

TERADATA CORP /DE/
Form 10-Q
November 12, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

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 001-33458

TERADATA CORPORATION

(Exact name of registrant as specified in its charter)

Edgar Filing: TERADATA CORP /DE/ - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

75-3236470
(I.R.S. Employer
Identification No.)

2835 Miami Village Dr.

Miamisburg, Ohio 45342

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (937) 242-4800

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, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

At October 31, 2008, the registrant has approximately 176.0 million shares of common stock outstanding.

Table of Contents

TABLE OF CONTENTS

PART I. Financial Information

	Page
Item 1. Description <u>Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Statements of Income Three and Nine Months Ended September 30, 2008 and 2007</u>	3
<u>Condensed Consolidated Balance Sheets September 30, 2008 and December 31, 2007</u>	4
<u>Condensed Consolidated Statements of Cash Flows Nine Months Ended September 30, 2008 and 2007</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	24
Item 4. <u>Controls and Procedures</u>	24

PART II. Other Information

	Page
Item 1. Description <u>Legal Proceedings</u>	25
Item 1A. <u>Risk Factors</u>	25
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	26
Item 3. <u>Defaults Upon Senior Securities</u>	26
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	26
Item 5. <u>Other Information</u>	26
Item 6. <u>Exhibits</u>	27
<u>Signatures</u>	28

Table of Contents**Part 1. Financial Information****Item 1. FINANCIAL STATEMENTS
Teradata Corporation****Condensed Consolidated Statements of Income (Unaudited)**

In millions, except per share amounts	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007*
Revenue				
Product revenue	\$ 213	\$ 232	\$ 599	\$ 644
Service revenue	226	207	670	592
Total revenue	439	439	1,269	1,236
Operating expenses				
Cost of products	76	90	211	235
Cost of services	126	120	378	346
Selling, general and administrative expenses	123	128	371	339
Research and development expenses	28	35	78	92
Total operating expenses	353	373	1,038	1,012
Income from operations	86	66	231	224
Interest and other (expense) income, net	(1)		4	
Income before income taxes	85	66	235	224
Income tax expense	25	37	64	103
Net income	\$ 60	\$ 29	\$ 171	\$ 121
Net income per common share				
Basic	\$ 0.34	\$ 0.16	\$ 0.95	\$ 0.67
Diluted	\$ 0.33	\$ 0.16	\$ 0.94	\$ 0.67
Weighted average common shares outstanding				
Basic	177.5	180.7	179.1	180.7
Diluted	179.4	180.7	181.0	180.7

* The results for the nine months ended September 30, 2007 have been revised as described under Revision of Prior Period Financial Statements in Note 1.

See Notes to Condensed Consolidated Financial Statements (Unaudited).

Table of Contents**Teradata Corporation****Condensed Consolidated Balance Sheets (Unaudited)**

In millions, except per share amounts	September 30, 2008	December 31, 2007
Assets		
Current Assets		
Cash and cash equivalents	\$ 328	\$ 270
Short-term investments	50	
Accounts receivable, net	380	507
Inventories, net	42	51
Other current assets	58	45
Total current assets	858	873
Property and equipment, net	89	94
Capitalized software, net	79	61
Goodwill	106	90
Deferred income taxes	129	140
Other assets	35	36
Total assets	\$ 1,296	\$ 1,294
Liabilities and stockholders equity		
Current liabilities		
Accounts payable	\$ 77	\$ 120
Payroll and benefits liabilities	80	91
Deferred revenue	237	246
Other current liabilities	99	115
Total current liabilities	493	572
Pension and other postemployment plan liabilities	83	88
Other liabilities	6	3
Total liabilities	582	663
Commitments and contingencies (Note 9)		
Stockholders equity		
Preferred stock: par value \$0.01 per share, 100.0 shares authorized, no shares issued and outstanding at September 30, 2008 and December 31, 2007		
Common stock: par value \$0.01 per share, 500.0 shares authorized, 180.0 and 181.0 shares issued at September 30, 2008 and December 31, 2007, respectively		
	2	2
Paid-in capital	557	555
Treasury stock: 4.0 and no shares at September 30, 2008 and December 31, 2007, respectively	(99)	
Retained earnings	250	79
Accumulated other comprehensive income (loss)	4	(5)
Total stockholders equity	714	631
Total liabilities and stockholders equity	\$ 1,296	\$ 1,294

See Notes to Condensed Consolidated Financial Statements (Unaudited).

Table of Contents**Teradata Corporation****Condensed Consolidated Statements of Cash Flows (Unaudited)**

In millions	Nine Months Ended September 30,	
	2008	2007*
Operating activities		
Net income	\$ 171	\$ 121
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	47	51
Stock-based compensation expense	15	11
Excess tax benefit from stock-based compensation	(1)	
Deferred income taxes	29	71
Impairment of equity investment	3	
Changes in assets and liabilities:		
Receivables	141	(11)
Inventories	9	
Current payables and accrued expenses	(60)	13
Deferred revenue	(3)	41
Other assets and liabilities	(29)	(8)
Net cash provided by operating activities	322	289
Investing activities		
Purchases of short-term investments	(50)	
Expenditures for property and equipment	(13)	(27)
Additions to capitalized software	(45)	(37)
Purchased software license	(2)	(5)
Other investing activities and business acquisition, net	(22)	(4)
Net cash used in investing activities	(132)	(73)
Financing activities		
Repurchases of common stock	(137)	
Excess tax benefit from stock-based compensation	1	
Cash contributions from former parent		196
Transfer to former parent, net		(216)
Other financing activities, net	6	
Net cash used in financing activities	(130)	(20)
Effect of exchange rate changes on cash and cash equivalents	(2)	
Increase in cash and cash equivalents	58	196
Cash and cash equivalents at beginning of period	270	
Cash and cash equivalents at end of period	\$ 328	\$ 196

* The results for the nine months ended September 30, 2007 have been revised as described under Revision of Prior Period Financial Statements in Note 1.

See Notes to Condensed Consolidated Financial Statements (Unaudited).

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****1. BASIS OF PRESENTATION**

These statements have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC) and, in accordance with those rules and regulations, do not include all information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, and the revision discussed below, necessary to fairly state the results of operations, financial position and cash flows of Teradata Corporation (Teradata or the Company) for the interim periods presented herein. The year-end 2007 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make use of estimates and assumptions that affect the reported amounts and disclosures. Actual results may vary from these estimates.

These condensed consolidated interim financial statements should be read in conjunction with the combined and consolidated financial statements and notes thereto included in Teradata 's most recent Annual Report on Form 10-K for the fiscal year ended December 31, 2007 (the 2007 Annual Report). The results of operations for any interim period are not necessarily indicative of the results of operations to be expected for the full year.

On August 27, 2007, the Board of Directors of NCR Corporation (NCR), the Company 's former parent, approved the separation of NCR into two independent, publicly-traded companies through the distribution of 100% of its Teradata data warehousing business to shareholders of NCR (the Separation). The Condensed Consolidated Financial Statements (Unaudited) reflect the consolidated operations of Teradata and its subsidiaries as a separate, stand-alone entity subsequent to the spin off from NCR on September 30, 2007, in addition to the historical operations of the Teradata data warehousing business which were operated as part of NCR prior to the Separation.

Management believes the assumptions underlying the Condensed Consolidated Financial Statements (Unaudited) for these periods are reasonable. However, the Condensed Consolidated Financial Statements (Unaudited) included herein for periods prior to September 30, 2007, do not necessarily reflect what the Teradata data warehousing business 's results of operations, financial position and cash flows would have been had the Teradata data warehousing business been a stand-alone company during those periods.

Prior to the second quarter of 2008, stock repurchased through the share repurchase programs was retired. Beginning in the second quarter of 2008, stock repurchased through the share repurchase programs is held as treasury stock. Teradata accounts for treasury stock using the cost method, recording the repurchases as a reduction to stockholders ' equity on the consolidated balance sheet.

