

CSG SYSTEMS INTERNATIONAL INC  
Form 10-K  
February 28, 2008  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from            to

Commission file number 0-27512

**CSG SYSTEMS INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: CSG SYSTEMS INTERNATIONAL INC - Form 10-K

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

**47-0783182**  
(I.R.S. Employer  
Identification No.)

**9555 Maroon Circle**

**Englewood, Colorado 80112**

(Address of principal executive offices, including zip code)

**(303) 200-2000**

(Registrant's telephone number, including area code)

**Securities Registered Pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of Each Exchange on Which Registered
<b>Common Stock, Par Value \$0.01 Per Share</b>	<b>Nasdaq Stock Market LLC</b>

**Securities Registered Pursuant to Section 12(g) of the Act: None.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the last sales price of such stock, as of the close of trading on June 29, 2007 was **\$1,110,309,714**.

Edgar Filing: CSG SYSTEMS INTERNATIONAL INC - Form 10-K

Shares of common stock outstanding at February 25, 2008: **34,922,179**

**DOCUMENTS INCORPORATED BY REFERENCE**

**Portions of the Registrant's Proxy Statement for its 2008 Annual Meeting of Stockholders to be filed on or prior to April 29, 2008, are incorporated by reference into Part III of the Form 10-K.**

**Table of Contents**

**CSG SYSTEMS INTERNATIONAL, INC.**

**2007 FORM 10-K**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I</u></b>	
Item 1. <u>Business</u>	3
Item 1A. <u>Risk Factors</u>	10
Item 1B. <u>Unresolved Staff Comments</u>	14
Item 2. <u>Properties</u>	14
Item 3. <u>Legal Proceedings</u>	14
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	14
<b><u>PART II</u></b>	
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	19
Item 6. <u>Selected Financial Data</u>	22
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operation</u>	24
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	43
Item 8. <u>Financial Statements and Supplementary Data</u>	44
Item 9. <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	82
Item 9A. <u>Controls and Procedures</u>	82
Item 9B. <u>Other Information</u>	82
<b><u>PART III</u></b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	82
Item 11. <u>Executive Compensation</u>	82
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	82
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	83
Item 14. <u>Principal Accounting Fees and Services</u>	83
<b><u>PART IV</u></b>	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	83
Signatures	84

---

**Table of Contents**

**PART I**

**Item 1. Business Overview**

CSG Systems International, Inc. (the Company, CSG, or forms of the pronoun we) was formed in October 1994 and acquired all of the outstanding stock of CSG Systems, Inc. (formerly Cable Services Group, Inc.) from First Data Corporation (FDC) in November 1994. CSG Systems, Inc. had been a subsidiary or division of FDC from 1982 until this acquisition.

We are a leading provider of outsourced solutions that facilitate customer interaction management on the behalf of our clients, generating approximately 95% of our 2007 revenues from the North American cable and Direct Broadcast satellite (DBS) communications markets. Our solutions also support an increasing number of other industries such as financial services, utilities, telecommunications, and home security.

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

Our principal executive offices are located at 9555 Maroon Circle, Englewood, Colorado 80112, and the telephone number at that address is (303) 200-2000. Our common stock is listed on the NASDAQ Stock Market, Inc. under the symbol CSGS. We are an S&P Midcap 400 company.

**General Development of Business**

*Comcast Business Relationship.* In September 1997, we entered into a 15-year exclusive contract (the Master Subscriber Agreement) with Tele-Communications, Inc. (TCI) to consolidate all TCI customers onto our customer care and billing systems. This transaction allowed our company to substantially increase the number of customers processed on our systems, and at the time, was one of the catalysts to the growth of our domestic broadband business.

In 1999 and 2000, respectively, AT&T completed its mergers with TCI and MediaOne Group, Inc. (MediaOne), and consolidated the merged operations into AT&T Broadband (AT&T), and we continued to service the merged operations under the terms of the Master Subscriber Agreement. On November 18, 2002, Comcast Corporation (Comcast) completed its merger with AT&T, and assumed the Master Subscriber Agreement. Comcast is our largest client, making up approximately 27% of our total revenues in 2007.

During 2002 and 2003, we were involved in various legal proceedings with Comcast, consisting principally of arbitration proceedings related to the Master Subscriber Agreement. In October 2003, we received an unfavorable ruling in the arbitration proceedings. The Comcast arbitration ruling included an award of \$119.6 million to be paid by us to Comcast. The award was based on the arbitrator's determination that we had violated the most favored nations (MFN) clause of the Master Subscriber Agreement. We recorded the full impact from the arbitration ruling in the third quarter of 2003 as a charge to revenues. In addition, the arbitration ruling also required that we invoice Comcast for lower fees under the MFN clause of the Master Subscriber Agreement beginning in October 2003. This had the effect of reducing quarterly revenues from Comcast by approximately \$13-14 million (\$52-56 million annually), when compared to amounts prior to the arbitration ruling. In March 2004, we signed a new contract with Comcast (the Comcast Contract) that runs through December 31, 2008. The Comcast Contract superseded the former Master Subscriber Agreement that was set to expire at the end of

## **Table of Contents**

2012. The pricing inherent in the Comcast Contract was consistent with that of the arbitration ruling in October 2003. See Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) for additional discussion of our business relationship with Comcast.

*Discontinued Operations.* In February 2002, we acquired the billing and customer care assets of Lucent Technologies ( Lucent ). Lucent's billing and customer care business consisted primarily of: (i) software products and related consulting services acquired by Lucent when it purchased Kenan Systems Corporation in February 1999; (ii) BILLDATS Data Manager mediation software; and (iii) elements of Lucent's client support, product support, and sales and marketing organizations (collectively, the Kenan Business ). This acquisition allowed us to expand our customer care and billing product and service offerings into international markets. On December 9, 2005, we sold our Global Software Services ( GSS ) business ( GSS Business ), which consisted principally of the acquired Kenan Business, to Comverse, Inc., a division of Comverse Technology, Inc. ( Comverse ). As a result of our sale of the GSS Business, we no longer provide customer care and billing products or services outside of North America. The decision to sell the GSS Business allowed us to intensify our focus on our core competencies in the cable and DBS markets utilizing our Advanced Convergent Platform ( ACP ) product and related services. See Note 2 to our Consolidated Financial Statements and MD&A for additional discussion of the sale of the GSS Business.

In addition to the sale of the GSS Business noted above, we also sold our plaNet Consulting business to a group of private investors led by the plaNet management team on December 30, 2005. As a result of these sales, the results of operations for the GSS and plaNet businesses have been reflected as discontinued operations for all periods presented in the accompanying Consolidated Statements of Income. The remainder of the Business section of this Form 10-K is focused on our continuing operations. See Notes 2 and 5 to our Consolidated Financial Statements and MD&A for additional discussion of our reporting of discontinued operations, and the impact these sales had on our reporting of segment and related information.

## **Industry Overview**

*Background.* We provide our customer interaction management solutions primarily to the North American cable and DBS communications markets. Our client base includes some of the world's largest and most innovative service providers of bundled multi-channel video, Internet, voice and IP-based services. Our solutions coordinate and manage the many aspects of the customers' interactions with a service provider, from the initial set-up and activation of customer accounts, to the support of various service activities, through the presentment of customer invoices and accounts receivable management.

*Market Conditions of Communications Industry.* The North American communications industry has experienced significant consolidation and increased competition among service providers, and there is the possibility of further consolidation. Market consolidation results in a fewer number of service providers who have massive scale and can deliver a total communications package. The significant plant upgrades and network rationalizations that have taken place have allowed service providers to focus their attention on new revenue and growth opportunities. In addition, new competitors, new technologies, and unique partnerships are forcing service providers to be more creative in their approaches for rolling out new products and services and enhancing their customers' experiences. These factors drive the demand for scalable, flexible, and cost efficient customer interaction management solutions, which we believe will provide us with revenue opportunities.

However, another facet of this market consolidation poses certain risks to our company. The consolidation of service providers decreases the potential number of buyers for our products and services, and carries the inherent risk that the consolidators may choose to move their purchased customers to a competitor's solution. Should this consolidation result in a concentration of customer accounts being owned by companies with whom we do not have a relationship, or with whom competitors are entrenched, it could negatively affect our ability to maintain or expand our market share, thereby having a material adverse effect to our results of operations. In addition, service providers at times have chosen to use their size and scale to exert more pressure on pricing negotiations.

## **Table of Contents**

In addition, it is widely anticipated that traditional wireline and wireless telephone service providers will continue their aggressive pursuit of providing convergent services. These providers have recently entered the residential video market, a market which has historically been dominated by our clients. Should these traditional telephone service providers be successful in their video strategy, it could threaten our clients market share, and thus our revenues as, generally speaking, traditional wireline and wireless telephone providers do not currently use our products and services.

### **Business Strategy**

Our business strategy is designed to achieve growth of revenues and profitability. The key elements of our business strategy include:

*Expand Our Core Customer Information Processing and Output Solutions.* Most of our revenues are generated from our core customer information processing and output solutions. We provide a fully outsourced processing solution that combines the reliability and high-volume transaction processing capabilities of an enterprise server platform with the flexibility of client/server architecture. As of December 31, 2007, we had approximately 45 million customer accounts on our processing systems. In addition, we provide a full suite of output solutions that include statement design, printing, marketing services, electronic bill presentment, inserting and mailing on a variety of high-speed equipment. We provide our output solutions primarily to those clients that utilize our information processing services, but also provide such services to clients that do not utilize our outsourced customer information processing services. As of December 31, 2007, our average production volume for our output solutions was approximately 60 million customer statements per month.

Our customer information processing and output solutions provide highly predictable, recurring revenues through multi-year contracts with a client base that includes leading cable and DBS providers. We will continue to leverage our investment in and expertise in providing enhanced customer interaction management solutions as we look to expand these core elements of our business. Our customer information processing solutions are currently designed to focus on the North American cable and DBS markets. While our output solution clients are primarily those that utilize our customer information processing solutions, we look to continue to expand this solution set to other markets that demand high-quality, recurring monthly output solutions, such as financial services, utilities, telecommunications, and home security.

*Increase the Penetration of Ancillary Products/Services.* We provide a complete suite of fully-integrated customer interaction management products and services that complement our customer information processing and output solutions platforms. While our primary value proposition to our clients is the breadth and depth of this integrated offering, we are evolving our product solutions to allow clients to utilize certain of our products as point solutions.

Our ancillary products and services enable and automate various aspects of a service provider's customer interactions, ranging from the call center, to the field technicians, to the end customer. As our clients' businesses have consolidated and become much more complex with an increasingly diverse portfolio of service offerings, we have seen an increase in demand for our ancillary products and services, as our products are designed to help our clients solve their ever-changing customer interaction business needs as they arise.

*Evolve Our Products and Services to Meet the Changing Needs of Our Clients.* In 1995, we offered our solutions solely to providers of analog cable video. Since then, our solutions have evolved and expanded to accommodate DBS, digital video, high-speed Internet ( HSI ) and digital voice. Our clients continue to look to add more services to their product bundle, including advanced IP and wireless services, as well as services to commercial customers. Our continued investment in our solution set is designed to expand our customer interaction management capabilities to enable our clients to grow their product offerings, control costs, and provide better customer service.

**Table of Contents**

*Enhance Growth Through Focused Acquisitions.* We follow a disciplined approach in acquiring assets and businesses which provide the technology and technical personnel to expedite our product development efforts, provide complementary products and services, increase market share, and/or provide access to new markets and clients.

*Continue Technology Leadership.* We believe that our product technology and integrated suite of software solutions gives communications service providers a competitive advantage. Our continuing investment in research and development ( R&D ) is designed to position us to meet the growing and evolving needs of existing and potential clients. Over the last five years, we have invested approximately \$200 million, or approximately 11% of our total revenues, into R&D.

In summary, our R&D and recent acquisition efforts, discussed below, have better positioned us to assist our clients and enable both of us to grow through maximizing every customer interaction. We have continually shown our commitment to deliver solutions and services to our clients with the highest level of performance and functionality, and with our continued investment in R&D and acquisition activities, we believe we will continue to find ways to solve our clients' business challenges and provide them with a competitive advantage. While we continue to strive to provide superior solutions and services to our existing clients, we will continue to focus on growing and diversifying our business and finding new ways to expand our footprint in some of the new vertical markets we have entered with our recent acquisitions.

**Description of Business**

*Clients.* We work with the leading cable and DBS providers located in the U.S. and Canada. A partial list of those service providers as of December 31, 2007 is included below:

Charter Communications ( Charter )	DISH Network Corporation ( DISH ), formerly EchoStar Communications Corporation
Comcast Corporation ( Comcast )	Mediacom Communications
Cox Communications	Time Warner Inc. ( Time Warner )

The North American communications industry has experienced significant consolidation over the last few years, resulting in a large percentage of the market being served by a limited number of service providers with greater size and scale. Consistent with this market concentration, a large percentage of our historical revenues have been generated from a limited number of clients, with approximately 70% of our revenues being generated from our four largest clients, which include Comcast, DISH, Time Warner, and Charter. Revenues from these clients represented the following percentages of our total revenues for 2007 and 2006:

	2007	2006
Comcast	27%	24%
DISH	20%	19%
Time Warner	13%	12%
Charter	9%	11%

*Research and Development.* Our clients are facing more competition than ever before from new entrants, and at the same time, are deploying new services at a faster pace than ever before, dramatically increasing the complexity of their business operations. Therefore, we continue to invest heavily in R&D to ensure that we stay ahead of our clients' needs and advance our clients' business as well as our own. We recognize these challenges and believe our value proposition is to provide solutions that help our clients ensure that each interaction they have with their customers is an opportunity to create value and deepen the business relationship. As a result of our R&D efforts, we have broadened our footprint within our client base with many innovative product offerings.



## **Table of Contents**

Our total R&D expenses were \$58.3 million and \$46.2 million, respectively, for 2007 and 2006, or approximately 14% and 12% of total revenues. In the near term, we expect that the percentage of our total revenues to be spent on R&D to be relatively consistent with that of 2007, with the level of our R&D spend highly dependent upon the opportunities that we see in our markets.

There are certain inherent risks associated with significant technological innovations. Some of these risks are described in this report in our Risk Factors section below.

*Products and Services.* Our primary product offerings include our core outsourced processing product, Advanced Convergent Platform ( ACP ), and related services and software products, to include our output solutions. A background in high-volume transaction processing and statement production, complemented with world-class applications software, allows us to offer one of the most comprehensive, pre-integrated products and services solutions to the cable and DBS market. We believe this pre-integrated approach and outsourced delivery model allows our clients to get new product offerings to market quickly and provide high-quality customer service in a cost effective manner.

