

OPEN SOLUTIONS INC
Form 10-Q
August 09, 2006

Table of Contents

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

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

For the quarterly period ended June 30, 2006

OR

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

For the transition period of ___ to ___

Commission file number 000-02333

Open Solutions Inc.

(Exact name of registrant as specified in its charter)

Delaware

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

22-3173050

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

455 Winding Brook Drive, Glastonbury, CT

(Address of principal executive offices)

06033

(Zip Code)

(860) 652-3155

(Registrant's telephone number, including area code)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of August 4, 2006, 20,650,855 shares of common stock, \$0.01 par value per share, were outstanding.

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Item 4. Controls and Procedures

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

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

Item 3. Defaults Upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits

SIGNATURES

EXHIBIT INDEX

EX-10.1 Incentive Stock Option Agreement

EX-10.2 Nonstatutory Stock Option Agreement

EX-31.1 Section 302 Certification of C.E.O.

EX-31.2 Section 302 Certification of C.F.O.

EX-32.1 Section 906 Certification of C.E.O.

EX-32.2 Section 906 Certification of C.F.O.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

OPEN SOLUTIONS INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)

	June 30, 2006	December 31, 2005
	(In thousands, except share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 45,953	\$ 174,426
Investments in marketable securities	8,038	
Accounts receivable, net	76,981	36,582
Prepaid expenses and other current assets	18,338	14,353
Deferred tax assets	11,601	13,000
Total current assets	160,911	238,361
Fixed assets, net	38,316	20,779
Intangible assets, net	224,511	46,794
Goodwill	416,098	94,081
Deferred tax assets	1,194	4,283
Other assets	19,253	6,914
Total assets	\$ 860,283	\$ 411,212
 LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 5,682	\$ 7,313
Accrued expenses	30,150	24,624
Deferred revenue, current portion	72,279	34,588
Capital lease obligations, current portion	4,668	102
Total current liabilities	112,779	66,627
Convertible notes payable	144,061	144,061
Long-term debt	342,000	
Capital lease obligations, less current portion	3,596	122
Deferred revenue, less current portion	36,892	3,251
Other long-term liabilities	3,216	1,447

Total liabilities	642,544	215,508
Commitments and contingencies (Note 6)		
Stockholders' equity;		
Preferred stock, \$0.01 par value; 5,000,000 shares authorized; no shares issued and outstanding at June 30, 2006 and December 31, 2005		
Common stock, \$0.01 par value; 95,000,000 shares authorized; 20,607,787 and 19,980,262 shares issued and 20,061,653 and 19,434,128 shares outstanding at June 30, 2006 and December 31, 2005, respectively	206	200
Additional paid-in capital	215,676	206,483
Deferred compensation		(127)
Accumulated other comprehensive income, net of tax	6,390	2,469
Retained earnings (accumulated deficit)	5,467	(3,321)
Treasury stock at cost; 546,134 and 546,134 treasury shares at June 30, 2006 and December 31, 2005, respectively	(10,000)	(10,000)
Total stockholders' equity	217,739	195,704
Total liabilities and stockholders' equity	\$ 860,283	\$ 411,212

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

Table of Contents

OPEN SOLUTIONS INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(In thousands, except share and per share data)			
Revenues:				
Software license	\$ 9,189	\$ 11,349	\$ 20,774	\$ 19,254
Service, maintenance and hardware	97,945	35,738	153,068	65,559
Total revenues	107,133	47,087	173,842	84,813
Cost of revenues:				
Software license	1,762	1,638	3,859	2,828
Service, maintenance and hardware	55,174	18,741	86,890	33,943
Total cost of revenues	56,936	20,379	90,749	36,771
Gross profit	50,197	26,708	83,093	48,042
Operating expenses:				
Sales and marketing	9,743	6,003	16,611	10,808
Product development	6,883	5,080	12,412	9,105
General and administrative	18,393	9,169	32,817	16,762
Total operating expenses	35,019	20,252	61,840	36,675
Gain on effective settlement of contract (Note 3)			4,252	
Income from operations	15,178	6,456	25,505	11,367
Interest income and other	605	1,170	1,892	2,040
Interest expense	(8,976)	(1,210)	(12,492)	(2,067)
Income before income taxes	6,807	6,416	14,905	11,340
Income tax provision	2,710	2,581	6,114	4,540
Net income	\$ 4,097	\$ 3,835	\$ 8,791	\$ 6,800

Net income per common share:

Basic	\$	0.21	\$	0.20	\$	0.45	\$	0.35
Diluted		0.19		0.18		0.40		0.32

Weighted average common shares
used to compute net income per
common share:

Basic	19,797,324	19,372,648	19,667,937	19,412,034
Diluted	25,652,446	25,399,423	25,571,621	24,638,388

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

Table of Contents

OPEN SOLUTIONS INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Six Months Ended June 30,	
	2006	2005
	(In thousands)	
Cash flows from operating activities		
Net income	\$ 8,791	\$ 6,800
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,923	3,313
Amortization	10,846	2,029
Gain on effective settlement of contract	(4,252)	
Non-cash interest expense	840	294
Stock based compensation expense	3,938	200
Deferred tax provision	5,547	3,707
Provision for doubtful accounts	680	277
Changes in operating assets and liabilities, excluding effects from acquisitions:		
Accounts receivable	(6,377)	(10,955)
Prepaid expenses and other assets	4,783	(1,023)
Accounts payable and accrued expenses	(16,779)	809
Deferred revenue	18,675	3,399
Net cash provided by operating activities	32,613	8,850
Cash flows from investing activities		
Purchases of fixed assets and capitalized software	(10,076)	(3,936)
Purchases of marketable securities	(8,038)	(92,758)
Sales of marketable securities		54,168
Business acquisitions, net of cash received	(476,309)	(41,936)
Net cash used in investing activities	(494,423)	(84,462)
Cash flows from financing activities		
Proceeds from exercise of stock options and issuance of common stock from employee stock purchase plan	4,581	1,441
Repayment of long-term debt from customers		(2,917)
Repayment of capital lease obligation	(1,864)	(479)
Proceeds from issuance of long-term debt	350,000	
Repayment of long-term debt	(8,000)	
Proceeds from convertible notes payable		144,061
Payment of debt issuance costs	(11,806)	(4,915)
Repurchase of common stock		(8,461)

Edgar Filing: OPEN SOLUTIONS INC - Form 10-Q

Net cash provided by financing activities	332,911	128,730
Effects of exchange rate on cash and cash equivalents	426	(48)
Net (decrease) increase in cash and cash equivalents	(128,473)	53,070
Cash and cash equivalents, beginning of period	174,426	49,447
Cash and cash equivalents, end of period	\$ 45,953	\$ 102,517
Supplemental disclosures		
Cash paid for interest	\$ 9,728	\$ 121
Cash paid for income taxes	\$ 818	\$ 405

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

Table of Contents

**OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)**

1. The Company

Open Solutions Inc. (the Company) is a provider of open relational software technologies and services designed to enable financial institutions to better compete and service their customers more effectively. The Company develops, markets, licenses and supports an enterprise-wide suite of software and services that performs a financial institution's core data processing and information management functions. The Company's software applications can be operated either by the financial institution itself, on an outsourced basis in one of the Company's outsourcing centers or through an outsourcing center hosted by one of the Company's resellers.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments (consisting only of normal, recurring adjustments) necessary for a fair presentation. The operating results for the three and six months ended June 30, 2006 may not be indicative of the results expected for any succeeding quarter or for the entire fiscal year ending December 31, 2006.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant accounts, transactions and profits between the consolidated companies have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounting for Stock-Based Compensation

The Company has adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), effective January 1, 2006, using the modified prospective application method (MPA). SFAS 123R requires the recognition of the fair value of stock-based compensation in net earnings. Under the MPA, compensation costs recognized in the three and six months ended June 30, 2006 include: (a) compensation costs for all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant-date fair value estimated in accordance with the original provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), and (b) compensation cost for all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated in

accordance with the provisions of SFAS 123R. The results of prior periods have not been restated.

The Company has four stock-based compensation plans: the 1994 Stock Option Plan, the 2000 Stock Incentive Plan, the 2003 Stock Incentive Plan (collectively the Plans), and the 2003 Employee Stock Purchase Plan. Under the Plans, restricted stock, stock options and other stock-related awards may be granted to directors, officers, employees and consultants or advisors of the Company. To date, stock-based compensation issued under the Plans consists of incentive and non-qualified stock options and restricted stock. Stock options are granted to employees at exercise prices equal to the fair market value of the Company's stock at the dates of grant. Stock options and restricted stock granted to employees vest over four and five years, respectively from the grant date, and stock options have a term of 10 years. A maximum of 14,482,757 shares of common stock is authorized for issuance under the Plans as of June 30, 2006. Upon exercise of stock options, the Company's policy is to issue new shares and, to date, the Company has not issued shares from treasury stock.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Compensation expense is measured at the grant date, based on the estimated fair value of the award. The Company recognizes stock-based compensation expense on a straight-line basis over the requisite service period of the individual grants, which generally equals the vesting period. Compensation expense related to all equity awards is recorded net of estimated forfeitures. Effective December 1, 2005, the 2003 Employee Stock Purchase Plan was amended to reduce the discount available to 5% and to eliminate the look-back feature. Accordingly, the 2003 Employee Stock Purchase Plan is non-compensatory under SFAS 123R.

Prior to January 1, 2006, the Company accounted for the stock-based compensation plans under the intrinsic value method described in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB No. 25), and related interpretations as permitted by SFAS 123. When applying the intrinsic value method, the Company did not record stock-based compensation cost in net income because the exercise price of the Company's stock options equaled the market price of the underlying stock on the date of grant, except with respect to certain awards granted prior to the Company's initial public offering in November 2003, for which the exercise price of those options was less than the underlying market price. Under the MPA, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. Upon adoption of SFAS 123R, the Company netted against additional paid-in capital approximately \$788,000 of deferred compensation related to the awards granted prior to the initial public offering which were granted at less than market value, which had previously been recorded as a liability. Upon adoption, the Company also netted the deferred compensation balance of \$127,000 previously recorded within equity against additional paid-in capital.

Consistent with the valuation method it used for the disclosure-only provisions of SFAS 123, the Company is using the Black-Scholes model to value the compensation expense associated with its stock-based awards under SFAS 123R. The key assumptions for this valuation method include the expected term of the options, stock price volatility, risk free interest rate, dividend yield and exercise price. Many of these assumptions require judgments by management and are highly sensitive in the determination of compensation expense. The Company estimates forfeitures when recognizing compensation expense, and will adjust its estimate of forfeitures over the requisite service period based on the extent to which actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative true-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods.

The assumptions made by the Company to value the compensation expense associated with its stock-based awards are based (in part) on class of employee.

During the three months ended June 30, 2006 and 2005, the weighted-average fair value of the options granted under Plans was \$12.68 and \$8.30, respectively. During the six months ended June 30, 2006 and 2005, the weighted-average fair value of the options granted under the Plans was \$11.49 and \$8.97, respectively, using the following assumptions:

	Three Months Ended June		Six Months Ended June	
	30,		30,	
	2006	2005	2006	2005
Expected life in years	5	4	5	4
Interest rate	5.47%	3.82%	4.88%	3.82%
Volatility	43.37%	48.63%	38.45%	48.63%
Dividend yield	None	None	None	None

The expected stock price volatility rates are based on historical volatilities of the Company's common stock. The risk-free interest rates are based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option. The average expected life represents the weighted average period

of time that options granted are expected to be outstanding giving consideration to vesting schedules and historical patterns.