Revision of Prior Period Financial Statements

As discussed in the Company 's 2007 Annual Report, during the fourth quarter of 2007 the Company identified an error related to a sales transaction that was originally recognized in the fourth quarter of 2006. Upon subsequent review, management determined that the transaction, which was made through a reseller, did not meet the conditions for revenue recognition until the first quarter of 2007 when the products were delivered and accepted by the end-user customer. The impact of this error was an overstatement of revenue and net income in the three- and twelve-month periods ended December 31, 2006, and an understatement of revenue and net income in the three-month period ended March 31, 2007. The Company assessed the materiality of this error on the three- and twelve-month periods ended December 31, 2006, in accordance with the SEC 's Staff Accounting Bulletin No. 99 (SAB 99) and concluded that the error was not material to either period. However, the Company did conclude that the error was material to the three-month period ended March 31, 2007, as it understated results for that period. Therefore, in accordance with the SEC 's Staff Accounting Bulletin No. 108 (SAB 108), the 2006 financial statements were revised in the 2007 Annual Report to correct for the immaterial error and to allow for the correct recording of this transaction in the 2007 consolidated financial statements. The correction has been reflected in these interim consolidated financial statements for the nine month period ended September 30, 2007 and resulted in a \$13 million increase in product revenue, a \$3 million increase in cost of products and a \$4 million increase to income tax expense, resulting in a \$6 million increase in net income (\$0.04 per basic and diluted share).

Table of Contents

Reclassifications. Certain prior-year amounts have been reclassified to conform to the 2008 presentation.

2. NEW ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 157. In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157 (SFAS 157), *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. SFAS 157 is effective for financial assets and financial liabilities measured at fair value on a recurring basis for fiscal years beginning after November 15, 2007. FASB Staff Position No. FAS 157-2 (FSP 157-2), *Effective Date of FASB Statement No. 157*, deferred the effective date of SFAS 157 for all non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. FASB Staff Position No. FAS 157-3 (FSP 157-3), *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, which was made effective on issuance on October 10, 2008, clarified the application of SFAS 157 in determining the fair value of financial assets in inactive markets. Refer to Note 10, for additional information related to the adoption of SFAS 157. The adoption of SFAS 157 did not have a material effect on the Condensed Consolidated Financial Statements for fair value measurements made during the first three quarters of 2008. The Company does not expect the adoption of this Statement for non-financial assets and liabilities to have a material impact on its consolidated financial statements in subsequent reporting periods.

Statement of Financial Accounting Standards No. 159. In February 2007, the FASB issued SFAS No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The fair value option may generally be elected on an instrument-by-instrument basis, subject to a few exceptions. SFAS 159 also establishes presentation and disclosure requirements to facilitate comparisons between companies that choose different measurement attributes for similar assets and liabilities. The implementation of this standard did not have a material impact on the Company's consolidated financial position and results of operations as the Company did not elect to record any additional assets or liabilities under the fair value option.

Statement of Financial Accounting Standards No. 141 (revised 2007). In December 2007, the FASB issued SFAS No. 141 (revised 2007) (SFAS 141R), *Business Combinations*. This Statement changes the accounting for acquisition transaction costs by requiring them to be expensed in the period incurred, and also changes the accounting for contingent consideration, acquired contingencies and restructuring costs related to an acquisition. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008. The Company does not expect that the adoption will have a material impact on its financial condition and results of operations, although its effects on future periods will depend on the nature and significance of business combinations subject to this statement.

Statement of Financial Accounting Standards No. 160. In December 2007, the FASB issued SFAS No. 160 (SFAS 160), *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. This Statement will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company does not expect that this statement will have a material effect on its financial condition and results of operations.

Statement of Financial Accounting Standards No. 161. In March 2008, the FASB issued SFAS No. 161 (SFAS 161), *Disclosures About Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133*. This Statement is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company does not believe that adopting SFAS 161 will have a material impact on the presentation of its annual and interim period disclosures.

Table of Contents**3. SUPPLEMENTAL FINANCIAL INFORMATION**

In millions	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007 As Revised
Comprehensive Income				
Net income	\$ 60	\$ 29	\$ 171	\$ 121
Other comprehensive income, net of tax:				
Amortization of costs associated with pension and postemployment benefits	11		12	
Currency translation adjustments	(3)	3	(3)	5
Total comprehensive income	\$ 68	\$ 32	\$ 180	\$ 126

In millions	As of	
	September 30, 2008	December 31, 2007
Inventories		
Finished goods, net	\$ 20	\$ 29
Service parts, net	22	22
Total inventories, net	\$ 42	\$ 51

4. GOODWILL

In millions	Balance	Additions	Other	Balance
	December 31, 2007			September 30, 2008
Goodwill				
Americas	\$ 56	\$ 15	\$	\$ 71
EMEA	10			10
APJ	24		1	25
Total goodwill	\$ 90	\$ 15	\$ 1	\$ 106

The change in goodwill from December 31, 2007 to September 30, 2008 was primarily due to an immaterial acquisition consummated during the three months ended March 31, 2008, as well as changes in foreign currency exchange rates, which are shown in the Other column.

5. TRANSACTIONS WITH NCR

Teradata's costs and expenses for periods prior to the Separation include allocations from NCR for, among other things, centralized treasury, tax, accounting, legal, internal audit, human resources, severance, pension, public and investor relations, general management, real estate, shared information technology systems, procurement and other statutory functions such as board of directors and centrally managed benefit arrangements. These allocations were determined on a basis that NCR and Teradata consider to be a reasonable reflection of the utilization of services provided to or the benefits received by Teradata. The allocations were based on methods that included such drivers as revenue, headcount, square footage, transaction processing costs and others considered as a reasonable method in relation to the costs being allocated.

Table of Contents

Allocated costs included in the statements of income (prior to the Separation) were as follows:

In millions	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Cost of products and services	\$ 9	\$ 27
Selling, general and administrative expenses	31	63
Research and development expenses	2	6
 Total allocated operating expenses	 \$ 42	 \$ 96

NCR and the Company entered into an Interim Services and Systems Replication Agreement, which provides for the provision of certain transitional services by the Company and its subsidiaries to NCR and its subsidiaries, and vice versa. The services include the provision of administrative and other services identified by the parties. The Interim Services and Systems Replication Agreement, effective October 1, 2007, provides for a term of up to 18 months for such services, which may be extended for an additional six months by mutual agreement of the parties. The pricing is based on actual costs incurred by the party rendering the services plus a fixed percentage.

NCR and the Company have also entered into certain other agreements, including the Separation and Distribution Agreement, the Tax Sharing Agreement, the Employee Benefits Agreement and several commercial agreements. The commercial agreements include a network support agreement, service and distributor arrangements, intellectual property agreements, and various real estate arrangements.

6. INCOME TAXES

Income tax provisions for interim periods are based on estimated annual income tax rates, adjusted to reflect the effects of any significant infrequent or unusual items which are required to be discretely recognized within the current interim period. The Company's intention is to permanently reinvest its foreign earnings outside of the United States. As a result, the effective tax rates in the periods presented are largely based upon the forecasted pre-tax earnings mix and allocation of certain expenses in various taxing jurisdictions where the Company conducts its business that apply a broad range of statutory income tax rates.

The effective tax rate for the three months ended September 30, 2008 was 29.4% compared to 56.1% for the three months ended September 30, 2007. The tax rate for the three months ended September 30, 2008 included a \$3 million charge to reflect a change in estimate identified in conjunction with filing the Company's 2007 U.S. federal tax return. The tax rate for the three months ended September 30, 2007 included a \$10 million charge relating to a tax rate change in Germany. The effective tax rate for the nine months ended September 30, 2008 was 27.2% as compared to 46.0% for the nine months ended September 30, 2007. For the three and nine months ended September 30, 2007, while the Company was still part of NCR, Teradata's provision for income taxes reflected only a portion of the tax benefits related to certain foreign operations' tax net operating losses due to the uncertainty of the ultimate realization of future benefits from those losses under NCR's structure. The provision for income taxes for the three and nine months ended September 30, 2008 is based on the forecasted annual pre-tax earnings mix by jurisdiction of Teradata and its subsidiaries under the Company's current structure.