We license certain software products (e.g., ACSR, Workforce Express, etc.) and provide our professional services principally to our existing base of processing clients to enhance the core functionality of ACP, increase the efficiency and productivity of the clients' operations, and allow clients to effectively roll out new products and services to new and existing markets, such as HSI and telephony to residential and commercial customers.

Historically, a substantial percentage of our total revenues have been generated from ACP processing and output services and related software products. These products and services are expected to provide a substantial percentage of our total revenues in the foreseeable future as well.

*ACP Architectural Upgrade and Migration.* During 2004, we completed a significant architectural upgrade to our primary product, then called CCS, and related services and software products. This enhancement, called ACP, has increased our ability to support convergent broadband services including cross-service bundling, convergent order entry and advanced service provisioning capabilities for multiple products to one end customer, such as video, HSI, and Voice over Internet Protocol ( VoIP ). This advanced convergent solution for broadband service providers facilitates our clients' offering of combinations of video, voice and data services (commonly referred to in the industry as the triple-play service offering). We have successfully migrated all of the cable customer accounts processed on our systems to our ACP platform, giving our clients the full benefit of our technology to support the advanced marketing and rollout of new services.

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

*Telution Acquisition.* As part of this product evolution strategy, we acquired Telution, Inc. ( Telution ) in March of 2006 to further expand these capabilities around our ACP platform. Our recent R&D efforts include the integration of these acquired technologies into our solution set. In particular, the acquired software assets are an integral part of the new functionality that has been added to our ACP platform since the acquisition, including a robust product catalog, offer and order management functions, and product capabilities to support commercial customers.

## **Table of Contents**

*ComTec Acquisition.* In July of 2007 we acquired ComTec, Inc. ( ComTec ), to expand our output solutions footprint and capabilities. With this acquisition, we added enhanced statement production and electronic statement presentation hardware and software technologies, as well as additional plant capacities. These technologies, which include extensive highlight color and cut-sheet printing capabilities, will accelerate our ability to offer enhanced output functionality to existing and prospective customers. In addition, the acquisition increased our presence in our core cable television and DBS markets, while also providing an established customer base in new industry verticals such as telecommunications, home security, healthcare, financial services, and utilities.

*Prairie Acquisition.* In August of 2007 we acquired Prairie Voice Services, Inc. This business, which was renamed Prairie Interactive Messaging, Inc. ( Prairie ), extends our suite of products and solutions that help our clients maximize the value of their interactions with their customers. Prairie provides inbound and outbound automated voice, text/SMS, email, and fax messaging services to manage workforce communications, collections, lead generation, automated order capture, service outage notifications, and other key business functions. We acquired Prairie to extend our customer interaction management capabilities within our core cable television and DBS markets, while also providing an established customer base in new industry verticals such as financial services and telecommunications.

*FDC Data Processing Facility.* We outsource to FDC the data processing and related computer services required for the operation of our processing services. Our ACP proprietary software and other software applications are run in FDC's facility to obtain the necessary enterprise server computer capacity and other computer support services without us having to make the substantial capital and infrastructure investments that would be necessary for us to provide these services internally. Our clients are connected to the FDC facility through a combination of private and commercially-provided networks. Our service agreement with FDC expires June 30, 2010, and is cancelable only for cause, as defined in the agreement. We believe we could obtain mainframe data processing services from alternative sources, if necessary. We have a business continuity plan as part of our agreement with FDC should the FDC data processing center suffer an extended business interruption or outage. This plan is tested on an annual basis.

*Client and Product Support.* Our clients typically rely on us for ongoing support and training needs related to our products. We have a multi-level support environment for our clients, which includes dedicated account management teams to support the business, operational, and functional requirements of each client. These account teams help clients resolve strategic and business issues and are supported by our Product Support Center ( PSC ), which operates 24 hours a day, seven days a week. Clients call an 800 number, and through an automated voice response unit, have their calls directed to the appropriate PSC personnel to answer their questions. We have a full-time training staff and conduct ongoing training sessions both in the field and at our training facilities.

*Sales and Marketing.* We organize our sales efforts to existing clients primarily within our dedicated account teams, with senior level account managers who are responsible for new revenues and renewal of existing contracts within a client account. The account teams are supported by sales support personnel who are experienced in the various products and services that we provide. In addition, we have dedicated staff engaged in selling our products and services to prospective clients.

*Competition.* The market for customer interaction management products and services in the converging communications industry in North America, as well as in other industries we serve, is highly competitive. We compete with both independent outsourced providers and in-house developers of customer management systems. We believe that our most significant competitors in our primary markets are Amdocs Limited, Convergys Corporation, Oracle Corporation, and in-house systems. Some of our actual and potential competitors have substantially greater financial, marketing, and technological resources than us.

## **Table of Contents**

We believe service providers in our industry use the following criteria when selecting a vendor to provide customer care and billing products and services: (i) functionality, scalability, flexibility, interoperability, and architecture of the software assets; (ii) the breadth and depth of pre-integrated product solutions; (iii) product quality, client service, and support; (iv) quality of R&D efforts; and (v) price. We believe that our products and services allow us to compete effectively in these areas.

### **Proprietary Rights and Licenses**

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

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

### **Employees**

As of December 31, 2007, we had a total of 1,877 employees, an increase of 192, or 11%, from December 31, 2006. The increase in number of employees is due to (i) the addition of employees from the ComTec and Prairie acquisitions, and (ii) an increase in our R&D and support function personnel to support the development and roll out of new products. Our success is dependent upon our ability to attract and retain qualified employees. None of our employees are subject to a collective bargaining agreement. We believe that our relations with our employees are good.

### **Available Information**

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy materials, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act are available free of charge on our website at [www.csgsystems.com](http://www.csgsystems.com). Additionally, these reports are available at the SEC's Public Reference Room at 100 F Street, NE., Washington, D.C. 20549 or on the SEC's website at [www.sec.gov](http://www.sec.gov). Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330.

### **Code of Business Conduct and Ethics**

A copy of our Code of Business Conduct and Ethics (the Code of Conduct) is maintained on our website. Any future amendment to the Code of Conduct, or any future waiver of a provision of our Code of Conduct, will be timely posted to our website upon their occurrence. Historically, we have had minimal changes to our Code of Conduct, and have had no waivers of a provision of our Code of Conduct.

## **Table of Contents**

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

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

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

*We Derive a Significant Portion of Our Revenues From a Limited Number of Clients, and the Loss of the Business of a Significant Client Would Materially Adversely Affect Our Financial Condition and Results of Operations.* The North American communications industry has experienced significant consolidation over the last few years, resulting in a large percentage of the market being served by a limited number of service providers with greater size and scale. Consistent with this market concentration, a large percentage of our revenues are generated from a limited number of clients, with approximately 70% of our revenues being generated from our four largest clients, which are (in order of size) Comcast, DISH, Time Warner, and Charter. See the Significant Client Relationships section of MD&A for key renewal dates and a brief summary of our business relationship with these clients.

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

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

*A Reduction in Demand for Our Key Customer Care and Billing Products and Services Could Have a Material Adverse Effect on Our Financial Condition and Results of Operations.* Historically, a substantial percentage of our total revenues have been generated from our core outsourced processing product, ACP, and related services. These products and services are expected to continue to provide a large percentage of our total revenues in the foreseeable future. Any significant reduction in demand for ACP and related services could have a material adverse effect on our financial condition and results of operations.

*We May Not Be Able to Respond to the Rapid Technological Changes in Our Industry.* The market for customer care and billing systems is characterized by rapid changes in technology and is highly competitive with respect to the need for timely product innovations and new product introductions. As a result, we believe that our

## Table of Contents

future success in sustaining and growing our revenues depends upon the continued market acceptance of our products, especially ACP, and our ability to continuously adapt, modify, maintain, and operate our products to address the increasingly complex and evolving needs of our clients, without sacrificing the reliability or quality of the products. In addition, the market is demanding that our products have greater architectural flexibility and interoperability with other computer systems, and that we are able to meet the demands for technological advancements to our products and services at a greater pace. Attempts to meet these demands subjects our R&D efforts to greater risks.

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

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

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

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

*The Consolidation of the North American Cable and DBS Industry May Have a Material Adverse Effect on Our Results of Operations.* The North American cable and DBS industry may continue to be subject to significant ownership changes. One facet of these changes is that consolidation by and among our core client base, the cable and DBS providers, as well as new entrants such as the traditional wireline and wireless carriers, will decrease the potential number of buyers for our products and services. Should these consolidations result in a concentration of customer accounts being owned by companies with whom we do not have a relationship, or with whom competitors are entrenched, we could be subject to the inherent risk that subscribers will be moved off of us and onto a competitor's system, thereby having a material adverse effect on our results of operations.

## **Table of Contents**

Furthermore, movement of our clients' customers from our systems to a competitor's system as a result of regionalization strategies by our clients could have a material adverse effect on our operations. Finally, as the result of the consolidations, our current and potential clients may choose to use their size and scale to exercise more severe pressure on pricing negotiations.

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

*Client Bankruptcies Could Adversely Affect Our Business, and Any Accounting Reserves We Have Established May Not Be Sufficient.* In the past, certain of our clients have filed for bankruptcy protection. Companies involved in bankruptcy proceedings pose greater financial risks to us, consisting principally of possible claims of preferential payments for certain amounts paid to us prior to the bankruptcy filing date, as well as increased collectibility risk for accounts receivable, particularly those accounts receivable that relate to periods prior to the bankruptcy filing date. We consider such risks in assessing our revenue recognition and the collectibility of accounts receivable related to our clients that have filed for bankruptcy protection, and for those clients that are seriously threatened with a possible bankruptcy filing. We establish accounting reserves for our estimated exposure on these items. However, there can be no assurance that our accounting reserves related to this exposure will be adequate. Should any of the factors considered in determining the adequacy of the overall reserves change adversely, an adjustment to the accounting reserves may be necessary. Because of the potential significance of this exposure, such an adjustment could be material.

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

*Failure to Attract and Retain Our Key Management and Other Highly Skilled Personnel Could Have a Material Adverse Effect on Our Business.* Our future success depends in large part on the continued service of our key management, sales, product development, and operational personnel. We believe that our future success also depends on our ability to attract and retain highly skilled technical, managerial, operational, and marketing personnel, including, in particular, personnel in the areas of R&D and technical support. Competition for qualified personnel at times can be intense, particularly in the areas of R&D, conversions, software implementations, and technical support, especially now that market conditions are improved and the demand for such talent has increased. For these reasons, we may not be successful in attracting and retaining the personnel we require, which could have a material adverse effect on our ability to meet our commitments and new product delivery objectives.

*We May Not Be Successful in the Integration of Our Acquisitions.* As part of our growth strategy, we seek to acquire assets, technology, and businesses which will provide the technology and technical personnel to expedite our product development efforts, provide complementary products or services, or provide access to new markets and clients.

## **Table of Contents**

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

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

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

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

*The Delivery of Our Products and Services is Dependent on a Variety of Computing Environments and Communications Networks, Which May Not Be Available or May Be Subject to Security Attacks.* Our products and services are generally delivered through a variety of computing environments operated by us, which we will collectively refer to herein as Systems. We provide such computing environments through both outsourced arrangements, such as our data processing arrangement with FDC, as well as internally operating numerous distributed servers in geographically dispersed environments. The end users are connected to our Systems through a variety of public and private communications networks, which we will collectively refer to herein as Networks. Our products and services are generally considered to be mission critical customer management systems by our clients. As a result, our clients are highly dependent upon the continuous availability and uncompromised security of our Networks and Systems to conduct their business operations.

Our Networks and Systems are subject to the risk of an extended interruption or outage due to many factors such as: (i) planned changes to our Systems and Networks for such things as scheduled maintenance and technology upgrades, or migrations to other technologies, service providers, or physical location of hardware; (ii) human and machine error; (iii) acts of nature; and (iv) intentional, unauthorized attacks from computer hackers. In addition, we continue to expand our use of the Internet with our product offerings thereby permitting, for example, our clients' customers to use the Internet to review account balances, order services or execute similar account management functions. Allowing access to our Networks and Systems via the Internet increases their vulnerability to unauthorized access and corruption, as well as increasing the dependency of our Systems' reliability on the availability and performance of the Internet's infrastructure.

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

---

**Table of Contents**

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

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

As of December 31, 2007, we were operating from eight leased sites in the U.S., representing approximately 535,000 square feet. This amount excludes approximately 84,000 square feet of leased space that we have abandoned.

We lease office facilities totaling approximately 100,000 square feet in Englewood, Colorado and surrounding communities. We utilize these office facilities primarily for: (i) corporate headquarters; (ii) sales and marketing activities; (iii) product and operations support; and (iv) R&D activities. The leases for these office facilities expire in the years 2013 through 2015.

We lease office facilities totaling approximately 225,000 square feet in Omaha, Nebraska. We utilize these facilities primarily for (i) client services, training and product support; (ii) systems and programming activities; (iii) R&D activities; and (iv) general and administrative functions. The leases for these facilities expire in the years 2009 through 2012.

We lease an office facility totaling approximately 16,000 square feet in Chicago, Illinois. We utilize this facility primarily for: (i) R&D activities; (ii) client services; and (iii) professional services staff. The lease for this office facility expires in 2008.

We lease statement production and mailing facilities totaling approximately 194,000 square feet in Omaha, Nebraska, Wakulla County, Florida, and Fairfield, New Jersey. The leases for these facilities expire in the years 2011 through 2013.

We believe that our facilities are adequate for our current needs and that additional suitable space will be available as required. We also believe that we will be able to extend the leases as they terminate at comparable rates. See Note 11 to our Consolidated Financial Statements for information regarding our obligations under our facility leases.

**Item 3. Legal Proceedings**

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

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

None.

\*\*\*\*\*



## **Table of Contents**

### **Executive Officers of the Registrant**

As of December 31, 2007, our executive officers were Peter E. Kalan (Chief Executive Officer and President), Randy R. Wiese (Executive Vice President and Chief Financial Officer), Robert M. ( Mike ) Scott (Executive Vice President and Chief Operating Officer), and Joseph T. Ruble (Executive Vice President, General Counsel, Corporate Secretary and Chief Administrative Officer). We have employment agreements with each of the executive officers.