Certain exercises of stock options resulted in tax deductions in excess of previously recorded benefits based on the option value at the time of grant (windfalls). Although these additional tax windfalls are reflected in net operating tax loss carry-forwards, pursuant to SFAS 123R, the additional tax benefit associated with the windfall is not recognized until the deduction reduces taxes payable. Accordingly, since the tax benefit does not reduce the Company s current taxes payable due to net operating loss carry-forwards, these windfall tax benefits are not reflected in the Company s net operating losses in deferred tax assets at June 30, 2006. Windfalls included in net operating loss carry-forwards but not reflected in deferred tax assets as of June 30, 2006 and 2005 are approximately \$6,000,000 and \$0, respectively.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

In conjunction with the Financial Accounting Standards Board Staff Position No. FAS 123(R)-3, *Transition Election Related to Accounting for Tax Effective of Share-Based Payment Awards*, the Company elected to adopt the alternative transition method for calculating the tax effective of stock-based compensation pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee stock-based compensation, and to determine the subsequent effect on the additional paid-in capital pool and the statements of cash flows of the tax effects of employee stock-based compensation awards that were outstanding upon the adoption of SFAS 123R.

SFAS 123R requires the presentation of pro forma information for periods prior to the adoption as if the Company had accounted for all stock-based compensation under the fair value method of SFAS 123. For purposes of pro forma disclosure, the estimated fair value of the options at the date of grant is amortized to expense over the requisite service period, which generally equals the vesting period. The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS 123 to its stock-based employee compensation during 2005.

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income, as reported	\$ 3,835,000	\$ 6,800,000
Add: Stock-based employee compensation expense included in reported net income, net of tax	86,000	152,000
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(1,539,000)	(2,827,000)
Pro forma net income	\$ 2,382,000	\$ 4,125,000
Reported net income per share:		
Basic	\$ 0.20	\$ 0.35
Diluted	\$ 0.18	\$ 0.32
Pro forma net income per share:		
Basic	\$ 0.12	\$ 0.21
Diluted	\$ 0.12	\$ 0.21

During the six months ended June 30, 2006, the Company recognized stock-based compensation expense of approximately \$3,535,000 for stock options and approximately \$403,000 for restricted stock. The income tax benefit for stock-based payment recorded in the statement of operations totaled \$877,000 for the six months ended June 30, 2006. As a result of adopting SFAS 123R, stock-based compensation charges during the six months ended June 30, 2006 increased by approximately \$3,300,000 and net income for the six months ended June 30, 2006 decreased by approximately \$2,500,000, or \$0.13 per basic share and \$0.10 per diluted share.

A summary of the status of the Company's stock options at June 30, 2006 and changes during the six months then ended are as follows:

Options	Weighted- Average Exercise Price
----------------	---

Edgar Filing: OPEN SOLUTIONS INC - Form 10-Q

Options outstanding at December 31, 2005	3,562,047	\$	14.99
Options granted	678,550		26.07
Options cancelled	(196,321)		19.51
Options exercised	(431,445)		10.35
Options outstanding at June 30, 2006	3,612,831		17.42
Options exercisable at June 30, 2006	1,706,356		12.29

7

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Options outstanding at June 30, 2006 had an aggregate intrinsic value of \$33,700,000, a weighted-average intrinsic value of \$9.33 per share and a weighted average remaining contractual life of 7.49 years. Intrinsic value of options outstanding consists of the amount by which the market price of the Company's stock at the end of the period exceeded the exercise price of the option. Options exercised during the six months ended June 30, 2006 had a weighted-average intrinsic value of \$16.96 per share. Intrinsic value of options exercised consists of the amount by which the average market price of the Company's stock during the six months ended June 30, 2006 exceeded the exercise price of the option. The following table presents weighted average information about significant option groups at June 30, 2006:

Range of Exercise Prices	Number	Options Outstanding		Options Exercisable	
		Weighted-Average Exercise Price	Weighted-Average Contractual Life	Number	Weighted-Average Exercise Price
\$0.00 - 2.94	297,459	\$ 2.83	6.73	178,217	\$ 2.79
\$2.95 - 5.86	270,005	5.70	3.18	270,005	5.70
\$5.87 - 8.81	589,666	7.25	4.97	588,454	7.25
\$8.82 - 17.62	60,594	13.97	7.30	21,801	13.76
\$17.63 - 20.56	549,578	19.39	8.74	150,584	19.37
\$20.57 - 23.49	1,001,382	22.29	8.24	392,721	21.97
\$23.50 - 26.43	511,639	25.67	9.39	28,262	24.37
\$26.44 - 29.37	332,508	28.16	8.93	76,312	27.87
	3,612,831	17.42	7.49	1,706,356	12.29

As of June 30, 2006, there was \$19,001,000 of unrecognized compensation expense related to non-vested options granted under the Plans, which is expected to be recognized over a weighted-average period of 1.91 years.

A summary of the status of non-vested restricted stock at June 30, 2006 and changes during the six months then ended are as follows:

	Restricted Stock	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2005		
Granted	213,862	\$ 25.87
Vested		
Cancelled		
Non-vested at June 30, 2006	213,862	\$ 25.87

As of June 30, 2006, there was \$5,233,000 of unrecognized compensation expense related to non-vested restricted stock granted under the Plans, which is expected to be recognized over a weighted-average period of 2.89 years.

Investments in Marketable Securities

The Company's investments in marketable securities at June 30, 2006 consist primarily of short-term time deposits that are held with a major financial institution. The Company's marketable securities are recorded at fair value. At June 30, 2006, there were no unrealized gains or losses on the Company's short term securities.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Segment Reporting

The Company applies the provisions of Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company views its operations and manages its business as one reportable segment, the development and marketing of financial services-focused computer software and related services. Factors used to identify the Company's single reportable segment include the organizational structure of the Company and the financial information available for evaluation by the chief operating decision-maker in making decisions about how to allocate resources and assess performance. The Company operates primarily in two geographical areas, the United States and Canada. The Company provides the following disclosures of revenues from products and services:

	Three Months Ended June		Six Months Ended June 30,	
	2006	30, 2005	2006	2005
Software license	\$ 9,189,000	\$ 11,349,000	\$ 20,774,000	\$ 19,254,000
Installation, training and professional services	11,831,000	6,812,000	19,915,000	12,566,000
Maintenance and support	14,966,000	11,320,000	27,725,000	20,555,000
Data center and payment processing services	68,149,000	15,352,000	100,287,000	28,705,000
Hardware and other	2,999,000	2,254,000	5,141,000	3,733,000
Service, maintenance and hardware	97,945,000	35,738,000	153,068,000	65,559,000
Total revenues	\$ 107,134,000	\$ 47,087,000	\$ 173,842,000	\$ 84,813,000

Revenues and tangible long-lived assets by significant geographic region are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues:				
United States	\$ 93,744,000	\$ 39,076,000	\$ 150,391,000	\$ 68,761,000
Canada	13,390,000	8,011,000	23,451,000	16,052,000
Total revenues	\$ 107,134,000	\$ 47,087,000	\$ 173,842,000	\$ 84,813,000

	June 30,	As of
	2006	December 31,
		2005

Tangible long-lived assets:

United States	\$ 31,988,000	\$ 14,773,000
Canada	6,328,000	6,006,000
	\$ 38,316,000	\$ 20,779,000

Net Income Per Share

Basic earnings per share (EPS), which excludes dilution, is computed by dividing income or loss available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Diluted EPS includes in-the-money stock options using the treasury stock method and also includes the assumed conversion of the Company's convertible debt using the if-converted method. Under the if-converted method, the after-tax interest expense is added to the numerator and the weighted average shares issuable upon conversion of the debt instrument are added to the denominator.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

The following table reconciles net income and the weighted average shares outstanding used to calculate basic and diluted income per share:

	Three Months Ended June		Six Months Ended June 30,	
	30,			
	2006	2005	2006	2005
Net income used for basic calculation	\$ 4,097,000	\$ 3,835,000	\$ 8,791,000	\$ 6,800,000
Interest expense from convertible debt, net of tax effect	716,000	703,000	1,421,000	1,167,000
Net income used for diluted calculation	\$ 4,813,000	\$ 4,538,000	\$ 10,212,000	\$ 7,967,000
Basic net income per share weighted average common shares outstanding	19,797,324	19,372,648	19,667,937	19,412,034
Dilutive effect of stock options, warrants and unvested restricted stock	890,918	1,062,571	939,480	1,139,799
Dilutive effect of convertible debt	4,964,204	4,964,204	4,964,204	4,086,555
Diluted net income per share weighted average common shares outstanding	25,652,446	25,399,423	25,571,621	24,638,388

Weighted average common shares of 299,966 and 259,427 were excluded from the computation of diluted EPS for the three and six months ended June 30, 2006, and 1,477,425 and 1,286,019 were excluded for the three and six months ended June 30, 2005, as their effect would have been anti-dilutive.

Comprehensive Income

The following table summarizes comprehensive income:

	Three Months Ended June		Six Months Ended June 30,	
	30,			
	2006	2005	2006	2005
Net income	\$ 4,097,000	\$ 3,835,000	\$ 8,791,000	\$ 6,800,000
Unrealized gain on marketable securities		38,000		54,000
Foreign currency translation adjustment	2,413,000	(452,000)	2,322,000	(945,000)
Unrealized gain on cash flow hedge, net of tax	1,446,000		1,601,000	
Total comprehensive income	\$ 7,956,000	\$ 3,421,000	\$ 12,714,000	\$ 5,909,000

Concentration of Credit Risk

Financial instruments that potentially expose the Company to concentrations of credit risk are limited to accounts receivable. No customers accounted for more than 10% of total revenues for the three and six month periods ended June 30, 2006 and 2005. At June 30, 2006 and December 31, 2005, no customer accounted for 10% or more of the total accounts receivable balance. The Company maintains allowances for potential credit risks and otherwise controls

this risk through monitoring procedures.

Derivative Financial Instruments

The Company does not engage in derivative trading, market-making or other speculative activities. The Company enters into agreements to manage certain exposures to fluctuations in interest rates. The Company's interest-rate contracts involve the exchange of fixed and floating rate interest payments without the exchange of the underlying principal. Net amounts paid or received are reflected as adjustments to interest expense (see Note 5).

The Company recognizes all derivative financial instruments, such as interest rate swap agreements, at their fair value regardless of the purpose or intent for holding the instrument. Changes in fair value of derivative financial instruments are either recognized periodically in income or in stockholders' equity as a component of comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or cash flow hedge. At June 30, 2006, the Company had solely utilized derivative instruments as cash flow hedges. Changes in fair values of derivatives accounted as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Software Developed for Internal Use

As a result of the acquisition of the Information Services Group of BISYS, Inc. (*BISYS*), a provider of outsourcing services, the Company has recently began to incur costs for the development of internal-use software. The Company capitalizes the costs of computer software developed or obtained for internal use in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (*SOP 98-1*). Capitalized computer software costs consist of purchased software licenses, implementation costs, consulting costs and payroll-related costs for certain projects that qualify for capitalization. Costs capitalized under SOP 98-1 are amortized over their estimated useful lives, which range from three to six years.