In addition to the discrete item described above, the effective tax rate for the nine months ended September 30, 2007 included a \$7 million net adjustment, to increase tax expense to correct prior period errors in the calculation of the income tax provision related to intercompany profit elimination. As the impact of this error was not material to any prior periods or to the full-year 2007 financial statements, it was recorded in the second quarter of 2007.

The Company adopted FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing thresholds and attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more

Table of Contents

likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon settlement. The adoption of FIN 48 did not have a material impact on our results of operations or net assets. In accordance with the Tax Sharing Agreement between NCR and Teradata, NCR is responsible for the payment of all income taxes reported on any separate or joint return of NCR, which may also include the results of operations of Teradata for periods prior to the Separation. As of September 30, 2008, the Company has no material unrecognized tax benefits.

7. EMPLOYEE STOCK COMPENSATION PLANS

The Company recorded share-based compensation expense for the periods ending September 30 as follows:

In millions	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Stock options	\$ 1	\$ 1	\$ 5	\$ 4
Restricted stock	4	4	10	7
Total share-based compensation (pre-tax)	5	5	15	11
Tax benefit	(1)	(2)	(5)	(4)
Total share-based compensation, net of tax	\$ 4	\$ 3	\$ 10	\$ 7

Prior to the Separation, all stock options granted to NCR employees engaged in Teradata's business were granted under the NCR Stock Incentive Plan (NCR SIP). In connection with the Separation on September 30, 2007, NCR share-based awards held by Teradata employees were converted to equivalent share-based awards of Teradata Corporation based on the ratio of the Company's fair market value to NCR and Teradata's combined fair market value at the time of the adjustment. The conversion was accounted for as a modification under the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004) (SFAS 123R), *Share-Based Payment*, and resulted in no increase in the fair value of the awards. The Teradata Corporation 2007 Stock Incentive Plan (the Teradata SIP) was adopted by Teradata's Board of Directors on September 6, 2007, after having been approved by NCR International, Inc., as sole stockholder of Teradata, on August 14, 2007. Stock options granted under the Teradata SIP contain similar terms and conditions as those granted under the NCR SIP, including terms no longer than 10 years, and exercise prices not less than the fair market value of Teradata common stock on the date of grant. Grants generally have a four-year vesting period. A total of 20 million shares were authorized to be issued under the Teradata SIP. New shares of the Company's common stock are issued as a result of stock option exercises.

Stock-based compensation expense is measured at fair value and recognized over the service period over which the awards are expected to vest. The Black-Scholes option-pricing model is used to calculate the fair value of stock options. The weighted average fair value of stock option grants was estimated based on the weighted average assumptions below. The weighted average fair value of grants made for the three and nine months ended September 30, 2008 were \$9.13 and \$8.69, respectively. The weighted average fair value of grants made for the three and nine months ended September 30, 2007 were \$18.30 and \$17.02, respectively (these were awards made prior to the Separation and consisted of options to purchase NCR stock).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008 Teradata Grants	2007 NCR Grants	2008 Teradata Grants	2007 NCR Grants
Dividend yield				
Risk-free interest rate	3.48%	4.66%	3.22%	4.52%
Expected volatility	32.4%	29.7%	33.5%	32.5%
Expected holding period (years)	6.3	5.0	6.3	5.0

Table of Contents

Prior to the Separation, expected volatility incorporated a blend of both historical volatility of NCR's stock over a period equal to the expected term of the options and implied volatility from traded options on NCR's stock, as NCR management believed this was more representative of prospective trends. NCR used historical data to estimate option exercise and employee termination within the valuation model. Subsequent to the Separation, the expected volatility assumption is determined based on peer group volatility, and the expected life assumption is based on the simplified method in accordance with the SEC's Staff Accounting Bulletin No. 107 (SAB 107). The SEC's Staff Accounting Bulletin No. 110 (SAB 110) continues to allow companies, under certain circumstances, to use the simplified method beyond December 31, 2007. The Company continues to use the simplified method because it does not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term. The simplified method is based on the vesting period and contractual term for each vesting tranche of awards. The mid-point between the vesting date and the expiration date is used as the expected term under this method. The risk-free interest rate for periods within the contractual life of the option is based on the five-year U.S. Treasury yield curve in effect at the time of grant.

As of September 30, 2008, the Company has \$13 million and \$15 million of total unrecognized compensation expense, net of estimated forfeitures, related to unvested stock options and unvested restricted stock, respectively. These awards will be recognized over the weighted average period of 1.3 years for stock options and 1.2 years for restricted stock.

8. EMPLOYEE BENEFIT PLANS

Prior to the Separation, NCR employees engaged in Teradata's business were eligible to participate in pension and postemployment benefit plans sponsored by NCR in many of the countries where Teradata does business. As Teradata participated in NCR's plans, it accounted for its pension and postemployment benefit costs under the multiemployer plan approach, and has recognized the pension and postemployment costs allocated to it by NCR as expense, with a corresponding contribution in parent company investment. Pension and postemployment benefit costs were allocated to Teradata based on the projected benefit obligation associated with Teradata-specific employees and other NCR employees who provided support services to Teradata. In conjunction with the Separation, certain of NCR's pension and postemployment benefit obligations and plan assets relating to the Teradata business were assumed by/transferred to the Company.

Components of net periodic benefit cost of the Company's pension plans for the three and nine months ended September 30 are as follows:

In millions	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Net service cost	\$	\$	\$ 4	\$
Interest cost		1		3
Expected return on plan assets				(2)
Pre-Separation allocation from NCR			2	6
Total costs	\$	1	\$	2
			\$	5
				\$
				6

Table of Contents

Components of net periodic benefit cost of the Company's postemployment plans for the three and nine months ended September 30 are as follows:

In millions	Three Months Ended		Nine Months Ended	
	September 30, 2008	2007	September 30, 2008	2007
Net service cost	\$ 1	\$	\$ 4	\$
Interest cost	1		2	
Amortization of actuarial loss	1		2	
Pre-Separation allocation from NCR		4		12
Total costs	\$ 3	\$ 4	\$ 8	\$ 12

Employer Contributions

Pension. For the three and nine months ended September 30, 2008, Teradata contributed approximately \$2 million and \$7 million to its pension plans, respectively. Teradata anticipates contributing an additional \$1 million to its pension plans in 2008 for a total of \$8 million.

Postemployment. For the three months ended September 30, 2008, Teradata had no significant postemployment benefits payments. For the nine months ended September 30, 2008, Teradata paid approximately \$2 million in postemployment benefits. Teradata anticipates paying an additional \$1 million in postemployment benefits in 2008 for a total of \$3 million.

9. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company is subject to proceedings, lawsuits, claims and other matters, including those that relate to the environment, health and safety, employee benefits, export compliance, intellectual property, tax matters, and other regulatory compliance and general matters, including those described below. Because such matters are subject to many uncertainties, their outcomes are not predictable. While the Company believes that amounts provided in our condensed consolidated financial statements are currently adequate in light of the probable and estimable liabilities, there can be no assurances that the amounts required to satisfy alleged liabilities from such matters will not impact future operating results.

The Company is subject to governmental investigations and requests for information from time to time. Presently, the United States Department of Justice is conducting an investigation regarding the propriety of the Company's arrangements or understandings with others in connection with certain federal contracts and the adequacy of certain disclosures related to such contracts. The investigation arises in connection with civil litigation in federal district court filed under the qui tam provisions of the civil False Claims Act against a number of information technology companies, including the Company. The complaints against the Company remain under seal. The Company has been conducting its own internal investigation focusing on the propriety of certain transactions under federal programs under which Teradata was a contractor. The Company has shared evidence of questionable conduct that the Company has uncovered with the Justice Department and intends to continue to cooperate with the Justice Department in its investigation. The Company has accrued approximately \$2 million related to the current best estimate of the potential liability relating to this matter.