#### ***Peter E. Kalan***

##### ***Chief Executive Officer and President***

Mr. Kalan, 48, joined CSG in January 1997 and was named Chief Financial Officer in October 2000. In April 2006, he was named Executive Vice President of Business and Corporate Development. In December 2007, Mr. Kalan was named Chief Executive Officer and President, and elected to the Board. Prior to joining CSG, he was Chief Financial Officer at Bank One, Chicago, and he also held various other financial management positions with Bank One in Texas and Illinois from 1985 through 1996. Mr. Kalan holds a BA degree in Business Administration from the University of Texas at Arlington.

#### ***Randy R. Wiese***

##### ***Executive Vice President and Chief Financial Officer***

Mr. Wiese, 48, joined CSG in 1995 as Controller and later served as Chief Accounting Officer. He was named Executive Vice President and Chief Financial Officer in April 2006. Prior to joining CSG, he was manager of audit and business advisory services and held other accounting-related positions at Arthur Andersen & Co. Mr. Wiese is a member of the AICPA and the Nebraska Society of Certified Public Accountants. He holds a BS degree in Accounting from the University of Nebraska-Omaha.

#### ***Robert M. Scott***

##### ***Executive Vice President and Chief Operating Officer***

Mr. Scott, 57, joined CSG in September 1999 as Vice President of the Broadband Services Division and served as Senior Vice President of that division from 2001 to 2004. In December 2004, Mr. Scott was named Executive Vice President, and became the head of the Broadband Services Division in March 2005. In July 2006, he was named Chief Operating Officer. Prior to joining CSG, he served for 21 years in a variety of management positions, both domestically and internationally, with First Data Corporation. Mr. Scott holds a BA degree in Social Studies from Florida Atlantic University.

#### ***Joseph T. Ruble***

##### ***Executive Vice President, General Counsel, Corporate Secretary and Chief Administrative Officer***

Mr. Ruble, 47, joined CSG in 1997 as Vice President and General Counsel. In November 2000 he was appointed Senior Vice President of Corporate Development, General Counsel & Corporate Secretary. In February 2007, he was named Executive Vice President. Prior to joining CSG, Mr. Ruble served from 1991 to 1997 as Vice President, General Counsel & Corporate Secretary for Intersolv, Inc., and as counsel to Pansophic Systems, Inc. for its international operations from 1988 to 1991. Prior to that, he represented the software industry in Washington, D.C. on legislative matters. Mr. Ruble holds a JD from Catholic University of America and a BS degree from Ohio University.

### **Board of Directors of the Registrant**

Effective November 14, 2007, our Board of Directors increased the number of directors of our company from eight to nine by adding a Class III director and approved Mr. Kalan to fill the vacancy created by the increase in the number of Class III directors.

## **Table of Contents**

Information related to our Board of Directors is provided below.

### ***Bernard W. Reznicek***

#### ***Consultant***

#### ***The Premier Group***

Mr. Reznicek, 71, was elected to the Board in January 1997 and presently serves as the Company's non-executive Chairman of the Board. He currently provides consulting services through Premier Enterprises. Mr. Reznicek previously was an Executive with Central States Indemnity Company of Omaha, a Berkshire Hathaway company, from 1997 to 2003. He has 40 years of experience in the electric utility industry, having served as Chairman, President and Chief Executive Officer of Boston Edison Company and President and Chief Executive Officer of Omaha Public Power District. Mr. Reznicek currently is a director of Pulte Homes, Inc. (NYSE) and infoUSA Inc. (NASDAQ).

### ***Peter E. Kalan***

#### ***Chief Executive Officer and President***

#### ***CSG Systems International, Inc.***

Mr. Kalan's biographical information is included in Executive Officers of the Registrant section shown directly above.

### ***Ronald Cooper***

#### ***Former President and Chief Operating Officer***

#### ***Adelphia Communications***

Mr. Cooper, 50, was elected to the Board in November 2006. He has spent nearly 25 years in the cable and telecommunications industry, most recently at Adelphia Communications where he served as President and Chief Operating Officer from 2003 to 2006. Prior to Adelphia, Mr. Cooper held a series of executive positions at AT&T Broadband, RELERA Data Centers & Solutions, and MediaOne and its predecessor Continental Cablevision, Inc. He has held various board and committee seats with the National Cable Television Association, California Cable & Telecommunications Association, Cable Television Association for Marketing and the New England Cable Television Association. In addition, Mr. Cooper is a trustee at the Denver Art Museum and a director for Colorado Public Radio.

### ***Edward C. Nafus***

#### ***Former Chief Executive Officer and President***

#### ***CSG Systems International, Inc.***

Mr. Nafus, 67, was elected to the Board in March 2005. Mr. Nafus joined CSG in August 1998 as Executive Vice President and became the President of our Convergent Services and Solutions Division in January 2002. In April 2005, Mr. Nafus assumed the position of Chief Executive Officer and President of CSG and held that position until his retirement in December 2007. Prior to joining CSG, Mr. Nafus held numerous management positions within FDC from 1978 to 1998. From 1992 to 1998, he served as Executive Vice President of FDC; from 1989 to 1992, he served as President of First Data International; and Executive Vice President of First Data Resources from 1984 to 1989. From 1971 to 1978, Mr. Nafus worked in sales management, training and sales for Xerox Corporation. From 1966 to 1971, Mr. Nafus was a pilot and division officer in the United States Navy. Mr. Nafus holds a BS degree from Jamestown College.

## **Table of Contents**

### ***Janice I. Obuchowski***

#### ***President***

#### ***Freedom Technologies, Inc.***

Ms. Obuchowski, 56, was elected to the Board in November 1997. She has been President of Freedom Technologies, Inc., a public policy and corporate strategy consulting firm specializing in telecommunications, since 1992. In 2003, Ms. Obuchowski was appointed by President George W. Bush to serve as Ambassador and Head of the U.S. Delegation to the World Radio Communication Conference. She has served as Assistant Secretary for Communications and Information at the Department of Commerce and as Administrator for the National Telecommunications and Information Administration. Ms. Obuchowski currently is a director of Orbital Sciences Corporation and Stratos Global Corporation.

### ***Donald B. Reed***

#### ***Former Chief Executive Officer***

#### ***Cable & Wireless Global***

Mr. Reed, 63, was elected to the Board in May 2005. He currently is retired, having served as Chief Executive Officer of Cable & Wireless Global from May 2000 to January 2003. Cable & Wireless Global, Cable & Wireless plc's wholly owned operations in the United States, United Kingdom, Europe and Japan, is a provider of internet protocol (IP) and data services to business customers. From June 1998 until May 2000, Mr. Reed served Cable & Wireless in various other executive positions. Mr. Reed's career includes 30 years at NYNEX Corporation (now part of Verizon), a regional telephone operating company. From 1995 to 1997 Mr. Reed served NYNEX Corporation as President and Group Executive with responsibility for directing the company's regional, national and international government affairs, public policy initiatives, legislative and regulatory matters, and public relations. Mr. Reed currently is a director of Intervoice, Inc., Idearc Media (formerly Verizon Yellow Pages) (NYSE) and Aggregate Industries in London, England, a wholly owned subsidiary of Holcim Group located in Switzerland.

### ***Frank V. Sica***

#### ***Managing Partner***

#### ***Tailwind Capital***

Mr. Sica, 57, has served as a director of the Company since its formation in 1994. He is currently a Managing Partner of Tailwind Capital. From 2004 to 2005, Mr. Sica was a Senior Advisor to Soros Private Funds Management. From 2000 until 2003, he was President of Soros Private Funds Management which oversaw the direct real estate and private equity investment activities of Soros. In 1998, he joined Soros Fund Management where he was a Managing Director responsible for Soros' private equity investments. From 1988 to 1998, Mr. Sica was a Managing Director at Morgan Stanley and its private equity affiliate, Morgan Stanley Capital Partners. Prior to 1988, Mr. Sica was a Managing Director in Morgan Stanley's mergers and acquisitions department. From 1974 to 1977, Mr. Sica was an officer in the U.S. Air Force. Mr. Sica currently is a director of JetBlue Airways, Kohl's Corporation, and NorthStar Realty Finance Corporation.

### ***Donald V. Smith***

#### ***Senior Managing Director***

#### ***Houlihan Lokey Howard & Zukin, Inc.***

Mr. Smith, 65, was elected to the Board in January 2002. He presently serves as Senior Managing Director of Houlihan Lokey Howard & Zukin, Inc., an international investment banking firm with whom he has been associated since 1988. Mr. Smith currently is in charge of the firm's New York office and serves on the board of directors of the firm. From 1978 to 1988, he was employed by Morgan Stanley & Co. Incorporated, where he headed the valuation and reorganization services within that firm's corporate finance group. Mr. Smith is director of the Princeton (NJ) Health Care Foundation and of Business Executives for National Security.



**Table of Contents**

*James A. Unruh*

*Managing Principal*

*Alerion Capital Group*

Mr. Unruh, 67, was elected to the Board in June 2005. He became a founding principal of Alerion Capital Group, LLC (a private equity investment company) in 1998 and currently holds such position. Mr. Unruh was an executive with Unisys Corporation from 1987 to 1997 and served as its Chairman and Chief Executive Officer from 1990 to 1997. From 1982 to 1987, Mr. Unruh held various executive positions, including Senior Vice President, Finance, with Burroughs Corporation, a predecessor of Unisys Corporation. Mr. Unruh currently is a director of Prudential Financial, Inc., Tenet Healthcare Corporation, and Qwest Communications International Inc.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is listed on the Nasdaq Stock Market LLC ( NASDAQ/NMS ) under the symbol CSGS . The following table sets forth, for the fiscal quarters indicated, the high and low sale prices of our common stock as reported by NASDAQ/NMS.

	High	Low
<b>2007</b>		
First quarter	\$ 26.97	\$ 24.02
Second quarter	28.22	24.45
Third quarter	27.26	19.64
Fourth quarter	21.97	14.52
	High	Low
<b>2006</b>		
First quarter	\$ 23.29	\$ 20.82
Second quarter	26.21	22.87
Third quarter	27.48	23.18
Fourth quarter	28.45	26.11

On February 25, 2008, the last sale price of our common stock as reported by NASDAQ/NMS was \$11.79 per share. On January 31, 2008, the number of holders of record of common stock was 235.

**Dividends**

We have not declared or paid cash dividends on our common stock since our incorporation. We did, however, complete a two-for-one stock split, effected in the form of a stock dividend, in March 1999. We intend to retain any earnings to finance the growth and development of our business, and at this time, we do not plan to pay cash dividends in the foreseeable future.

Our revolving credit facility contains certain restrictions on the payment of dividends. In addition, the payment of dividends has certain impacts to our Convertible Debt Securities. See Note 7 to our Consolidated Financial Statements for additional discussion of our revolving credit facility and Convertible Debt Securities, and the impact the payment of dividends may have on these items.

---

**Table of Contents****Stock Price Performance**

The following graph compares the cumulative total stockholder return on our common stock, the S&P 500 Index, and our Standard Industrial Classification ( SIC ) Code Index: Computer Processing and Data Preparation and Processing Services during the indicated five-year period. The graph assumes that \$100 was invested on December 31, 2002, in our common stock and in each of the two indexes and that all dividends, if any, were reinvested.

	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07
CSG Systems International, Inc.	100.00	91.50	137.00	163.52	195.82	107.84
Data Preparation & Processing Services	100.00	119.04	130.74	131.39	146.87	146.76
S&P 500 Index	100.00	128.68	142.69	149.70	173.34	182.87

**Table of Contents****Equity Compensation Plan Information**

The following table summarizes certain information about our equity compensation plans as of December 31, 2007:

<b>Plan Category</b>	<b>Number of securities to be issued upon exercise of outstanding options, warrants, and rights</b>	<b>Weighted-average exercise price of outstanding options, warrants, and rights</b>	<b>Number of securities remaining available for future issuance</b>
Equity compensation plans approved by security holders	388,876	\$ 31.05	10,744,076
Equity compensation plan not approved by security holders	87,565	22.60	9,927
<b>Total</b>	<b>476,441</b>	<b>\$ 29.49</b>	<b>10,754,003</b>

Of the total number of securities remaining available for future issuance, 10,428,827 shares can be used for various types of stock-based awards, as specified in the individual plans, with the remaining 325,176 shares to be used for our employee stock purchase plan. See Note 13 to our Consolidated Financial Statements for additional discussion of our equity compensation plans.

**Issuer Repurchases of Equity Securities**

The following table presents information with respect to purchases of company common stock made during the three months ended December 31, 2007 by CSG Systems International, Inc. or any affiliated purchaser of CSG Systems International, Inc., as defined in Rule 10b-18(a)(3) under the Exchange Act.

<b>Period</b>	<b>Total Number of Shares Purchased (2)</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under the Plan or Programs (1)</b>
October 1 - October 31	1,541,100	\$ 20.90	1,541,100	2,477,596
November 1 - November 30	1,275,216	17.90	1,273,500	1,204,096
December 1 - December 31	44,397	14.64		1,204,096
<b>Total</b>	<b>2,860,713</b>	<b>\$ 19.46</b>	<b>2,814,600</b>	

- (1) Our Board of Directors have authorized us to repurchase up to 30 million shares of our common stock under the Stock Repurchase Program. The Stock Repurchase Program does not have an expiration date.
- (2) The total number of shares purchased that are not part of the Stock Repurchase Program represents shares purchased and cancelled in connection with stock incentive plans.



**Table of Contents****Item 6. Selected Financial Data**

The following selected financial data have been derived from our audited financial statements. The selected financial data presented below should be read in conjunction with, and is qualified by reference to, our MD&A and our Consolidated Financial Statements. The information below is not necessarily indicative of the results of future operations.

