

KRONOS INC  
Form 10-Q  
August 10, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q**

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

For the quarterly period ended July 1, 2006

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 0-20109

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**Kronos Incorporated**

(Exact name of registrant as specified in its charter)

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Massachusetts  
(State or other jurisdiction of

incorporation or organization)

297 Billerica Road, Chelmsford, MA  
(Address of principal executive offices)

04-2640942  
(I.R.S. Employer

Identification No.)

01824  
(Zip Code)

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(978) 250-9800

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of August 4, 2006, 31,869,620 shares of the registrant's common stock, \$.01 par value, were outstanding.

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**Table of Contents****PART I. FINANCIAL INFORMATION**

## Item 1. Condensed Consolidated Financial Statements (Unaudited)

**KRONOS INCORPORATED****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except share and per share amounts)

**UNAUDITED**

	Three Months Ended		Nine Months Ended	
	July 1, 2006	July 2, 2005	July 1, 2006	July 2, 2005
Net revenues:				
Product	\$ 53,639	\$ 53,366	\$ 160,664	\$ 152,949
Maintenance	49,103	43,780	142,582	124,899
Professional services	38,636	32,845	109,598	91,040
	141,378	129,991	412,844	368,888
Cost of sales:				
Costs of product	10,900	11,988	36,369	35,012
Costs of maintenance	14,889	11,293	43,655	33,416
Costs of professional services	31,024	26,920	91,534	76,591
	56,813	50,201	171,558	145,019
Gross profit	84,565	79,790	241,286	223,869
Operating expenses and other income:				
Sales and marketing	42,631	36,547	123,798	107,025
Engineering, research and development	14,841	12,707	41,764	37,523
General and administrative	11,571	11,590	35,653	28,582
Amortization of intangible assets	1,479	1,160	4,686	3,450
Other income, net	(1,653)	(1,119)	(5,018)	(4,432)
	68,869	60,885	200,883	172,148
Income before income taxes	15,696	18,905	40,403	51,721
Provision for income taxes	5,363	6,276	13,992	17,211
Net income	\$ 10,333	\$ 12,629	\$ 26,411	\$ 34,510
Net income per common share:				
Basic	\$ 0.32	\$ 0.39	\$ 0.83	\$ 1.08
Diluted	\$ 0.32	\$ 0.39	\$ 0.82	\$ 1.06
Weighted-average common shares outstanding:				
Basic	32,030,501	31,985,327	31,913,196	31,822,612
Diluted	32,294,587	32,583,532	32,272,370	32,672,326

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Stock-based compensation expense included in the above captions:

Costs of product	\$	98	\$		\$	277	\$
Costs of maintenance		313				902	
Costs of professional services		651				1,847	
Sales and marketing		1,393				4,049	
Engineering, research and development		677				2,347	
General and administrative		1,066				3,215	
	\$	4,198	\$		\$	12,637	\$

See accompanying notes to condensed consolidated financial statements.

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**KRONOS INCORPORATED**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per share amounts)

**UNAUDITED**

	July 1, 2006	September 30, 2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 80,965	\$ 43,492
Marketable securities	74,182	37,078
Accounts receivable, less allowances of \$9,734 at July 1, 2006 and \$11,156 at September 30, 2005	107,524	120,746
Deferred income taxes	7,281	10,937
Other current assets	23,168	20,142
<b>Total current assets</b>	<b>293,120</b>	<b>232,395</b>
Marketable securities	23,064	59,865
Property, plant and equipment, net	59,735	56,158
Customer related intangible assets	30,952	31,085
Other intangible assets	15,242	15,818
Goodwill	157,760	142,665
Capitalized software, net	22,792	23,092
Other assets	20,927	18,348
<b>Total assets</b>	<b>\$ 623,592</b>	<b>\$ 579,426</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 10,320	\$ 9,013
Accrued compensation	45,764	43,379
Accrued expenses and other current liabilities	24,316	27,877
Deferred product revenues	2,739	3,938
Deferred professional service revenues	21,506	36,530
Deferred maintenance revenues	120,712	102,038
<b>Total current liabilities</b>	<b>225,357</b>	<b>222,775</b>
Deferred maintenance revenues	7,215	4,921
Deferred income taxes	13,036	15,261
Other liabilities	5,052	4,435
Shareholders equity:		
Preferred Stock, par value \$1.00 per share: authorized 1,000,000 shares, no shares issued and outstanding		
Common Stock, par value \$.01 per share: authorized 50,000,000 shares, 31,970,308 and 31,724,460 shares issued at July 1, 2006 and September 30, 2005 respectively	320	317
Additional paid-in capital	65,848	52,802
Retained earnings	304,406	277,995
Accumulated other comprehensive income:		
Foreign currency translation	2,771	1,307
Net unrealized (loss) on available-for-sale investments	(413)	(387)

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	2,358	920
Total shareholders' equity	372,932	332,034
Total liabilities and shareholders' equity	\$ 623,592	\$ 579,426

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****KRONOS INCORPORATED****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

**UNAUDITED**

	<b>Nine Months Ended</b>	
	<b>July 1, 2006</b>	<b>July 2, 2005</b>
<b>Operating activities:</b>		
Net income	\$ 26,411	\$ 34,510
Adjustments to reconcile net income to net cash and equivalents provided by operating activities:		
Depreciation	12,102	10,287
Amortization of intangible assets	5,350	3,634
Amortization of capitalized software	10,638	10,431
Provision for deferred income taxes	606	220
Stock-based compensation	12,933	
Changes in certain operating assets and liabilities:		
Accounts receivable, net	15,854	(4,943)
Deferred product revenues	(1,485)	(6,340)
Deferred professional service revenues	(16,860)	(10,093)
Deferred maintenance revenues	19,213	8,379
Accounts payable, accrued compensation and other liabilities	67	(770)
Taxes payable	3,782	2,598
Tax benefit from exercise of stock options	(5,808)	11,235
Other	(6,671)	(1,323)
Net cash and equivalents provided by operating activities	76,132	57,825
<b>Investing activities:</b>		
Purchase of property, plant and equipment	(15,473)	(20,325)
Capitalized internal software development costs	(10,337)	(10,966)
(Increase) decrease in marketable securities	(303)	29,342
Acquisitions of businesses and software, net of cash acquired	(13,136)	(52,433)
Net cash and equivalents used in investing activities	(39,249)	(54,382)
<b>Financing activities:</b>		
Net proceeds from exercise of stock options and employee purchase plans	14,946	19,298
Tax benefit from exercise of stock options	5,808	
Repurchase of common stock	(20,633)	(27,392)
Net cash and equivalents provided by financing activities	121	(8,094)
Effect of exchange rate changes on cash and equivalents	469	344
Increase (decrease) in cash and equivalents	37,473	(4,307)
Cash and equivalents at the beginning of the period	43,492	45,877
Cash and equivalents at the end of the period	\$ 80,965	\$ 41,570

See accompanying notes to condensed consolidated financial statements.





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**KRONOS INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE A - General**

The accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring accruals that management of Kronos Incorporated ( the Company or Kronos ) considers necessary for a fair presentation of the Company s financial position and results of operations as of and for the interim periods presented pursuant to the rules and regulations of the Securities and Exchange Commission. Certain footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes the disclosures in these financial statements are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the Company s audited financial statements for the fiscal year ended September 30, 2005. The results of operations for the nine months ended July 1, 2006 are not necessarily indicative of the results for a full fiscal year. The Company has reclassified \$2.0 million of accrued liabilities which were classified as accounts payable on the September 30, 2005 balance sheet to accrued expenses and other current liabilities to conform with current period presentation.

**NOTE B - Fiscal Quarters**

The Company utilizes a system of fiscal quarters. Under this system, the first three quarters of each fiscal year end on a Saturday. However, the fourth quarter of each fiscal year will always end on September 30. Because of this, the number of days in the first quarter (92 days in fiscal 2006 and 93 days in fiscal 2005) and fourth quarter (91 days in fiscal 2006 and 90 days in fiscal 2005) of each fiscal year varies from year to year. The second and third quarters of each fiscal year will be exactly thirteen weeks long. This policy does not have a material effect on the comparability of results of operations between quarters.

**NOTE C - Stock-Based Compensation**

On October 1, 2005, the Company was required to adopt Statement of Financial Accounting Standard No. 123R, Share-Based Payment ( FAS 123R ), which requires all share-based payments, including grants of stock options, to be recognized in the income statement as an operating expense, based on their fair values.

Prior to adopting FAS 123R, the Company accounted for stock-based compensation under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( Opinion 25 ), as permitted by Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation, ( FAS 123 ). No stock-based compensation cost was recognized in the Statement of Income for the three and nine-month periods ended July 2, 2005, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The Company has applied the modified prospective method in adopting FAS 123R. Accordingly, periods prior to adoption have not been restated. Under the modified prospective method, compensation cost recognized in the three and nine-month periods ended July 1, 2006 includes (a) compensation cost for all share-based payments granted prior to, but not yet vested as of October 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of FAS 123, and (b) compensation cost for all share-based payments granted subsequent to October 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R.

As a result of adopting FAS 123R on October 1, 2005, the Company s income before income taxes and net income for the three-month period ended July 1, 2006, are \$4.2 million and \$2.9 million lower, respectively, than if it had continued to account for share-based compensation under Opinion 25. Income before income taxes and net income for the nine-month period ended July 1, 2006, are \$12.6 million and \$8.7 million lower, respectively, than if the Company had continued to account for share-based compensation under Opinion 25. Basic and diluted earnings per share are each \$0.09 lower for the three-month period ended July 1, 2006 and \$0.27 lower for the nine-month period ended July 1, 2006, than if the Company had not adopted FAS 123R.

Prior to the adoption of FAS 123R, the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Statement of Cash Flows. FAS 123R requires the cash flows

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resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The \$5.8 million tax benefit from the exercise of stock options classified as a financing cash inflow would have been classified as an operating cash inflow if the Company had not adopted FAS 123R.

The following table illustrates the effect on net income and earnings per share if the fair value based method had been applied to the prior period:

	Three Months Ended July 2, 2005	Nine Months Ended July 2, 2005
Net income, as reported	\$ 12,629	\$ 34,510
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects		
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(3,094)	(8,692)
Pro forma net income	\$ 9,535	\$ 25,818
<b>Earnings per share:</b>		
Basic as reported	\$ 0.39	\$ 1.08
Basic pro forma	\$ 0.30	\$ 0.81
Diluted as reported	\$ 0.39	\$ 1.06
Diluted pro forma	\$ 0.29	\$ 0.79

On July 1, 2006, the Company had two share-based compensation plans, which are described below (together, the Plans). The compensation cost that has been charged against income for the Plans during the three and nine month periods ended July 1, 2006 was approximately \$4.2 million and \$12.6 million, respectively. As required by FAS 123R, the Company has made an estimate of expected forfeitures and is recognizing compensation cost only for those stock-based compensation awards expected to vest. The total income tax benefit recognized in the income statement for the three and nine month periods ended July 1, 2006 for share-based payments was approximately \$1.3 million and \$3.9 million, respectively.