A separate portion of the government's investigation relates to the adequacy of pricing disclosures made to the government in connection with negotiation of NCR's General Services Administration Federal Supply Schedule as it relates to Teradata, and to whether certain subsequent price reductions were properly passed on to the government. Both NCR and the Company are participating in this aspect of the investigation, with respect to certain products and services of each, and each will assume financial responsibility for its own exposures, if any, without indemnification from the other. At this time, the Company is unable to determine whether a liability is probable with respect to this aspect of the investigation.

Table of Contents

The Company believes the amounts provided in its financial statements are adequate in light of the probable and estimable liabilities. However, there can be no assurances that the actual amounts required to satisfy alleged liabilities from the matter described above and other matters, and to comply with applicable laws and regulations, will not exceed the amounts reflected in the Company's financial statements or will not have a material adverse effect on its results of operations, financial condition or cash flows. Any liabilities that may be incurred in excess of those amounts provided as of September 30, 2008, cannot be reasonably determined at this time.

Guarantees and Product Warranties. Guarantees associated with the Company's business activities are reviewed for appropriateness and impact to the Company's financial statements. Periodically, the Company's customers enter into various leasing arrangements coordinated with a leasing partner. In some instances, the Company guarantees the leasing partner a minimum value at the end of the lease term on the leased equipment or guarantees lease payments between the customer and the leasing partner. As of September 30, 2008, the maximum future payment obligation of this guaranteed value and the associated liability balance was \$3 million.

The Company provides its customers a standard manufacturer's warranty and records, at the time of the sale, a corresponding estimated liability for potential warranty costs. Estimated future obligations due to warranty claims are based upon historical factors such as labor rates, average repair time, travel time, number of service calls and cost of replacement parts. For each consummated sale, the Company recognizes the total customer revenue and records the associated warranty liability using pre-established warranty percentages for that product class.

The following table identifies the activity relating to the warranty reserve for the nine months ended September 30:

In millions	2008	2007
Warranty reserve liability		
Beginning balance at January 1	\$ 6	\$ 8
Provisions for warranties issued	9	9
Settlements (in cash or in kind)	(10)	(12)
Balance at end of period	\$ 5	\$ 5

The Company also offers extended and/or enhanced coverage to its customers in the form of maintenance contracts. The Company accounts for these contracts by deferring the related maintenance revenue over the extended and/or enhanced coverage period. Costs associated with these maintenance contracts are not included in the table above.

In addition, the Company provides its customers with certain indemnification rights. In general, the Company agrees to indemnify the customer if a third party asserts patent or other infringement on the part of the customer for its use of the Company's products. The Company has entered into indemnification agreements with the officers and directors or its subsidiaries. From time to time, the Company also enters into agreements in connection with its acquisition and divestiture activities that include indemnification obligations by the Company. The fair value of these indemnification obligations is not readily determinable due to the conditional nature of the Company's potential obligations and the specific facts and circumstances involved with each particular agreement, and as such the Company has not recorded a liability in connection with these indemnifications. Historically, payments made by the Company under these types of agreements have not had a material effect on the Company's consolidated financial condition, results of operations or cash flows.

10. FAIR VALUE MEASUREMENTS

In September 2006, the FASB issued statement No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. The Company has adopted the provisions of SFAS 157 as of January 1, 2008, for financial assets and liabilities recorded at fair value on a recurring basis. Although the adoption of SFAS 157 did not materially impact its financial condition, results of operations, or cash flow, the Company is now required to provide additional disclosures as part of its financial statements.

Table of Contents

SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable, quoted prices in active markets for similar assets or liabilities, or quoted prices in less-active markets for identical assets; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

The Company's assets and liabilities measured at fair value on a recurring basis include money market funds and foreign currency exchange contracts. A portion of the Company's excess cash reserves are held in money market funds which generate interest income based on the prevailing market rates. Money market funds are included in cash and cash equivalents in the Company's balance sheet. Money market fund holdings are measured at fair value using quoted market prices and are classified within Level 1 of the valuation hierarchy. When deemed appropriate, the Company minimizes its exposure to changes in foreign currency exchange rates through the use of derivative financial instruments, specifically, forward foreign exchange contracts. The fair value of these contracts are measured at the end of each interim reporting period using observable inputs other than quoted prices. As such, these derivative instruments are classified within Level 2 of the valuation hierarchy. Fair value gains for open contracts are recognized as assets and fair value losses are recognized as liabilities. At September 30, 2008, the Company had foreign exchange currency contracts in effect with a gross contract notional amount of \$56 million (\$49 million on a net basis). The foreign exchange currency contracts in effect had a net fair value loss of approximately \$1 million, and an insignificant amount of fair value gains. These gains and losses would be mitigated by corresponding gains on the underlying exposures. The Company's short-term investments consist of bank time deposits with original maturities between three months and one year. These assets are not measured at fair value on a recurring basis and as such are not included in the table below.

The Company's assets measured at fair value on a recurring basis subject to the disclosure requirements of SFAS 157 at September 30, 2008 were as follows:

In millions	September 30, 2008	Fair Value Measurements at Reporting Date Using Quoted Prices in		
		Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Money market funds	\$ 241	\$ 241	\$	\$
Foreign exchange currency contracts	\$	\$	\$	\$
Total Assets	\$ 241	\$ 241	\$	\$
Liabilities				
Foreign exchange currency contracts	\$ 1	\$	\$ 1	\$
Total Liabilities	\$ 1	\$	\$ 1	\$

11. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net income by the weighted average number of shares outstanding during the reported period. The calculation of diluted earnings per share is similar to basic earnings per share, except that the weighted average number of shares outstanding includes the dilution from potential shares resulting from stock options and unvested restricted stock awards.

Table of Contents

The components of basic and diluted earnings per share are as follows:

In millions, except per share amounts	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007 As Revised
Net income available for common stockholders	\$ 60	\$ 29	\$ 171	\$ 121
Weighted average outstanding shares of common stock	177.5	180.7	179.1	180.7
Dilutive effect of employee stock options and restricted stock	1.9		1.9	
Common stock and common stock equivalents	179.4	180.7	181.0	180.7
Earnings per share:				
Basic	\$ 0.34	\$ 0.16	\$ 0.95	\$ 0.67
Diluted	\$ 0.33	\$ 0.16	\$ 0.94	\$ 0.67

Options to purchase 1.4 million shares of common stock for the third quarter of 2008 and 1.3 million shares of common stock for the first nine months of 2008 were not included in the computation of diluted earnings per share because their exercise prices were greater than the average market price of the common shares and, therefore, the effect would have been anti-dilutive. There were no potential common shares in the three and nine months ended September 30, 2007 as for periods prior to the Separation, no potentially dilutive securities (stock options, restricted shares, etc.) of the Company were outstanding.

12. SEGMENT AND OTHER SUPPLEMENTAL INFORMATION

Teradata manages its business in three geographic regions, which are also the Company's operating segments: (1) the North America and Latin America (Americas) region; (2) the Europe, Middle East and Africa (EMEA) region; and (3) the Asia Pacific and Japan (APJ) region. Management evaluates the performance of its segments based on revenue and segment margin, and does not include segment assets for management reporting purposes. Corporate-related costs are fully-allocated to the segments.