	2007	Year Ended December 31,			2003
		2006	2005	2004	
		(in thousands, except per share amounts)			
<b>Statement of Operations Data:</b>					
Revenues:					
Processing and related services (1)(3)	\$ 382,070	\$ 351,764	\$ 346,463	\$ 326,556	\$ 341,628
Software, maintenance and services (3)	37,191	31,342	30,854	24,845	25,766
	419,261	383,106	377,317	351,401	367,394
Charge for arbitration ruling attributable to periods prior to July 1, 2003 (3)					(105,679)
<b>Total revenues, net</b>	<b>419,261</b>	<b>383,106</b>	<b>377,317</b>	<b>351,401</b>	<b>261,715</b>
Cost of revenues (6):					
Processing and related services (1)	193,135	173,536	170,344	146,837	140,475
Software, maintenance and services	24,674	20,975	19,720	25,047	30,359
<b>Total cost of revenues</b>	<b>217,809</b>	<b>194,511</b>	<b>190,064</b>	<b>171,884</b>	<b>170,834</b>
<b>Gross margin (exclusive of depreciation)</b>	<b>201,452</b>	<b>188,595</b>	<b>187,253</b>	<b>179,517</b>	<b>90,881</b>
Operating expenses (1)(6):					
Research and development	58,342	46,191	33,932	31,887	30,398
Selling, general and administrative	45,743	43,127	52,492	39,453	50,041
Depreciation	12,900	10,438	9,862	10,412	12,701
Restructuring charges (5)	630	2,368	14,534	1,292	2,149
<b>Total operating expenses</b>	<b>117,615</b>	<b>102,124</b>	<b>110,820</b>	<b>83,044</b>	<b>95,289</b>
<b>Operating income (loss)</b>	<b>83,837</b>	<b>86,471</b>	<b>76,433</b>	<b>96,473</b>	<b>(4,408)</b>
Other income (expense):					
Interest expense	(7,126)	(7,465)	(7,537)	(10,261)	(14,296)
Write-off of deferred financing costs (7)				(6,569)	
Interest and investment income, net (2)	16,529	21,984	4,059	975	920
Other, net	221	(21)	6	(303)	(85)
<b>Total other</b>	<b>9,624</b>	<b>14,498</b>	<b>(3,472)</b>	<b>(16,158)</b>	<b>(13,461)</b>
<b>Income (loss) from continuing operations before income taxes</b>	<b>93,461</b>	<b>100,969</b>	<b>72,961</b>	<b>80,315</b>	<b>(17,869)</b>
<b>Income tax (provision) benefit (3)</b>	<b>(33,298)</b>	<b>(38,408)</b>	<b>(26,219)</b>	<b>(29,317)</b>	<b>12,703</b>
<b>Income (loss) from continuing operations</b>	<b>60,163</b>	<b>62,561</b>	<b>46,742</b>	<b>50,998</b>	<b>(5,166)</b>
Discontinued operations (2):					
Gain (loss) from discontinued operations (6)	547	(6,555)	(5,685)	(11,109)	(30,591)
Income tax benefit	61	3,764	12,172	7,295	9,480
<b>Discontinued operations, net of tax</b>	<b>608</b>	<b>(2,791)</b>	<b>6,487</b>	<b>(3,814)</b>	<b>(21,111)</b>
<b>Net income (loss)</b>	<b>\$ 60,771</b>	<b>\$ 59,770</b>	<b>\$ 53,229</b>	<b>\$ 47,184</b>	<b>\$ (26,277)</b>

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

Diluted net income (loss) per common share:

Income (loss) from continuing operations	\$ 1.50	\$ 1.33	\$ 0.96	\$ 0.99	\$ (0.10)
Discontinued operations, net of tax	0.02	(0.06)	0.13	(0.07)	(0.41)

Net income (loss)	\$ 1.52	\$ 1.27	\$ 1.09	\$ 0.92	\$ (0.51)
-------------------	---------	---------	---------	---------	-----------

Weighted-average diluted shares outstanding (4)	40,021	47,102	48,571	51,223	51,432
---	--------	--------	--------	--------	--------

**Other Data (at Period End):**

Number of clients customers processed	45,104	45,354	45,228	43,472	44,148
---------------------------------------	--------	--------	--------	--------	--------

**Balance Sheet Data (at Period End):**

Cash, cash equivalents and short-term investments (1)(2)(4)(8)	\$ 132,832	\$ 415,490	\$ 392,224	\$ 149,436	\$ 105,397
Working Capital (3)(4)(8)	180,983	454,117	444,738	172,675	69,642
Total assets (4)	422,388	653,496	638,376	710,407	724,775
Total debt (7)	230,000	230,000	230,000	230,000	228,925
Total treasury stock (4)	667,858	360,259	296,976	224,008	171,111
Stockholders equity (4)	82,524	317,734	298,330	308,070	290,785

**Table of Contents**

- (1) In July 2007, we acquired the ComTec business for approximately \$22 million, and in August 2007, we acquired the Prairie business for approximately \$40 million. These acquired businesses contributed approximately \$16 million of revenue for 2007 and did not materially impact our results of operations. See Note 4 to our Consolidated Financial Statements and MD&A for additional discussion.
- (2) We sold our GSS and plaNet businesses in 2005. As a result, the results of operations for the GSS and plaNet businesses have been reflected as discontinued operations for all periods presented in our Consolidated Statements of Income. We recorded a net pretax gain (loss) on the disposal of these businesses of \$(6.0) million and \$10.9 million, respectively, in 2006 and 2005. We received approximately \$233 million in net cash proceeds from the sale of these businesses, which is the primary reason for the significant increase in cash, cash equivalents, and short-term investments between 2004 and 2005. See Note 2 to our Consolidated Financial Statements for additional discussion.
- (3) During 2003, we recorded a \$119.6 million charge to revenue related to the Comcast arbitration ruling award. The award was segregated such that \$105.7 million was attributable to periods prior to July 1, 2003, and \$13.9 million was attributable to the third quarter of 2003. Of the \$13.9 million attributable to the third quarter, we attributed \$13.5 million to processing revenues, and the remaining \$0.4 million to software maintenance revenues. The arbitration ruling also required us to begin invoicing Comcast lower monthly processing fees beginning in October 2003, which had the effect of reducing quarterly revenues from Comcast by approximately \$13-\$14 million (\$52-\$56 million annually), when compared to amounts prior to the arbitration ruling. As a result of the Comcast arbitration award, we were in a net operating loss position for the year, and recorded an income tax benefit of \$12.7 million. During the fourth quarter of 2003, we paid Comcast \$94.4 million of the arbitration award and in January 2004, we paid the remaining \$25.2 million.
- (4) In August 1999, our Board of Directors approved our Stock Repurchase Program which authorized us to purchase shares of our common stock from time-to-time as business conditions warrant. During 2007, 2006, 2005, 2004, and 2003, we repurchased 13.2 million, 2.5 million, 3.8 million, 3.0 million, and zero shares, respectively. As of December 31, 2007, 1.2 million shares of the 30.0 million shares authorized under the Stock Repurchase Program remain available for repurchase. See Note 12 to our Consolidated Financial Statements and MD&A for additional discussion of the Stock Repurchase Program.
- (5) We have made several changes to our business operations and implemented several cost reduction initiatives that resulted in restructuring charges of \$0.6 million, \$2.4 million, \$14.5 million, \$1.3 million, and \$2.1 million, respectively, for 2007, 2006, 2005, 2004, and 2003. See Note 8 to our Consolidated Financial Statements and MD&A for additional discussion of the restructuring charges.
- (6) In 2003, we adopted the fair value method of accounting for our stock-based awards. In addition, we completed our exchange of certain stock options for restricted stock (also referred to by us as our tender offer) in December 2003. As a result, our stock-based compensation expense is significantly higher in 2007, 2006, 2005, and 2004 when compared to previous years. Additionally, in 2005, certain equity awards held by key members of our management team included a change in control provision that was triggered upon the closing of the sale of the GSS Business. The change in control provision resulted in accelerated vesting as of December 9, 2005 for the equity awards impacted, and thus, stock-based compensation expense of \$4.7 million related to the accelerated vesting of these equity awards was recorded as stock-based compensation expense in the fourth quarter of 2005, of which \$0.9 million was included in discontinued operations, and \$3.8 million was included in continuing operations as part of restructuring charges. Total stock-based compensation expense recognized during 2007, 2006, 2005, 2004, and 2003, was \$11.1 million, \$12.2 million, \$20.4 million, \$14.9 million, and \$5.6 million, respectively. Of these amounts, \$11.1 million, \$12.2 million, \$17.0 million, \$10.6 million, and \$5.0 million, are reflected in continuing operations for 2007, 2006, 2005, 2004, and 2003, respectively, with the remaining amounts reflected in discontinued operations for the respective periods. See Notes 3 and 13 to our Consolidated Financial Statements for additional discussion of these matters.
- (7) In February 2002, we entered into a \$300 million term credit facility to finance the acquisition of the Kenan Business (which became part of our GSS Business). In June 2004, we completed an offering of \$230 million of Convertible Debt Securities and used the proceeds, along with available cash, cash equivalents and short-term investments to: (i) repay the outstanding balance of the term credit facility; (ii) repurchase 2.1 million of shares of our common stock; and (iii) pay debt issuance costs of \$7.2 million. As a result, we wrote off unamortized deferred financing costs attributable to the term credit facility of \$6.6 million. See Note 7 to our Consolidated Financial Statements for additional discussion of our long-term debt.
- (8) As a result of the sale of the GSS and plaNet businesses, our December 31, 2007, 2006 and 2005 Consolidated Balance Sheets no longer include any amounts related to these sold businesses. To provide for consistent comparisons, the December 31, 2004 Consolidated Balance Sheet was restated to reflect the components of the sold GSS and plaNet businesses as assets and liabilities related to discontinued operations. Thus, the 2007, 2006, 2005, and 2004 cash, cash equivalents and short-term investments and working capital amounts in the above table are presented on a different basis, as the 2003 amounts have not been restated and still include amounts related to the GSS and plaNet businesses.

---

## **Table of Contents**

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation Forward-Looking Statements**

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

#### **Management Overview**

*Our Company.* We are a leading provider of outsourced solutions that facilitate customer interaction management on the behalf of our clients, generating approximately 95% of our 2007 revenues from the North American cable and Direct Broadcast satellite (DBS) communications markets. Our solutions also support an increasing number of other industries such as financial services, utilities, telecommunications, and home security.

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

The North American communications industry has experienced significant consolidation over the last few years, resulting in a large percentage of the market being served by a fewer number of service providers with greater size and scale. Consistent with this market concentration, a large percentage of our revenues from continuing operations are generated from a limited number of clients, with approximately 70% of our revenues for 2007 being generated from our four largest clients, which are Comcast, DISH, Time Warner, and Charter.

*Results of Operations.* A summary of our results of operations and other key performance metrics for 2007 are as follows:

Our consolidated revenues from continuing operations for 2007 were \$419.3 million, up \$36.2 million, or 9.4% when compared to \$383.1 million for 2006. The increase in revenues is primarily due to: (i) the continued growth in the use of various ancillary products and services we offer; and to a slightly lesser degree (ii) the revenues generated from the acquired ComTec and Prairie businesses, discussed in greater detail below.

Our operating expenses from continuing operations for 2007 increased \$38.8 million, or 13.1%, to \$335.4 million, when compared to \$296.6 million for 2006. The increase in operating expenses from continuing operations between years is primarily due to: (i) the impact of the ComTec and Prairie business acquisitions; and (ii) an increase in labor-related costs, primarily as a result of an increase in staff levels between periods related to the increase in our R&D and other product support efforts.

Income from continuing operations (net of tax) for 2007 was \$60.2 million, or \$1.50 per diluted share, compared to \$62.6 million, or \$1.33 per diluted share, for 2006. The 13% increase in diluted EPS between years is primarily due to a decrease in shares outstanding as a result of our significant share repurchases made under our stock repurchase program during 2007, discussed in greater detail below.

Continuing operations for 2007 include non-cash charges related to depreciation, amortization, and stock-based compensation expense totaling \$41.8 million (pretax impact), or \$0.68 per diluted share impact, as compared to non-cash charges for 2006 of \$38.6 million (pretax impact), or \$0.51 per diluted share impact.



## Table of Contents

We continue to generate strong cash flows as a result of our profitable operations and through our effective management of our working capital items. During 2007, we generated \$115.4 million of cash flows from operating activities, as compared to \$118.2 million for 2006, with the decrease between years primarily related to lower interest income in 2007 as a result of lower investment balances in 2007. Our cash and short-term investments totaled \$415.5 million at December 31, 2006, compared to \$132.8 million as of December 31, 2007, with this decrease resulting primarily from significant cash outlays we made for stock repurchases during 2007.

Other key events related to our operations for 2007 were as follows:

As discussed in greater detail above, as part of our strategy to extend our customer interaction management capabilities and enter new vertical markets, we closed on the ComTec and Prairie acquisitions during 2007. Combined, these acquisitions contributed approximately \$16 million in revenues and were slightly accretive to our 2007 results of operations. See Note 4 to our Financial Statements for additional discussion of these acquisitions.

In November 2007, we completed our planned \$350 million of stock repurchases that we announced in August 2006. During 2007, we repurchased a total of 13.2 million shares, for a total of \$307.6 million (a weighted-average price of \$23.34 per share). In total, under this program, we purchased 14.8 million shares at a weighted-average price of \$23.72 per share, or approximately 30% of our outstanding common stock at the time we announced the program.

During 2007, we invested \$58.3 million, or approximately 14% of our revenues, on R&D activities. We continued to invest heavily in R&D to ensure that we stay ahead of our clients' needs and advance our clients' business as well as our own. Our clients are facing more competition than ever before from new entrants, and at the same time, are deploying new services at a faster pace than ever before, dramatically increasing the complexity of their business operations. We recognize these challenges and believe our value proposition is to provide solutions that help our clients ensure that each interaction they have with their customers is an opportunity to create value and deepen the business relationship. As a result of our R&D efforts, we have broadened our footprint within our client base with many innovative product offerings.

Effective December 28, 2007, our then-current Chief Executive Officer ( CEO ) and President, Mr. Edward C. Nafus, retired from the company. In conjunction with his retirement, we entered into a Separation and Release Agreement dated December 6, 2007. Under the terms of the Separation and Release Agreement, Mr. Nafus:

Was paid his regular base salary through his retirement date. However, pursuant to the terms of CSG's Performance Bonus Program, Mr. Nafus was not entitled to his 2007 cash incentive bonus as he was not employed on the last calendar day of 2007. Thus, the expense accrued in earlier quarters related to his bonus was reversed in December 2007;

Vested in 102,500 shares of previously granted restricted stock on the date of his retirement. The expense related to this acceleration of vesting was not significant. These shares would have also vested under their original terms had Mr. Nafus retired anytime after March 31, 2008; and

Received a one-time cash payment of \$1.9 million.

The net impact of these retirement benefits to our 2007 operating income was \$1.3 million. We received certain income tax benefits related to Mr. Nafus' retirement such that the net reduction to our net income for 2007 was \$0.01 per diluted share. Mr. Nafus will continue to serve as a member of our Board of Directors, with his current Board term running through mid-2010. See our Form 8-K filed on November 20, 2007 and Form 8-K/A filed on December 11, 2007 for additional details of these matters.

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

Effective December 29, 2007, Mr. Peter E. Kalan, our then current Executive Vice President of Business and Corporate Development assumed the position of CEO and President of our company.