3. Acquisitions

On March 3, 2006, the Company purchased the outstanding common stock of the Information Services Group of BISYS for total cash consideration of approximately \$472,400,000, subject to adjustments set forth in the purchase agreement. In conjunction with this acquisition, the Company has incurred approximately \$5,700,000 of acquisition related costs. This acquisition is expected to expand the Company's product offerings, further increase the Company's presence in the financial service marketplace and extend the Company's client base to include insurance, healthcare and other industries. This acquisition was recorded under the purchase method of accounting with the total consideration allocated to the assets acquired and liabilities assumed based on estimates of fair value. The fair value of purchased technology was determined based on management's best estimate of future cash flows expected to be generated by such technology. The excess of the purchase price over the fair value of the net assets acquired has been allocated to goodwill. The operating results of this acquisition have been included in the Company's consolidated financial statements from the date of acquisition. The purchased technology related to this acquisition is being amortized over its useful life of 5 years. The other intangible assets, comprised of customer relationships and tradenames, are being amortized over their useful lives of 15 and 5 years, respectively based on the pattern in which economic benefits of the asset are consumed. The Company reclassified approximately \$27,950,000 of purchased third party licenses that were recorded within fixed assets on its March 31, 2006 balance sheet to intangible assets as part of the finalization process of the purchase price allocation. Purchase accounting for this acquisition is preliminary and is expected to be finalized during 2006.

The preliminary allocation of purchase price is summarized below:

Tangible assets acquired	\$ 59,942,000
Purchased technology	53,899,000
Goodwill	321,150,000
Other intangibles	128,000,000
Liabilities assumed	(82,340,000)
Gain on settlement of contract, net of tax	(2,594,000)

Purchase price	\$ 478,057,000
----------------	----------------

Under the terms of the Company's pre-existing reseller agreement with BISYS, BISYS paid the Company non-refundable minimum license fees related to the achievement of certain minimum sales requirements. The Company agreed not to compete with BISYS for the sale of data processing services using The Complete Banking Solution (*TCBS*) software on an outsourced basis to banks and thrifts in the United States, except in certain circumstances. In connection with the purchase of the Information Services Group of BISYS, this reseller

agreement with BISYS was terminated. In accordance with Emerging Issued Task Form (EITF) 04-01, *Accounting for Pre-existing Relationships between the Parties to a Business Combination* (EITF 04-01), the Company reviewed the terms of the reseller agreement to determine if this executory contract included terms that were favorable or unfavorable when compared to pricing for current market transactions for the same or similar items, and measured a settlement gain or loss as the lesser of (A) the amount by which the reseller agreement was favorable or unfavorable to market terms or (B) the stated settlement provisions of the reseller agreement available to BISYS to which the reseller agreement is unfavorable. Accordingly, the Company recognized an imputed gain on the effective settlement of the reseller agreement with BISYS of approximately \$4,252,000. This gain represents the stated settlement provision available to BISYS.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Pro Forma Financial Information (Unaudited)

The financial information in the table below summarizes the combined results of operations of the Company and its material acquisitions, (the U.S. based services to credit unions business of CGI-AMS Inc. and the Information Services Group of BISYS), on a pro forma basis, as though the companies had been combined at the beginning of each period presented. The pro forma information excludes the effect of Omega Systems of North America LLC, S.O.S. Computer Systems, Inc., Financial Data Systems, Inc. and COWWW Software, Inc., as the results of their operations, individually and in the aggregate, are not significant to the Company. This pro forma financial information is not necessarily indicative of the results of operations that would have been achieved had the acquisition actually taken place as of the beginning of the period being presented below.

	Three Months Ended, June 30, 2005	Six Months Ended June 30, 2006	2005
Pro forma revenues	\$ 95,564,000	\$214,041,000	\$ 181,970,000
Pro forma net income	\$ 3,517,000	8,510,000	7,924,000
Pro forma net income per share basic	\$ 0.18	\$ 0.43	\$ 0.41
Pro forma net income per share diluted	\$ 0.17	\$ 0.39	\$ 0.37

Included in the pro forma results for the six months ended June 30, 2006 and 2005 is a gain of approximately \$4,252,000 which represents the effective settlement of the Company's pre-existing reseller agreement with BISYS. In addition, the pro forma results for both periods presented have been adjusted to reflect the impact of the settlement of the pre-existing reseller agreement at the beginning of each period presented, including reductions of revenue and related costs of the Company and the Information Services Group of BISYS related to this agreement.

4. Bank Financing

In connection with the acquisition of the Information Services Group of BISYS, the Company obtained bank financing. The bank financing is in the form of two agreements: a \$320,000,000 First Lien Senior Secured Credit Agreement (the First Agreement), which provides for a \$290,000,000 term loan (the First Term Facility) and a \$30,000,000 revolving line of credit (the Line of Credit), and a \$60,000,000 Second Lien Senior Term Loan Agreement (the Second Term Facility).

The First Term Facility, which has a term of 5.5 years and bears interest at LIBOR plus 250 basis points, was originally payable beginning June 30, 2006 in the amount of \$725,000 per quarter through March 31, 2011, with balloon payments of \$137,750,000 due on June 30, 2011 and September 3, 2011. The Company may prepay the First Term Facility in aggregate principal amounts of \$1,000,000 or a multiple of \$250,000 in excess thereof during the term of the First Agreement. During the six months, ended June 30, 2006, the Company prepaid an aggregate of \$8,000,000 of principal and, as a result, the next principal payment is not due until June 30, 2008. The remaining principal balance of the First Term Facility as of June 30, 2006 was \$282,000,000.

The Line of Credit expires on March 3, 2011 and bears interest at LIBOR plus 250 basis points. Borrowings under the Line of Credit are required to be in an aggregate amount of \$1,000,000 or a multiple of \$250,000 in excess thereof. To date, the Company has not drawn against the Line of Credit.

The Second Term Facility has a term of 6 years and bears interest at LIBOR plus 650 basis points and is payable on November 30, 2011. The remaining principal balance of the Second Term Facility as of June 30, 2006 was

\$60,000,000.

The bank financing contains both financial and non-financial covenants including maintaining a senior leverage ratio, as defined, a total leverage ratio, as defined, and a fixed charge ratio, as defined. These financial covenants are designed to measure the Company's ability to repay its outstanding debt as well as to fund the related interest payments. Borrowings under the bank financing are collateralized by substantially all of the Company's assets.

The costs of approximately \$8.1 million related to the First and Second Term Facilities have been recorded as deferred financing costs within other assets in the accompanying financial statements. During the six months ended June 30, 2006, the Company recognized approximately \$0.5 million of interest expense related to the amortization of these deferred financing costs. The deferred financing costs are being amortized into interest expense using the effective interest rate method over the term of the First Term Facility, which is through September 2011. To the extent the Company prepays all or a portion of the debt, the amortization of the deferred costs may be accelerated.

Table of Contents

OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

5. Interest Rate Swap Agreements

On March 12, 2006, the Company entered into two separate interest rate swap agreements with a bank. The objective of these derivative instruments is to offset the changes in variable benchmark interest rates and to limit exposure to uncertainty in interest expense and cash flow on the Company's bank financing. The first swap agreement is for \$217,500,000 of the Company's \$290,000,000 First Term Facility and steps down quarterly in conjunction with the Company's anticipated repayment of the First Term Facility. This swap agreement extends through December 31, 2010. The second swap agreement is for \$60,000,000 of the Company's \$60,000,000 Second Term Facility. This swap agreement extends through November 30, 2011. The fair value of these derivative instruments at June 30, 2006 was \$2.7 million and has been recorded within other assets.

The accounting for changes in the fair value of a derivative or hedging instrument depends upon the intended use of the derivative and the resulting designation. The effective portion of the derivative's gain/loss is initially reported as a component of other comprehensive income and subsequently reclassified to earnings when the forecasted transaction affects earnings. The ineffective portion of gain/loss is reported in earnings immediately. Upon entering into the swap agreements, the Company assessed the effectiveness of the hedging transactions by considering the guidance in the Derivative Implementation Group (DIG) Issue G-7, *Cash Flow Hedges: Measuring the Ineffectiveness of a Cash Flow Hedge under Paragraph 30(b) when the Shortcut Method is Not Applied*. The Company has determined that at inception, the Company's swap agreements are effective hedges and therefore changes in fair value will be recorded as a component of other comprehensive income as long as the hedge remains effective.

6. Commitments and Contingencies

At June 30, 2006, the Company was committed under facility and various other operating leases, which expire at various dates through January 2013. Minimum future lease payments under non-cancelable leases with a remaining term of greater than one year at June 30, 2006 are approximately as follows:

2006	\$ 8,020,000
2007	7,499,000
2008	6,852,000
2009	4,586,000
2010	2,751,000
Thereafter	2,777,000
Total minimum obligations	\$ 32,485,000

Rent expense under operating leases was approximately \$3,740,000 and \$2,085,000 for the six months ended June 30, 2006 and 2005, respectively. The Company recognizes rent expense on a straight-line basis for all lease agreements with periods of free rent or escalating payment terms. In connection with the acquisition of the Information Services Group of BISYS, the Company recorded a liability of approximately \$1,200,000 for certain facility leases that contain lease payments above fair value as of the acquisition date. The liability will be amortized against rent expense over the term of the leases.

Legal Proceedings

The Company is from time to time a party to legal proceedings which arise in the normal course of business. The Company is not currently involved in any material litigation, the outcome of which would, in management's judgment based on information currently available, have a material effect on the Company's results of operations or financial condition, nor is management aware of any such litigation.

Filing of Internal Revenue Service Tax Forms on Behalf of Certain Customers

In August 2005, the Company became aware that it had not timely filed certain federal tax forms on behalf of certain of its data processing customers with the Internal Revenue Service. Upon discovering this oversight, those filings were promptly made in August 2005. The Internal Revenue Code provides that penalties can be imposed upon the failure to make timely IRS filings on those parties ultimately responsible for filings, which in this case would be the Company's data processing clients. However, Treasury department regulations provide that a filer's established history of timely complying with its filing obligations may, in certain instances, result in a waiver of any penalties. The potential range of penalties is \$0 to approximately \$2,500,000, but because the imposition of penalties is neither probable nor estimable, no amounts have been accrued in the financial statements as of June 30, 2006 and December 31, 2005.

Table of Contents

**OPEN SOLUTIONS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)**

7. Recently Issued Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation 48, *Accounting for Income Tax Uncertainties* (FIN 48). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties.

FIN 48 is effective for fiscal years beginning after December 31, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48, and the amounts reported after adoption, will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. Because the guidance was recently issued, management has not yet determined the impact, if any, of adopting the provisions of FIN 48 on the Company's financial position and results of operations.

Table of Contents

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with, and are derived from, our consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. In addition to historical information, this discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions, which could cause actual results to differ materially from management's expectations. Important factors that could cause these differences include those described in Part II, Item 1A. Risk Factors and elsewhere in this Quarterly Report on Form 10-Q.

We use the terms Open Solutions, we, us and our to refer to the business of Open Solutions Inc. and our subsidiaries. All references to years, unless otherwise noted, refer to our fiscal years, which end on December 31.