The following table presents regional segment revenue and segment gross margin for the Company:

In millions	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007 As Revised
Revenue				
Americas	\$ 253	\$ 245	\$ 699	\$ 711
EMEA	106	116	337	302
APJ	80	78	233	223
Total revenue	439	439	1,269	1,236
Gross margin				
Americas	144	133	394	402
EMEA	55	59	175	144
APJ	38	37	111	109
Total gross margin	237	229	680	655
Selling, general and administrative expenses	123	128	371	339
Research and development expenses	28	35	78	92

Total income from operations	\$ 86	\$ 66	\$ 231	\$ 224
-------------------------------------	-------	-------	--------	--------

Table of Contents

The following table presents revenue by product and services revenue for the Company:

In millions	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Products (software and hardware) ⁽¹⁾	\$ 213	\$ 232	\$ 599	\$ 644
Professional and installation-related services	118	113	351	323
Total solution	331	345	950	967
Maintenance services	108	94	319	269
Total revenue	\$ 439	\$ 439	\$ 1,269	\$ 1,236

- ⁽¹⁾ Our data warehousing hardware and software products are often sold and delivered together in the form of a node of capacity as an integrated technology solution. Accordingly, it is impracticable to provide the breakdown of revenue from various types of hardware and software products.

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(MD&A)**

You should read the following discussion in conjunction with the condensed consolidated financial statements and the notes to those statements included elsewhere in this Quarterly Report on Form 10-Q. This Quarterly Report on Form 10-Q contains certain statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. Certain statements contained in the MD&A are forward-looking statements that involve risks and uncertainties. The forward-looking statements are not historical facts, but rather are based on current expectations, estimates, assumptions and projections about our industry, business and future financial results. Our actual results could differ materially from the results contemplated by these forward-looking statements due to a number of factors, including those discussed in other sections of this Quarterly Report on Form 10-Q.

Third Quarter Financial Overview

As more fully discussed in later sections of this MD&A, the following were significant financial items for the third quarter of 2008:

Total revenue of \$439 million in the third quarter of 2008 was the same as reported in the third quarter of 2007. The total year-over-year revenue comparison included a 1% benefit from foreign currency fluctuations. The lack of growth from the prior-year quarter was primarily the result of decreased product revenues in the EMEA region.

Gross margin increased to 54.0% in the third quarter of 2008 from 52.2% in the third quarter of 2007. Gross margin improved in both product and services, driven by a favorable deal mix, improved contribution from maintenance services, and the benefit of currency translation.

Operating income was \$86 million in the third quarter of 2008, up from \$66 million in the third quarter of 2007. The increase in operating income was largely due to higher product and services margins, and the \$15 million of costs related to the Separation from NCR in the third quarter of 2007, which more than offset the incremental costs of Teradata now operating as an independent, publicly-traded company.

Edgar Filing: TERADATA CORP /DE/ - Form 10-Q

Net income of \$60 million in the third quarter of 2008 increased from \$29 million in the third quarter of 2007. In addition to the factors listed above, third quarter 2008 net income was aided by a lower effective tax rate as compared to the third quarter of 2007.

Table of Contents

Strategic Overview

Teradata is in a leadership position to help companies manage the continual increases in data volume and complexity and gain a competitive advantage. We have four key initiatives underway to broaden our position in the market and take advantage of this opportunity. These initiatives include:

Further increasing our market coverage by adding more sales territories (through hires of additional sales account executives as well as technology and industry consultants),

Expanding our family of compatible data warehouse platforms that we take to market,

Extending our market reach through an expansion of our consulting services business, and

Continuing to invest in partners to increase the number of solutions available on Teradata, as well as to provide more market coverage.

Future Trends

We believe that demand for our solutions will continue to increase due to the continued increase in data volumes, the scale and complexity of business requirements, and the growing use of new data elements and more near real-time analytics over time. The adoption by customers of more near real-time analysis for enterprise intelligence is driving more applications, usage and capacity.

In the Company's third quarter 2008 earnings press release, the Company lowered its revenue growth expectation for 2008, due to currency movement and the economic environment. We now expect 2008 full-year revenue growth of approximately 1% to 4%. This revised outlook for 2008 reflects the actual and anticipated further impact of certain macroeconomic factors on capital spending. Recently, the U.S. and global economies have experienced a significant downturn driven by a financial and credit crisis that could continue to challenge such economies for some period of time, and may have a negative effect on our business. As we have reported, we have seen a lengthening of the sales cycle as a result of closer scrutiny and tighter review processes for larger capital expenditures during 2008. The size, timing and contracted terms of large customer orders for our products and services can impact, both positively and negatively, our long-term operating results.

While macroeconomic challenges and fluctuations in the information technology environment do occur, our outlook remains positive. We have not experienced significant changes from the competitive and/or technological pricing trends experienced in 2007, although there is a risk that pricing pressure could occur in the future. We continue to be committed to new product development and achieving maximum yield from our research and development spending and resources, which are intended to drive revenue growth, as evidenced by our recent release of our new expanded family of compatible data warehouse platforms. We also continue to evaluate opportunities to increase our market coverage and are committed to adding new sales territories (through hires of additional sales account executives as well as technology and industry consultants), among other things, to drive revenue growth. Given the length of sales cycles in the data warehouse market, new sales account territories typically take a year or more, on average, to become productive. We currently estimate our full year effective tax rate for 2008 to be within the range of 26 to 27%.

Table of Contents**Results of Operations for the Three Months Ended September 30, 2008****Compared to the Three Months Ended September 30, 2007**

In millions	2008	% of Revenue	2007	% of Revenue
Product revenue	\$ 213	48.5%	\$ 232	52.8%
Service revenue	226	51.5%	207	47.2%
Total revenue	439	100%	439	100%
Gross margin				
Product gross margin	137	64.3%	142	61.2%
Service gross margin	100	44.2%	87	42.0%
Total gross margin	237	54.0%	229	52.2%
Expenses				
Selling, general and administrative expenses	123	28.0%	128	29.2%
Research and development expenses	28	6.4%	35	8.0%
Total expenses	151	34.4%	163	37.1%
Operating income	\$ 86	19.6%	\$ 66	15.0%

Total revenue of \$439 million in the third quarter of 2008 was the same as reported in the third quarter of 2007. The 2008 year-over-year revenue comparison included 1% of benefit from foreign currency fluctuations. Product revenue in the third quarter of 2008 was down 8% from the prior-year period, with growth in the North and Latin America (Americas) region more than offset by reductions in the Europe, Middle East and Africa (EMEA) and Asia Pacific and Japan (APJ) regions. Service revenue increased 9% in the third quarter of 2008 from the prior-year period, driven primarily by strong growth in maintenance services in all regions, as well as increases in professional services in EMEA and APJ. Operating income increased \$20 million in the third quarter of 2008 compared to the prior-year period, driven primarily by margin improvements and lower operating expenses as compared to the third quarter of 2007. Operating expenses for the third quarter of 2007 included \$15 million in costs associated with the Separation from NCR. In addition to the currency translation impact on revenue, operating income in 2008 was affected by incremental costs of \$6 million (consisting of \$3 million of cost of revenue and \$3 million of operating expenses) associated with Teradata operating as an independent, publicly-traded company, as well as the negative impact of currency translation on the Company's expenses outside of the United States.

Gross Margin

Gross margin for the third quarter of 2008 was 54.0% compared to 52.2% in the third quarter of 2007. Product gross margin increased to 64.3% in the third quarter of 2008, compared to 61.2% in the prior-year period. Service gross margin improved to 44.2% in the third quarter of 2008 compared to 42.0% in the prior-year period. The increase in product gross margins was driven primarily by an improved deal mix as compared to the third quarter of 2007, as well as benefit from currency translation. The services gross margin rate for the third quarter of 2008 benefited from strong maintenance services growth in all regions.