---

## **Table of Contents**

Additionally, Mr. Kalan was also added to our Board of Directors, with his term running through mid-2009. See our Form 8-K filed on November 20, 2007 for additional details of these matters.

We had no material client relationships up for renewal in 2007. However, our current processing agreements with Comcast and DISH run through December 31, 2008. See our Significant Client Relationship Section below for further discussion.

Total customer accounts processed on our systems as of December 31, 2006 were 45.1 million, compared to 45.4 million as of December 31, 2006. We have successfully migrated all of the cable customer accounts processed on our systems to our ACP solution.

### **Significant Client Relationships**

*Comcast.* Comcast continues to be our largest client. For 2007 and 2006, revenues from Comcast represented approximately 27% and 24%, respectively, of our total revenues. Our processing agreement with Comcast runs through December 31, 2008. We are currently engaged in discussions with Comcast regarding contract renewal terms. Although we believe our operating relationship with Comcast is good, there can be no assurances around the timing and/or the terms of any renewal arrangement at this time. The Comcast processing agreement and related material amendments are included in the exhibits to our periodic filings with the SEC. The documents are available on the Internet and we encourage readers to review these documents for further details.

*DISH.* DISH is our second largest client. For 2007 and 2006, revenues from DISH represented approximately 20% and 19%, respectively, of our total revenues. Our processing agreement with DISH runs through December 31, 2008, and provides DISH with the option to extend the term of the agreement for either one or two years beyond the end of December 2008. We are currently engaged in discussions with DISH regarding contract renewal options. Although we believe our operating relationship with DISH is good, there can be no assurances around the timing and/or the terms of any contract extension or renewal arrangement at this time. The DISH processing agreement includes certain annual financial commitments that we expect DISH to exceed based on the number of DISH customers currently on our systems. The DISH processing agreement and related material amendments are included in the exhibits to our periodic filings with the SEC. The documents are available on the Internet and we encourage readers to review these documents for further details.

*Time Warner.* Time Warner is our third largest client. For 2007 and 2006, revenues from Time Warner represented approximately 13% and 12%, respectively, of our total revenues. Our processing agreement with Time Warner runs through March 31, 2013. The Time Warner processing agreement contains provisions establishing annual minimum customer account levels that have to be processed on our systems, which we expect Time Warner to exceed based on the number of Time Warner customers currently on our systems.

*Charter.* Charter is our fourth largest client. For 2007 and 2006, revenues from Charter represented approximately 9% and 11%, respectively, of our total revenues. Our processing agreement with Charter runs through December 31, 2012. The Charter processing agreement contains certain annual minimum customer account levels that have to be processed on our systems, which we expect Charter to exceed based on the number of Charter customers currently on our systems.

*Adelphia.* Adelphia had historically been our fifth largest client, with revenues from Adelphia for 2006 representing approximately 5% of our total revenues. Adelphia had been operating under bankruptcy protection since June 2002. On July 31, 2006, Adelphia completed the sale of its broadband assets to Comcast and Time Warner. Prior to the closing of this transaction, we processed approximately three million Adelphia domestic broadband customer accounts (the Acquired Customer Accounts ) on our systems under a processing agreement that ran through March 31, 2009. Upon closing of this transaction, the Acquired Customer Accounts we processed remained on our systems and were transferred to the respective Comcast and Time Warner processing agreements. This transaction had the following impacts to our business:

In August 2006, we recognized \$2.8 million of one-time, non-recurring revenues related to the Adelphia processing agreement when the Acquired Customer Accounts were transferred under our



**Table of Contents**

Comcast and Time Warner processing agreements. These revenues included items such as upfront payments for services that had previously been deferred and were being recognized ratably over the remaining term of the Adelphia processing agreement.

Our monthly processing revenues related to the Acquired Customer Accounts were \$4.5 million lower in 2006 when compared to 2005 due to the Comcast and Time Warner contracts having lower per unit pricing than the Adelphia contract (due to the relative size of Comcast and Time Warner when compared to Adelphia). The \$4.5 million reflects five months of invoices at the lower per unit pricing for these Acquired Customer Accounts.

Although there was some movement of customer accounts between Comcast and Time Warner as the result of this transaction, it had minimal impact on the overall number of customer accounts processed on our systems as of the end of 2006.

**Stock-Based Compensation Expense**

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

	2007	2006	2005
Continuing operations:			
Cost of processing and related services.	\$ 3,277	\$ 4,371	\$ 3,259
Cost of software, maintenance and services	745	713	758
Research and development	1,246	1,530	1,137
Selling, general and administrative	5,834	5,600	7,688
Restructuring charges			4,205
<b>Total continuing operations</b>	<b>11,102</b>	<b>12,214</b>	<b>17,047</b>
Discontinued operations			3,311
<b>Total stock-based compensation expense (1)</b>	<b>\$ 11,102</b>	<b>\$ 12,214</b>	<b>\$ 20,358</b>

- (1) The decrease in stock-based compensation expense for continuing operations from 2005 is due primarily to certain equity awards held by key members of our management team having a change in control provision that was triggered upon the closing of the sale of the GSS Business in the fourth quarter of 2005, which resulted in accelerated vesting for the equity awards impacted.

See Notes 3 and 13 to our Consolidated Financial Statements for additional discussion of our stock-based compensation expense.

**Critical Accounting Policies**

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

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

## Table of Contents

*Revenue Recognition.* The revenue recognition policies that involve the most complex or subjective decisions or assessments that may have a material impact on our business continuing operations relate to: (i) the application of the guidelines of Emerging Issues Task Force ( EITF ) Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables ( EITF 00-21 ) when determining a revenue arrangement s separate units of accounting; and (ii) the accounting for software arrangements.

For those revenue arrangements within the scope of EITF No. 00-21, we are required to evaluate all deliverables in the arrangement to determine whether they represent separate units of accounting. If the deliverables qualify as separate units of accounting, the arrangement consideration is allocated among the separate units of accounting based upon their relative fair values, and applicable revenue recognition criteria are considered for the separate units of accounting. If the deliverables do not qualify as separate units of accounting, the consideration allocable to delivered items is combined with the consideration allocable to the undelivered items, and the appropriate recognition of revenue is then determined for those combined deliverables as a single unit of accounting. For the processing agreements that we have historically evaluated under EITF No. 00-21, we have generally concluded that the deliverables do not qualify as separate units of accounting, and thus have treated the deliverables as a single unit of accounting, with the revenue recognized ratably over the term of the processing agreement. The determination of separate units of accounting, and the determination of objective and reliable evidence of fair value of the undelivered items, if applicable, both require judgments to be made by us.

The accounting for software arrangements, especially when software is sold in a multiple-element arrangement, is complex and requires judgments in the following areas: (i) the identification of the separate elements of the software arrangement; (ii) the determination of whether any undelivered elements are essential to the functionality of the delivered elements; (iii) the assessment of whether our hosted service transactions meet the requirements of EITF Issue No. 00-03, Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity s Hardware , to be treated as a separate element to the software arrangement; (iv) the determination of vendor-specific objective evidence of fair value for the various undelivered elements of the software arrangement; and (v) the period of time maintenance services are expected to be performed. The evaluation of these factors, and the ultimate revenue recognition decisions, require significant judgments to be made by us. The judgments made in this area could have a significant effect on revenues recognized in any period by changing the amount and/or the timing of the revenue recognized. In addition, because software licenses typically have little or no direct, incremental costs related to the recognition of the revenue, these judgments could also have a significant effect on our results of operations.

*Allowance for Doubtful Accounts Receivable.* We maintain an allowance for doubtful accounts receivable based on client-specific allowances, as well as a general allowance. Specific allowances are maintained for clients which are determined to have a high degree of collectibility risk based on such factors, among others, as: (i) the aging of the accounts receivable balance; (ii) the client s past payment experience; (iii) the economic condition of the industry in which the client conducts the majority of its business; and (iv) a deterioration in a client s financial condition, evidenced by weak financial condition and/or continued poor operating results, reduced credit ratings, and/or a bankruptcy filing. In addition to the specific allowance, we maintain a general allowance for all our accounts receivable which are not covered by a specific allowance. The general allowance is established based on such factors, among others, as: (i) the total balance of the outstanding accounts receivable, including considerations of the aging categories of those accounts receivable; (ii) past history of uncollectible accounts receivable write-offs; and (iii) the overall creditworthiness of the client base. Our credit risk is heightened due to our concentration of clients within the North American cable television and satellite industries. A considerable amount of judgment is required in assessing the realizability of accounts receivable. Should any of the factors considered in determining the adequacy of the overall allowance change significantly, an adjustment to the allowance for doubtful accounts receivable may be necessary. Because of the overall significance of our gross billed accounts receivable balance (\$115.6 million as of December 31, 2007), such an adjustment could be material.

---

**Table of Contents**

*Impairment Assessments of Long-Lived Assets.* Long-lived assets, which for us relates primarily to property and equipment, software and client contracts, are required to be evaluated for possible impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. A long-lived asset is impaired if estimated future undiscounted cash flows associated with that asset, without consideration of interest, are insufficient to recover the carrying amount of the long-lived asset. Once deemed impaired, even if by \$1, the long-lived asset is written down to its fair value which could be considerably less than the carrying amount or future undiscounted cash flows. The determination of estimated future cash flows and, if required, the determination of the fair value of a long-lived asset, are by their nature, highly subjective judgments. Changes to one of more of the assumptions utilized in such an analysis could materially affect our impairment conclusions for long-lived assets.

*Loss Contingencies.* In the ordinary course of business, we are subject to claims (and potential claims) related to various items including but not limited to: (i) legal and regulatory matters; (ii) client and vendor contracts; (iii) product and service delivery matters; and (iv) labor matters. We follow the guidelines of SFAS No. 5, *Accounting for Contingencies* in determining the appropriate accounting and disclosures for such matters, which requires us to assess the likelihood of any adverse judgments in or outcomes to these matters, as well as the potential ranges of probable losses. A determination of the amount of reserves for such contingencies, if any, for these contingencies is based on an analysis of the issues, often with the assistance of legal counsel. The evaluation of such issues, and our ultimate accounting and disclosure decisions, are by their nature, subject to various estimates and highly subjective judgments. Should any of the factors considered in determining the adequacy of any required reserves change significantly, an adjustment to the reserves may be necessary. Because of the potential significance of these issues, such an adjustment could be material.

*Income Taxes.* We are required to estimate our income tax liability in each jurisdiction in which we operate, which is primarily the U.S. (including both Federal and state income taxes). Various judgments are required in evaluating our income tax positions and determining our provisions for income taxes. During the ordinary course of our business, there are certain transactions and calculations for which the ultimate income tax determination may be uncertain. In addition, we may be subject to examination of our income tax returns by various tax authorities which could result in adverse outcomes. For these reasons, we establish a liability associated with unrecognized tax benefits based on estimates of whether additional taxes and interest may be due. We adjust this liability based upon changing facts and circumstances, such as the closing of a tax audit or the closing of a tax year upon the expiration of a statute of limitations. Should any of the factors considered in determining the adequacy of this liability change significantly, an adjustment to the liability may be necessary. Because of the potential significance of these issues, such an adjustment could be material.

This income tax evaluation process requires us to estimate the actual current tax liability together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These temporary differences result in deferred income tax assets and liabilities in our Consolidated Financial Statements. We must then assess the likelihood that our net deferred income tax assets will be recovered, primarily from future taxable income. To the extent recovery is not likely, we must establish a valuation allowance. As of December 31, 2007, we had net deferred income tax assets of \$20.1 million, which represented approximately 5% of our total assets. We believe that between (i) carryback opportunities to past periods with taxable income; and (ii) sufficient taxable income to be generated in the future, we will realize the benefit of our net deferred income tax assets. The assumption of future taxable income is, by its nature, subject to various estimates and highly subjective judgments.

*Business Combinations and Asset Purchases.* Accounting for business combinations and asset purchases, including the allocation of the purchase price to acquired assets and assumed liabilities based on their estimated fair values, requires us in certain circumstances to estimate fair values for items that have no ready market or for which no independent market exists. Under such circumstances, we use our best judgment to determine a fair value based upon inference to other transactions and other data. As a result, the amounts determined by us for such items as accounts receivable, identifiable intangible assets, goodwill, and deferred revenue are not individually the result of an arm's length transaction, but are the result of management estimates of the fair value

## **Table of Contents**

and the allocation of the purchase price. Accordingly, revenue recognized by us related to fulfillment of assumed contractual obligations is based on fair value estimates made by us.

For larger and/or more complex acquisitions, the assignment of value to individual intangible assets generally requires the use of a specialist, such as an appraiser or valuation expert. The assumptions used in the appraisal or valuation process are forward-looking, and thus subject to significant judgments and interpretations by us. Because individual intangible assets: (i) may be expensed immediately upon acquisition (e.g., purchased in-process R&D assets); (ii) amortized over their estimated useful life (e.g., acquired software); or (iii) not amortized at all (e.g., goodwill), the assigned values could have a material impact on our results of operations in current and future periods.

### **Detailed Discussion of Results of Operations**

*Total Revenues.* Total revenues from continuing operations for: (i) 2007 increased \$36.2 million, or 9.4% to \$419.3 million, from \$383.1 million for 2006; and (ii) 2006 increased \$5.8 million, or 1.5%, to \$383.1 million, from \$377.3 million for 2005. The increases in total revenues from continuing operations between years relates primarily to an increase in our processing revenues, discussed in further detail below.

*Processing Revenue.* Processing revenues for: (i) 2007 increased \$30.3 million, or 8.6%, to \$382.1 million, from \$351.8 million for 2006; and (ii) 2006 increased \$5.3 million, or 1.5%, to \$351.8 million, from \$346.5 million for 2005.

The increase in processing revenues between 2007 and 2006 was primarily due to: (i) the acquisition of the ComTec and Prairie businesses, discussed above; and (ii) increased utilization of new and existing products and services by our clients, to include such things as higher usage of marketing services and various ancillary customer care solutions, which include things such as order workflow tools, professional services, system interfaces and reporting tools. All ComTec and Prairie revenues fall within this revenue classification.

Processing revenues for 2006 were up slightly when compared to 2005. This is a result of certain downward revenue pressures we experienced during 2006 related to several specific client matters, which were more than offset by the continued growth we saw in the use of various ancillary products

**Table of Contents**

and services we offer to our existing client base. The downward revenue pressures consisted primarily of the following items: (i) lower revenues in 2006 from DISH due to new contract pricing becoming effective November 1, 2005; (ii) client regionalization projects which resulted in the movement of approximately one million customer accounts from our systems to a competitor's system during the early part of 2006; (iii) lower revenues beginning in August 2006 related to the Adelphia Acquired Customer Accounts as a result of these accounts moving under our Comcast and Time Warner contracts, as discussed above; and (iv) \$2.3 million related to one-time contract termination and bankruptcy settlements recorded in 2005, with no comparable amounts in 2006. These downward pressures were more than offset by the continued growth we saw in the use of various ancillary products and services we offer.