**Stock Award Plan:** In February 2006, the stockholders approved an amended and restated 2002 Stock Incentive Plan (Award Plan), which was previously adopted in February 2002 and amended in February 2004 and February 2005. The amended and restated award plan increased the number of shares available for issuance under the 2002 plan from 5,000,000 to 9,000,000, clarified the right of the board to issue restricted stock units, replaced the limit on the number of shares which may be granted with respect to awards other than options and stock appreciation rights with a share counting formula, and eliminated the ability to add to the number of shares available for grant any shares of common stock tendered to us to exercise an award or any shares withheld from the exercise of an award to cover the resulting tax liability. The Award Plan enables the Compensation Committee of the Board of Directors to utilize various forms of equity awards as defined by the Award Plan, including stock options, restricted stock, and restricted stock units, as and when they deem necessary. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant. Options granted under the Award Plan during the three and nine month periods ended July 1, 2006 and during the fiscal years of 2005, 2004, 2003 and 2002 are exercisable in equal annual installments over a four-year period beginning one year from the date of grant and have a contractual life of four years and six months. Restricted stock units granted under the Award Plan during the three and nine month periods ended July 1, 2006 vest in equal annual installments over a four-year period beginning one year from the date of grant.

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**Stock Purchase Plan:** In July 2005, the Company's Board of Directors voted to amend the 2003 Employee Stock Purchase Plan (Purchase Plan), which was previously approved for adoption by the stockholders in February 2003. The amendment eliminated the look-back feature previously contained in the Purchase Plan. Under the Purchase Plan, eligible employees may authorize payroll deductions of up to 10% of their compensation (not to exceed \$12,500 in a six month period) to purchase shares at 85% of the fair market value of the Company's common stock at the end of the six-month option period. As required by FAS 123R, the 15% discount is charged to income as stock-based employee compensation expense.

The fair value of each option award issued under the Plans is estimated on the date of grant using a Black-Scholes based option-pricing model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of the Company's stock. The expected term of the options is based on the Company's historical option exercise data taking into consideration the exercise patterns of the option holders during the option's life. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant.

	Nine Month Period Ended	
	July 1, 2006	July 2, 2005
Expected Volatility	41.8%	50.3%
Expected Term	3.42 years	4.0 years
Risk Free Interest Rate	4.39%	3.38%
Dividend Yield	0.0%	0.0%

The Company has not paid and does not anticipate paying cash dividends; therefore, the expected dividend yield is assumed to be zero.

The expected term used to value the shares issued under the Purchase Plan is assumed to be zero as there is no look-back feature contained in the Purchase Plan.

The value of the restricted stock units is based on the intrinsic value of the award at the date of grant. The resulting compensation charges are then recognized ratably over the vesting period of the awards, which is typically four years.

A summary of option activity under the Award Plan as of July 1, 2006, and changes during the nine month period then ended is presented below:

Options	Shares (000s)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000s)
Outstanding at September 30, 2005	3,362	\$ 33.80		
Granted*	861	47.69		
Exercised	(684)	19.51		
Canceled*	(87)	41.99		
Outstanding at July 1, 2006	3,452	\$ 39.90	2.6 years	\$ 11,559
Exercisable at July 1, 2006	1,041	\$ 34.26	1.8 years	\$ 6,188

\* Does not include restricted stock units.

A summary of restricted stock unit activity under the Award Plan as of July 1, 2006, and the changes during the nine month period then ended is presented below:

Restricted Stock Units	Shares (000s)
Outstanding at September 30, 2005	

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Granted	70
Exercised	
Canceled	(2)
Outstanding at July 1, 2006	68

Exercisable at July 1, 2006

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The restricted stock units were granted with an exercise price of \$0.01, and vest equally on an annual basis over a four year period. The market price of the Company's common stock on the date of grant was \$48.22.

The weighted-average grant-date fair value of the options granted during the three and nine month periods ended July 1, 2006, estimated using a Black-Scholes based option pricing model, was \$17.10 for both periods. For the three and nine month periods ended July 2, 2005, the weighted-average grant-date fair value was \$21.81 and \$20.72, respectively, using a Black-Scholes based option pricing model. The total intrinsic value of options exercised was approximately \$1.5 million and \$16.0 million for the three and nine month periods ended July 1, 2006 and \$1.1 million and \$32.7 million for the three and nine month periods ended July 2, 2005.

A summary of the status of the Company's nonvested stock options as of July 1, 2006, and changes during the period then ended, is presented below:

<b>Nonvested Shares</b>	<b>Shares (000s)</b>	<b>Weighted-Average Grant-Date Fair Value*</b>
Nonvested at October 1, 2005	2,718	\$ 16.07
Granted	861	17.10
Vested	(1,079)	13.68
Forfeited	(87)	17.70
<b>Nonvested at July 1, 2006</b>	<b>2,413</b>	<b>\$ 17.05</b>

\* Estimated using a Black-Scholes based option pricing model.

As of July 1, 2006, there was approximately \$34.6 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plans, including compensation cost related to stock options, restricted stock units and stock purchase plan shares. That cost is expected to be recognized over a weighted-average period of 2.7 years. The total fair value of shares vested during the three and nine month periods ended July 1, 2006 was \$0.2 million and \$14.9 million, respectively. The compensation cost related to stock options, restricted stock units and stock purchase plan shares is recognized ratably over the vesting periods.

Cash received from option exercise under the Plans for the three and nine month periods ended July 1, 2006 was \$1.8 million and \$14.9 million, respectively. For the three and nine month periods ended July 2, 2005 the total cash received from option exercises was \$0.7 million and \$19.3 million, respectively. The tax benefit realized for the tax deductions from option exercises totaled \$0.5 million and \$5.8 million for the three and nine month periods ended July 1, 2006, respectively. For the three and nine month periods ended July 2, 2005, the tax benefit realized for the tax deductions from option exercises was \$0.1 million and \$11.2 million, respectively.

The Company has a policy of repurchasing shares on the open market to satisfy share option exercises. The Company repurchased 164,607 shares of its common stock during the three month period ended July 1, 2006 and 503,857 shares of its common stock during the nine month period ended July 1, 2006. Under the Company's current repurchase program up to an additional 549,619 shares may be repurchased.

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Other current assets consists of the following (in thousands):

	July 1, 2006	September 30, 2005
Inventory	\$ 5,972	\$ 4,995
Prepaid expenses	17,196	15,147
<b>Total</b>	<b>\$ 23,168</b>	<b>\$ 20,142</b>

**NOTE E Intangible Assets**

Acquired intangible assets subject to amortization are presented in the following table (dollars in thousands). Due to the timing of recent acquisitions, the Company has not finalized the allocation of the purchase price on certain acquisitions and the amounts shown below for intangible assets and goodwill are estimates.

	Weighted Average Life in Years	Gross Carrying Value	Accumulated Amortization	Net Book Value
As of July 1, 2006:				
Intangible assets:				
Customer related	9.8	\$ 48,465	\$ 17,513	\$ 30,952
Maintenance relationships	11.8	10,738	3,354	7,384
Non-compete agreements	3.7	6,219	4,959	1,260
Technology	9.6	7,993	1,395	6,598
<b>Total intangible assets</b>		<b>\$ 73,415</b>	<b>\$ 27,221</b>	<b>\$ 46,194</b>
As of September 30, 2005:				
Intangible assets:				
Customer related	9.8	\$ 45,452	\$ 14,367	\$ 31,085
Maintenance relationships	12.0	9,492	2,739	6,753
Non-compete agreements	3.7	5,860	4,055	1,805
Technology	10.0	7,956	696	7,260
<b>Total intangible assets</b>		<b>\$ 68,760</b>	<b>\$ 21,857</b>	<b>\$ 46,903</b>

For the three months ended July 1, 2006 and July 2, 2005, the amount of goodwill acquired is \$7.3 million and \$0.3 million, respectively. The amount of goodwill acquired during the nine months ended July 1, 2006 and July 2, 2005 is \$15.1 million and \$41.0 million, respectively. The Company has approximately \$157.8 million and \$142.7 million of goodwill recorded on its balance sheet as of July 1, 2006 and September 30, 2005, respectively.

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For the three months ended July 1, 2006 and July 2, 2005, the Company recorded amortization expense for intangible assets of \$1.7 million and \$1.3 million, respectively. The Company recorded \$5.3 million and \$3.6 million of amortization expense for intangible assets for the nine months ended July 1, 2006 and July 2, 2005, respectively. The estimated annual amortization expense for intangible assets for the current and next five fiscal years is as follows (in thousands):

Fiscal Year Ending	Estimated Annual Amortization
<b>September 30,</b>	<b>Expense</b>
2006	\$ 7,083
2007	6,666
2008	6,492
2009	5,813
2010	5,123
2011	4,723

**NOTE F Acquisitions**

On April 25, 2006, the Company purchased the outstanding shares of common stock of ClarityMatters Inc. ( ClarityMatters ). ClarityMatters was a workforce analytics solution provider and business analytics consulting firm. The aggregate consideration paid, which includes actual cash paid (approximately \$5.3 million, including a \$0.8 million holdback) and the liabilities assumed (approximately \$2.5 million) was approximately \$7.8 million. The amounts allocated to identifiable intangible assets and goodwill were approximately \$1.6 million and \$4.9 million, respectively. The goodwill recognized is deductible for income tax purposes over a 15 year amortization period. Due to the timing of the acquisition, the Company has not finalized the allocation of the purchase price. The Company anticipates that the allocation of the purchase price will be completed by September 30, 2006. The results of ClarityMatters operations, which are not material to the Company's results of operations, have been included in the consolidated financial statements since the date of acquisition. As a result of this acquisition, and in support of the premium paid for ClarityMatters, the Company expects to enhance its time and labor solutions. The deferred revenue related to the maintenance revenue streams, which was recorded at fair value of the Company's remaining performance obligation, was recorded as the Company had assumed a legal performance obligation as described in Emerging Issues Task Force 01-03, Accounting in a Business Combination for Deferred Revenue of an Acquiree ( EITF 01-03 ).

On January 17, 2006, the Company purchased the outstanding shares of common stock of TimeWorks, Inc. ( TimeWorks ). The aggregate consideration paid, which includes actual cash paid (approximately \$5.0 million) and the liabilities assumed (approximately \$0.1 million), was approximately \$5.1 million. TimeWorks was formerly a provider of time and labor software solutions. The amounts allocated to identifiable intangible assets and goodwill were approximately \$1.8 million and \$3.9 million, respectively. The goodwill recognized is deductible for income tax purposes over a 15 year amortization period. Due to the timing of the acquisition, the Company has not finalized the allocation of the purchase price. The Company anticipates that the allocation of the purchase price will be completed by September 30, 2006. The results of TimeWorks operations, which are not material to the Company's results of operations, have been included in the consolidated financial statements since the date of acquisition. As a result of this acquisition, and in support of the premium paid for TimeWorks, the Company expects to enhance its time and labor solutions. The deferred revenue related to the maintenance revenue streams was recorded at fair value of the Company's remaining performance obligation.

On December 19, 2005, the Company assumed certain assets, liabilities and the ongoing business operations of Compu-Cash Systems ( Compu-Cash ), the former Nevada-based Kronos reseller. The aggregate consideration paid, which includes actual cash paid (approximately \$2.2 million) and the liabilities assumed (approximately \$0.1 million), was approximately \$2.3 million. The amounts allocated to identifiable intangible assets and goodwill are approximately \$1.0 million and \$1.3 million, respectively. The goodwill recognized is deductible for income tax purposes over a 15 year amortization period. The results of Compu-Cash's operations, which are not material to the Company's results of operations, have been included in the consolidated financial statements since December 19, 2005.



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Compu-Cash was engaged in the sale and service of employee time and attendance, employee scheduling, data collection and labor management hardware and software systems, including the resale of the Company's products through a reseller relationship. As a result of the acquisition, the Company gained access to direct sales and service organizations, as well as access to the entire existing maintenance revenue stream from Compu-Cash's customers. The deferred revenue related to the maintenance revenue streams was recorded at fair value of the Company's remaining legal performance obligation.

The acquisitions described above were not material to the Company's results of operations.