Overview

Open Solutions is a provider of open relational software technologies and services designed to enable financial institutions to better compete and service their customers more effectively. We develop, market, license and support an enterprise-wide suite of software and services that performs a financial institution's core data processing and information management functions, including account, transaction, deposit, lending, operations, back office, client information and reporting. Our complementary products and services supplement our relational core software to provide our clients with fully-integrated business intelligence, customer relationship management, or CRM, check and document imaging, Internet banking and cash management, general ledger and profitability, loan origination, payment, web services, interactive voice solutions, HSA (health savings accounts) and Check 21 enabled check and item processing solutions. Our software applications can be operated either by the financial institution itself, on an outsourced basis in one of our outsourcing centers or through an outsourcing center hosted by one of our resellers. Substantially all of our historical revenue has been generated through the licensing of our core software and our complementary products and the provision of related services and maintenance to small and mid-size commercial banks and thrifts and credit unions of all sizes. We also derive revenue from payment processing services. We view our operations and manage our business as one reportable segment, the development and marketing of financial services focused computer software and related services.

We derive revenues from two primary sources:

sales of licenses for our core software and complementary products, and

fees from installation, training, maintenance and support services, as well as fees generated from our outsourcing and payment processing centers and the outsourcing centers hosted by our resellers.

Our revenues have grown from approximately \$27.3 million in 2001 to approximately \$193.8 million in 2005. Our revenues for the six months ended June 30, 2006 were \$173.8 million. This growth has resulted from strategic acquisitions and internal expansion, through which we have developed and acquired new products and services and have expanded the number of clients using one or more of our products to approximately 5,400 as of June 30, 2006. On March 3, 2006, we purchased the outstanding common stock of the Information Services Group of BISYS, Inc. (BISYS) for total cash consideration of approximately \$472.4 million, subject to certain adjustments. In connection with this acquisition, we incurred approximately \$5.7 million of acquisition related costs. This acquisition expands our product offerings, offers us additional cross selling solutions, further increases our presence in the financial services marketplace and extends our client base for our outsourcing services to include the insurance, healthcare and other industries. We anticipate that this acquisition will increase the recurring portion of our revenues. In addition, in conjunction with this acquisition, our pre-existing reseller agreement with BISYS was terminated, and we recognized a pre-tax gain on the effective settlement of this contract of approximately \$4.3 million, which represents the stated settlement provision available to BISYS. We used the net proceeds from a \$350.0 million bank financing and \$129.1 million of available cash to fund the purchase price. As discussed in greater detail under Liquidity and Capital Resources, this bank financing substantially increased our indebtedness.

Software license revenue includes fees received from the licensing of application software. We license our proprietary software products under standard agreements which typically provide our clients with the perpetual, non-exclusive, non-transferable right to use the software for a single financial institution upon payment of a license fee. We also license certain third-party software to clients.

Table of Contents

We generate service and maintenance fees by converting clients to our core software suite, installing our software, assisting our clients in operating the applications, modifying and updating the software and providing outsourcing and payment processing services. Our software license agreements typically provide for five years of support and maintenance, with automatic annual renewals.

We perform outsourcing services through our outsourcing centers and our check, item and payment processing centers. Revenues from outsourcing services, payment processing services and the check and item processing services are derived from monthly and transaction based fees, typically under three to five-year service contracts.

We derive other revenues from hardware sales and client reimbursement of out-of-pocket and telecommunication costs. We have entered into agreements with several hardware manufacturers under which we sell computer hardware and related services. Client reimbursements represent direct costs paid to third parties primarily for data communication, postage and travel.

We expect that our revenues from installation, training, support and maintenance, our outsourcing centers and the outsourcing centers hosted by our resellers will continue to expand as our base of clients expands. Our maintenance and outsourcing revenues are the largest of these revenue components, and we expect that these revenues, due to their recurring nature, will continue to be a significant portion of our total revenue as our client base grows. In addition, as a result of our acquisition of the Information Services Group of BISYS, we expect the revenue from outsourcing services to increase as a percentage of total revenue.

Application of Critical Accounting Policies

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, which require that management make numerous estimates and assumptions. Actual results could differ from those estimates and assumptions, impacting our reported results of operations and financial position. The application of our critical accounting policies is described in our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities Exchange Commission. These critical accounting policies include:

Revenue Recognition

Allowance for Doubtful Accounts

Software Development Costs

Accounting for Purchase Business Combinations

Long-Lived Assets, Intangible Assets and Goodwill

Income Taxes

The following material changes to the application of our critical accounting policies for the six months ended June 30, 2006 were as follows:

Stock Compensation

We adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), effective January 1, 2006. We utilize the Black-Scholes option pricing model to estimate the fair value of employee stock based compensation at the date of grant, which requires the input of highly subjective assumptions, including expected volatility and expected term. Further, as required under SFAS 123R, we now estimate forfeitures for options granted which are not expected to vest. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation. We adopted the provisions of SFAS 123R on January 1, 2006 using the modified prospective application method (MPA), which provides for certain changes to the method for valuing share-based compensation. Under the MPA, prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new awards and to the modification and cancellation of awards that are outstanding on the effective date.

Table of Contents

Upon the adoption of SFAS 123R, we recognized compensation expense associated with awards granted after January 1, 2006 and the unvested portion of previously granted awards that remain outstanding as of January 1, 2006 in our condensed consolidated statement of income for the six months ended June 30, 2006. During the six months ended June 30, 2006, we recognized compensation expense of \$3.5 million for stock options and \$0.4 million for restricted stock in our condensed consolidated statement of operations. Upon the adoption of SFAS 123R, we also netted against additional paid-in capital the deferred compensation balance previously recorded in liabilities of \$0.8 million. We also netted the deferred compensation balance of \$0.1 million previously recorded in equity against additional paid-in capital.

Derivative Financial Instruments

We recognize all derivative financial instruments, such as our interest rate swap agreements, at their fair value regardless of the purpose or intent for holding the instrument. Changes in fair value of derivative financial instruments are either recognized periodically in income or in stockholders' equity as a component of comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in fair values of derivatives accounted for as fair value hedges are recorded in income along with the portions of the changes in the fair values of the hedged items that relate to the hedged risk. Changes in fair values of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income.

Software Developed for Internal Use

As a result of the acquisition of the Information Services Group of BISYS, a provider of outsourcing services, we have recently begun to incur material costs for the development of internal-use software. We capitalize the costs of computer software developed or obtained for internal use in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). Capitalized computer software costs consist of purchase software licenses, implementation costs, consulting costs and payroll-related costs for certain projects that qualify for capitalization. Costs capitalized under SOP 98-1 are amortized over their estimated useful lives, which range from three to six years.

New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation 48, *Accounting for Income Tax Uncertainties* (FIN 48). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 31, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48, and the amounts reported after adoption, will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. Because the guidance was recently issued, we have not yet determined the impact, if any, of adopting the provisions of FIN 48 on our financial position and results of operations.

Results of Operations

	Three Months Ended June		Six Months Ended June	
	30,		30,	
	2006	2005	2006	2005
As a Percentage of Revenues:				
Revenues:				
Software license	8.6%	24.1%	12.0%	22.7%
Service, maintenance and hardware	91.4	75.9	88.0	77.3
Total revenues	100.0	100.0	100.0	100.0

Edgar Filing: OPEN SOLUTIONS INC - Form 10-Q

Cost of revenues:				
Software license	1.6	3.5	2.2	3.3
Service, maintenance and hardware	51.5	39.8	50.0	40.1
Total cost of revenues	53.1	43.3	52.2	43.4
Operating expenses:				
Sales and marketing	9.1	12.8	9.6	12.7
Product development	6.4	10.8	7.1	10.7
General and administrative	17.2	19.5	18.9	19.8
Total operating expenses	32.7	43.1	35.6	43.2
Gain on effective settlement of contract			2.4	
Income from operations	14.2	13.6	14.6	13.4
Interest expense, net	(7.8)	(0.1)	(6.0)	
Income before income taxes	6.4	13.5	8.6	13.4
Income tax provision	(2.5)	(5.5)	(3.5)	(5.4)
Net income	3.9%	8.0%	5.1%	8.0%

17

Table of Contents***Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005******Revenues.***

We generate revenues from licensing the rights to use our software products and certain third-party software products to clients. We also generate revenues from installation, training, maintenance and support services provided to clients, from outsourcing services and from hardware sales related to the licensing of our software and other third party software products. Revenues increased 127.5% from \$47.1 million for the three months ended June 30, 2005 to \$107.1 million for the three months ended June 30, 2006.

Software Licenses.

Software license revenues decreased 19.0% from \$11.3 million for the three months ended June 30, 2005 to \$9.2 million for the three months ended June 30, 2006. This decrease was primarily as a result of no longer recognizing license revenues related to our reseller arrangement with BISYS after that arrangement was settled upon our acquisition of the Information Services Group of BISYS in March 2006. The license fees from this reseller arrangement accounted for approximately zero and \$2.9 million of our license revenues for the three months ended June 30, 2006 and 2005, respectively. This decrease was partially offset by an increase of \$0.7 million due to sales of products that we acquired in the recent acquisition of the Information Services Group of BISYS and COWWW Software, Inc. Software license revenues will vary depending on the timing, size and nature of our license transactions.

Maintenance.

Maintenance revenues increased 32.2% from \$11.3 million for the three months ended June 30, 2005 to \$15.0 million for the three months ended June 30, 2006. The increase was primarily due to our recent acquisitions, which contributed \$3.3 million, and an increase in our core processing maintenance, which contributed \$0.4 million. Additionally, we will not be recognizing maintenance revenues related to our reseller agreement with BISYS in the future as this arrangement was settled upon our acquisition of the Information Services Group of BISYS. The maintenance fees under the BISYS reseller agreement accounted for approximately zero and \$1.0 million for the three months ended June 30, 2006 and 2005, respectively. We typically provide maintenance services under five-year contracts with automatic renewals that provide for an annual increase in fees, generally tied to the change in the consumer price index. Future maintenance revenue growth is dependent on new license sales and retention of existing clients and additional product sales to existing clients.

Implementation and Other Professional Services.

Implementation and other professional services revenues increased 73.7% from \$6.8 million for the three months ended June 30, 2005 to \$11.8 million for the three months ended June 30, 2006. The increase in implementation and other professional services is directly related to the increase in recent sales of licenses to new clients over the past few quarters and sales of additional products to existing clients. The increase was also due to our recent acquisitions, which contributed \$2.1 million, and an increase in our core service revenues, which contributed \$3.0 million. Our overall software license revenue levels and market demand for implementation and other professional services will continue to affect our implementation and other professional services revenues.

Outsourcing.

Outsourcing revenues increased 343.9% from \$15.4 million for the three months ended June 30, 2005 to \$68.1 million for the three months ended June 30, 2006. The increase in outsourcing revenues was primarily due to the acquisitions completed after June 30, 2005 of the Information Services Group of BISYS, Financial Data Solutions, Inc. and COWWW Software, Inc., which contributed \$51.6 million, combined with the addition of new clients in our pre-existing outsourcing centers. Future outsourcing revenue growth is dependent on our ability to retain existing clients, add new clients and increase average outsourcing fees.

Cost of Revenues.