Additional information related to processing revenues is as follows:

Amortization of the client contracts intangible asset (reflected as a reduction of processing revenues) for 2007, 2006, and 2005, was \$14.4 million, \$13.4 million, and \$12.7 million, respectively.

Total customer accounts processed on our systems as of December 31, 2007, 2006, and 2005, were 45.1 million, 45.4 million, and 45.2 million, respectively.

The decrease in total customer accounts processed on our systems between 2007 and 2006 is primarily due to the transition of certain customer accounts onto a client's internal system, and to a lesser degree, certain smaller subscriber deconversions related to the clean-up of some of the Adelphia matters between Time Warner and Comcast, as discussed above.

As a result of certain client regionalization projects completed during 2006, approximately one million customer accounts processed on our systems moved to a competitor's system. However, this decrease was offset primarily by organic growth experienced by our clients. Additionally, as discussed above, the impact of the closing of the Adelphia transaction had minimal impact on the overall number of customer accounts processed on our systems as of the end of 2006.

*Software, Maintenance and Services Revenues.* Software, maintenance and services revenues for: (i) 2007 increased \$5.9 million, or 18.7%, to \$37.2 million, from \$31.3 million for 2006; and (ii) 2006, which includes revenues from Telution, acquired on March 1, 2006, were relatively flat between years at \$31.3 million, compared to \$30.9 million for 2005. The increase in software, maintenance and services revenues between 2007 and 2006 is due primarily to our emphasis on expanding our professional services organization, to include the acquisition of Telution.

*Cost of Processing and Related Services.* The cost of processing and related services revenues consists principally of the following: (i) data processing and communications costs; (ii) statement production costs (e.g., labor, paper, envelopes, equipment, equipment maintenance, etc.); (iii) client support organizations (e.g., our client support call center, account management, etc.); (iv) various product support organizations (e.g., product management and delivery, product maintenance, etc.); and (v) facilities and infrastructure costs related to the statement production and support organizations. The costs related to new product development (including significant enhancements to existing products) are included in R&D expenses.

The cost of processing and related services for: (i) 2007 increased \$19.6 million, or 11.3%, to \$193.1 million, from \$173.5 million for 2006; and (ii) 2006 increased \$3.2 million, or 1.9%, to \$173.5 million, from \$170.3 million for 2005.

The increase in cost of processing and related services between 2007 and 2006 was primarily due to: (i) the acquisitions of the ComTec and Prairie businesses, as all of the ComTec and Prairie cost of revenues fall within this expense classification; and to a lesser degree, (ii) an increase in data processing costs, primarily due to greater processing requirements for ACP functionality, and an increase in variable costs related to the delivery of ancillary products and services (e.g., print costs, etc.), which directly correlate with the increase in revenues related to ancillary products and services.

---

## **Table of Contents**

The increase in cost of processing and related services between 2006 and 2005 was primarily due to an increase in labor-related costs, to include the impact of annual merit wage increases.

Gross margin percentages related to our processing and related services revenues were 49.5%, 50.7%, and 50.8%, for 2007, 2006, and 2005, respectively.

The decrease in gross margin percentages between 2007 and 2006 is primarily the result of the acquisition of the ComTec and Prairie businesses. These acquired businesses operate at a lower gross margin percentage level than our historical business operations.

The relatively flat gross margins between 2006 and 2005 are consistent with the relatively flat revenues and cost of related revenues, as noted above.

*Cost of Software, Maintenance and Services.* The cost of software, maintenance and services revenues consists principally of the following: (i) client support organizations (e.g., our client support call center, account management, etc.); (ii) various product support organizations (e.g., product management and delivery, product maintenance, etc.); (iii) professional services organization; (iv) facilities and infrastructure costs related to these organizations; (v) third-party software costs and/or royalties related to certain software products; and (vi) amortization of acquired software and acquired client contracts. The costs related to new product development (including significant enhancements to existing products) are included in R&D expenses.

The cost of software, maintenance and services for: (i) 2007 increased \$3.7 million, or 17.6%, to \$24.7 million, from \$21.0 million for 2006; and (ii) 2006 increased \$1.3 million, or 6.4%, to \$21.0 million, from \$19.7 million for 2005.

The increase in cost of software, maintenance and services between 2007 and 2006 was due primarily to an increase in employee-related costs as a result of an increase in personnel assigned internally to software maintenance projects and our emphasis on expanding our professional services organization. This increase in expense is reflective of the increase in revenues between years.

The increase in cost of software, maintenance and services between 2006 and 2005 was due primarily to the amortization of the Telution intangible assets acquired in March 2006.

Gross margin percentages related to our software, maintenance and services revenues were 33.7%, 33.1%, and 36.1%, respectively, for 2007, 2006, and 2005. The decrease in the gross margin percentages between 2006 and 2005 is primarily related to 2005 having a greater mix of software licenses as part of total revenues for the year. Variability in quarterly revenues and operating results are inherent characteristics of companies that sell software licenses, and perform professional services. Our quarterly revenues for software licenses and professional services may fluctuate, depending on various factors, including the timing of executed contracts and revenue recognition, and the delivery of contracted services or products. However, the costs associated with software and professional services revenues are not subject to the same degree of variability (i.e., these costs are generally fixed in nature within a relatively short period of time), and thus, fluctuations in our software and maintenance, professional services, and overall gross margins, will likely occur between periods.

*Overall Gross Margin (Exclusive of Depreciation).* Our overall gross margin for 2007, 2006, and 2005, was \$201.5 million, \$188.6 million, and \$187.3 million, respectively. The overall gross margin percentages for 2007, 2006, and 2005, were 48.0%, 49.2%, and 49.6%, respectively. The changes in the gross margin and gross margin percentage between 2007, 2006, and 2005, were due to the factors discussed above.

*R&D Expense.* R&D expense for: (i) 2007 increased \$12.1 million, or 26.3%, to \$58.3 million, from \$46.2 million for 2006; and (ii) 2006 increased \$12.3 million, or 36.1%, to \$46.2 million, from \$33.9 million for 2005. We did not capitalize any software development costs in 2007, 2006, or 2005.

The increase in R&D expense between 2007 and 2006 was primarily due to an increase in employee-related costs, as more employees were hired and dedicated to R&D efforts during the year, reflective of our increased focus on product development and enhancement efforts.



## Table of Contents

The increase in R&D expense between 2006 and 2005 was primarily due to an increase in employees, to include the development personnel that came over in the acquisition of Telution.

During 2007, 2006, and 2005, our R&D efforts were focused on the continued evolution of our ACP product, both functionally and architecturally, in response to market demands that our products have certain functional features and capabilities, as well as architectural flexibilities (such as service oriented architecture, or SOA). This product evolution will result in the modularization of certain product functionality that historically has been tightly integrated with the ACP platform, which will allow us to respond more quickly to required changes to our products and provide greater interoperability with other computer systems. Although our primary value proposition to our clients will continue to be the breadth and depth of our fully pre-integrated solution, these R&D efforts will also allow us to separate certain software components so as to allow such components to be marketed on a stand-alone basis where a specific client requirement and/or business need dictates, including the use of certain products across non-CSG customer care and billing systems.

As part of this product evolution strategy, we acquired Telution, Inc. ( Telution ) in March of 2006 to further expand these capabilities around our ACP platform. Our recent R&D efforts include the integration of these acquired technologies into our solution set. In particular, the acquired software assets are an integral part of the new functionality that has been added to our ACP platform since the acquisition, including a robust product catalog, offer and order management functions, and product capabilities to support commercial customers.

As a percentage of total revenues, R&D expense for 2007, 2006, and 2005, was 13.9%, 12.1%, and 9.0%, respectively. At this time, we expect our future R&D efforts to continue to focus on similar tasks as noted above. In the near term, we expect that the percentage of our total revenues spent on R&D to be relatively consistent with that of 2007, which reflected R&D expenses as a percentage of total revenues of approximately 14%, with the level of our R&D spend highly dependent upon the opportunities that we see in our markets.

*Selling, General and Administrative Expense ( SG&A ).* SG&A expense for: (i) 2007 increased by \$2.6 million, or 6.1%, to \$45.7 million, from \$43.1 million for 2006; and (ii) 2006 decreased \$9.4 million, or 17.8%, to \$43.1 million, from \$52.5 million for 2005. As a percentage of total revenues, SG&A expense for 2007, 2006, and 2005, was 10.9%, 11.3%, and 13.9%, respectively.

The increase in SG&A expense between 2007 and 2006 is primarily due to the impact of the ComTec and Prairie sales and marketing costs.

The decrease in SG&A expense between 2006 and 2005 relates primarily to the retirement benefits for our former CEO, Mr. Neal Hansen, who retired in 2005. In conjunction with his retirement, Mr. Hansen was paid \$9.6 million in retirement benefits, of which \$0.2 million, \$8.9 million, and \$0.5 million were expensed in 2006, 2005, and 2004 respectively.

*Depreciation Expense.* Depreciation expense for all property and equipment is reflected separately in the aggregate and is not included in the cost of revenues or the other components of operating expenses. Depreciation expense for 2007, 2006, and 2005, was \$12.9 million, \$10.4 million, and \$9.9 million, respectively. The increase in depreciation expense for 2007 is due primarily to the increased capital expenditures we have made over the last five quarters, to include the acquired property and equipment from our acquisition activities.



**Table of Contents**

*Restructuring Charges.* See Note 8 to our Consolidated Financial Statements for a more detailed discussion of our cost reduction initiatives and related restructuring charges, including the current activity in accrued liabilities related to the restructuring charges. Restructuring charges included in total operating expenses, and the impact (net of related estimated income tax expense) these restructuring charges had on net income from continuing operations and diluted earnings per share, for 2007, 2006, and 2005, are as follows (in thousands, except diluted earnings per share):

	2007	2006	2005
Activities related to the sale of the GSS Business:			
Stock-based compensation related to change in control provision	\$	\$	\$ 3,783
Involuntary termination of executive officer			1,357
Involuntary termination of certain corporate support staff		379	590
Management incentive bonuses related to the GSS Business sale			1,409
Subtotal restructuring charges related to the sale of the GSS Business		379	7,139
Disposal of corporate aircraft		100	1,556
Termination of long-term processing agreement		1,115	6,209
Facility abandonments	246	748	(389)
All other restructuring charges	384	26	19
Total restructuring charges	\$ 630	\$ 2,368	\$ 14,534

Impact of restructuring charges on results of continuing operations (i.e., have reduced operating results):

Net income	\$ 406	\$ 1,467	\$ 9,311
Diluted earnings per share	\$ 0.01	\$ 0.03	\$ 0.19

*Operating Income.* Operating income for: (i) 2007 was \$83.8 million, or 20.0% of total revenues, compared to \$86.5 million, or 22.6% of total revenues for 2006; and (ii) 2006 was \$86.5 million, or 22.6% of total revenues, compared to \$76.4 million, or 20.3% of total revenues for 2005.

The decreases in operating income and the operating income margin between 2007 and 2006 were primarily due to: (i) an overall increase in R&D expenditures, as discussed above; and (ii) the impact of the ComTec and Prairie acquisitions in 2007.

The increases in operating income and the operating income margin between 2006 and 2005 were primarily due to the decreases in restructuring charges between years and the expense incurred in conjunction with the retirement of our former CEO in 2005, as discussed above. The \$14.5 million of restructuring charges in 2005 and the \$8.9 million of retirement benefits recorded in 2005 had the effect of reducing our operating margin by 6.2 percentage points for 2005. Ignoring the one-time impact of these items on 2005, the comparable, normalized operating margins between years decreased, with such decrease in 2006 related primarily to our 2006 increase in R&D expense, and the impact of our Telution acquisition in March 2006.

**Table of Contents**

Our operating results include non-cash charges related to depreciation, amortization of intangible assets (primarily shown as a reduction of processing revenues), and stock-based compensation expense. The total amount of these non-cash expenses, and their impact (net of related estimated income tax expense) on net income from continuing operations and diluted earnings per share, for 2007, 2006, and 2005, are as follows (in thousands, except diluted earnings per share):

	2007	2006	2005
Non-cash expenses related to:			
Depreciation	\$ 12,900	\$ 10,438	\$ 9,862
Amortization of intangible assets	17,789	15,913	13,586
Stock-based employee compensation	11,102	12,214	17,047
<b>Total</b>	<b>\$ 41,791</b>	<b>\$ 38,565</b>	<b>\$ 40,495</b>

Impact of non-cash expenses on results of continuing operations (i.e., have reduced operating results):

Net income	\$ 26,902	\$ 23,895	\$ 25,941
Diluted earnings per share	\$ 0.68	\$ 0.51	\$ 0.53

*Interest Expense.* Our interest expense relates primarily to our Convertible Debt Securities, issued in June 2004, which have a stated coupon rate of 2.5%. The following are the key points related to our interest expense between years:

Interest expense for: (i) 2007 decreased \$0.4 million, or 4.5%, to \$7.1 million, from \$7.5 million for 2006; and (ii) 2006 and 2005 remained consistent between periods at \$7.5 million.

The weighted-average balance of our long-term debt for 2007, 2006, and 2005 was \$230.0 million.

The weighted-average interest rate on our debt borrowings for 2007, 2006, and 2005, including the amortization of deferred financing costs and commitment fees on our revolving credit facility, was 3.2%.

See Note 7 to our Consolidated Financial Statements for additional discussion of our Convertible Debt Securities.

*Interest and Investment Income, net.* Interest and investment income, net, for: (i) 2007 decreased \$5.5 million, or 24.8%, to \$16.5 million, from \$22.0 million for 2006; and (ii) 2006 increased \$17.9 million to \$22.0 million, from \$4.1 million for 2005.

The decrease in interest and investment income between 2007 and 2006 was the result of a significant decrease in our cash and short-term investment balances between years primarily due to our stock repurchase activity in 2007, and to a lesser degree, the purchase of the ComTec and Prairie businesses in 2007.

The large increase in interest and investment income between 2006 and 2005 was primarily a result of a significant increase in our cash, cash equivalents, and short-term investment balances between periods, primarily the result of the cash proceeds we received from the sale of the GSS Business in December 2005.