On November 18, 2004, the Company acquired through Kronos Acquisition Inc., a Canadian corporation and the Company's wholly-owned subsidiary, approximately 10.5 million common shares of AD OPT Technologies Inc. (AD OPT), a Canadian corporation, representing approximately 95.6% of the outstanding common shares, for an aggregate purchase price of approximately \$39.1 million, net of cash and short-term investments acquired of approximately \$16.0 million. On December 16, 2004, the Company acquired the remaining 4.4% outstanding common shares through the compulsory acquisition provisions of the Canada Business Corporations Act, for an additional purchase price of approximately \$2.5 million. The results of AD OPT's operations have been included in the consolidated financial statements since November 18, 2004. AD OPT was a provider of advanced workforce planning and scheduling solutions. As a result of this acquisition, and in support of the premium paid for AD OPT, the Company expects to enhance its growth strategy and its leadership in employee scheduling solutions.

The transaction was accounted for under the purchase method of accounting and accordingly, the assets and liabilities acquired were recorded at their estimated fair values at the effective date of the acquisition. The goodwill recognized is deductible for income tax purposes, over a 15 year amortization period. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed (in thousands):

Accounts receivable	\$ 4,062
Fixed assets	1,817
Deferred taxes	4,924
Other assets	1,667
Identifiable intangible assets	13,672
Goodwill	32,221
<b>Total assets acquired</b>	<b>58,363</b>
Accounts payable	4,742
Deferred product revenues	732
Deferred maintenance revenues	3,344
Deferred professional services	963
Deferred tax liabilities	5,291
Other liabilities	180
<b>Total liabilities assumed</b>	<b>15,252</b>
<b>Net assets acquired</b>	<b>\$ 43,111</b>

The preceding table reflects the payment of approximately \$1.5 million in transaction costs related to the AD OPT acquisition.

The deferred revenue included in the table above was recorded at estimated fair value of the Company's remaining performance obligation.

The following table presents the consolidated results of operations on an unaudited pro forma basis as if the acquisition of AD OPT had taken place at the beginning of the periods presented. The following table has been prepared on the basis of estimates and assumptions available at the time of this filing that the Company and AD OPT believe are reasonable (in thousands, except per share data).

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Unaudited	Three Months Ended July 2, 2005	Nine Months Ended July 2, 2005
Total revenues	\$ 129,991	\$ 372,742
Net income	12,629	35,321
Earnings per share basic	\$ 0.39	\$ 1.11
Earnings per share diluted	\$ 0.39	\$ 1.08

The unaudited pro forma results of operations are for comparative purposes only and do not necessarily reflect the results that would have occurred had the acquisitions occurred at the beginning of the periods presented or the results which may occur in the future.

As a result of the AD OPT and 3i Systems acquisitions, the Company began to provide customized software solutions to its customers. Revenue related to the sale of customized software solutions is recognized on a contract accounting basis in accordance with the provisions of Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, ( SOP 81-1 ). The contract accounting is applied based on a percentage-of-completion basis generally representing labor costs incurred relative to total estimated labor costs. Provisions for estimated losses on contracts are recorded when identified. Deferred revenues are recorded when invoicing exceeds recognized revenues. Revenue derived from the development and delivery of customized software solutions is included in product revenues. Revenue recognized under SOP 81-1 is not material to the Company's results of operations.

Certain acquisition agreements which were previously entered into contain provisions that require the Company to make a guaranteed payment and/or contingent payments based upon profitability of the business unit or if specified minimum revenue requirements are met. Guaranteed payments are accrued at the time of the acquisition and are included in the purchase price allocation. As of July 1, 2006, the Company was obligated to pay \$3.0 million in guaranteed payments. These payments will be made at various dates through fiscal 2008. Amounts due to be paid within twelve months of the balance sheet date are included in accrued expenses and amounts due to be paid in excess of twelve months of the balance sheet date are included in other liabilities. Contingent payments due under the terms of the agreements are recognized when earned and are principally recorded as goodwill. However, under certain circumstances, a portion of the contingent payment may be recorded as compensation expense. The provisions for contingent payments expire during fiscal 2006 and 2009. During the three and nine months ended July 1, 2006, there were no contingent payments earned. During the three months ended July 2, 2005, there were no contingent payments earned; during the nine months ended July 2, 2005 there were \$207,000 of contingent payments earned of which \$108,000 were recorded as goodwill. The remainder was recorded as compensation expense.

**NOTE G Comprehensive Income**

For the three and nine months ended July 1, 2006 and July 2, 2005, comprehensive income consisted of the following (in thousands):

	Three Months Ended		Nine Months Ended July 2,	
	July 1, 2006	July 2, 2005	July 1, 2006	2005
Comprehensive income:				
Net income	\$ 10,333	\$ 12,629	\$ 26,411	\$ 34,510
Cumulative translation adjustment	1,567	(924)	1,464	(724)
Unrealized loss on available-for-sale securities	11	394	(26)	(414)
Total comprehensive income	\$ 11,911	\$ 12,099	\$ 27,849	\$ 33,372

**Table of Contents****NOTE H - Earnings Per Share**

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except share and per share data):

	Three Months Ended		Nine Months Ended	
	July 1, 2006	July 2, 2005	July 1, 2006	July 2, 2005
Net income	\$ 10,333	\$ 12,629	\$ 26,411	\$ 34,510
Weighted-average shares	32,030,501	31,985,327	31,913,196	31,822,612
Effect of dilutive securities:				
Employee stock options and awards	264,086	598,205	359,174	849,714
Adjusted weighted-average shares and assumed conversions	32,294,587	32,583,532	32,272,370	32,672,326
Basic earnings per share	\$ 0.32	\$ 0.39	\$ 0.83	\$ 1.08
Diluted earnings per share	\$ 0.32	\$ 0.39	\$ 0.82	\$ 1.06

**NOTE I Recently Issued Accounting Pronouncements**

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is in the process of evaluating the impact of implementation on its consolidated financial statements and will incorporate the results in the first quarter of fiscal year 2008.

**NOTE J Subsequent Events**

On August 1, 2006, we acquired all of the outstanding capital stock of Unicru, Inc. ( Unicru ), a leading provider of talent management solutions. In accordance with the Agreement and Plan of Merger (the Merger Agreement ), all shares of Unicru s preferred stock were converted into shares of common stock immediately prior to the merger taking place. Thereafter, each share of Unicru s common stock outstanding immediately prior to the merger was converted into the right to receive \$4.15 in cash. In addition, at the effective time of the merger, all outstanding options and warrants were converted into the right to receive a cash payment except for one outstanding Unicru warrant, which we assumed. We paid \$150 million in cash in the aggregate for all of the outstanding capital stock of Unicru, less certain expenses and other deductions set forth in the Merger Agreement.

The Merger Agreement also required us to deposit \$16 million of the cash consideration paid for Unicru s outstanding capital stock into an escrow fund to secure certain indemnification and other payments under the terms of the Merger Agreement. On or about August 1, 2008, the balance of the escrow fund in excess of any amounts held for unresolved claims will be distributed to the former holders of Unicru securities.

The results of Unicru s operations will be included in our consolidated financial statements beginning on the acquisition date, August 1, 2006. The acquisition was funded in part by a three-year revolving credit facility with Citizens Bank of Massachusetts under which we delivered a promissory note dated July 11, 2006 in the principal amount of up to \$100 million. The entire amount was drawn down on August 1, 2006, in connection with the acquisition.

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

This discussion includes certain forward-looking statements about our business and our expectations, including statements relating to revenues, product revenues, revenue growth rates, gross margin, operating expenses, stock-based expenses, earnings per share, future acquisitions, capital expenditures, capitalization of software development costs, customer purchase patterns, income tax rates, available cash, investments and operating cash flow, and the current economic climate. Any such statements are subject to risk that could cause the actual results to vary materially from expectations. For a further discussion of the various risks that may affect our business and expectations, see Item 1A. Risk Factors in Part II of this Quarterly Report on Form 10-Q. The risks and uncertainties discussed herein do not reflect the potential future impact of any mergers, acquisitions or dispositions. In addition, any forward-looking statements represent our estimates only as of the day this Quarterly Report was filed with the Securities and Exchange Commission and should not be relied upon as representing our estimates as of any subsequent date. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our estimates change.

**Overview**

We provide a suite of solutions that automate employee-centric processes and provide tools to optimize the workforce. Our solutions, which include human resources, payroll, scheduling and time and labor applications, are designed for a wide range of businesses and organizations from single-site to large multi-site enterprises. We derive revenues from the licensing of our software solutions, sales of our hardware solutions and by providing professional services as well as ongoing customer support and maintenance.

**SUMMARY:**

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Product revenues	\$ 53,639	\$ 53,366	1%	\$ 160,664	\$ 152,949	5%
Maintenance revenues	49,103	43,780	12%	142,582	124,899	14%
Professional services revenues	38,636	32,845	18%	109,598	91,040	20%
Total revenues	\$ 141,378	\$ 129,991	9%	\$ 412,844	\$ 368,888	12%
Net income	\$ 10,333	\$ 12,629	(18)%	\$ 26,411	\$ 34,510	(23)%
Earnings per share - basic	\$ 0.32	\$ 0.39	(18)%	\$ 0.83	\$ 1.08	(23)%
Earnings per share - diluted	\$ 0.32	\$ 0.39	(18)%	\$ 0.82	\$ 1.06	(23)%

**Subsequent Events**

On August 1, 2006, we acquired all of the outstanding capital stock of Unicru, Inc. ( Unicru ), a leading provider of talent management solutions. In accordance with the Agreement and Plan of Merger (the Merger Agreement ), all shares of Unicru's preferred stock were converted into shares of common stock immediately prior to the merger taking place.

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Thereafter, each share of Unicru's common stock outstanding immediately prior to the merger was converted into the right to receive \$4.15 in cash. In addition, at the effective time of the merger, all outstanding options and warrants were converted into the right to receive a cash payment except for one outstanding Unicru warrant, which we assumed. We paid \$150 million in cash in the aggregate for all of the outstanding capital stock of Unicru, less certain expenses and other deductions set forth in the Merger Agreement.

The Merger Agreement also required us to deposit \$16 million of the cash consideration paid for Unicru's outstanding capital stock into an escrow fund to secure certain indemnification and other payments under the terms of the Merger Agreement. On or about August 1, 2008, the balance of the escrow fund in excess of any amounts held for unresolved claims will be distributed to the former holders of Unicru securities.

The results of Unicru's operations will be included in our consolidated financial statements beginning on the acquisition date. The acquisition was funded in part by a three-year revolving credit facility with Citizens Bank of Massachusetts under which we delivered a promissory note dated July 11, 2006 in the principal amount of up to \$100 million. The entire amount was drawn down on August 1, 2006, in connection with the acquisition.

### **Operations Overview**

Total revenues in the three and nine month periods ended July 1, 2006 increased 9% and 12%, respectively, over the comparable periods in fiscal 2005. The growth was primarily attributable to revenues from our core business, which excludes revenues generated from customers that have been part of an acquired business transaction over the preceding four fiscal quarters. The growth quarter over quarter was due to increases of 12% and 18%, respectively, in maintenance and professional services revenues as well as a slight increase in product revenues. Product revenues increased 5% in the nine month period ended July 1, 2006 as compared to the same period in 2005, and maintenance and professional service revenues increased 14% and 20%, respectively, during that same period.

