T. Platt effective July 25, 2007. (8)
- 10.4 Intervoice, Inc. 2007 Stock Incentive Plan. (9)
- 10.5 Resignation Agreement between the Company and Saj-nicole A. Joni dated June 22, 2007. (10)
- 10.6 Resignation Agreement between the Company and Joseph J. Pietropaolo dated June 22, 2007. (10)
- 10.7 Resignation Agreement between the Company and Jack P. Reily dated June 22, 2007. (10)
- 10.8

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Board Representation and Governance Agreement between the Company and David W. Brandenburg dated June 22, 2007. (10)

10.9 Amendment No. 1 dated July 1, 2007 to the Board Representation and Governance Agreement. (11)

31.1 Certification of Chief Executive Officer of Periodic Report Pursuant to Rule 13a-14(a) or Rule 15d-14(a). (12)

31.2 Certification of Chief Financial Officer of Periodic Report Pursuant to Rule 13a-14(a) or Rule 15d-14(a). (12)

32.1 Certification of Chief Executive Officer of Periodic Report Pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350. (12)\*

32.2 Certification of Chief Financial Officer of Periodic Report Pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350. (12)\*

(1) Incorporated by reference to exhibits to the Company's 1995 Annual Report on Form 10-K for the fiscal year ended February 28, 1995, filed with the SEC on May 30, 1995.

(2) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended August 31, 1999, filed with the SEC on October 14, 1999.

(3) Incorporated by reference to exhibits to the Company's Quarterly



Report on Form  
10-Q for the  
quarter ended  
August 31,  
2002, filed with  
the SEC on  
October 15,  
2002.

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- (4) Incorporated by reference to exhibits to Form 8-A/A (Amendment 3) filed with the SEC on May 9, 2001.
- (5) Incorporated by reference to exhibits to the Company's Current Report on Form 8-K, filed with the SEC on May 30, 2002.
- (6) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended August 31, 2004, filed with the SEC on October 12, 2004.
- (7) Incorporated by reference to exhibits to the Company's Current Report on Form 8-K, filed with the SEC on March 7, 2007.
- (8) Incorporated by reference to exhibits to the Company's Current Report on Form 8-K,

filed with the  
SEC on  
April 26, 2007.

- (9) Incorporated by reference to exhibits to the Company's Current Report on Form 8-K, filed with the SEC on June 1, 2007.
- (10) Incorporated by reference to exhibits to the Company's Current Report on Form 8-K, filed with the SEC on June 25, 2007.
- (11) Incorporated by reference to exhibits to the Company's Current Report on Form 8-K, filed with the SEC on July 3, 2007.
- (12) Filed herewith.

\* The certifications attached as Exhibit 32.1 and 32.2 accompany the Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company

for purposes of  
Section 18 of  
the Securities  
Exchange Act of  
1934, as  
amended.

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**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.

INTERVOICE, INC.

Date: July 6, 2007

By: /s/ CRAIG E. HOLMES  
Craig E. Holmes  
Executive Vice President and  
Chief Financial Officer

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**Index to Exhibits**

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8-A/A  
(Amendment 3)  
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(6) Incorporated by  
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Company's  
Quarterly  
Report on Form  
10-Q for the  
fiscal quarter  
ended  
August 31,  
2004, filed with  
the SEC on  
October 12,  
2004.

(7) Incorporated by  
reference to  
exhibits to the  
Company's  
Current Report  
on Form 8-K,  
filed with the  
SEC on  
March 7, 2007.

(8) Incorporated by  
reference to  
exhibits to the  
Company's  
Current Report  
on Form 8-K,  
filed with the  
SEC on  
April 26, 2007.

(9)



Incorporated by reference to exhibits to the Company's Current Report on Form 8-K, filed with the SEC on June 1, 2007.

- (10) Incorporated by reference to exhibits to the Company's Current Report on Form 8-K, filed with the SEC on June 25, 2007.

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(12) Filed herewith.

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