Operating Expenses

Total operating expenses, characterized as selling, general and administrative expenses and research and development expenses, were \$151 million in the third quarter of 2008 compared to \$163 million in the third quarter of 2007. As a percentage of revenue, total operating expenses decreased to 34.4% in the third quarter of 2008 from 37.1% in the third quarter of 2007. Selling, general and administrative expenses for the third quarter of 2007 included \$15 million of costs associated with the Separation from NCR. Operating expenses for the third quarter of 2008 included recurring incremental costs of \$3 million associated with Teradata operating as an independent, publicly-traded company, as well as a negative impact from foreign currency fluctuations. Research and development (R&D) expenses were lower by \$7 million in the third quarter of

Edgar Filing: TERADATA CORP /DE/ - Form 10-Q

2008 compared to the third quarter of 2007, primarily as a result of higher capitalization of internally developed external-use software development cost during 2008.

Table of Contents**Revenue and Gross Margin by Operating Segment**

As described in Note 12 of Notes to Condensed Consolidated Financial Statements (Unaudited), Teradata manages its business in three geographic regions, which are also the Company's operating segments: (1) the Americas region; (2) the EMEA region; and (3) the APJ region. Teradata believes this format is useful to investors because it allows analysis and comparability of operating trends by operating segment. It also includes the same information that is used by Teradata management to make decisions regarding the segments and to assess our financial performance. The discussion of our segment results describes the changes in results as compared to the prior-year period.

The following table presents revenue and operating performance by segment for the three months ended September 30:

In millions	2008	% of Revenue	2007	% of Revenue
Revenue				
Americas	\$ 253	58%	\$ 245	56%
EMEA	106	24%	116	26%
APJ	80	18%	78	18%
Total revenue	439	100%	439	100%
Gross margin				
Americas	144	56.9%	133	54.3%
EMEA	55	51.9%	59	50.9%
APJ	38	47.5%	37	47.4%
Total gross margin	\$ 237	54.0%	\$ 229	52.2%

Americas: Revenue increased 3% in the third quarter of 2008 from the prior-year period, driven by growth in both maintenance and product revenue. Gross margin increased to 56.9% for the third quarter of 2008, from 54.3% in the prior-year period. The increase was driven primarily by higher product margins due to deal mix, as well as increased contribution from maintenance services, offset somewhat by lower professional services margins.

EMEA: Revenue decreased 9% in the third quarter of 2008 from the prior-year period, with reduced product revenue as compared to the strong prior year period, somewhat offset by double-digit growth in service revenue. The revenue comparison included 2% of benefit from foreign currency fluctuations. Gross margin increased to 51.9% in the third quarter of 2008, from 50.9% in the prior-year period, primarily driven by higher product margins due to improved deal mix and the benefit of currency translation, offset in part by the impact of the greater mix of service revenue to product revenue in the period.

APJ: Revenue increased 3% in the third quarter of 2008 from the prior-year period, with growth in service revenue offset by reductions in product revenue. The revenue comparison included 3% of benefit from foreign currency fluctuations. Gross margin was 47.5% in the third quarter of 2008, compared to 47.4% in the prior-year period. Gross margins were influenced by improved service margins, largely offset by the geographic mix of product sales within the region compared to the prior-year period, as well as the higher proportion of service revenue compared to the third quarter of 2007.

Table of Contents**Provision for Income Taxes**

The effective tax rate in the third quarter of 2008 was 29.4% as compared to 56.1% in the third quarter of 2007. The tax rate for the three months ended September 30, 2008 included a \$3 million charge, or approximately 3%, to reflect a change in estimate identified in conjunction with filing the Company's 2007 U.S. federal tax return. The tax rate for the three months ended September 30, 2007 included a \$10 million charge, or 15%, relating to a tax rate change in Germany, and \$4 million of expense, or 6%, related to permanent differences from non-deductible Separation costs. Additionally, for the three months ended September 30, 2007, while the Company was operated as part of NCR, Teradata's provision for income taxes in certain tax jurisdictions reflected only a portion of the tax benefits related to certain foreign operations' tax net operating losses due to the uncertainty of the ultimate realization of future benefits from those losses under NCR's tax structure. The provision for income taxes for the three months ended September 30, 2008 is based on the forecasted annual pre-tax earnings mix by jurisdiction of Teradata and its subsidiaries under the Company's current structure.

The Company's intention is to permanently reinvest its foreign earnings outside of the United States. As a result, the effective tax rate in the periods presented for 2008 largely results from the mix of income earned and the allocation of certain expenses in various tax jurisdictions that apply a broad range of statutory income tax rates. See Note 6 of Notes to Condensed Consolidated Financial Statements (Unaudited) for additional information on the income tax provision.

Results of Operations for the Nine Months Ended September 30, 2008**Compared to the Nine Months Ended September 30, 2007**

In millions	2008	% of Revenue	2007 As Revised	% of Revenue
Product revenue	\$ 599	47.2%	\$ 644	52.1%
Service revenue	670	52.8%	592	47.9%
Total revenue	1,269	100%	1,236	100%
Gross margin				
Product gross margin	388	64.8%	409	63.5%
Service gross margin	292	43.6%	246	41.6%
Total gross margin	680	53.6%	655	53.0%
Expenses				
Selling, general and administrative expenses	371	29.2%	339	27.4%
Research and development expenses	78	6.1%	92	7.4%
Total expenses	449	35.4%	431	34.9%
Operating income	\$ 231	18.2%	\$ 224	18.1%

Total revenue increased 3% in the first nine months of 2008 from the first nine months of 2007. The revenue increase included a benefit of 3% from foreign currency fluctuations. Product revenue decreased 7% in the first nine months of 2008 from the prior-year period, primarily due to lower volume in the Americas and APJ regions. Service revenue increased 13% in the first nine months of 2008 from the prior-year period, driven by strong growth in maintenance services, which grew double-digits in each of Teradata's operating regions, as well as by growth in professional services revenue, particularly in the EMEA and APJ regions. Operating income increased \$7 million in the first nine months of 2008 compared to the prior-year period, with increased volume and margin improvement offset in part by higher operating expenses. In addition to the currency translation impact on revenue, operating income was affected by incremental costs of \$26 million (consisting of \$10 million of cost of revenue and \$16 million of operating expenses) associated with Teradata operating as an independent, publicly-traded company, as well as the negative impact of currency translation on the Company's expenses outside of the United States.

Table of Contents**Gross Margin**

Gross margin for the first nine months of 2008 was 53.6% compared to 53.0% in the first nine months of 2007. Overall gross margin improvements were aided by the benefit of currency translation, offset somewhat by the increased proportion of service revenue, which carries lower margins on average. Product gross margin increased to 64.8% in the first nine months of 2008, from 63.5% in the first nine months of 2007, with improvements in product margins in EMEA offset in part by product margin declines in the Americas and APJ regions. Service gross margins improved to 43.6% in the first nine months of 2008 compared to 41.6% in the prior-year period, with strong maintenance volume growth as well as improvements in maintenance margin rates.

Operating Expenses

Total operating expenses, characterized as selling, general and administrative expenses and research and development expenses, were \$449 million in the first nine months of 2008 compared to \$431 million in the first nine months of 2007. As a percentage of revenue, total operating expenses increased to 35.4% in the first nine months of 2008 from 34.9% in the first nine months of 2007. The increase in operating expenses included incremental costs of \$16 million associated with Teradata operating as an independent, publicly-traded company, as well as negative impact from foreign currency fluctuations. Included in the operating expenses for the first nine months of 2007 were \$15 million in expenses related to the Separation from NCR. R&D expenses were lower by \$14 million in the first nine months of 2008 compared to the first nine months of 2007, primarily as a result of higher capitalization of internally developed external-use software development cost.

Revenue and Gross Margin by Operating Segment

The description of our operating segments is discussed in this MD&A under **Revenue and Gross Margin by Operating Segment** for the three months ended September 30, 2008, compared to the three months ended September 30, 2007.