Net income in the third quarter of fiscal 2006 decreased 18% to \$10.3 million from \$12.6 million in the prior year third quarter, with earnings per share decreasing to \$0.32 from \$0.39 per diluted share. Net income in the first nine months of fiscal 2006 decreased 23% to \$26.4 million from \$34.5 million in the prior year, with earnings per share decreasing to \$0.82 from \$1.06 per diluted share. The decrease in net income as compared to the prior year was primarily due to the recording of stock-based compensation during the three and nine month periods ended July 1, 2006 related to our adoption of Financial Accounting Standards Board, or FASB, Statement No. 123 (revised 2004), Share-Based Payment, or FAS 123R, on October 1, 2005. These costs were approximately \$2.9 million and \$8.7 million, respectively, net of tax benefits.

Regarding expectations for the fourth quarter, we presently anticipate revenue in the range of \$157 - \$165 million for the fourth quarter and \$570 - \$578 million for fiscal 2006, with diluted earnings per share in the range of \$0.41 - \$0.47 for the fourth quarter of fiscal 2006 and \$1.23 - \$1.29 for the entire fiscal 2006. We expect that the impact of FAS 123R (including outstanding, unvested awards and new stock and stock-based awards) will be approximately \$0.09 per diluted share for the fourth quarter and \$0.36 for the entire fiscal 2006. We expect amortization of intangible assets to be approximately \$0.07 per diluted share for the fourth quarter of fiscal 2006 and \$0.18 per diluted share for the entire fiscal 2006.

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### **Critical Accounting Policies and Estimates**

Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition

Allowance for Doubtful Accounts and Sales Returns Allowance

Valuation of Intangible Assets and Goodwill

Capitalization of Software Development Costs

Income Taxes

Business Combinations

Stock-Based Compensation

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result. Our senior management has reviewed these critical accounting policies and related disclosures with our Audit Committee. We have not made any material changes in the risk factors previously disclosed in our annual report on Form 10-K for the year ended September 30, 2005.

*Revenue Recognition* We license software and sell data collection hardware and related ancillary products to end-user customers through our direct sales force as well as indirect channel customers, which include Automatic Data Processing, Inc., or ADP, and other independent resellers. Substantially all of our software license revenue is earned from perpetual licenses of off-the-shelf software requiring no modification or customization. The software license, data collection hardware and related ancillary product revenues from our end-user customers and indirect channel customers are generally recognized using the residual method when:

Persuasive evidence of an arrangement exists, which is typically when a non-cancelable sales and software license agreement has been signed;

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Delivery, which is typically FOB shipping point, is complete for the software (either physically or electronically), data collection hardware and related ancillary products;

The customer's fee is deemed to be fixed or determinable and free of contingencies or significant uncertainties;

Collectibility is probable; and

Vendor-specific objective evidence of fair value exists for all undelivered elements, typically maintenance and professional services.

Although these factors are governed by specific and detailed rules and guidelines related to revenue recognition, there is often a significant amount of judgment involved in determining the amount of revenue to be recognized for a specific customer arrangement as well as the timing of that revenue. Areas most often affected are:

Determining whether the fee is fixed or determinable

Determining whether collectibility is probable

When multiple elements exist and there is an undelivered element:

determining whether undelivered elements are non-essential

determining whether vendor-specific objective evidence of fair value for each separate undelivered element exists

determining vendor specific objective evidence

determining the amount of revenue to be recognized on shipment and

determining the timing of the recognition of any revenue that is deferred

in addition, we may change our pricing models in the future, which could result in a different fair value assignment for undelivered elements. This could cause our future revenue recognition to differ significantly from our historical results.

We base our judgment on the specific facts and circumstances of the arrangements and our general experience in addressing these subjective factors. Historically, our estimates and assumptions have been accurate and we do not anticipate that this will change significantly in the near future. However, if our estimates and assumptions are inaccurate in any period, it could have a material adverse affect on our results of operations.

Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue, assuming all other conditions for revenue recognition have been satisfied. Substantially all of our product revenue is recognized in this manner. If we cannot determine the fair value of any undelivered element included in an arrangement, we will defer revenue until all elements are delivered, services are performed or until fair value can be objectively determined.

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As part of an arrangement, end-user customers typically purchase maintenance contracts as well as professional services from us. Maintenance services include telephone and web-based support as well as rights to unspecified upgrades and enhancements, when and if we make them generally available. Professional services are typically deemed to be non-essential to the functionality of the software and typically are for implementation planning, loading of software, installation of the data collection hardware, training, building simple interfaces, running test data and assisting in the development and documentation of pay rules and best practices consulting.



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Revenues from maintenance services are recognized ratably over the term of the maintenance contract period based on vendor-specific objective evidence of fair value. Vendor-specific objective evidence of fair value is based upon the amount charged when purchased separately, which is typically the contract's renewal rate. Maintenance services are typically stated separately in an arrangement. We have classified the allocated fair value of revenues pertaining to the contractual maintenance obligations that exist for the 12-month period subsequent to the balance sheet date as a current liability, and the contractual obligations with a term beyond 12 months as a non-current liability. Revenues from time and material customer support services are recognized as the services are delivered.

Revenues from professional services are generally recognized based on vendor-specific objective evidence of fair value when:

A non-cancelable agreement for the services has been signed or a customer's purchase order has been received;

The professional services have been delivered;

The customer's fee is deemed to be fixed or determinable and free of contingencies or significant uncertainties; and

Collectibility is probable.

Vendor-specific objective evidence of fair value is based upon the price charged when these services are sold separately and are typically an hourly rate for professional services and a per-class rate for training. Based upon our experience in completing product implementations, we have determined that these services are typically delivered within a 12-month period subsequent to the contract signing, and we therefore have classified deferred professional services as a current liability.

Our arrangements with end-user customers and indirect channel customers do not include any contractual rights of return or price protection, nor do arrangements with indirect channel customers include any acceptance provisions. Our arrangements with end-user customers generally include our standard acceptance provision. Our standard acceptance provision provides the end-user customer with a right to a refund if the arrangement is terminated because the product did not meet our published technical specifications. Generally, we determine that these acceptance provisions are not substantive and therefore should be accounted for as a warranty in accordance with Statement of Financial Accounting Standards No. 5, Accounting for Contingencies.

At the time we enter into an arrangement, we assess the probability of collection of the fee and the terms granted to the customer. For end-user customers, our typical payment terms include payments based on specific due dates, such that all payments for the software license, data collection hardware and related ancillary products, as well as training services included in the original arrangement, are ordinarily paid within one year of contract signing. Professional services are typically rendered on a buy-as-you-go basis such that the customer is invoiced for services on a monthly basis, in arrears. Professional services billings are generally due within 30 days of the invoice date. Our payment terms for indirect channel customers are less than 90 days and payments are typically due within 30 days of the invoice date.

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If the arrangement includes a substantive acceptance provision, we defer revenue not meeting the criterion for recognition under Statement of Position 97-2, Software Revenue Recognition, and classifies this revenue as deferred revenue. We report the allocated fair value of revenues related to the product element of arrangements as a current liability because of the expectation that these revenues will be recognized within 12 months of the balance sheet date. Revenue that is deferred due to a substantive acceptance provision is recognized, assuming all other conditions for revenue recognition have been satisfied, when the uncertainty regarding acceptance is resolved as generally evidenced by written acceptance or payment of the arrangement fee.

If the payment terms for an arrangement are considered extended, other than those arrangements that are financing arrangements as discussed below, we defer revenue on the arrangement until the payment of the arrangement fee becomes due. The deferred amounts, both product and services, related to arrangements with extended payment terms are removed from deferred revenue and accounts receivable, as we have determined that these amounts do not represent either a receivable or deferred revenue until the payment becomes due.

Since fiscal 1996, we have had a standard practice of providing creditworthy end-user customers the option of financing arrangements beyond one year. Our policy for recognizing revenue and the timing of the recognition for arrangements that are financed is the same as our non-financed arrangements. The financed arrangements, which encompass separate fees for software license, data collection hardware and ancillary products, maintenance and support contracts, and professional services, are evidenced by distinct standard sales, license and maintenance agreements and typically require equal monthly payments. The terms of these arrangements typically range between 18 and 48 months. The short-term component (amounts due within 12 months) of these financing arrangements is included in accounts receivable on our balance sheet. The long-term component is included in other assets. At the time we enter into an arrangement, we assess the probability of collection and whether the arrangement fee is fixed or determinable. We consider our history of collection without concessions as well as whether each new transaction involves similar customers, products and arrangement economics to ensure that the history developed under previous arrangements remains relevant to current arrangements. If the fee is not determined to be collectible, fixed or determinable, we will initially defer the revenue and recognize it when collection becomes probable, which typically is when payment is due, assuming all other conditions for revenue recognition have been satisfied. As a financing arrangement, we apply a present value factor using annual interest rates ranging from 5% to 9%. These rates may vary depending upon when the financing arrangement is entered into and the length of the financing arrangement.

As a result of our acquisition of AD OPT Technologies, Inc., or AD OPT, completed on November 18, 2004 and 3i Systems, completed on September 21, 2004, we began to provide customized software solutions to our customers. Revenue related to the sale of customized software solutions is recognized on a contract accounting basis in accordance with the provisions of Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain

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**Production-Type Contracts.** The contract accounting is applied based on a percentage-of-completion basis generally representing labor costs incurred relative to total estimated labor costs. If we are not able to produce reasonably dependable estimates, revenue is recognized upon completion of the project and final acceptance from the customer. If significant uncertainties exist about project completion or receipt of payment, the revenue is deferred until the uncertainty is resolved. Provisions for estimated losses on contracts are recorded during the period in which they are identified. Deferred revenues are recorded when invoicing exceeds recognized revenues. Revenue derived from the development and delivery of customized software solutions are included in product revenues. The significant amount of estimation that is involved with percentage-of-completion accounting can have a material impact on the amounts of revenue and related expenses that are reported in our consolidated financial statements. A number of factors can affect these estimates such as labor rates, utilization and efficiency variances and contract change orders by the customer.

In accordance with FASB Technical Bulletin No. 79-10, *Fiscal Funding Clauses in Lease Agreements*, SOP 97-2 requires that all arrangements with governmental entities containing fiscal funding provisions be evaluated to determine the probability of contract cancellation. Some of the factors that we evaluate are our history with this customer and similar customers in other fiscal funding transactions as well as the governmental unit's financial condition and past practices.

*Allowance for Doubtful Accounts and Sales Returns Allowance* We maintain an allowance for doubtful accounts to reflect estimated losses resulting from the inability of customers to make required payments. This allowance is based on estimates made by us after consideration of factors such as the composition of the accounts receivable aging and bad debt history. If the historical data we use to calculate the allowance for doubtful accounts does not reflect the future ability to collect outstanding receivables, or if the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances and bad debt expense may be required and our future results could be materially affected. Historically, there has not been a significant amount of deviation between our estimates and actual results and we do not anticipate that this will change in the future.

In addition, we maintain a sales returns allowance to reflect estimated losses for sales returns and adjustments. Sales returns and adjustments are generally due to incorrect ordering of product, general customer satisfaction issues or incorrect billing. This allowance is established by us using estimates based on historical experience. If we experience an increase in sales returns and adjustments, additional allowances and charges against revenue may be required. Estimates used to establish the allowance for doubtful accounts and sales returns allowance have been consistently applied. If the historical data we use to calculate these estimates do not properly reflect future returns, then a change in the allowances would be made in the period in which such a determination is made and revenues in that period could be materially affected. Historically, we have not seen a significant amount of deviation between our estimates and actual results and we do not anticipate that this will change in the future.