Cost of revenues includes third party license fees and the direct expenses associated with providing our services, such as systems operations, customer support, installations, professional services and other related expenses. Cost of revenues increased 179.4% from \$20.4 million for the three months ended June 30, 2005 to \$56.9 million for the three months ended June 30, 2006. Gross margin decreased from 56.7% for the three months ended June 30, 2005 to 47.1% for the three months ended June 30, 2006. The decrease in gross margin is primarily attributable to our acquisition of

the Information Services Group of BISYS, which generates gross margins lower than our historical gross margins, as the acquired business primarily consists of outsourcing services. Additionally, as a result of the BISYS acquisition, the mix of revenue generated from third party license sales has increased, which has also resulted in a decrease in our gross margins.

Table of Contents*Cost of Software Licenses Revenues.*

Cost of software license revenues consists primarily of amortization expense of purchased technology, royalties, third-party software, and the costs of product media, packaging and documentation. Cost of license revenues increased 7.6% from \$1.6 million for the three months ended June 30, 2005 to \$1.8 million for the three months ended June 30, 2006. The increase in cost of software license revenues was primarily due to increased third-party software licenses sold in connection with our core and complementary products as well as increases in amortization of purchased technology related to our recent acquisitions.

Cost of Service, Maintenance and Hardware Revenues.

Cost of service, maintenance and hardware revenues consists primarily of personnel utilized to provide implementation, conversion and training services to our software licensees; technical client support and related costs; personnel, facility, telecommunication, depreciation of capital assets and amortization of developed technology utilized in servicing our outsourcing clients; and third party hardware costs. Cost of service, maintenance and hardware revenues increased 194.4% from \$18.7 million for the three months ended June 30, 2005 to \$55.2 million for the three months ended June 30, 2006. The increase in cost of service, outsourcing and hardware revenues was due primarily to a \$30.6 million increase in costs associated with the growth of our outsourcing and payment processing business, \$30.1 million of which is from the recently acquired businesses. There was also a \$4.2 million increase in costs associated with implementation and other professional services, \$2.1 million of which is from acquired businesses and the remainder of which is primarily related to an increased investment in our professional services organization to support the services related to increased license sales and potential future acquisitions. Maintenance costs increased \$1.0 million, which primarily related to the acquired business. Gross margin decreased from 47.6% for the three months ended June 30, 2005 to 43.9% for the three months ended June 30, 2006. The decrease in gross margin is primarily due to our acquisition of the Information Services Group of BISYS, as the acquired outsourcing business generates lower margins than our other service, maintenance and hardware revenue sources. This lower margin of the Information Services Group outsourcing business is primarily a result of a greater mix of revenue from third party vendors which generates lower margins.

*Operating Expenses**Sales and Marketing.*

Sales and marketing expenses include salaries and commissions paid to sales and marketing personnel and other costs incurred in marketing our products and services. Sales and marketing expenses increased 62.3% from \$6.0 million for the three months ended June 30, 2005 to \$9.7 million for the three months ended June 30, 2006. This increase was due primarily to increases in commissions from higher revenues of approximately \$0.3 million, stock compensation costs of \$0.5 million and \$2.7 million of sales and marketing costs as a result of our recent acquisitions. Sales and marketing expenses represented 12.8% of revenues for the three months ended June 30, 2005 as opposed to 9.1% of revenues for the three months ended June 30, 2006. Sales and marketing expenses as a percentage of revenues decreased primarily because of the increase in recurring service revenues which require lower selling costs than new sales.

Product Development.

Product development expenses include salaries of personnel in our product development department, consulting fees and other related expenses. Product development expenses increased 35.5% from \$5.1 million for the three months ended June 30, 2005 to \$6.9 million for the three months ended June 30, 2006. This increase was due primarily to a \$2.0 million increase in product development expenses from the acquired businesses. Product development expenses represented 10.8% of revenues for the three months ended June 30, 2005 as opposed to 6.4% of revenues for the three months ended June 30, 2006. Product development expenses as a percentage of revenues decreased primarily because product development expenses did not increase proportionally to our revenue growth.

General and Administrative.

General and administrative expenses consist of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance and depreciation. General and administrative expenses increased 100.6% from \$9.2 million for the three months ended June 30, 2005 to \$18.4 million for the three months ended June 30, 2006. The increase was due primarily to \$5.6 million of expenses from the acquired

businesses, an increase in stock compensation costs of \$1.1 million, an increase in legal, audit and audit related services of approximately \$0.3 million, an increase in consulting expenses of approximately \$0.5 million, and investments in our infrastructure, including increases in depreciation expense of \$0.4 million primarily related to the development of our new accounting systems and leasehold improvements at our facilities. General and administrative expenses represented 19.5% of revenues for the three months ended June 30, 2005 as opposed to 16.9% of revenues for the three months ended June 30, 2006.

Table of Contents*Interest and Other Income*

Interest and other income decreased 48.4% from \$1.2 million for the three months ended June 30, 2005 to \$0.6 million for the three months ended June 30, 2006. The decrease was primarily due to lower cash balances available for investment in 2006.

Interest Expense

Interest expense increased from \$1.2 million for the three months ended June 30, 2005 to \$9.0 million for the three months ended June 30, 2006. The increase in interest expense was due to interest from our March 2006 bank financing used to acquire the Information Services Group of BISYS.

Income Tax Provision.

Income tax provision increased from \$2.6 million for the three months ended June 30, 2005 to \$2.7 million for the three months ended June 30, 2006. Our effective tax rate decreased from 40.2% to 39.8% for the three months ended June 30, 2005 and 2006, respectively, primarily as a result of certain changes in Canadian tax laws which increased long-term deferred tax assets, partially offset by the adoption of SFAS 123R and the effect of stock-based compensation expense recorded for incentive stock options. An incentive stock option does not ordinarily result in a tax benefit for us unless there is a disqualifying disposition of stock. Accordingly, no deferred tax asset or benefit has been recognized by us for compensation expense recorded for incentive stock options. We expect to record a higher tax rate in the near term than has been recorded historically as incentive stock options continue to vest. Additional factors that may impact our expected rate would include changes in the magnitude and location of taxable income among taxing jurisdictions, including the blended state tax rate based on the mix of states we do business in, any non-deductible expenses and any tax credits we may receive.

Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005*Revenues.*

Revenues increased 105.0% from \$84.8 million for the six months ended June 30, 2005 to \$173.8 million for the six months ended June 30, 2006.

Software Licenses.

Software license revenues increased 7.9% from \$19.3 million for the six months ended June 30, 2005 to \$20.8 million for the six months ended June 30, 2006. Licensing of our core and complementary products increased due to an increase in the number of software license agreements in the six months ended June 30, 2006 as compared to the six months ended June 30, 2005, as well as an increase of \$1.5 million due to sales of products that we acquired in the recent acquisitions of the Information Services Group of BISYS and COWWW Software, Inc. These increases were partially offset by reduced license revenues from our reseller arrangement with BISYS as this arrangement was settled upon our acquisition of the Information Services Group of BISYS in March 2006. The license fees from BISYS accounted for approximately \$3.6 million and \$5.9 million of our license revenue for the six months ended June 30, 2006 and 2005, respectively. Software license revenues will vary depending on the timing, size and nature of our license transactions.

Maintenance.

Maintenance revenues increased 34.9% from \$20.6 million for the six months ended June 30, 2005 to \$27.7 million for the six months ended June 30, 2006. The increase was due to our recent acquisitions, which contributed \$7.1 million, and an increase in our core processing maintenance, which contributed \$2.1 million. Additionally, we will not be recognizing maintenance revenues related to our reseller agreement with BISYS in the future as this arrangement was settled upon our acquisition of the Information Services Group of BISYS. The maintenance fees under the BISYS reseller agreement accounted for approximately \$0.9 million and \$2.6 million for the six months ended June 30, 2006 and 2005, respectively. We typically provide maintenance services under five-year contracts with automatic renewals that provide for an annual increase in fees, generally tied to the change in the consumer price index. Future maintenance revenue growth is dependent on new license sales, retention of existing clients and additional product sales to existing clients.

Implementation and Other Professional Services.

Implementation and other professional services revenues increased 58.5% from \$12.6 million for the six months ended June 30, 2005 to \$19.9 million for the six months ended June 30, 2006. The increase in implementation and

other professional services is directly related to the increase in recent sales of licenses to new clients over the past few quarters and sales of additional products to existing clients. The increase in professional services revenues was also due to our recent acquisitions, which contributed \$3.6 million. Our overall software license revenue levels and market demand for implementation and other professional services will continue to affect our implementation and other professional services revenues.

Outsourcing.

Outsourcing revenues increased 249.4% from \$28.7 million for the six months ended June 30, 2005 to \$100.3 million for the six months ended June 30, 2006. The increase in outsourcing revenues was primarily due to the acquisitions completed after June 30, 2005 of the Information Services Group of BISYS and COWWW Software, Inc., which contributed \$63.8 million, combined with the addition of new clients in our pre-existing outsourcing centers. Future outsourcing revenue growth is dependent on our ability to retain existing clients, add new clients and increase average outsourcing fees.

Table of Contents*Cost of Revenues.*

Cost of revenues increased 146.8% from \$36.8 million for the six months ended June 30, 2005 to \$90.7 million for the six months ended June 30, 2006. Gross margin decreased from 56.6% for the six months ended June 30, 2005 to 47.8% for the six months ended June 30, 2006. The decrease in gross margin is primarily attributable to our acquisition of the Information Services Group of BISYS, which generates gross margins lower than our historical gross margins, as the acquired business primarily consists of outsourcing services. Additionally, as a result of the BISYS acquisition, the mix of revenue generated from third party license sales has increased, which has also resulted in a decrease in our gross margins.

Cost of Software License Revenues.

Cost of license revenues increased 36.5% from \$2.8 million for the six months ended June 30, 2005 to \$3.9 million for the six months ended June 30, 2006. The increase in cost of software license revenues was primarily due to increased third-party software licenses sold in connection with our core and complementary products as well as increases in amortization of purchased technology related to our recent acquisitions.

Cost of Service, Maintenance and Hardware Revenues.

Cost of service, maintenance and hardware revenues increased 155.4% from \$33.9 million for the six months ended June 30, 2005 to \$86.9 million for the six months ended June 30, 2006. The increase in cost of service, outsourcing and hardware revenues was due primarily to a \$42.9 million increase in costs associated with the growth of our outsourcing and payment processing business, \$41.3 million of which is from the recently acquired businesses. There was also a \$7.1 million increase in costs associated with implementation and other professional services, \$3.2 million of which is from acquired businesses and the remainder of which is primarily related to an increased investment in our professional services organization to support the services related to the recent increase in license sales and potential future acquisitions. Maintenance costs increased \$2.1 million, which primarily related to the acquired business. Gross margin decreased from 48.2% for the six months ended June 30, 2005 to 43.2% for the six months ended June 30, 2006. The decrease in gross margin is primarily due to our acquisition of the Information Services Group of BISYS, as the acquired outsourcing business generates lower margins than our other service, maintenance and hardware revenue sources. This lower margin of the Information Services Group outsourcing business is primarily a result of a greater mix of revenue from third party vendors which generate lower margins.