*Income Tax Provision.* The following are the key changes related to our income tax provision from continuing operations between years:

For 2007, we recorded an income tax provision of \$33.3 million, or an effective income tax rate of approximately 36%, compared to an income tax provision of \$38.4 million, or an effective income tax rate of approximately 38% for 2006.

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

For 2006, we recorded an income tax provision of \$38.4 million, or an effective income tax rate of approximately 38%, compared to an income tax provision of \$26.2 million, or an effective income tax rate of approximately 36% in 2005.

---

## **Table of Contents**

The increase in the 2006 effective income tax rate is the result of recording an effective income tax rate of approximately 42% during the fourth quarter. The higher effective income tax rate was primarily the result of a correction of minor income tax expense items from previous periods that were not considered material to the current or past periods, giving consideration to the SEC's Staff Accounting Bulletin No. 108, and thus were recorded in their entirety in the fourth quarter. The accounting correction of these items was considered one-time in nature and did not impact our estimated income tax rate for 2007.

As of December 31, 2007, our net deferred income tax assets were \$20.1 million and represented approximately 5% of total assets. We continue to believe that sufficient taxable income will be generated in the future to realize the benefit of these deferred income tax assets. Our assumptions of future profitable operations are supported by our strong operating performances over the last several years.

*Discontinued Operations.* As discussed above, as a result of the sale of the GSS and plaNet businesses in December 2005, the GSS and plaNet businesses have been reflected as discontinued operations in our results of operations for all periods presented. Gain (loss) from discontinued operations (net of tax) for 2007, 2006, and 2005, was \$0.6 million, \$(2.8) million, and \$6.5 million, respectively.

Discontinued operations activity in 2007 consisted primarily of the reduction of a certain reserve related to an indemnification agreement associated with the sale of the GSS business in 2005.

Discontinued operations activity for 2006 consisted of the following:

During the third quarter of 2006, we made a \$6.0 million payment to Comverse related to the settlement of a dispute over a joint tax election associated with the sale of our GSS Business to Comverse in December 2005. This payment was considered a reduction in the purchase price previously paid by Comverse, and thus is reflected as part of discontinued operations. This settlement payment was not anticipated, and we do not expect any similar purchase price adjustments in future periods.

During the fourth quarter of 2006, we recorded an income tax benefit from the true-up of certain state income tax items related to the GSS Business. The previous accounting for these matters was appropriately based on various estimates. With the filing of the various state income tax returns during the fourth quarter, the determination of the actual benefits due became certain.

As a result of this activity, 2006 net income per diluted share was reduced by \$(0.06).

Discontinued operations activity for 2005 included a net pretax gain on the disposals of the GSS and plaNet businesses of \$10.9 million.

## **Liquidity**

*Basis of Presentation.* Cash flows, primarily related to 2005, have not been segregated between continuing operations and discontinued operations in the accompanying Consolidated Statements of Cash Flows. Therefore, unless indicated otherwise, all historical cash flow information presented below reflects the cash flow results from both continuing and discontinued operations.

*Cash and Liquidity.* As of December 31, 2007, our principal sources of liquidity included cash, cash equivalents, and short-term investments of \$132.8 million, compared to \$415.5 million as of December 31, 2006. The significant decrease in cash, cash equivalents, and short-term investments between years is primarily due to the stock repurchase activity during 2007, and to a lesser degree, the purchase of the ComTec and Prairie businesses in 2007. We generally invest our excess cash balances in low-risk, short-term investments to limit our exposure to market and credit risks. We have ready access to all of our cash, cash equivalents, and short-term investment balances.

In addition to the above sources of liquidity, we also have a \$100 million senior secured revolving credit facility (the 2004 Revolving Credit Facility ) with a syndicate of U.S. financial institutions that expires in September 2009. The 2004 Revolving Credit Facility has a \$40 million

sub-facility for standby and commercial

**Table of Contents**

letters of credit and a \$10 million sub-facility for same day advances. As of the date of this filing, we have made no borrowings under the 2004 Revolving Credit Facility. Our ability to borrow under the 2004 Revolving Credit Facility is subject to a limitation of total indebtedness based upon the results of consolidated leverage and interest coverage ratio calculations, and a minimum liquidity requirement. As of December 31, 2007, we were in compliance with the financial ratios and other covenants of the 2004 Revolving Credit Facility, and had \$99.5 million of the Revolving Credit Facility available to us.

*Cash Flows From Operating Activities.* We calculate our cash flows from operating activities in accordance with generally accepted accounting principles, beginning with net income and then adding back the impact of non-cash items (e.g., depreciation, amortization, stock-based compensation, etc.), and then factoring in the impact of changes in working capital items.

Our primary source of cash is from our operating activities. Our current business model consists of a significant amount of recurring revenue sources related to our long-term processing arrangements (billed monthly), and software maintenance agreements (billed monthly, quarterly, or annually.) This recurring revenue base provides us with a reliable and predictable source of cash. In addition, software license fees and professional services revenues provide for material amounts of cash, but the payment streams for these items are not as predictable.

The primary use of our cash is to fund our operating activities. Approximately 50% of our total operating costs relate to labor costs (both employees and contracted labor) for: (i) compensation; (ii) related fringe benefits; and (iii) reimbursements for travel and entertainment expenses. The other primary cash requirements for our operating expenses consist of: (i) postage; (ii) paper and related supplies for our statement processing centers; (iii) data processing and related services and communication lines for our outsourced processing business; and (iv) rent and related facility costs. These items are purchased under a variety of both short-term and long-term contractual commitments. A summary of our material contractual obligations is provided below as well.

See *Cash Flows From Investing Activities* and *Cash Flows From Financing Activities* below for the other primary sources and uses of our cash.

Our 2006 and 2007 consolidated net cash flows from operating activities, broken out between operations and changes in working capital assets and liabilities, for the indicated periods are as follows (in thousands):

	Operations	Changes in Working Capital Assets and Liabilities	Net Cash Provided by Operating Activities Quarter Totals
<b>Cash Flows from Operating Activities:</b>			
<b>2006:</b>			
March 31	\$ 25,872	\$ (3,894)	\$ 21,978
June 30 (1)	29,358	9,393	38,751
September 30	31,489	(2,937)	28,552
December 31	29,549	(680)	28,869
<b>Year-to-date total</b>	<b>\$ 116,268</b>	<b>\$ 1,882</b>	<b>\$ 118,150</b>
<b>2007:</b>			
March 31 (2)	\$ 27,199	\$ 8,464	\$ 35,663
June 30	28,217	(3,719)	24,498
September 30 (3)	28,404	7,266	35,670
December 31 (4)	30,355	(10,807)	19,548
<b>Year-to-date total</b>	<b>\$ 114,175</b>	<b>\$ 1,204</b>	<b>\$ 115,379</b>

- (1) Cash flows from operating activities for the second quarter of 2006 were positively impacted by favorable changes in working capital items during the quarter, primarily related to the reduction in the accounts receivable balance.



**Table of Contents**

- (2) Cash flows from operating activities for the first quarter of 2007 were positively impacted by approximately \$10 million as we received an additional monthly processing invoice payment from a key client before quarter end. As a result, we received four monthly processing invoice payments from this key client during the first quarter of 2007, as compared to three monthly processing invoice payments in all other quarters presented above.
- (3) Cash flows from operating activities for the third quarter of 2007 were positively impacted by normal timing changes in certain operating assets and liabilities for the quarter.
- (4) Cash flows from operating activities for the fourth quarter of 2007 were negatively impacted by normal changes in working capital items, primarily related to the timing of payments for accrued payables and the collections on outstanding accounts receivable at quarter end.
- We believe the above table illustrates our ability to consistently generate strong quarterly and annual cash flows, and the importance of managing our working capital items, in particular, timely collections of our accounts receivable.

Management of our billed accounts receivable is one of the primary factors in maintaining strong quarterly cash flows from operating activities. Our billed trade accounts receivable balance includes billings for several non-revenue items (primarily postage, sales tax, and deferred revenue items). As a result, we evaluate our performance in collecting our accounts receivable through our calculation of days billings outstanding ( DBO ) rather than a typical days sales outstanding ( DSO ) calculation. DBO is calculated based on the billings for the period (including non-revenue items) divided by the average monthly net trade accounts receivable balance for the period. Our target range for our DBO is 55-65 days.

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

Quarter Ended	Gross	Allowance	Net Billed	DBO
<b>2006:</b>				
December 31	111,163	(1,143)	110,020	64
<b>2007:</b>				
March 31 (1)	104,677	(1,577)	103,100	63
June 30	104,254	(1,619)	102,635	61
September 30 (2)	111,541	(1,589)	109,952	60
December 31 (3)	115,619	(1,487)	114,132	59

- (1) The decrease in gross and net billed trade accounts receivable at March 31, 2007 is primarily due to the receipt of an additional monthly processing invoice payment from a key client of approximately \$10 million before quarter end.
- (2) The \$7.3 million increase in gross and net billed trade accounts receivable at September 30, 2007 is primarily due to the acquisitions of the ComTec and Prairie businesses.
- (3) The \$4.1 million increase in gross and net billed trade accounts receivable at December 31, 2007 is primarily due to the timing of client payments at quarter end.

Other significant fluctuations in key balance sheet items between December 31, 2007 and 2006 are as follows:

*Deferred Income Tax Assets.*

The decrease in net deferred income tax assets (current and non-current) from \$28.5 million as of December 31, 2006 to \$20.1 million as of December 31, 2007 is primarily due to the difference in tax and book amortization related to intangible assets and the interest deduction related to our Convertible Debt Securities.



**Table of Contents***Income Taxes Receivable/Payable.*

Effective January 1, 2007, we adopted the provisions of Financial Accounting Standards Board Interpretation 48, Accounting for Uncertainty in Income Taxes (FIN 48). As a result, we: (i) recognized a \$1.5 million reduction in our income taxes payable balance, which was accounted for as an increase to our January 1, 2007 accumulated earnings balance; and (ii) reclassified, on our Consolidated Balance Sheet, a portion of our income taxes payable balance from current liabilities to non-current liabilities. The adoption of FIN 48 had no impact on our 2007 cash flows. See Note 3 to our Consolidated Financial Statements for additional discussion of the adoption of FIN 48. The income taxes receivable balance in current assets on our Consolidated Balance Sheet as of December 31, 2007 was primarily the result of making estimated Federal tax payments in 2007 in excess of our anticipated Federal income tax liability.

*Cash Flows From Investing Activities.* Our typical investing activities consist of purchases/sales of short-term investments, purchases of property and equipment, and investments in client contracts, which are discussed below. However, during 2007 and 2006, we had several unique items included in our cash flows from investing activities. As discussed above, during 2007, we acquired the ComTec and Prairie businesses in July 2007 and August 2007, respectively. During 2006, our cash flows from investing activities included: (i) a \$6.0 million payment made to Comverse during the third quarter of 2006 related to the sale of the GSS Business in 2005; (ii) the proceeds received from the sale of our corporate aircraft in January 2006 that was purchased in December 2005 and held for sale; and (iii) the acquisition of Telution in March 2006.

*Purchases/Sales of Short-term Investments.*

During 2007, 2006, and 2005, we purchased \$209.4 million, \$283.1 million, and \$88.1 million, respectively, and sold or had mature \$379.0 million, \$156.2 million, and \$66.3 million, respectively, of short-term investments. We continually evaluate the possible uses of our excess cash balances and will likely purchase additional short-term investments in the future.

*Property and Equipment/Client Contracts.*

Our capital outlays typically relate to computer hardware and related software items, and statement production equipment. Our investment in client contracts typically consists of: (i) cash payments to clients as an incentive to bring new customers to, or retain customers on, our processing systems; and (ii) direct and incremental costs that we have capitalized related to revenue arrangements where we are required to defer conversion/set-up services fees and recognize those fees as the related processing services are performed.

Our annual capital expenditures for property and equipment, and investments in client contracts were as follows (in thousands):

	2007	2006	2005
Property and equipment	\$ 20,271	\$ 12,651	\$ 12,798
Client contracts	7,436	10,658	6,060

Capital expenditures related to continuing operations consisted principally of the following: (i) computer hardware and related software; (ii) statement production equipment; and (iii) facilities and internal infrastructure improvements. Capital expenditures related to continuing operations during 2005 were approximately \$7 million. The increase in capital expenditures for 2007 consists principally of purchases of hardware and software infrastructure items to support many of our new products and services to meet our clients expanding business needs. While our core ACP processing product utilizes data processing capacity leased from FDC, and therefore, allowing us to avoid the large capital investment needed for such equipment, many of our new products and services ancillary to ACP (e.g., certain aspects of our WorkForce Express product, enhanced product catalog functionalities, etc.) are run on open system computer servers (that generally interface with ACP) that we own.

## Table of Contents

Our investments in client contracts for 2007, 2006, and 2005, relate primarily to: (i) incentives provided to clients to convert their customer accounts to, or retain their customer's accounts on, our customer care and billing systems; and (ii) direct and incremental costs incurred for conversion/set-up services related to long-term processing arrangements. As of December 31, 2007, we did not have any material commitments for capital expenditures or for investments in client contracts.

*Cash Flows From Financing Activities.* We have had limited financing activities over the last several years, and historically, we have not been active in the capital markets. Our financing activities typically consist of various activities with our common stock.

### *Issuance of Common Stock.*

Proceeds from the issuance of common stock for 2007, 2006, and 2005, were \$2.2 million, \$11.5 million, and \$5.3 million, respectively, and relates primarily to the exercise of stock options.

### *Repurchase of Common Stock.*

As discussed above, during 2007, 2006, and 2005, we repurchased shares of our common stock under the guidelines of our Stock Repurchase Program for \$307.6 million, \$63.3 million, and \$73.0 million, respectively. In addition, outside of our Stock Repurchase Program, during 2007, 2006, and 2005, we repurchased from our employees and then cancelled approximately 176,000 shares, 148,000 shares, and 394,000 shares of our common stock for \$4.0 million, \$3.7 million, and \$8.3 million, respectively, in connection with minimum tax withholding requirements resulting from the vesting of restricted stock under our stock incentive plans.

## **Contractual Obligations and Other Commercial Commitments and Contingencies**

We have various contractual obligations that are recorded as liabilities in our Consolidated Balance Sheet. Other items, such as certain purchase commitments and other executory contracts are not recognized as liabilities in our Consolidated Balance Sheet, but are required to be disclosed.

The following table summarizes our significant contractual obligations and commercial commitments as of December 31, 2007, and the future periods in which such obligations are expected to be settled in cash (in thousands).