*Valuation of Intangible Assets and Goodwill* In assessing the recoverability of goodwill and other intangible assets, we must make assumptions regarding the estimated future cash flows

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and other factors to determine the fair value of these assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges against these assets in the reporting period in which the impairment is determined. For intangible assets, this evaluation includes an analysis of estimated future undiscounted net cash flows expected to be generated by the assets over their estimated useful lives. If the estimated future undiscounted net cash flows are insufficient to recover the carrying value of the assets over their estimated useful lives, we will record an impairment charge in the amount by which the carrying value of the assets exceeds their fair value. For goodwill, the impairment evaluation includes a comparison of the carrying value of the reporting unit for which goodwill is attributable to that reporting unit's fair value. We have only one reporting unit. The fair value of the reporting unit is based upon the net present value of future cash flows, including a terminal value calculation. Determining these amounts is judgmental in nature and involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and operating margins used to calculate projected cash flows, risk-adjusted discount rates as well as future economic and market conditions. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates. However, a 100 basis point increase in the assumed discount rate, which is a significant assumption that affects terminal value and the net present value of the cash flows, would not have a material effect on our financial statements. If the reporting unit's estimated fair value exceeds the reporting unit's carrying value, no impairment of goodwill exists. If the fair value of the reporting unit does not exceed its carrying value, then further analysis would be required to determine the amount of the impairment, if any.

If we determine that there is an impairment in either an intangible asset or goodwill, we will be required to record an impairment charge in the reporting period in which the impairment is determined. During fiscal 2005 we completed the annual testing of the impairment of goodwill, and as a result of those tests, we concluded that no impairment of goodwill existed as of July 3, 2005, the annual goodwill impairment measurement date for fiscal 2005. In addition, we have determined that no events or circumstances currently exist that would indicate that either the fair value of the reporting unit has been reduced, or the carrying value of the intangible assets is no longer recoverable. Therefore, no impairment charges have been recorded in the three or nine months ended July 1, 2006.

*Capitalization of Software Development Costs* - Costs incurred in the research, design and development of software for sale to others, which we refer to as software development costs, are charged to expense until technological feasibility is established. Thereafter, software development costs are capitalized and amortized to product cost of sales on a straight-line basis over the lesser of three years or the estimated economic lives of the respective products.

Capitalized software development costs are stated at the lower of amortized cost or net realizable value, using management's best estimates and appropriate assumptions and projections at that time. Upon review, if it is determined that the carrying value exceeds net realizable value the asset is written down, which could materially affect our future results. However, a 10% reduction in our estimated net realizable value would not have a material effect on our financial statements. Historically, we have not seen a significant amount of deviation between our estimates and actual results and no write-downs have been necessary. We do not anticipate that this will change in the future.

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In addition to the software development costs described above, costs incurred in the development of software for internal use are charged to expense until it becomes probable that future economic benefits will be realized. Thereafter, certain costs are capitalized and amortized to operating expense on a straight-line basis. We have determined that, due to the scope of the project and based on the expected estimated economic life of the software, the capitalized costs related to the current replacement of our information technology systems will be amortized over a period of five years. For other projects related to the development of software for internal use, we will generally amortize the capitalized costs over the lesser of three years or the estimated economic life of the software. We have capitalized approximately \$21.0 million (including internal personnel related costs) in costs associated with the replacement of information technology systems since the start of this project in fiscal 2004, and anticipate capitalizing approximately \$2.0 million in additional costs for the balance of fiscal 2006.

*Income Taxes* We account for income taxes under the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and the tax basis of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. When necessary, we record a valuation allowance in accordance with generally accepted accounting principles to reduce our deferred tax assets to the amount of future tax benefit that is more likely than not to be realized. Significant judgment and estimates are used in determining our income tax assets and liabilities as well as our income tax provision. The interim tax provision is dependent on the forecast of consolidated current year earnings, tax credits and other permanent items, the most significant of which are meals and entertainment, the deduction for qualified production activities, permanent effects of FAS 123R and tax free interest income. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, there is no assurance that the valuation allowance will not need to be increased to cover additional deferred tax assets that may not be realizable. Any increase in the valuation allowance could have a material adverse impact on our income tax provision and net income in the period in which such determination is made. Additionally, although we believe that our estimates are reasonable, no assurance can be given that our final tax outcome will not be different from that which is reflected in our historical income tax provisions and accruals. Such differences could have a material effect on our income tax provision and net income in the period in which such a determination is made. Historically, we have not seen a significant amount of deviation between our estimates and actual rates and we do not anticipate that this will change in the future.

*Business Combinations* - In accordance with SFAS No. 141, *Business Combinations*, we are required to allocate the purchase price of acquired companies to the tangible assets and liabilities and identifiable intangible assets acquired based on their estimated fair values. Any residual purchase price is recorded as goodwill. For our more significant acquisitions, these fair values are determined with the assistance of a third-party valuation firm and require us to make significant estimates and assumptions, especially with respect to intangible assets. The estimates are based on historical experience, in combination with information obtained from the

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management of the acquired companies, and we believe them to be reasonable at the time they are made. However, these estimates are inherently uncertain, and if unanticipated events and/or circumstances should occur they may affect the accuracy or validity of these assumptions and estimates. We also make significant estimates when determining the useful lives of our intangible assets, based on the expected period over which we anticipate generating economic benefits from these assets. Changes to any of these judgments, estimates and assumptions could materially affect the fair values of these assets and require us to record an impairment loss, which could have a material effect on our future results. Historically, we have not seen a significant amount of deviation between our estimates and actual results and we do not anticipate that this will change in the future.

*Stock-Based Compensation* - On October 1, 2005, we were required to adopt SFAS 123R, which requires all share-based payments, including grants of stock options, to be recognized in the income statement as an operating expense, based on their fair values.

We estimate the fair value of each option award on the date of grant using a Black-Scholes based option-pricing model. Various assumptions are used in these estimations, including:

Expected volatility, which is based on historical volatility of our stock

Expected option term, which is based on our historical option exercise data taking into consideration the exercise patterns of the option holders during the option's life

Risk-free interest rate, based on the U.S. Treasury yield curve in effect at the time of the grant

Forfeiture rate

A 10% unfavorable change in expected volatility and option term, which represent the most sensitive and judgmental assumptions, would not have a material effect on our financial statements.

Prior to adopting FAS 123R, we accounted for stock-based compensation under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, as permitted by Statement of Financial Accounting Standard No. 123, *Accounting for Stock-Based Compensation*. We have applied the modified prospective method in adopting FAS 123R. Accordingly, periods prior to adoption have not been restated.

The implementation of FAS 123R has had no adverse effect on our balance sheet or total cash flows, but it does impact our operating expenses, net income and earnings per share. Because we are not restating periods prior to adoption, comparability between periods has been affected. Additionally, management uses estimates of and assumptions about forfeiture rates, volatility and interest rates to calculate stock-based compensation. Changing these estimates could materially affect our operating results.

**Table of Contents****Results of Operations**

**Revenues.** We derive revenues from the licensing of our software solutions, sales of our hardware solutions and by providing professional services as well as ongoing customer support and maintenance.

**Total Revenues (dollars in thousands):**

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Total revenues	\$ 141,378	\$ 129,991	9%	\$ 412,844	\$ 368,888	12%

Revenue growth in the three month period ended July 1, 2006 was primarily related to service revenue growth (12% in maintenance and 18% in professional services), with a slight increase in product revenue. Overall our core business, which excludes revenues generated from customers that have been part of an acquired business transaction over the preceding four fiscal quarters, increased 6% during this three month period. The increase in demand for our maintenance and professional services solutions was principally related to the continued expansion of our installed customer base, the success of our implementation methodology, continued innovation of our existing products and, to a lesser extent, introduction of new products. Revenue growth in the nine month period ended July 1, 2006 was also principally driven by maintenance and professional services (increases of 14% and 20%, respectively), due to those factors described above. Product revenues also contributed to the increase, growing 5% over the same period in the prior year. Overall, revenues from our core business grew during the nine month period while revenues from acquired businesses decreased, principally due to the timing of when those acquisitions were completed.

During the third quarter we experienced extended sales cycles for larger, more significant customer deals due to our products competing with a number of other high priority IT projects for customer investment and resource allocation. Additionally, many of our customers are choosing to purchase licenses in smaller increments, rather than doing a bulk software purchase as they have done in the past. We expect these conditions to continue for the foreseeable future.

	Three Months Ended		Nine Months Ended	
	July 1,	July 2,	July 1,	July 2,
	2006	2005	2006	2005
Revenues from acquired businesses*	\$ 3,493	\$ 7,879	\$ 14,112	\$ 17,254
Percentage of total revenues	2.5%	6.1%	3.4%	4.7%

\* Revenues from acquired businesses are revenues generated from customers during the applicable periods noted above that have been part of an acquired business transaction over the preceding four fiscal quarters.

**Table of Contents**Product Revenues (dollars in thousands):

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Product revenues	\$ 53,639	\$ 53,366	1%	\$ 160,664	\$ 152,949	5%
Product revenues as a percent of total revenues	38%	41%		39%	41%	

Product revenues for the three month period ended July 1, 2006 were comparable to the same period for the prior year. During the three months ended July 1, 2006 we experienced a shift in product mix from hardware (which decreased \$1.4 million or 6%) to software (which increased \$1.7 million or 5%). During the second quarter of 2006 we implemented a promotional terminal upgrade program that accelerated the sales cycle and close rate of a significant volume of hardware transactions into that quarter. This acceleration had more of an adverse impact on the third quarter's hardware revenue volume than we had previously anticipated. The increase in product revenues for the nine month period ended July 1, 2006 over the prior year was primarily related to an increase in hardware sales of \$7.3 million or 12%, primarily driven by the one-time, sales incentive-related, promotional terminal upgrade program in the second quarter which resulted in approximately \$6.0 million in sales of our Kronos 4500 terminals to customers who were using our legacy products. Substantially all of our product revenue in each quarter results from orders received in that quarter. Therefore, product revenues are subject to quarterly fluctuations relative to sales volume and the proportion of total revenues, based on the timing of transactions.

	Three Months Ended		Nine Months Ended	
	July 1,	July 2,	July 1,	July 2,
	2006	2005	2006	2005
Product revenues from acquired businesses	\$ 50	\$ 3,176	\$ 697	\$ 7,970
Percentage of product revenues	0.1%	6.0%	0.4%	5.2%

Maintenance Revenues (dollars in thousands):

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Maintenance revenues	\$ 49,103	\$ 43,780	12%	\$ 142,582	\$ 124,899	14%
Maintenance revenues as a percent of total revenues	35%	34%		35%	34%	

The increase in maintenance revenues in the three and nine month periods ended July 1, 2006 was principally the result of expansion of our installed base of software solutions, resulting from an increase in demand for our Workforce Central suite and related software modules in the preceding periods, and an increase in the value of maintenance contracts. The increase in the value of the maintenance contracts was principally attributable to the sales of capacity upgrade licenses and add-on modules to existing customers. Capacity upgrade and add-on module sales typically result in an increased value of maintenance contracts due to the increased selling price for the products. Revenue generated by a particular maintenance contract is typically based on the related



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product's selling price. Maintenance revenues in the nine month period ended July 1, 2006 were also positively impacted by an increase in revenues associated with acquired businesses. Maintenance revenues were slightly higher in relation to total revenues in the three and nine month periods ended July 1, 2006 as compared with the same periods from the prior fiscal year due to a lower proportion of product revenues in the mix.