*Operating Expenses**Sales and Marketing.*

Sales and marketing expenses increased 53.7% from \$10.8 million for the six months ended June 30, 2005 to \$16.6 million for the six months ended June 30, 2006. This increase was due primarily to increases in commissions from higher revenues of approximately \$0.6 million, stock compensation costs of \$0.8 million and \$4.0 million of sales and marketing costs as a result of our recent acquisitions. Sales and marketing expenses represented 12.7% of revenues for the six months ended June 30, 2005 as opposed to 9.6% of revenues for the six months ended June 30, 2006. Sales and marketing expenses as a percentage of revenues decreased primarily because of the increase in recurring service revenues which generate lower selling costs over the course of the recurring revenue stream.

Product Development.

Product development expenses increased 36.3% from \$9.1 million for the six months ended June 30, 2005 to \$12.4 million for the six months ended June 30, 2006. This increase was due primarily to a \$3.6 million increase in product development expenses from the acquired businesses. Product development expenses represented 10.7% of revenues for the six months ended June 30, 2005 as opposed to 7.1% of revenues for the six months ended June 30, 2006. Product development expenses as a percentage of revenues decreased primarily because product development expenses did not increase proportionally to our revenue growth.

General and Administrative.

General and administrative expenses increased 95.8% from \$16.8 million for the six months ended June 30, 2005 to \$32.8 million for the six months ended June 30, 2006. The increase was due primarily to \$8.7 million of expenses from the acquired businesses, an increase in stock compensation costs of \$1.9 million, an increase in legal, audit and audit related services of approximately \$1.0 million, an increase in consulting expenses of approximately \$1.2 million and investments in our infrastructure, including increases in depreciation expense of \$0.6 million primarily from the

development of new internal software systems and leasehold improvements at our facilities. General and administrative expenses represented 19.8% of revenues for the six months ended June 30, 2005 as opposed to 18.7% of revenues for the six months ended June 30, 2006.

Gain on Effective Settlement of Contract.

In connection with the acquisition of the Information Services Group of BISYS, the pre-existing reseller agreement between us and BISYS was terminated. In connection with that termination, we recorded an imputed gain on the effective settlement of this contract of \$4.3 million, which represents the stated settlement provision to BISYS at the acquisition date.

Interest and Other Income.

Interest and other income decreased 7.3% from \$2.0 million for the six months ended June 30, 2005 to \$1.8 million for the six months ended June 30, 2006. The decrease was primarily due to lower cash balances available for investment in 2006.

Table of Contents*Interest Expense.*

Interest expense increased from \$2.1 million for the six months ended June 30, 2005 to \$12.5 million for the six months ended June 30, 2006. The increase in interest expense was due to interest from our March 2006 bank financing used to acquire the Information Services Group of BISYS combined with a full six months of interest on our convertible notes, which were issued in February 2005.

Income Tax Provision.

Income tax provision increased 34.7% from \$4.5 million for the six months ended June 30, 2005 to \$6.1 million for the six months ended June 30, 2006. Our effective tax rate increased from 40.0% to 41.0% for the six months ended June 30, 2005 and 2006, respectively, primarily as a result of the adoption of SFAS 123R and the effect of stock-based compensation expense recorded for incentive stock options, partially offset by certain changes in Canadian tax laws which increased long-term deferred tax assets. We expect to record a higher tax rate than has been recorded historically as incentive stock options continue to vest. Additional factors that may impact our expected rate would include changes in the magnitude and location of taxable income among taxing jurisdictions, including the blended state tax rate based on the mix of states we do business in, any non-deductible expenses and any tax credits we may receive.

Liquidity and Capital Resources

At June 30, 2006 and December 31, 2005, we had cash and cash equivalents totaling \$46.0 million and \$174.4 million, respectively.

The following table sets forth the elements of our cash flow statement for the following periods:

	Six Months Ended June 30,	
	2006	2005
	(in thousands)	
Net cash provided by operating activities	32,613	8,850
Net cash used in investing activities	(494,423)	(84,462)
Net cash provided by financing activities	332,911	128,730

Cash from Operating Activities

Cash provided by operations in the six months ended June 30, 2006 increased \$23.8 million compared to the six months ended June 30, 2005. The increase was primarily attributable to an increase in net income of \$2.0 million, an increase in depreciation and amortization of \$11.4 million due to the impact of recent acquisitions, an increase in stock compensation expense of \$3.7 million for the adoption of SFAS 123R, an increase in the deferred tax provision of \$1.8 million, and a decrease in working capital of \$8.1 million, partially offset by the non-cash gain on settlement of a contract of \$4.3 million.

Cash from Investing Activities

Cash from investing activities consists primarily of purchases of fixed assets, capitalization of software development costs, investments in marketable securities and business acquisitions. Total capital expenditures for the six months ended June 30, 2006 and 2005 were \$10.1 million and \$4.0 million, respectively, and were primarily related to the purchase of computer equipment, computer software, software development services, furniture and fixtures and leasehold improvements. We currently have no significant capital spending or purchase commitments, but expect to continue to engage in capital spending in the ordinary course of business.

In the six months ended June 30, 2006, we purchased \$8.0 million in marketable securities. In the six months ended June 30, 2005, we purchased \$92.8 million in marketable securities and \$54.2 million of marketable securities matured or were sold.

Additionally, net cash used in investing activities for the six months ended June 30, 2006 included \$476.3 million used for the acquisition of Information Services Group of BISYS, net of cash received. Net cash used in investing activities for the six months ended June 30, 2005 included \$41.9 million used for the acquisitions of the information services business of CGI-AMS Inc., S.O.S. Computer Systems, Inc., and Financial Data Solutions, Inc., net of cash received.

Cash from Financing Activities

During the six months ended June 30, 2006 and 2005, we received \$4.5 million and \$0.8 million, respectively, of proceeds from the exercise of stock options.

In March 2006, we used the proceeds from a \$350.0 million bank financing, in addition to \$129.1 million of available cash, to fund the purchase price of the Information Services Group of BISYS. The bank financing is in the form of two agreements: a \$320.0 million First Lien Senior Secured Credit Agreement (the "First Agreement"), which provides for a \$290.0 million term loan (the "First Term Facility") and a \$30.0 million revolving line of credit (the "Line of Credit"), and a \$60 million Second Lien Senior Secured Term Loan Agreement (the "Second Term Facility"). The First Term Facility has a term of 5.5 years and bears interest at LIBOR plus 250 basis points and was originally payable beginning June 30, 2006 in the amount of \$725,000 per quarter through May 31, 2011, with balloon payments of \$137.8 million due on June 30, 2011 and September 2011. We may prepay the First Term Facility in aggregate principal amounts of \$1.0 million or a multiple of \$250,000 in excess thereof during the term of the First Agreement. During the six months ended June 30, 2006, we prepaid \$8.0 million of principal and, as a result, the next principal payment is not due until June 30, 2008. The Line of Credit expires on March 3, 2011 and bears interest at LIBOR plus 250 basis points. Borrowings under the Line of Credit are required to be in an aggregate amount of \$1.0 million or a multiple of \$250,000 in excess thereof. To date, we have not drawn against the Line of Credit. The second Term Facility

Table of Contents

has a term of 6 years and bears interest at LIBOR plus 650 basis points. The bank financing contains both financial and non-financial covenants including maintaining a senior leverage ratio, as defined, a total leverage ratio, as defined and a fixed charge ratio, as defined. These financial covenants are designed to measure our ability to repay our outstanding debt as well as fund the related interest payments. Borrowing under the bank financing is secured by substantially all of our assets. We believe we will be in compliance with the covenants related to our bank financing for the next twelve months.

In March 2006, we entered into two separate interest rate swaps with a bank, the objective of which is to offset the changes in benchmark interest rates and the associated uncertainty in interest expense and cash flows of our bank financing. The first swap agreement is for \$217,500,000 of our \$290,000,000 First Term Facility and steps down quarterly in conjunction with our anticipated repayment of the First Term Facility. This swap agreement is through December 31, 2010. The second swap agreement is for \$60,000,000 of our \$60,000,000 Second Term Facility. This swap agreement is through November 30, 2011. We have assessed the interest rate swaps as effective cash flow hedges from their inception and will continue to monitor hedge effectiveness during the period they are outstanding. We currently anticipate that our current cash balance and cash flow from operations will be sufficient to meet our presently anticipated capital needs for the next twelve months, but may be insufficient to provide funds necessary for any future acquisitions we may make during that time. To the extent we require additional funds, whether for acquisitions or otherwise, we may seek additional equity or debt financing. Such financing may not be available to us on terms that are acceptable to us, if at all, and any equity financing may be dilutive to our stockholders. To the extent we obtain additional debt financing, our debt service obligations will increase and the relevant debt instruments may, among other things, impose additional restrictions on our operations, require us to comply with additional financial covenants or require us to pledge assets to secure our borrowings.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Contractual Obligations as of June 30, 2006

Contractual Obligations	Total	Payments Due by Period			More than
		Less than 1 year	1-3 years	3-5 years	5 years
Bank financing principal and interest	\$ 491,614	\$ 29,019	\$ 61,496	\$ 198,807	\$ 202,292
Convertible notes payable principal and interest	292,779	3,962	7,923	7,923	272,971
Capital lease obligations	8,269	4,655	3,614		
Operating leases	32,485	8,020	14,351	7,337	2,777
Total contractual obligations	\$ 825,147	\$ 45,656	\$ 87,384	\$ 214,067	\$ 478,040

The contractual obligations related to the bank financing include a portion of our interest expense payable at fixed rates pursuant to our interest rate swap agreements.

Table of Contents

Item 3. Quantitative and Qualitative Disclosure About Market Risk

We transact business with clients almost exclusively in the United States and Canada and receive payments for our services exclusively in United States dollars or Canadian dollars. Therefore, we are exposed to foreign currency exchange risks and fluctuations in foreign currencies which could impact our results of operations and financial condition. A 10% increase or decrease in currency exchange rates would not have a material adverse effect on our financial condition or results of operations.

Our interest expense is generally not sensitive to changes in the general level of interest rates in the United States. Although a majority of our indebtedness is at variable rates, we manage the interest rate risk of our variable rate bank financing, principally by using cash flow hedges to achieve a desired position of fixed and floating rate debt. As of June 30, 2006, we have utilized effective cash flow hedges which fix the interest payments on \$277.5 million of our variable rate debt, allowing us to maintain 81.0% of our debt at fixed interest rates and 19.0% at variable interest rates. Our cash flow hedges had the affect of increasing interest expense by \$0.3 million for the six month period ended June 30, 2006. A 10% increase or decrease in interest rates would not have a material adverse effect on our financial condition or results of operations.

All of our cash and cash equivalents are held on deposit with banks and highly liquid marketable securities with maturities of three months or less.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2006. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the 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 SEC'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. Our 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 the evaluation of our disclosure controls and procedures as of June 30, 2006, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Controls over Financial Reporting

The implementation of additional modules of our new accounting system, completed effective January 1, 2006, and the adoption of new accounting pronouncements, including SFAS 123R, required us to modify and add certain internal controls and processes and procedures. Otherwise, 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 six months ended June 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. In addition, we are currently evaluating the internal controls and processes and procedures over financial reporting with respect to the Information Services Business of BISYS, which we acquired on March 3, 2006.