	<b>Total</b>	<b>Less than 1 year</b>	<b>Years 2-3</b>	<b>Years 4-5</b>	<b>More than 5 Years</b>
Long-term debt	\$ 324,875	\$ 5,750	\$ 11,500	\$ 11,500	\$ 296,125
Operating leases	52,279	10,541	17,389	11,955	12,394
Purchase obligations	75,730	32,786	42,454	413	77
Severance/retirement	2,393	2,393			
<b>Total</b>	<b>\$ 455,277</b>	<b>\$ 51,470</b>	<b>\$ 71,343</b>	<b>\$ 23,868</b>	<b>\$ 308,596</b>

Our long-term debt obligations are discussed in more detail in Note 7 to our Consolidated Financial Statements. The contractual obligation amount reflected for our long-term debt is based upon the following assumptions: (i) our Convertible Debt Securities are outstanding through their due date of June 15, 2024; (ii) upon settlement of the Convertible Debt Securities, our cash obligation will not exceed the principal amount of the Convertible Debt Securities; and (iii) interest paid through the life of the Convertible Debt Securities at a rate of 2.5% per annum. The operating leases are discussed in Note 11 to our Consolidated Financial Statements. Our purchase obligations consist primarily of our expected base fees under the FDC services agreement (discussed in Note 11 to our Consolidated Financial Statements), data communication services, and third-party software /software maintenance.

Of the total contractual obligations and commercial commitments above, approximately \$235 million is reflected on our Consolidated Balance Sheet and approximately \$220 million is not.

## **Table of Contents**

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

In conjunction with the sale of the GSS business in 2005, we have agreed to indemnify the buyer of the business against certain losses it may incur in connection with the purchased business subsequent to the sale date. See Note 11 to the Consolidated Financial Statements for further discussion of those indemnifications. We have no other material off-balance sheet arrangements as of December 31, 2007.

### **Capital Resources**

As of December 31, 2007, we had \$132.8 million of cash and short-term investments available to fund our operations, and we expect to generate material amounts of additional cash during 2008. The following are the key items to consider in assessing our sources and uses of capital resources:

As noted above, in 2006, our Board of Directors authorized the repurchase of \$350 million of our outstanding common stock under our Stock Repurchase Program. In August 2006, we established a new Rule 10b5-1 Plan to facilitate the repurchase of the \$350 million of common stock. As of December 31, 2007, we have completed the repurchase of \$350 million of our common stock, purchasing a total of 14.8 million shares at a weighted-average price of \$23.72 per share. As of December 31, 2007, we have remaining 1.2 million shares authorized for repurchase under our Stock Repurchase Program.

As discussed in greater detail in Note 4 to our financial statements, we have the following contingent purchase price payments open as of December 31, 2007:

For Telution, we paid the remaining contingent purchase price payment of \$0.7 million related to integration earn out rights in January 2008. In addition, the Telution stock purchase agreement included contingent purchase price payments (related to revenue earn outs) of up to \$3 million. As of December 31, 2007, we have not reflected any of the \$3 million in the Telution purchase price because of the uncertainty of payment. The rights to these contingent purchase price payments go through December 31, 2008.

The ComTec stock purchase agreement included a contingent purchase price payment (related to the achievement of certain operating criteria) of up to \$2.5 million. As of December 31, 2007, we have not reflected any of the \$2.5 million in the ComTec purchase price because of the uncertainty of payment. The rights to this contingent purchase price payment go through June 30, 2008.

The Prairie stock purchase agreement included contingent purchase price payments (related to the achievement of certain operating criteria) of up to \$6 million. As of December 31, 2007, we have not reflected any of the \$6 million in the Prairie purchase price because of the uncertainty of payment. The rights to the contingent purchase price payments go through December 31, 2009.

In 2007, we spent \$20.3 million on capital expenditures. At this time, we expect our 2008 capital expenditures to be relatively comparable to the amount spent in 2007, but this amount can vary significantly from our expectations depending upon the revenue opportunities we may come across during the year. Our expected capital expenditures consist principally of hardware and software infrastructure to support our clients' expanding business needs, and statement production equipment to continue to offer enhanced functionalities to our clients. As of December 31, 2007, we have made no significant capital expenditure commitments.

Our Convertible Debt Securities bear interest at a rate of 2.5% per annum, which is payable semiannually in arrears on June 15 and December 15 of each year. The Convertible Debt Securities are callable by us for cash, on or after June 20, 2011. The Convertible Debt Securities can be put back to us by the holders for cash at June 15, 2011, 2016 and 2021, or upon a change of control, at a

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

repurchase price equal to 100% of the principal amount of the Convertible Debt Securities, plus accrued interest. The Convertible Debt Securities are subject to certain conversion triggers based upon: (i) the price of

**Table of Contents**

our common stock; (ii) the trading price of the Convertible Debt Securities; (iii) us putting the Convertible Debt Securities back to the holders; (iv) the occurrence of specified corporate transactions, to include a change of control as defined in the Convertible Debt Securities bond indenture ( Bond Indenture ); and (v) if a certain level of dividends are declared, or a certain number of shares of our common stock are repurchased under a self-tender offer by us. We do not expect any of the conversion triggers to occur during the next 12 months. As a result, in the near-term, we expect our annual debt service costs related to the Convertible Debt Securities to be limited to the annual interest payments of \$5.8 million.

The Convertible Debt Securities are convertible into our common stock, under the specified conditions and settlement terms outlined above, at an initial conversion rate of 37.3552 shares per \$1,000 principal amount of Convertible Debt Securities, which is equal to an effective conversion price of \$26.77 per share. The Bond Indenture includes anti-dilution provisions for the holders such that the conversion rate (and thus, the effective conversion price) can be adjusted in the future for certain events, to include stock dividends, stock splits/reverse splits, the issuance of warrants to purchase our stock at a price below the then-current market price, cash dividends, and certain purchases of our common stock by us pursuant to a self-tender offer or exchange offer. A lower effective conversion price may have several impacts to us, including a greater potential for: (i) the occurrence of the conversion trigger based upon the price of our common stock; and (ii) the Convertible Debt Securities having an impact on our diluted earnings per share if our average common stock price exceeds the then-current effective conversion price. The repurchase of \$350 million of our outstanding common stock, as discussed above, had no impact on the current effective conversion price, or any other terms in the Bond Indenture.

The interest rate for borrowings under the 2004 Revolving Credit Facility, except for same day advances, is chosen at our option and is based upon a base rate or adjusted LIBOR rate, plus an applicable margin. The base rate represents the higher of a floating prime rate and a floating rate equal to 50 basis points in excess of the Federal Funds Effective Rate. The interest rate for same day advances is based upon base rate, plus an applicable margin. The applicable margins are dependent on our leverage ratio, as defined, and range from zero to 100 basis points for base rate loans and 125 to 225 basis points for LIBOR loans. As of December 31, 2007, we had made no borrowings under the 2004 Revolving Credit Facility. We pay a quarterly commitment fee on the unused portion of the 2004 Revolving Credit Facility. This rate is dependent on our leverage ratio and ranges from 25 to 50 basis points per annum. As of December 31, 2007, the commitment fee rate was 37.5 basis points per annum. As of December 31, 2007, due to an outstanding irrevocable letter of credit of \$0.5 million, we had \$99.5 million of the 2004 Revolving Credit Facility available to us.

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

**Ratio of Earnings to Fixed Charges**

The ratio of earnings to fixed charges is computed by dividing fixed charges into earnings. Earnings is defined as income from continuing operations before income taxes, plus fixed charges. Fixed charges consist of interest expense (including the amortization of deferred financing costs) and the estimated interest component of rental expense. Our consolidated ratio of earnings to fixed charges for 2007, was 10.01:1.00. See Exhibit 12.10 to this document for information regarding the calculation of our ratio of earnings to fixed charges.

## **Table of Contents**

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the potential loss arising from adverse changes in market rates and prices. As of December 31, 2007, we are exposed to market risks related to changes in interest rates, and fluctuations and changes in the market value of our short-term investments. We have not historically entered into derivatives or other financial instruments for trading or speculative purposes.

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

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

The interest rate for borrowings under the 2004 Revolving Credit Facility, except for same day advances, is chosen at our option, and is based upon a base rate or adjusted LIBOR rate, plus an applicable margin. The base rate represents the higher of a floating prime rate and a floating rate equal to 50 basis points in excess of the Federal Funds Effective Rate. The interest rate for same day advances is based upon base rate, plus an applicable margin. The applicable margins are dependent on our leverage ratio, as defined, and range from zero to 100 basis points for base rate loans and 125 to 225 basis points for LIBOR loans. As of December 31, 2007 we had made no borrowings under the 2004 Revolving Credit Facility.

See Note 7 to the Consolidated Financial Statements for additional information related to our long-term debt.

*Market Risk Related to Cash Equivalents and Short-term Investments.* Our cash and cash equivalents as of December 31, 2007 and 2006 were \$123.4 million and \$240.7 million, respectively. Our cash balances are typically swept into overnight money market accounts on a daily basis, and at times, any excess funds are invested in low-risk, somewhat longer term, cash equivalent instruments and short-term investments. We have minimal market risk for our cash and cash equivalents due to the relatively short maturities of the instruments.

Our short-term investments as of December 31, 2007 and 2006 were \$9.4 million and \$174.8 million, respectively. The day-to-day management of our cash equivalents and short-term investments is performed by two large financial institutions in the U.S., using strict and formal investment guidelines approved by our Board of Directors. Under these guidelines, short-term investments are limited to certain acceptable investments with: (i) a maximum maturity, (ii) a maximum concentration and diversification; and (iii) a minimum acceptable credit quality.

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

**Table of Contents**

**Item 8. Financial Statements and Supplementary Data**  
**CSG SYSTEMS INTERNATIONAL, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**INDEX**

<u>Management's Report on Internal Control Over Financial Reporting</u>	45
<u>Reports of Independent Registered Public Accounting Firm</u>	46
<u>Consolidated Balance Sheets as of December 31, 2007 and 2006</u>	48
<u>Consolidated Statements of Income for the Years Ended December 31, 2007, 2006, and 2005</u>	49
<u>Consolidated Statements of Stockholders' Equity for the Years Ended</u>	
<u>December 31, 2007, 2006, and 2005</u>	50
<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2007, 2006, and 2005</u>	52
<u>Notes to Consolidated Financial Statements</u>	53

**Table of Contents**

**Management's Report on Internal Control Over Financial Reporting**

Management of CSG Systems International, Inc. and subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) or 15d-15(f) under the Securities Exchange Act of 1934, as amended. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

- (i) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- (ii) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- (iii) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment and those criteria, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2007.

The Company's independent registered public accounting firm, KPMG LLP, has issued an attestation report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. That report appears immediately below.



**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

CSG Systems International, Inc.:

We have audited CSG Systems International, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). CSG Systems International, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, CSG Systems International, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of CSG Systems International, Inc. as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2007, and our report dated February 28, 2008 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Denver, Colorado

February 28, 2008

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

CSG Systems International, Inc.:

We have audited the accompanying consolidated balance sheets of CSG Systems International, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CSG Systems International, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), CSG Systems International, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 28, 2008 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

KPMG LLP

Denver, Colorado

February 28, 2008

**Table of Contents****CSG SYSTEMS INTERNATIONAL, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

	December 31, 2007	December 31, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 123,416	\$ 240,687
Short-term investments	9,416	174,803
Total cash, cash equivalents and short-term investments	132,832	415,490
Trade accounts receivable-		
Billed, net of allowance of \$1,487 and \$1,143	114,132	110,020
Unbilled and other	6,038	5,555
Deferred income taxes	10,657	8,927
Income taxes receivable	2,128	
Other current assets	6,399	5,636
Total current assets	272,186	545,628
Property and equipment, net of depreciation of \$69,565 and \$66,656	32,656	23,680
Software, net of amortization of \$34,445 and \$32,989	8,649	7,725
Goodwill	60,745	14,228
Client contracts, net of amortization of \$98,822 and \$82,486	31,526	36,024
Deferred income taxes	9,453	19,617
Other assets	7,173	6,594
Total assets	\$ 422,388	\$ 653,496
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Client deposits	\$ 26,657	\$ 23,645
Trade accounts payable	18,429	15,509
Accrued employee compensation	21,042	20,962
Deferred revenue	17,480	17,586
Income taxes payable		3,651
Other current liabilities	7,595	10,158
Total current liabilities	91,203	91,511
Non-current liabilities:		
Long-term debt	230,000	230,000
Deferred revenue	9,790	8,632
Income taxes payable	4,918	
Other non-current liabilities	3,953	5,619
Total non-current liabilities	248,661	244,251
Total liabilities	339,864	335,762
Stockholders' equity:		

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

Preferred stock, par value \$.01 per share; 10,000,000 shares authorized; zero shares issued and outstanding		
Common stock, par value \$.01 per share; 100,000,000 shares authorized; 11,230,444 and 12,843,061 shares reserved for employee stock purchase plan and stock incentive plans; 34,275,280 and 46,831,643 shares outstanding	622	616
Additional paid-in capital	350,272	340,564
Treasury stock, at cost, 27,956,808 and 14,776,238 shares	(667,858)	(360,259)
Accumulated other comprehensive income (loss):		
Unrealized gain on short-term investments, net of tax	15	25
Unrecognized pension plan losses and prior service costs, net of tax	(435)	(852)
Accumulated earnings	399,908	337,640
<b>Total stockholders' equity</b>	<b>82,524</b>	<b>317,734</b>
Total liabilities and stockholders' equity	\$ 422,388	\$ 653,496

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

**Table of Contents**

**CSG SYSTEMS INTERNATIONAL, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)

	Year Ended December 31,		
	2007	2006	2005
<b>Revenues:</b>			
Processing and related services	\$ 382,070	\$ 351,764	\$ 346,463
Software, maintenance and services	37,191	31,342	30,854
<b>Total revenues</b>	<b>419,261</b>	<b>383,106</b>	<b>377,317</b>
<b>Cost of revenues:</b>			
Processing and related services	193,135	173,536	170,344
Software, maintenance and services	24,674	20,975	19,720
<b>Total cost of revenues</b>	<b>217,809</b>	<b>194,511</b>	<b>190,064</b>
<b>Gross margin (exclusive of depreciation)</b>	<b>201,452</b>	<b>188,595</b>	<b>187,253</b>
<b>Operating expenses:</b>			
Research and development	58,342	46,191	33,932
Selling, general and administrative	45,743	43,127	52,492
Depreciation	12,900	10,438	