	Three Months Ended		Nine Months Ended	
	July 1,	July 2,	July 1,	July 2,
	2006	2005	2006	2005
Maintenance revenues from acquired businesses	\$ 1,079	\$ 2,451	\$ 6,701	\$ 5,523
Percentage of maintenance revenues	2.2%	5.6%	4.7%	4.4%

Professional Services Revenues (dollars in thousands):

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Professional services revenues	\$ 38,636	\$ 32,845	18%	\$ 109,598	\$ 91,040	20%
Professional services revenues as a percent of total revenues	27%	25%		27%	25%	

The growth in professional services revenues in the three and nine month periods ended July 1, 2006 was principally due to an increase in the capacity to deliver professional services, as well as an increase in the utilization rate experienced by our services organization due to more efficient implementation methodologies, such as remote services. The expansion of our complementary product offerings, as well as an expansion of our professional consulting and value added professional services offerings also contributed to the increase in professional services revenues. In addition, professional services revenue growth in the nine month period ended July 1, 2006 was positively impacted by an increase in professional services revenues associated with acquired businesses.

	Three Months Ended		Nine Months Ended	
	July 1,	July 2,	July 1,	July 2,
	2006	2005	2006	2005
Professional services revenues from acquired businesses	\$ 2,365	\$ 2,252	\$ 6,715	\$ 3,761
Percentage of professional services revenues	6.1%	6.9%	6.1%	4.1%

**Gross Profit.** Gross profit is the result of revenues, less cost of sales. Product cost of sales primarily consists of salaries, facilities and related expenses for manufacturing personnel and personnel developing and delivering customized software solutions, including stock-based compensation, costs of materials for the manufacturing of certain hardware products, amortization of capitalized software costs and acquired technology, as well as the cost of royalties paid to third-parties for certain products. Service cost of sales primarily consists of salaries, facilities and related expenses for service personnel, including stock-based compensation, as well as the cost of

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maintenance contracts paid to third-parties for certain products. As the costs incurred related to the development of our products cannot be segregated between development for existing customers and new customers, the cost of developing unspecified product upgrades, which are received by our customers who maintain a current maintenance program, are included in Net Operating Expenses as Engineering, Research and Development Costs.

	Three Months Ended			Nine Months Ended		
	July 1, 2006	July 2, 2005	Percent Change	July 1, 2006	July 2, 2005	Percent Change
Product gross profit	\$ 42,739	\$ 41,378	3%	\$ 124,295	\$ 117,937	5%
Stock-based compensation expenses included in product gross profit	\$ 98		N/A	\$ 277		N/A
Maintenance gross profit	\$ 34,214	\$ 32,487	5%	\$ 98,927	\$ 91,483	8%
Stock-based compensation expenses included in maintenance gross profit	\$ 313		N/A	\$ 902		N/A
Professional Services gross profit	\$ 7,612	\$ 5,925	28%	\$ 18,064	\$ 14,449	25%
Stock-based compensation expenses included in professional services gross profit	\$ 651		N/A	\$ 1,847		N/A
Service gross profit	\$ 41,826	\$ 38,412	9%	\$ 116,991	\$ 105,932	10%
Stock-based compensation expenses included in service gross profit	\$ 964		N/A	\$ 2,749		N/A
Total gross profit	\$ 84,565	\$ 79,790	6%	\$ 241,286	\$ 223,869	8%
Stock-based compensation expenses included in total gross profit	\$ 1,062		N/A	\$ 3,026		N/A
Product gross margin	80%	78%		77%	77%	
Maintenance gross margin	70%	74%		69%	73%	
Professional services gross margin	20%	18%		16%	16%	
Total service gross margin	48%	50%		46%	49%	
Total gross margin	60%	61%		58%	61%	

N/A = Not applicable

Total gross margin for the three and nine month periods ended July 1, 2006 declined as compared with the total gross margin for the comparable periods in the prior year. In the three months ending July 1, 2006, product gross margins increased two percentage points, from 78% to 80%. Total service gross margins declined as compared to the three month period ended July 2, 2005, with a decline in maintenance margins being partially offset by an increase in professional services margins. Product gross margins were consistent in the nine month period ended July 1, 2006 as compared to the nine month period ended July 2, 2005. Service gross margins declined during that same period, with maintenance gross margins declining and professional services

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margins remaining consistent with the prior year. Total gross margins were negatively impacted by stock-based compensation of \$1.1 million and \$3.0 million, respectively, for the three and nine months ended July 1, 2006. Other factors driving the changes in gross margin are described in further detail below. We anticipate that the total gross margins will increase sequentially during the fourth quarter of fiscal 2006, including the effect of the acquisition of Unicru in August 2006 as described above. As compared to the prior year, we anticipate total gross margin will continue to decrease for the remainder of the fiscal year, principally as a result of our expectation of a higher proportion of services revenues which typically generate lower gross margins than product revenues as well as stock-based compensation.

Product gross margin, which consists of hardware and software revenue and costs, increased two percentage points in the three month period ended July 1, 2006 as compared to the same period in the prior fiscal year. This increase is principally due to product revenues containing a higher proportion of software than hardware, as software typically generates a higher gross margin than hardware and third party product sales. Additionally, our revenues include a lower proportion of customized software products (which typically generate a lower gross margin) than other software products during the period. Although software gross margin also increased in the nine month period ended July 1, 2006 due to a lower proportion of product revenues associated with our customized software solutions (which typically generate a lower gross margin), this positive impact was offset during this period by lower margins resulting from a one-time, sales incentive-related, promotional terminal upgrade program and an accrual related to a loss associated with a strategic customer contract, both recorded in the second quarter. The strategic customer contract is being accounted for using the completed contract basis under Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, and includes customer specific feature development as well as core development to be included in our future product offerings. As the expected costs of this project exceed our expected revenue, as provided for in SOP 81-1, we have accrued the loss (approximately \$2.3 million) as a component of Costs of Product. When this project is completed, we expect to have a much more advanced, more configurable, less costly product to support certain of our scheduling applications. Stock-based compensation also reduced product gross margin in the three and nine month periods ending July 1, 2006. We currently anticipate that our product gross margins for the fourth quarter of fiscal 2006 will increase when compared to the same period in the prior year.

Maintenance gross margin in the three and nine month periods ended July 1, 2006 decreased as compared to maintenance gross margin in the same periods in the prior year primarily due to stock-based compensation as well as increased costs associated with account management positions, which are partially allocated to our maintenance line of business. Our account managers are responsible for both customer satisfaction and for generating revenue opportunities within our installed base.

Professional services gross margin increased in the three month period and remained consistent in the nine month period ended July 1, 2006 as compared to the same periods in the prior year. We experienced an increase in the utilization rate in the service organization during these periods due to an increase in revenues associated with more efficient implementation methodologies, such as remote services, which was offset by stock-based compensation and an increase in costs related to our continued investment in account management positions and other non-revenue generating positions, which are also partially allocated to this line of business.

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We expect that gross margin for maintenance as well as professional services for the fourth quarter of fiscal 2006 will be lower than the comparable period in fiscal 2005 due to stock-based compensation and our continued investment in account management and other non-revenue generating positions.

**Net Operating Expenses.** Net operating expenses includes sales and marketing expenses, engineering, research and development expenses, general and administrative expenses, amortization of intangible assets, stock-based compensation and other income, net.

Total Net Operating Expenses (dollars in thousands):

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Net operating expenses	\$ 68,869	\$ 60,885	13%	\$ 200,883	\$ 172,148	17%
Stock-based compensation included in net operating expenses	\$ 3,136		N/A	\$ 9,611		N/A
Net operating expenses as a % of total revenues	49%	47%		49%	47%	

N/A = Not applicable

The increase in operating expenses for the three and nine month periods ended July 1, 2006 was principally attributable to an increase in stock-based compensation expense (approximately \$3.1 million and \$9.6 million, respectively), compensation, overhead and support costs (approximately \$5.3 million and \$11.8 million, respectively) which include increased headcount from acquisitions, costs related to the implementation of our new information technology system (approximately \$0.4 million and \$3.4 million, respectively), and an increase in spending related to marketing programs (approximately \$0.7 million and \$3.0 million, respectively), offset by a decrease in bad debt provisions (approximately \$0.9 and \$0.2 million, respectively) and consulting fees. The following discussions on each functional area analyze the spending in further detail.

**Sales and Marketing Expenses:** Sales and marketing expenses primarily consist of personnel and overhead-related expenses for sales and marketing functions, including stock-based compensation, as well as costs associated with advertising, promotions, tradeshows, seminars, training and other sales and marketing programs (dollars in thousands).

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Sales and marketing expenses	\$ 42,631	\$ 36,547	17%	\$ 123,798	\$ 107,025	16%
Stock-based compensation included in sales and marketing expenses	\$ 1,393		N/A	\$ 4,049		N/A
Sales and marketing expenses as a % of total revenues	30%	28%		30%	29%	

N/A = Not applicable

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The increase in sales and marketing expenses for the three and nine month periods ended July 1, 2006 was primarily attributable to an increase in expenses related to compensation, overhead and support costs (approximately \$4.2 million and \$8.2 million, respectively), which includes higher commission costs associated with our sales incentive-related, promotional terminal upgrade program in the second quarter, the hiring of additional personnel (including increased headcount from acquisitions) and increases in salaries and fringe benefits due to annual salary increases, stock-based compensation (approximately \$1.4 million and \$4.0 million, respectively), and an increase in spending related to marketing programs (approximately \$0.7 million and \$3.0 million, respectively).

**Engineering, Research and Development Expenses:** Engineering, research and development expenses primarily consist of personnel and overhead-related expenses for engineering functions, including stock-based compensation, as well as costs associated with training and third-party consulting (dollars in thousands).

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Total engineering, research and development spending	\$ 18,277	\$ 16,435	11%	\$ 52,101	\$ 48,489	7%
Capitalized software development costs	(3,436)	(3,728)	(8)%	(10,337)	(10,966)	(6)%
Engineering, research and development expenses	\$ 14,841	\$ 12,707	17%	\$ 41,764	\$ 37,523	11%
Stock-based compensation included in engineering, research and development expenses	\$ 677		N/A	\$ 2,347		N/A
Engineering, research and development expenses as a % of total revenues	10%	10%		10%	10%	

N/A = Not applicable

The increase in engineering, research and development spending for the three and nine month periods ended July 1, 2006 as compared to the same periods in the prior year was primarily attributable to an increase in expenses related to compensation, overhead and support costs (approximately \$1.1 million and \$2.3 million, respectively), which includes the hiring of additional personnel and increases in salaries and fringe benefits due to annual salary increases, and stock-based compensation (\$0.7 million and \$2.3 million, respectively), partially offset by a decrease in spending related to the use of outside consultant resources (approximately \$0.7 million in the nine months ended July 1, 2006). The significant product development efforts in the first nine months of fiscal 2006 were principally related to further development and enhancement of the Workforce Central<sup>®</sup> suite, including Workforce HR, Workforce Payroll software, Workforce Scheduler and Workforce Scheduler with Optimization, Altitude<sup>®</sup>, Total Care, and the Kronos 4500 terminal.

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**General and Administrative Expenses:** General and administrative expenses primarily consist of personnel and overhead-related expenses, including stock-based compensation, for administrative, information technology, finance, legal and human resources support functions (dollars in thousands).

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
General and administrative expenses	\$ 11,571	\$ 11,590		% \$ 35,653	\$ 28,582	25%
Stock-based compensation included in general and administrative expenses	\$ 1,066		N/A	\$ 3,215		N/A
General and administrative expenses as a % of total revenues	8%	9%		9%	8%	

N/A = Not applicable

General and administrative expenses were consistent in the three month period ended July 1, 2006 as compared to the same period in the prior year as the increase in stock-based compensation (approximately \$1.1 million) as well as an increase in costs and lower capitalization of internal costs related to the implementation of our new information technology system (approximately \$0.4 million) were offset by a reduction in bad debt expense (approximately \$0.9 million) as well as legal and audit fees (approximately \$0.4 million). The increase in general and administrative expenses in the nine month period ended July 1, 2006 was primarily due to an increase in costs and lower capitalization of internal costs related to the implementation of our new information technology system (approximately \$3.4 million), an increase in expenses related to compensation, overhead and support costs, which include the hiring of additional personnel and increases in salaries and fringe benefits due to annual salary increases (approximately \$1.3 million) and stock-based compensation (approximately \$3.2 million), offset by a decrease in bad debt provisions (approximately \$0.2 million) resulting from our periodic calculation of our bad debt reserve requirements.