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

We are from time to time a party to legal proceedings which arise in the normal course of business. We are not currently involved in any material litigation, the outcome of which would, in management's judgment based on information currently available, have a material adverse effect on our results of operations or financial condition, nor is management aware of any such litigation threatened against us.

Item 1A. Risk Factors

The risks and uncertainties described below are not the only risks we face. Additional risks and uncertainties not presently known to us or that are currently deemed immaterial may also impair our business operations. If any of the following risks actually occur, our financial condition and operating results could be materially adversely affected.

We are dependent on the banking and credit union industry, and changes within that industry could reduce demand for our products and services.

The large majority of our revenues are derived from financial institutions in the banking and credit union industry, primarily small to mid-size banks and thrifts and credit unions of all sizes, and we expect to continue to derive substantially all of our revenues from these institutions for the foreseeable future. Unfavorable economic conditions adversely impacting the banking and credit union industry could have a material adverse effect on our business, financial condition and results of operations. For example, financial institutions in the banking and credit union industry have experienced, and may continue to experience, cyclical fluctuations in profitability as well as increasing challenges to improve their operating efficiencies. Due to the entrance of non-traditional competitors and the current environment of low interest rates, the profit margins of commercial banks, thrifts and credit unions have narrowed. As a result, some institutions have slowed, and may continue to slow, their capital spending, including spending on computer software and hardware, which can negatively impact license sales of our core and complementary products to new and existing clients. Decreases in or reallocation of capital expenditures by our current and potential clients, unfavorable economic conditions and new or persisting competitive pressures could adversely affect our business, financial condition and results of operations.

Consolidation in the banking and financial services industry could adversely impact our business by eliminating a number of our existing and potential clients.

There has been and continues to be merger, acquisition and consolidation activity in the banking and financial services industry. Mergers or consolidations of banks and financial institutions in the future could reduce the number of our clients and potential clients. A smaller market for our services could have a material adverse impact on our business and results of operations. In addition, it is possible that the larger banks or financial institutions which result from mergers or consolidations could decide to perform themselves some or all of the services which we currently provide or could provide. If that were to occur, it could have a material adverse impact on our business, financial condition and results of operations.

Our success depends on decisions by potential clients to replace their legacy computer systems, and their failure to do so would adversely affect demand for our products and services.

We primarily derive our revenues from two sources: license fees for software products and fees for a full range of services complementing our products, including outsourcing, installation, training, maintenance and support services. A large portion of these fees are either directly attributable to licenses of our core software system or are generated over time by clients using our core software. Banks and credit unions historically have been slow to adapt to and accept new technologies. Many of these financial institutions have traditionally met their information technology needs through legacy computer systems, in which they have often invested significant resources. As a result, these financial institutions may be inclined to resist replacing their legacy systems with our core software system. Our future financial performance will depend in part on the successful development, introduction and client acceptance of new and enhanced versions of our core software system and our other complementary products. A decline in demand for, or failure to achieve broad market acceptance of, our core software system or any enhanced version as a result of competition, technological change or otherwise, will have a material adverse effect on our business, financial condition and results of operations.

If we fail to expand our outsourcing business and other sources of recurring revenue, we may be unable to successfully implement our business strategy.

We can host a financial institution's data processing functions at our outsourcing centers. Our outsourcing centers currently serve clients using our core software and our Internet banking, ATM, cView, cash management, collections, automated clearing house, or ACH, processing, and check and item processing, telephony products and payment processing. In the future we plan to offer all of our products in our outsourcing centers and continue to market our outsourcing services aggressively.

Table of Contents

Our outsourcing services provide a source of recurring revenue which can grow as the number of accounts processed for a client increases. We also seek to generate recurring revenue through our licensing model, which generates additional fees for us as a client's business grows or it adds more software applications, as well as through the provision of maintenance, support and other professional services. Our data center and payment processing services are the largest of these revenue components, and we expect that these revenues will continue to be a significant portion of our total revenues as our client base grows due to their recurring nature. To the extent we fail to persuade new or existing clients to purchase our outsourcing services or we are unable to offer some or all of our products to clients on an outsourced basis, we will be unable to implement our strategy and our revenue may be less predictable.

We have had several profitable quarters, but we may not sustain profitability in future periods.

Although we were profitable for the year ended December 31, 2005, and the three and six months ended June 30, 2006, we cannot guarantee that we will continue to be profitable in the future, either on a short or long-term basis. There can be no assurance that operating losses will not recur in the future, that we will sustain profitability on a quarterly or annual basis or that our actual results will meet our projections, expectations or announced guidance. To the extent that revenues do not grow at anticipated rates, increases in operating expenses precede or are not subsequently followed by commensurate increase in revenues or we are unable to adjust operating expense levels accordingly, our business, financial condition and results of operations will be materially adversely affected.

If we fail to adapt our products and services to changes in technology or in the marketplace, we could lose existing clients and be unable to attract new business.

The markets for our software products and services are characterized by technological change, frequent new product introductions and evolving industry standards. The introduction of products embodying new technologies and the emergence of new industry standards can render our existing products obsolete and unmarketable in short periods of time. We expect new products and services, and enhancements to existing products and services, to continue to be developed and introduced by others, which will compete with, and reduce the demand for, our products and services. Our products' life cycles are difficult to estimate. Our future success will depend, in part, on our ability to enhance our current products and to develop and introduce new products that keep pace with technological developments and emerging industry standards and to address the increasingly sophisticated needs of our clients. There can be no assurance that we will be successful in developing, marketing, licensing and selling new products or product enhancements that meet these changing demands, that we will not experience difficulties that could delay or prevent the successful development, introduction and marketing of these products or that our new products and product enhancements will adequately meet the demands of the marketplace and achieve market acceptance.

We encounter a long sales and implementation cycle requiring significant capital commitments by our clients which they may be unwilling or unable to make.

The implementation of our core software system involves significant capital commitments by our clients. Potential clients generally commit significant resources to an evaluation of available software and require us to expend substantial time, effort and money educating them as to the value of our software. Sales of our core processing software products require an extensive education and marketing effort throughout a client's organization because decisions relating to licensing our core processing software generally involve the evaluation of the software by senior management and a significant number of client personnel in various functional areas, each having specific and often conflicting requirements.

We may expend significant funds and management resources during the sales cycle and ultimately fail to close the sale. Our core software product sales cycle generally ranges between six to nine months, and our implementation cycle for our core software generally ranges between six to nine months. Our sales cycle for all of our products and services is subject to significant risks and delays over which we have little or no control, including:

- § our clients' budgetary constraints,
- § the timing of our clients' budget cycles and approval process,
- § our clients' willingness to replace their core software solution vendor,

§ the success and continued support of our strategic marketing partners sales efforts, and

§ the timing and expiration of our clients current license agreements or outsourcing agreement for similar services.

If we are unsuccessful in closing sales after expending significant funds and management resources or if we experience delays as discussed above, it could have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

We utilize certain key technologies from third parties, and may be unable to replace those technologies if they become obsolete or incompatible with our products.

Our proprietary software is designed to work in conjunction with certain third-party software products, including Microsoft and Oracle relational databases. Although we believe that there are alternatives to these products generally available to us, any significant interruption in the supply of such third-party software could have a material adverse effect on our sales unless and until we can replace the functionality provided by these products. In addition, we are dependent upon these third parties' abilities to enhance their current products, to develop new products on a timely and cost-effective basis and to respond to emerging industry standards and other technological changes. There can be no assurance that we would be able to replace the functionality provided by the third-party software currently offered in conjunction with our products in the event that such software becomes obsolete or incompatible with future version of our products or is otherwise not adequately maintained or updated. The absence of, or any significant delay in, the replacement of that functionality could have a material adverse effect on our business, financial condition and results of operations. Furthermore, delays in the release of new and upgraded versions of third-party software products, particularly the Oracle relational database management system, could have a material adverse effect on our revenues and results of operations. Because of the complexities inherent in developing sophisticated software products and the lengthy testing periods associated with these products, no assurance can be given that our future product introductions will not be delayed.

We operate in a competitive business environment, and if we are unable to compete effectively, we may face price reductions and decreased demand for our products.

The market for our products and services is intensely competitive and subject to technological change. Competitors vary in size and in the scope and breadth of the products and services they offer. We encounter competition from a number of sources, all of which offer core software systems to the banking and credit union industry. We expect additional competition from other established and emerging companies as the market for core processing software solutions and complementary products continues to develop and expand.

We also expect that competition will increase as a result of software industry consolidation, including particularly the acquisition of any of our competitors or any of the retail banking system providers by one of the larger service providers to the banking industry. We encounter competition in the United States from a number of sources, including Fiserv, Inc., Jack Henry & Associates, Inc., Fidelity National Information Services and John H. Harland Company, all of which offer core processing systems or outsourcing alternatives to banks, thrifts and credit unions. Some of our current, and many of our potential, competitors have longer operating histories, greater name recognition, larger client bases and significantly greater financial, engineering, technical, marketing and other resources than we do. As a result, these companies may be able to respond more quickly to new or emerging technologies and changes in client demands or to devote greater resources to the development, promotion and sale of their products than we can.

In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address the needs of our prospective clients. Accordingly, it is possible that new competitors or alliances among competitors may emerge and acquire significant market share. We expect that the banking and credit union software market will continue to attract new competitors and new technologies, possibly involving alternative technologies that are more sophisticated and cost-effective than our technology. There can be no assurance that we will be able to compete successfully against current or future competitors or that competitive pressures faced by us will not materially adversely affect our business, financial condition and results of operations.

An impairment of the value of our goodwill, capitalized software costs and other intangible assets could significantly reduce our earnings.

We periodically review items on our balance sheet for impairment and record an impairment charge if we determine that the value of our assets has been impaired. As of June 30, 2006, we had approximately \$417.5 million of goodwill and \$224.5 million of capitalized software costs and other intangible assets. We periodically review these assets for impairment. If we determine that the carrying value of these assets are not recoverable, we would record an impairment charge against our results of operations. Such an impairment charge may be significant, and we are unable to predict the amount, if any, of potential future impairments. In addition, if we engage in additional acquisitions, we

may incur additional goodwill and other intangible assets.

Table of Contents

Our quarterly revenues, operating results and profitability will vary from quarter to quarter, which may result in volatility in our stock price.

Our quarterly revenues, operating results and profitability have varied in the past and are likely to continue to vary significantly from quarter to quarter. This may lead to volatility in our stock price. These fluctuations are due to several factors relating to the license and sale of our products, including:

- § the timing, size and nature of our licensing transactions,
- § lengthy and unpredictable sales cycles,
- § the timing of introduction and market acceptance of new products or product enhancements by us or our competitors,
- § the timing of acquisitions by us of businesses and products,
- § product and price competition,
- § the relative proportions of revenues derived from license fees and services,
- § changes in our operating expenses,
- § software bugs or other product quality problems, and
- § personnel changes and fluctuations in economic and financial market conditions.

We believe that period-to-period comparisons of our results of operations are not necessarily meaningful. There can be no assurance that future revenues and results of operations will not vary substantially. It is also possible that in future quarters, our results of operations will be below the expectations of public market analysts or investors or our announced guidance. In either case, the price of our common stock could be materially adversely affected.

We face a lengthy sales cycle for our core software, which may cause fluctuations in our revenues from quarter to quarter.