The following table presents revenue and operating performance by segment for the nine months ended September 30:

In millions	2008	% of Revenue	2007 As Revised	% of Revenue
Revenue				
Americas	\$ 699	55%	\$ 711	58%
EMEA	337	27%	302	24%
APJ	233	18%	223	18%
Total revenue	1,269	100%	1,236	100%
Gross margin				
Americas	394	56.4%	402	56.5%
EMEA	175	51.9%	144	47.7%
APJ	111	47.6%	109	48.9%
Total gross margin	\$ 680	53.6%	\$ 655	53.0%

Americas: Revenue decreased 2% in the first three quarters of 2008 from the prior-year period, with reductions in product revenue somewhat offset by increased service revenue. The revenue comparison included less than 1% of benefit from foreign currency fluctuations. The revenue decline in the Americas region was impacted by customer deferrals of new product purchases relating to the economic environment in the United States. Lower product revenue was offset in part by growth in maintenance services revenue. Gross margin decreased marginally to 56.4% for the first three quarters of 2008, from 56.5% in the prior-year period.

Table of Contents

EMEA: Revenue increased 12% in the first three quarters of 2008 from the prior-year period, led by double-digit increases in professional and maintenance services revenue. The revenue comparison included 7% of benefit from foreign currency fluctuations. Gross margin increased to 51.9% in the first three quarters of 2008, from 47.7% in the prior-year period, primarily driven by higher product margins due to the benefit of currency translation.

APJ: Revenue increased 4% in the first three quarters of 2008 from the prior-year period, with double-digit increases in both professional and maintenance services revenue offset somewhat by a reduction in product revenue. However, the revenue comparison included 8% of benefit from foreign currency fluctuations. Gross margin decreased to 47.6% in the first three quarters of 2008, from 48.9% in the prior-year period. Improvement in service gross margin was more than offset by the higher percentage of service revenue and lower product margins compared to the first three quarters of 2007.

Provision for Income Taxes

The effective tax rate in the first nine months of 2008 was 27.2%, as compared to 46.0% in the first nine months of 2007. For the nine months ended September 30, 2007, while the Company was operated as part of NCR, Teradata's provision for income taxes in certain tax jurisdictions reflected only a portion of the tax benefits related to certain foreign operations' tax net operating losses due to the uncertainty of the ultimate realization of future benefits from those losses under NCR's tax structure. The provision for income taxes for the nine months ended September 30, 2008 is based on the forecasted annual pre-tax earnings mix by jurisdiction of Teradata and its subsidiaries under the Company's current structure.

Income tax expense for the nine months ended September 30, 2008 included a \$3 million charge, or 1%, to reflect a change in estimate identified in conjunction with filing the Company's 2007 U.S. federal tax return. Income tax expense for the nine months ended September 30, 2007 included a \$10 million charge, or 4%, relating to a tax rate change in Germany, a \$7 million net charge, or 3%, to correct prior period errors in the calculation of the income tax provision related to intercompany profit elimination and \$4 million of expense, or 2%, related to permanent differences from non-deductible Separation costs. As the impact of the error was not material to any prior periods or to the full-year 2007 financial statements, it was recorded in the second quarter of 2007.

The Company's intention is to permanently reinvest its foreign earnings outside of the United States. As a result, the effective tax rate in the 2008 periods presented largely results from the mix of income earned and allocation of certain expenses in various tax jurisdictions that apply a broad range of statutory income tax rates. See Note 6 of Notes to Condensed Consolidated Financial Statements (Unaudited) for additional information on the income tax provision.

Financial Condition, Liquidity and Capital Resources

Cash provided by operating activities increased by \$33 million in the first three quarters of 2008. The increase in cash provided by operating activities was primarily due to increased collections on accounts receivables and higher net income in the nine months ended September 30, 2008, as compared to the nine months ended September 30, 2007. These improvements were partially offset by decreased payables and accrued expenses due to the timing of related payments, decreased deferred income taxes, and higher releases of deferred revenue as compared to the first nine months of 2007.

Teradata's management uses a non-GAAP measure called "free cash flow," which we define as net cash provided by operating activities less capital expenditures for property and equipment, and additions to capitalized software, as one measure of assessing the financial performance of the Company. Free cash flow does not have a uniform definition under GAAP; and therefore, Teradata's definition of this measure may differ from the definition used by other companies. The components that are used to calculate free cash flow are GAAP measures taken directly from the Condensed Consolidated Statements of Cash Flows (Unaudited). We believe that free cash flow information is useful for investors because it relates the operating cash flow of the Company to the capital that is spent to continue and improve business operations. In particular, free cash flow indicates the amount of cash available after capital expenditures for, among other things, investments in the Company's existing businesses, strategic acquisitions and repurchase of

Table of Contents

Teradata common stock. Free cash flow does not represent the residual cash flow available for discretionary expenditures since there may be other non-discretionary expenditures that are not deducted from the measure. This non-GAAP measure should not be considered a substitute for, or superior to, cash flows from operating activities under GAAP.

The table below shows net cash provided by operating activities and capital expenditures for the following periods:

In millions	Nine Months Ended September 30,	
	2008	2007
Net cash provided by operating activities	\$ 322	\$ 289
Less:		
Expenditures for property and equipment	(13)	(27)
Additions to capitalized software	(45)	(37)
Free cash flow	\$ 264	\$ 225

Financing activities and certain other investing activities are not included in our calculation of free cash flow. These other investing activities primarily consisted of purchases of short-term investments and an immaterial tuck-in acquisition consummated during the first quarter of 2008. Teradata's short-term investments consist of bank time deposits with original maturities between three months and one year. Teradata's financing activities for the nine months ended September 30, 2008 consisted primarily of cash outflows from our share repurchase activities. During the first three quarters of 2008, the Company purchased 5.6 million shares of its common stock at an average price per share of \$24.52 under the two share repurchase programs authorized by our Board of Directors in 2008. The first program (the dilution offset program) authorizes the Company to purchase Teradata common stock to the extent of cash received from the exercise of stock options and the Teradata Employee Stock Purchase Plan (ESPP). The second program (the general share repurchase program) authorizes the Company to repurchase an additional \$250 million of the Company's outstanding shares of common stock. As of September 30, 2008, the Company had \$120 million of authorization remaining under the \$250 million general share repurchase program to repurchase outstanding shares of Teradata common stock. Our share repurchase activity depends on factors such as our working capital needs, our cash requirements for capital investments, our stock price, and economic and market conditions. Proceeds from the ESPP and the exercise of stock options are \$6 million for the nine months ended September 30, 2008. These proceeds are included in Other financing activities, net in the Condensed Consolidated Statement of Cash Flows (Unaudited).

Prior to the second quarter of 2008, stock repurchased through the share repurchase programs was retired. Beginning in the second quarter of 2008, stock repurchased through the share repurchase programs was held as treasury stock.

Teradata had no short- or long-term debt outstanding as of September 30, 2008, and was in compliance with all covenants of the revolving credit facility. Management believes current cash and short-term investment resources, Company cash flows from operations and its \$300 million credit facility will be sufficient to satisfy future working capital, research and development activities, capital expenditures, pension contributions, and other financing requirements for the foreseeable future. The Company uses a number of financial instruments to hold its cash, cash equivalents and short-term investments, including bank deposits, money market funds and government treasuries.

The Company's ability to generate positive cash flows from operations is dependent on general economic conditions, competitive pressures, and other business and risk factors described in the Company's 2007 Annual Report, and elsewhere in this Quarterly Report. If the Company is unable to generate sufficient cash flows from operations, or otherwise to comply with the terms of the credit facilities, the Company may be required to seek additional financing alternatives.

Contractual and Other Commercial Commitments. There has been no significant change in our contractual and other commercial commitments as described in the 2007 Annual Report. Our guarantees and product warranties are discussed in Note 9 of Notes to Condensed Consolidated Financial Statements (Unaudited).

Table of Contents

Critical Accounting Policies and Estimates

There have not been any material changes to the methodology applied by management for critical accounting policies and estimates previously disclosed in the 2007 Annual Report.