**Amortization of Intangible Assets and Other Income, Net:** Amortization of intangible assets includes the amortization expense related to certain identified intangible assets recorded by us related to acquisitions of businesses. Other income, net is principally interest income earned from cash as well as investments in our marketable securities and financing arrangements (dollars in thousands).

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Amortization of intangible assets	\$ 1,479	\$ 1,160	28%	\$ 4,686	\$ 3,450	36%
Amortization of intangible assets as a % of total revenues	1%	1%		1%	1%	
Other income, net	\$ 1,653	\$ 1,119	48%	\$ 5,018	\$ 4,432	13%
Other income, net as a % of total revenues	1%	1%		1%	1%	

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The increase in amortization of intangible assets in the three and nine month periods ended July 1, 2006, as compared to the same periods in the prior year, was principally attributed to amortization charges related to acquisitions which were completed during the previous four fiscal quarters. The increase in other income, net in the three and nine month periods ended July 1, 2006, as compared to the same periods in the prior year, was principally attributed to interest income earned on our cash and investment balances.

**Income Taxes.** The provision for income taxes as a percentage of pre-tax income was 34.2% and 34.6% for the three and nine month periods ended July 1, 2006 as compared to 33.2% and 33.3% for the comparable periods in the prior year. The provision for income taxes for the nine month period ended July 1, 2006 was unfavorably impacted by the expiration on December 31, 2005 of the research and development credit and the impact of a permanent item related to the employee stock purchase plan expense under FAS 123R. The provision for income taxes for the nine month period ended July 2, 2005 was favorably impacted as a result of the retroactive reinstatement of legislation related to certain research and development tax credits as well as the impact of certain research and development tax credits related to the AD OPT operations. We currently anticipate that the income tax rate will range approximately between 34 - 35% for the remainder of the fiscal year.

**Newly Issued Accounting Standards.** During the quarter, the FASB released Interpretation 48, Accounting for Uncertainty in Income Taxes an Interpretation of FAS 109 , or FIN 48, which we must adopt for our fiscal year ending September 30, 2008. We are currently assessing the impact of the adoption of FIN 48 and will incorporate the results in the first quarter of our Fiscal 2008.

## **Liquidity and Capital Resources**

We fund our business through cash generated by operations. If near-term demand for our products weakens or if significant anticipated sales in any quarter do not close when expected, the availability of such funds may be adversely impacted. To be more in line with competitive practices, effective April 2, 2005, we completed the change in our business process to one in which our customers are billed in arrears for professional services as the services are delivered, rather than being billed in advance of service delivery. As a result of this change, we have experienced and expect to continue to experience a short-term negative impact in cash provided by operating activities, as reflected in our Statement of Cash Flows. However, we do believe that this practice will ultimately generate more service revenues.

On July 11, 2006, we entered into a credit agreement with Citizens Bank of Massachusetts regarding a three-year, \$100,000,000 revolving credit facility. On August 1, 2006 we completed the acquisition of Unicru, a leading provider of talent management solutions, for approximately \$150 million in cash. Approximately \$100 million was drawn down on the line of credit in order to complete this transaction.

**Table of Contents**Cash, Cash Equivalents and Marketable Securities (dollars in thousands):

	July 1,	As of September 30,	Percent Change
	2006	2005	Change
Cash, cash equivalents and marketable securities (including short and long-term)	\$ 178,211	\$ 140,435	27%
Working capital	\$ 67,763	\$ 9,620	604%

The increase in cash, cash equivalents and marketable securities was primarily due to cash generated from operations, partially offset by cash paid for the repurchase of our common stock, the purchase of property, plant and equipment and capitalized software development costs as well as cash paid for acquired businesses during the nine month period ended July 1, 2006. The increase in working capital was primarily due to an increase in cash and short-term marketable securities balances, partially offset by a decrease in accounts receivable. A portion of our cash reserves is invested in long-term marketable securities.

Cash Flow Highlights (dollars in thousands):

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent Change	July 1,	July 2,	Percent Change
	2006	2005	Change	2006	2005	Change
Cash provided by operations	\$ 31,842	\$ 21,788	46%	\$ 76,132	\$ 57,825	32%
Cash used for property, plant and equipment	\$ (5,562)	\$ (5,472)	2%	\$ (15,473)	\$ (20,325)	(24)%
Cash used for acquisitions of businesses	\$ (4,544)	\$ (55)	8162%	\$ (13,136)	\$ (52,433)	(75)%
(Increase)/decrease in marketable securities	\$ 2,932	\$ (12,213)	(125)%	\$ (303)	\$ 29,342	101%
Net proceeds from exercise of stock options and employee stock purchase	\$ 1,826	\$ 714	156%	\$ 14,946	\$ 19,298	(23)%
Repurchases of common stock	\$ (6,521)	\$ (16,994)	(62)%	\$ (20,633)	\$ (27,392)	(25)%

N/A = Not applicable

The increase in cash provided by operations in the nine month period ended July 1, 2006, as compared to the same period in the prior year, was primarily due to an increase in deferred maintenance, a lower decrease in deferred product revenues, collections of accounts receivable, and an increase in net income, net of non-cash stock-based compensation charges. These factors are partially offset by a decrease in deferred professional services revenues (due to the impact of billing our customers in arrears for professional services as the services are delivered).

Our use of cash for property, plant and equipment in the nine month period ended July 1, 2006 includes investments in information systems and infrastructure to improve and support our expanding operations. We anticipate making significant capital investments during the remainder of fiscal 2006 in conjunction with the replacement of our information technology systems. To date, we have invested approximately \$22.8 million (excluding internal personnel related costs) related to the replacement of our information technology systems of which \$15.8 million has been capitalized, with the remainder expensed through operations. We expect our total investment in this project



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(excluding internal personnel related costs) to range between \$25.0 million and \$27.0 million. Our use of cash for the acquisition of businesses in the first nine months of 2006 was principally related to the acquisition of ClarityMatters on April 25, 2006, TimeWorks, Inc. on January 17, 2006 and Compu-Cash Systems on December 19, 2005. Our use of cash for the acquisition of businesses during the same period ended July 2, 2005 was principally related to the acquisition of AD OPT on November 18, 2004 and Nextime, Inc. on February 28, 2005. Please refer to Note F in the Notes to the Condensed Consolidated Financial Statements for further details. We continue to assess potential acquisition opportunities; however, we currently do not have any major acquisitions planned. Excess cash reserves not required for operations, investments in property, plant and equipment or acquisitions are invested in marketable securities.

**Stock Repurchases Under Stock Repurchase Program (dollars in thousands):**

	Three Months Ended			Nine Months Ended		
	July 1,	July 2,	Percent	July 1,	July 2,	Percent
	2006	2005	Change	2006	2005	Change
Shares of common stock repurchased	164,607	394,802	(58)%	503,857	606,396	(17)%
Cost of shares of common stock repurchased	\$ 6,520	\$ 16,994	(62)%	\$ 20,633	\$ 27,392	(25)%

The common stock repurchased under our stock repurchase program is used to partially cover the shares required for our employee stock option plans and employee stock purchase plan.

We lease certain office space, manufacturing facilities and equipment under long-term operating lease agreements. In addition, certain acquisition agreements contain provisions that require us to make a guaranteed payment and/or contingent payments based upon profitability of the business unit or if specified minimum revenue requirements are met. Future minimum rental commitments under operating leases, and future payment obligations related to guaranteed payments from acquisitions are as follows:

**Payments Due by Period (in thousands)**

Contractual Obligations	Total	Less Than 1 Year	More Than 1	More Than 3	More Than 5 Years
			Year, Less Than 3 Years	Years, Less Than 5 Years	
Operating lease obligations	\$ 44,649	\$ 11,707	\$ 14,986	\$ 11,384	\$ 6,572
Guaranteed payment obligations	2,991	2,496	496		
<b>Total</b>	<b>\$ 47,640</b>	<b>\$ 14,203</b>	<b>\$ 15,482</b>	<b>\$ 11,384</b>	<b>\$ 6,572</b>

We believe that we have adequate cash and investments and operating cash flow to fund our investments in property, plant and equipment, software development costs, cash requirements under operating leases, cash payments related to acquisitions, if any, and any additional stock repurchases for the foreseeable future.

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

We are exposed to a variety of market risks, including changes in interest rates affecting the return on our investments and foreign currency fluctuations. Refer to Note A, Summary of Significant Accounting Policies, in the Notes to Consolidated Financial Statements in the Annual Report on Form 10-K for the year ended September 30, 2005 for further discussion regarding marketable securities and foreign currency forward exchange contracts. Our marketable securities that expose us to market rate risks are comprised of debt securities. A decrease in interest rates would not adversely impact interest income or related cash flows pertaining to securities held at July 1, 2006, as all of these securities have fixed rates of interest. A 100 basis point increase in interest rates would not adversely impact the fair value of these securities by a material amount due to the size and average duration of the portfolio. Our exposure to market risk for fluctuations in foreign currency relate primarily to the amounts due from subsidiaries. Exchange gains and losses related to amounts due from subsidiaries have not been material. For foreign currency exposures existing at July 1, 2006, a 10% unfavorable movement in the foreign exchange rates for each subsidiary location would not expose us to material losses in earnings or cash flows. The calculation assumes that each exchange rate would change in the same direction relative to the U.S. dollar.

**Item 4. Controls and Procedures.**

(a) *Evaluation of Disclosure Controls and Procedures.* Our management, with the participation of our Principal Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of July 1, 2006. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our Principal Executive Officer and Chief Financial Officer concluded that, as of July 1, 2006, our disclosure controls and procedures were effective at the reasonable assurance level.

(b) *Changes in Internal Controls.* No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended July 1, 2006 that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

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### Part II. OTHER INFORMATION

#### Item 1. Legal Proceedings

None

#### Item 1A. Risk Factors

##### **Certain Factors That May Affect Future Operating Results**

Except for historical matters, the matters discussed in this Quarterly Report on Form 10-Q are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Act). We desire to take advantage of the safe harbor provisions of the Act and include this statement for the express purpose of availing ourselves of the protection of the safe harbor with respect to all forward-looking statements that involve risks and uncertainties.

Actual operating results may differ from those indicated by forward-looking statements made in this Quarterly Report on Form 10-Q and presented elsewhere by us from time to time because of a number of factors including the potential fluctuations in quarterly results, timing and acceptance of new product introductions by us and our competitors, the dependence on our time and labor product line, the ability to attract and retain sufficient technical personnel, the protection of our intellectual property and the potential infringement on our intellectual property rights, competitive pricing pressure, and the dependence on alternate distribution channels and on key vendors, as further described. We have not made any material changes in the risk factors previously disclosed in our annual report on Form 10-K for the year ended September 30, 2005.

**Potential Fluctuations in Results.** Our operating results, including revenue growth, sources of revenue, effective tax rate and liquidity, may fluctuate as a result of a variety of factors, including general economic conditions and related effects on workforce size, the purchasing patterns of our customers, the diversion of public companies' resources to address compliance with new regulatory requirements on internal controls, the mix of products and services sold, the ability to effectively integrate acquired businesses into our operations, the timing of the introduction of new products and product enhancements by us and our competitors, the strategy employed by us in the human resources and payroll market, market acceptance of new products and competitive pricing pressure. We historically have realized a relatively larger percentage of our annual revenues and profits in the third and fourth quarters and a relatively smaller percentage in the first and second quarters of each fiscal year, although there can be no assurance that this pattern will continue. In addition, substantially all of our product revenue and profits in each quarter result from orders received in that quarter. If near-term demand for our products weakens or if significant anticipated sales in any quarter do not close when expected, our revenues for that quarter will be adversely affected. We believe that our operating results for any one period are not necessarily indicative of results for any future period.

**New Information Technology System Implementation.** We completed the first phase of the implementation of our new information technology system in April 2005, and therefore have begun incurring certain recurring costs that were not incurred prior to completion of this first phase, including amortization and depreciation related costs.

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During the implementation of and transition to our new information technology systems we may experience some short-term erosion to our productivity resulting from duplicate data entry, troubleshooting and mitigation of any issues related to the rollout of these systems as well as increased costs related to the completion of the implementation, which may have an impact on our cash flows.

**Integration of Acquired Businesses.** As part of our overall growth strategy, we acquire from time to time resellers of our products and, in certain instances, complementary business lines. Even if we are successful in identifying and acquiring businesses strategic to us, these acquisition activities involve a number of risks, including:

We may find the acquired business does not further our business strategy, that we overpaid for the company or the economic assumptions underlying our acquisition decision have changed or were not accurate;

Difficulties integrating the acquired companies' products and services and customer base with our existing product and service offerings;

Difficulties integrating the operations, technology and personnel of the acquired company, or retaining the key personnel of the acquired company critical to its continued operation and success;

Disruption of our ongoing business and diversion of management's attention by transition or integration issues and the complexity of managing geographically or culturally diverse enterprises;

Difficulties maintaining uniform standards, controls, procedures and policies across locations and businesses;

Litigation by terminated employees or third parties; and

Problems or liabilities associated with product quality, technology and legal contingencies relating to the acquired business or technology, such as intellectual property matters.

These and other factors could have a material adverse effect on our results of operations, particularly in the case of a larger acquisition or multiple acquisitions in a short period of time. Acquisitions may also have a negative effect on our earnings per share. If we were to proceed with one or more significant acquisitions or investments in which the consideration included cash, we could be required to use a substantial portion of our available cash to consummate such acquisition or investment. To the extent we issue shares of our capital stock or other rights to purchase our capital stock, including options and warrants, existing stockholders may be diluted and earnings per share may decrease. In addition, acquisitions and investments may result in the incurrence of debt, large one-time write-offs, such as acquired in-process research and development costs, and restructuring charges. They may also result in goodwill and other intangible assets that are subject to impairment tests, which could result in future impairment charges.

**Changes in stock option accounting rules may have a significant adverse affect on our operating results.** We have a history of using broad based employee stock option programs to hire, incentivize and retain our workforce in a competitive marketplace. FASB Statement No. 123, Accounting for Stock-Based Compensation, or Statement 123 previously allowed companies the choice of either using a fair value method of accounting for options that would result in expense recognition for all options granted, or using an intrinsic value method, as prescribed by Accounting Principles Board

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Opinion No. 25, Accounting for Stock Issued to Employees, or Opinion No. 25, with pro forma disclosure of the impact on net income of using the fair value option exercise recognition method. We had previously elected to apply Opinion No. 25 and accordingly, had not recognized any compensation expense with respect to employee stock options through the end of fiscal 2005.

In December 2004, the FASB issued FAS 123R, which is a revision of FASB Statement No. 123 and supersedes Opinion No. 25. FAS 123R requires all companies to measure compensation cost for all share-based payments, including employee stock options, at fair value. This statement is effective for fiscal years beginning after June 15, 2005. Adoption of FAS 123R results in the recognition of stock compensation expense. We adopted FAS 123R on October 1, 2005, the beginning of our 2006 fiscal year. The actual impact on future periods will depend on a number of factors, including our stock price and the level of future grants and awards made from our stock-based compensation plans. Our financial statements beginning with the first quarter of fiscal 2006 include stock-based compensation expense, as required by our adoption of FAS 123R. If we had used the fair value method to measure compensation related to stock awards to employees in periods prior to the three month period ended December 31, 2005, we would have incurred stock-based compensation expense. Refer to Note C of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for further details on the pro forma net income and stock compensation expense for the three and nine month periods ended July 2, 2005.

**Competition.** The workforce management market, which includes time and labor, scheduling, human resources and payroll, is highly competitive. Technological changes such as those allowing for increased use of the Internet have resulted in new entrants into the market. Increased competition could adversely affect our operating results through price reductions or loss of market share. With our efforts to expand our workforce management offering with the introduction of our human resources and payroll product suite and the expansion of our scheduling product offerings, we will continue to meet strong competition. Many of these competitors may be able to adapt more quickly to new or emerging technologies or to devote greater resources to the promotion and sale of their human resources and payroll products. Many of our human resources and payroll competitors have significantly greater financial, technical and sales and marketing resources than us, as well as more experience in delivering human resources and payroll solutions. Although we believe our organization has core competencies that position us strongly in the marketplace, maintaining our technological and other advantages over competitors will require continued investment in research and development as well as marketing and sales programs. There can be no assurance that we will have sufficient resources to make such investments or be able to achieve the technological advances necessary to maintain our competitive advantages. There can be no assurance that we will be able to compete successfully in the human resources and payroll marketplace, and our failure to do so could have a material adverse impact on our business, prospects, financial condition and operating results.

**Dependence on Time and Labor Product Line.** To date, the substantial majority of our revenues have been attributable to sales of time and labor systems and related services. Although we have introduced products for scheduling solutions and the licensed human resources and payroll market, we expect that our dependence on the time and labor product line for revenues will continue for the foreseeable future. Competitive pressures or other factors could cause our time and labor products to lose market acceptance or experience significant price erosion, adversely affecting the results of our operations.

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**Product Development and Technological Change.** Continual change and improvement in computer software and hardware technology characterize the markets for workforce management systems. Our future success will depend largely on our ability to enhance the capabilities and increase the performance of our existing products and to develop new products and interfaces to third-party products on a timely basis to meet the increasingly sophisticated needs of our customers. Although we are continually seeking to further enhance our workforce management offerings and to develop new products and interfaces, there can be no assurance that these efforts will succeed, or that, if successful, such product enhancements or new products will achieve widespread market acceptance, or that our competitors will not develop and market products that are superior to our products or achieve greater market acceptance.

**Dependence on Alternate Distribution Channels.** We market and sell our products through our direct sales organization, independent resellers and ADP under an original equipment manufacturer agreement. In the first nine months of fiscal 2006, approximately 7% of our revenue was generated through sales to resellers and ADP. A reduction in the sales efforts of either our major resellers or ADP, or termination or changes in their relationships with us, could have a material adverse effect on the results of our operations.

**Attracting and Retaining Sufficient Technical Personnel for Product Development, Support and Sales.** We have encountered intense competition for experienced technical personnel for product development, technical support and sales and expect such competition to continue in the future. Any inability to attract and retain a sufficient number of qualified technical personnel could adversely affect our ability to produce, support and sell products in a timely manner.

**Protection of Intellectual Property.** We have developed, and through our acquisitions of businesses and software, acquired, proprietary technology and intellectual property rights. Our success is dependent upon our ability to further develop and protect our proprietary technology and intellectual property rights. We seek to protect products, software, documentation and other written materials primarily through a combination of trade secret, patent, trademark and copyright laws, confidentiality procedures and contractual provisions. While we have attempted to safeguard and maintain our proprietary rights, it is unknown whether we have been or will be successful in doing so.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or obtain and use information that is regarded as proprietary. Policing unauthorized use of our products is difficult. While we are unable to determine the extent to which piracy of our software products exists, software piracy can be expected to be a persistent problem, particularly in foreign countries where the laws may not protect proprietary rights as fully as in the United States. We can offer no assurance that we can adequately protect our proprietary rights or that our competitors will not reverse engineer or independently develop similar technology.

**Infringement of Intellectual Property Rights.** We cannot provide assurance that others will not claim that our developed or acquired intellectual property rights infringe on their intellectual property rights or that we do not in fact infringe on those intellectual property rights.

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Any litigation regarding intellectual property rights could be costly and time-consuming and divert the attention of our management and key personnel from business operations. The complexity of the technology involved in our products and the uncertainty of intellectual property litigation increase these risks. Claims of intellectual property infringement might also require us to enter into costly royalty or license agreements, and in this event, we may not be able to obtain royalty or license agreements on acceptable terms, if at all. We may also be subject to significant damages or an injunction against the use of our products. A successful claim of patent or other intellectual property infringement against us could cause immediate and substantial damage to our business and financial condition.

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

In the following table, we provide information about our purchases during the quarter ended July 1, 2006 of equity securities that are registered by the company pursuant to Section 12 of the Exchange Act.

**ISSUER PURCHASES OF EQUITY SECURITIES**

<b>Period</b>	<b>(a)</b> <b>Total Number of Shares Purchased</b>	<b>(b)</b> <b>Average Price Paid per Share</b>	<b>(c)</b> <b>Total Number of Shares Purchased as Part of Publicly Announced Programs</b>	<b>(d)</b> <b>Maximum Number of Shares that May Yet Be Purchased Under the Programs</b>
04/02/06 - 05/02/06	67,907	\$ 39.05	67,907	646,319
05/03/06 - 06/03/06	42,950	\$ 41.79	42,950	603,369
06/04/06 - 07/01/06	53,750	\$ 38.58	53,750	549,619
<b>Total:</b>	<b>164,607</b>	<b>\$ 39.61</b>	<b>164,607</b>	<b>549,619</b>

Our board of directors approved the repurchase by us of up to an aggregate of 750,000 shares of our common stock pursuant to the repurchase program that we publicly announced on February 16, 2006 (the Program). We repurchased an aggregate of approximately 165,000 shares of our common stock pursuant to the Program in the third fiscal quarter. Unless terminated earlier by resolution of our board of directors, the Program will expire when we have repurchased all shares authorized for repurchase thereunder.

**Item 3. Defaults Upon Senior Securities**

None

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

None

Item 5. Other Information

On May 11, 2006, we entered into senior executive retention agreements with each of Stuart Itkin, our Vice President of Marketing, and Mark Julien, our Chief Financial Officer. The retention agreements generally provide that, if within 12 months following a change in control the executive's employment is terminated for reasons other than for cause (as defined in the retention agreement) or by the executive for good reason (as defined in the retention agreement), the executive will receive a cash payment equal to three times the sum of the executive's highest base salary and highest bonus, received in any year for the five-year period prior to such change in control. The executive has the option to receive this cash payment in one lump sum or in 36 equal monthly installments, with an annual interest rate on the unpaid principal balance equal to the minimum applicable federal rate in effect on the date of termination. The retention agreements also provide that we will continue to provide benefits to each executive for a period of one year after the date of his termination. The form of senior executive retention agreement entered into between us and Messrs. Itkin and Julien has been filed with the Securities and Exchange Commission with our Annual Report on Form 10-K for the year ended September 30, 2003.



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Item 6. Exhibits

- 31.1 Certification by Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 31.2 Certification by Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 32.1 Certificate by Principal Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

KRONOS INCORPORATED

August 10, 2006

By

/s/ Mark V. Julien  
Mark V. Julien  
Chief Financial Officer  
(Duly Authorized Officer and  
Principal Financial Officer)

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**KRONOS INCORPORATED**

**EXHIBIT INDEX**

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