Our financial statements are prepared in accordance with GAAP. In connection with the preparation of these financial statements, we are required to make assumptions, estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and the related disclosure of contingent liabilities. These assumptions, estimates and judgments are based on historical experience and assumptions that are believed to be reasonable at the time. However, because future events and their effects cannot be determined with certainty, the determination of estimates requires the exercise of judgment. Our critical accounting policies are those that require assumptions to be made about matters that are highly uncertain. Different estimates could have a material impact on our financial results. Judgments and uncertainties affecting the application of these policies and estimates may result in materially different amounts being reported under different conditions or circumstances. Our management periodically reviews these estimates and assumptions to ensure that our financial statements are presented fairly and are materially correct.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require significant management 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. The significant accounting policies and estimates that we believe are the most critical to aid in fully understanding and evaluating our reported financial results are discussed in the 2007 Annual Report. Teradata's senior management has reviewed these critical accounting policies and related disclosures and determined there were no significant changes in our critical accounting policies in the nine months ended September 30, 2008. Also, there were no significant changes in our estimates associated with those policies.

New Accounting Pronouncements

See discussion in Note 2 of Notes to Condensed Consolidated Financial Statements (Unaudited) for new accounting pronouncements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have not been any material changes to the market risk factors previously disclosed in Part II, Item 7A of the Company's 2007 Annual Report on Form 10-K.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the rules and regulations of the SEC, the Company is not required to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 until we file our Annual Report on Form 10-K for our fiscal year ending December 31, 2008 (the 2008 Annual Report). In our 2008 Annual Report, management and our independent registered public accounting firm will be required to provide an assessment as to the effectiveness of our internal control over financial reporting.

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act)) as of September 30, 2008. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in its reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the chief executive officer and the chief financial officer, to allow timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Table of Contents

In our 2007 Annual Report, we disclosed a material weakness in our internal control over financial reporting relating to the accounting for revenue transactions involving resellers. Specifically, effective controls did not exist to ensure the accuracy of revenue recognized on sales to resellers for which fees were not fixed or determinable. As of September 30, 2008, the Company is still in the process of developing and implementing a plan of remediation to eliminate this material weakness and to strengthen the Company's control environment with respect to revenue recognition in general, and accordingly our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were not effective as of September 30, 2008.

Additionally, in light of the material weakness in our internal control over financial reporting as of September 30, 2008, the Company performed additional analyses and other post-closing procedures in an effort to ensure that our Condensed Consolidated Financial Statements (Unaudited) included in this Quarterly Report on Form 10-Q, as of and for the quarter ended September 30, 2008, have been prepared in accordance with GAAP.

Plan for Remediation of Material Weakness

Throughout 2008, we have been taking steps intended to remediate this material weakness, and are improving our control processes and procedures with respect to revenue recognition in general as part of our efforts to become compliant with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. These activities include:

conducting an end-to-end review of our contract process,

evaluating, designing and implementing, as appropriate, new policies, procedures and controls,

conducting additional training on revenue recognition for appropriate personnel, and

evaluating the proper organizational structure, including hiring a sufficient compliment of personnel with the requisite knowledge and expertise of revenue recognition accounting standards under U.S. GAAP.

In particular, our remediation plan is being designed to ensure that revenue transactions with non-standard terms and conditions are identified and undergo more comprehensive review by our internal personnel to assure that the earnings process in accordance with GAAP is complete before revenue recognition occurs.

Changes in Internal Control over Financial Reporting

Other than those listed above, there have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Part II. Other Information

Item 1. LEGAL PROCEEDINGS

The information required by this item is included in the material under Note 9 of Notes to Condensed Consolidated Financial Statements (Unaudited) of this Quarterly Report on Form 10-Q and is incorporated herein by reference.

Item 1A. RISK FACTORS

There have not been any material changes to the risk factors previously disclosed in Part I, Item IA of the Company's 2007 Annual Report on Form 10-K.

Table of Contents**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Purchase of Company Common Stock**

During the third quarter of 2008, the Company purchased approximately 2.7 million shares of its common stock at an average price per share of \$24.38 under the two share repurchase programs authorized by our Board of Directors in 2008. The first program (the "dilution offset program") authorizes the Company to purchase Teradata common stock to the extent of cash received from the exercise of stock options and the Teradata Employee Stock Purchase Plan ("ESPP"). The second program (the "general share repurchase program") authorizes the Company to repurchase an additional \$250 million of the Company's outstanding shares of common stock. As of September 30, 2008, the Company had \$120 million of authorization remaining on the \$250 million general share repurchase program to repurchase outstanding shares of Teradata common stock.

In addition to those share purchases, Section 16 officers occasionally sell vested shares of restricted stock to the Company at the current market price to cover their withholding taxes. For the nine months ended September 30, 2008, the total of these purchases was 12,909 shares at an average price of \$24.68 per share.

The following table provides information relating to the Company's repurchase of common stock for the nine months ended September 30, 2008:

Month	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Dilution Offset Program	Total Number of Shares Purchased as Part of Publicly Announced General Share Repurchase Program	Maximum Dollar Value that May Yet Be Purchased Under the Dilution Offset Program	Maximum Dollar Value that May Yet Be Purchased Under the General Share Repurchase Program
First Quarter Total	1,564,100	\$ 24.53	50,000	1,514,100	\$ 1,137,142	\$ 212,912,054
Second Quarter Total	1,362,800	\$ 24.79	50,000	1,312,800	\$ 2,501,180	\$ 180,433,920
July 2008		N/A			\$ 2,968,846	\$ 180,433,920
August 2008	1,812,900	\$ 24.74	125,000	1,687,900	\$ 1,040,112	\$ 138,672,939
September 2008	850,000	23.62	50,000	800,000	\$ 588,398	\$ 119,739,011
Third Quarter Total	2,662,900	\$ 24.38	175,000	2,487,900	\$ 588,398	\$ 119,739,011

Item 3. DEFAULTS UPON SENIOR SECURITIES

None

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

Item 5. OTHER INFORMATION

None

Table of Contents

Item 6. EXHIBITS

- 2.1 Form of Separation and Distribution Agreement between Teradata Corporation and NCR Corporation (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K dated September 11, 2007).
- 3.1 Amended and Restated Certificate of Incorporation of Teradata Corporation, as amended and restated on September 24, 2007 (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K dated September 25, 2007).
- 3.2 Amended and Restated Bylaws of Teradata Corporation, as amended and restated on October 22, 2007 (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K dated October 24, 2007).
- 4.1 Common Stock Certificate of Teradata Corporation (incorporated by reference to Exhibit 4.1 to the Quarterly Report on Form 10-Q dated November 13, 2007).
- 10.1 First Amendment to Teradata Corporation Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.7 to the Quarterly Report on Form 10-Q dated August 14, 2008).
- 10.2 Amendment to the Offer Letter from Teradata Corporation to Michael Koehler, dated October 7, 2008 (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K dated October 13, 2008).
- 10.3 Amendment to the Offer Letter from Teradata Corporation to Stephen Scheppmann, dated October 7, 2008 (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K dated October 13, 2008).
- 10.4 Amended and Restated Teradata Change in Control Severance Plan, dated October 7, 2008 (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K dated October 13, 2008).
- 10.5 Amended and Restated Teradata Corporation 2007 Stock Incentive Plan, dated October 7, 2008 (incorporated by reference to Exhibit 10.4 to the Current Report on Form 8-K dated October 13, 2008).
- 10.6 Amendment to form of Restricted Stock Unit and Performance-Based Restricted Stock Unit Agreements under the Amended and Restated Teradata Corporation 2007 Stock Incentive Plan (incorporated by reference to Exhibit 10.5 to the Current Report on Form 8-K dated October 13, 2008).
- 31.1 Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated November 12, 2008.
- 31.2 Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated November 12, 2008.
- 32 Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 12, 2008.

Table of Contents

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.

TERADATA CORPORATION

Date: November 12, 2008

By: /s/ Stephen M. Scheppmann
Stephen M. Scheppmann
Executive Vice President and Chief Financial Officer