We may not be able to increase revenue or decrease expenses to meet expectations for a given quarter. We recognize software license revenues upon delivery and, if required by the underlying agreement, upon client acceptance, if such criteria is other than perfunctory, which does not always occur in the same quarter in which the software license agreement for the system is signed. As a result, we are constrained in our ability to increase our software license revenue in any quarter if there are unexpected delays in delivery or required acceptance of systems for which software licenses were signed in previous quarters. Implementation of our core software system typically occurs over six to nine months. Delays in the delivery, implementation or any required acceptance of our products could materially adversely affect our quarterly results of operations. Revenues from software license sales accounted for 11.9% of revenues for the six months ended June 30, 2006, and 22.7% of revenues for the six months ended June 30, 2005. We expect that revenues from software license sales will continue to provide a significant percentage of our revenues in future periods, and our ability to close license sales, as well as the timing of those sales, may have a material impact on our quarterly results. In addition, increased sales and marketing expenses for any given quarter may negatively impact operating results of that quarter due to lack of recognition of associated revenues until the delivery of the product in a subsequent quarter.

If we do not retain our senior management and other key employees, we may not be able to successfully implement our business strategy.

We have grown significantly in recent years, but our management remains concentrated in a small number of key employees. Our future success depends to a significant extent on our executive officers and key employees, including our sales force and software professionals, particularly project managers, software engineers and other senior technical personnel. The loss of the services of any of these individuals or group of individuals could have a material adverse

effect on our business, financial condition and results of operations. Competition for qualified personnel in the software industry is intense and we compete for these personnel with other software companies that have greater financial and other resources than we do. Our future success will depend in large part on our ability to attract, retain and motivate highly qualified personnel, and there can be no assurance that we will be able to do so. Any difficulty in hiring personnel could have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

Our indebtedness could adversely affect our financial health and prevent us from fulfilling our obligations under our senior subordinated convertible notes and our bank financing.

We have a significant amount of indebtedness, including approximately \$144.1 million in senior subordinated notes and \$342.0 million in bank financing. In connection with our bank financing, we are required to maintain sufficient leverage and fixed charge ratios. Our substantial indebtedness could have important consequences to our stockholders and note holders. For example, it could:

- § make it more difficult for us to satisfy our obligations with respect to our notes, our bank financing or other indebtedness,
- § increase our vulnerability to general adverse economic and industry conditions,
- § require us to dedicate a substantial portion of our cash flows from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions, product development efforts and other general corporate purposes,
- § limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate,
- § put us at a disadvantage compared to our competitors that have less debt, and
- § limit our ability to borrow additional funds.

If we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments, or if we fail to comply with the various requirements of our notes, our bank financing or any indebtedness that we may incur in the future, we would be in default, which would permit the holders of the notes, our lenders and the holders of such other indebtedness to accelerate the maturity of the notes, our bank financing or such other indebtedness, as the case may be, and could cause defaults under the notes, our bank financing and such other indebtedness. Any default under the notes, our bank financing or any indebtedness that we may incur in the future could have a material effect on our business, operating results, liquidity and financial condition.

Our level of fixed expenses may cause us to incur operating losses if we are unsuccessful in maintaining our current revenue levels.

Our expense levels are based, in significant part, on our expectations as to future revenues and are largely fixed in the short term. As a result, we may be unable to adjust spending in a timely manner to compensate for any unexpected shortfall in revenues. Accordingly, any significant shortfall of revenues in relation to our expectations would have an immediate and materially adverse effect on our business, financial condition and results of operations. In addition, as we expand we would anticipate increasing our operating expenses to expand our installation, product development, sales and marketing and administrative organizations. The time of such expansion and the rate at which new personnel become productive could cause material losses to the extent we do not generate additional revenue.

We rely on our direct sales force to generate revenue, and may be unable to hire additional sales personnel in a timely manner.

We rely primarily on our direct sales force to sell licenses of our core software system. We may need to hire additional sales, client care and implementation personnel in the near-term and beyond if we are to achieve revenue growth in the future. Competition for such personnel is intense, and there can be no assurance that we will be able to retain our existing sales, customer service and implementation personnel or will be able to attract, assimilate or retain additional highly qualified personnel in the future. If we are unable to hire or retain qualified sales personnel on a timely basis, our business, financial condition and results of operations could be materially adversely affected.

Table of Contents

We have entered into and may continue to enter into or seek to enter into business combinations and acquisitions which may be difficult to integrate, disrupt our business, dilute stockholder value or divert management attention.

Since January 1, 2001, we have acquired fourteen businesses. As part of our business strategy, we may enter into additional business combinations and acquisitions in the future. In addition, acquisitions are typically accompanied by a number of risks, including:

- § the difficulty of integrating the operations and personnel of the acquired companies,
- § the maintenance of acceptable standards, internal controls, procedures and policies,
- § the potential disruption of our ongoing business and distraction of management,
- § the impairment of relationships with employees and clients as a result of any integration of new management and other personnel,
- § the inability to maintain relationships with clients of the acquired business,
- § the difficulty of incorporating acquired technology and rights into our products and services,
- § the failure to achieve the expected benefits of the combination or acquisition,
- § expenses related to the acquisition,
- § the incurrence of additional debt related to the acquisition,
- § potential unknown liabilities associated with acquired businesses,
- § unanticipated expenses related to acquired technology and its integration into existing technology, and
- § differing regulatory and industry standards, certification requirements and product functional requirements.

If we are not successful in completing acquisitions that we may pursue in the future, we would be required to reevaluate our growth strategy and we may have incurred substantial expenses and devoted significant management time and resources in seeking to complete the acquisitions. In addition, with future acquisitions, we could use substantial portions of our available cash as all or a portion of the purchase price. We could also issue additional securities as consideration for these acquisitions, which could cause our stockholders to suffer significant dilution. Any future acquisitions may not generate additional revenue for us.

On March 3, 2006, we purchased the outstanding common stock of the Information Services Group of BISYS, our largest acquisition to date. We expect that the integration of this acquisition will require significant management time and resources and may pose unexpected challenges. Any failure by us to successfully integrate this acquisition would have a material adverse effect on our business, results of operations and financial condition.

We receive a portion of our revenues from relationships with strategic marketing partners, and if we lose one or more of these marketing partners or fail to add new ones it could have a negative impact on our business.

We expect that revenues generated from the sale of our products and services by our strategic marketing partners will account for a meaningful portion of our revenues for the foreseeable future. In particular, our reseller agreement with BISYS had historically accounted for a meaningful portion of our revenues. During the six months ended June 30, 2006 and 2005, BISYS represented approximately \$4.5 million and \$7.9 million, or 2.5% and 9.3%, respectively, of our total revenues. In conjunction with our acquisition of the Information Services Group of BISYS, our reseller agreement with BISYS was terminated.

In December 2005, we signed an agreement with Celero Solutions (Celero). The agreement provides Celero with 10-year licensing, reseller and maintenance rights for the Canadian version of The Complete Credit Union Solution.

This agreement grants Celero license to market and use The Complete Credit Union Solution and the right to provide outsourcing services to credit union clients in the Canadian provinces of Alberta, Manitoba and Saskatchewan. Celero has the right to provide data center services to credit unions in the previously mentioned territories up to an aggregate member base of 940,000. Under the agreement, the license fees for these 940,000 members will be paid over a three-year period. During the six months ended June 30, 2006, Celero represented approximately \$5.1 million, or 2.9% of our total revenues.

Table of Contents

Our strategic marketing partners pay us license fees based on the volume of products and services that they sell. If we lose one or more of our major strategic marketing partners or experience a decline in the revenue from them, we may be unable in a timely manner, or at all, to replace them with another entity with comparable client bases and user demographics, which would adversely affect our business, financial condition and results of operations. In addition, we plan to supplement our existing distribution partners with other national and regional outsourcing centers. If we are unable to identify appropriate resellers and enter into arrangements with them for the outsourcing of our products and services to financial institutions, we may not be able to sustain or grow our business.

We rely on internally developed software and systems as well as third-party products, any of which may contain errors and bugs.

Our software may contain undetected errors, defects or bugs. Although we have not suffered significant harm from any errors or defects to date, we may discover significant errors or defects in the future that we may or may not be able to correct. Our products involve integration with products and systems developed by third parties. Complex software programs of third parties may contain undetected errors or bugs when they are first introduced or as new versions are released. There can be no assurance that errors will not be found in our existing or future products or third-party products upon which our products are dependent, with the possible result of delays in or loss of market acceptance of our products, diversion of our resources, injury to our reputation and increased service and warranty expenses and/or payment of damages.

We could be sued for contract or product liability claims and lawsuits may disrupt our business, divert management's attention or have an adverse effect on our financial results.

Failures in a client's system could result in an increase in service and warranty costs or a claim for substantial damages against us. There can be no assurance that the limitations of liability set forth in our contracts would be enforceable or would otherwise protect us from liability for damages. We maintain general liability insurance coverage, including coverage for errors and omissions in excess of the applicable deductible amount. There can be no assurance that this coverage will continue to be available on acceptable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not deny coverage as to any future claim. The successful assertion of one or more large claims against us that exceeds available insurance coverage, or the occurrence of changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business, financial condition and results of operations. Furthermore, litigation, regardless of its outcome, could result in substantial cost to us and divert management's attention from our operations. Any contract liability claim or litigation against us could, therefore, have a material adverse effect on our business, financial condition and results of operations. In addition, because many of our projects are business-critical projects for financial institutions, a failure or inability to meet a client's expectations could seriously damage our reputation and affect our ability to attract new business.

In August 2005, we became aware that we had not timely filed certain federal tax forms on behalf of some of our clients. Although we do not believe that this instance will result in penalties against us or indemnification obligations to our clients, we cannot be assured that similar instances will not occur in the future and that in the event that they do occur, that such future instances will not result in penalties or indemnification obligations.

Government regulation of our business could cause us to incur significant expenses, and failure to comply with applicable regulations could make our business less efficient or impossible.

The financial services industry is subject to extensive and complex federal and state regulation. Financial institutions, including banks, thrifts and credit unions, operate under high levels of governmental supervision. Our clients must ensure that our products and services work within the extensive and evolving regulatory requirements applicable to them, including those under federal and state truth-in-lending and truth-in-savings rules, usury laws, the Equal Credit Opportunity Act, the Fair Housing Act, the Electronic Fund Transfer Act, the Fair Credit Reporting Act, the Bank Secrecy Act, the Community Reinvestment Act, the Gramm-Leach-Bliley Act of 1999, the USA Patriot Act, the Health Insurance Portability and Accountability Act of 1996 and other federal, state, provincial and local laws and regulations. The compliance of our products and services with these requirements may depend on a variety of factors, including the product at issue and whether the client is a bank, thrift, credit union or other type of financial institution.

Neither federal depository institution regulators nor other federal or state regulators of financial services require us to obtain any licenses. We are subject to examination by federal depository institution regulators under the Bank Service Company Act and the Examination Parity and Year 2000 Readiness for Financial Institutions Act.

Although we believe we are not subject to direct supervision by federal and state banking agencies relating to other regulations, we have from time to time agreed to examinations of our business and operations by these agencies.

These regulators have broad supervisory authority to remedy any shortcomings identified in any such examination.

Table of Contents

Federal, state or foreign authorities could also adopt laws, rules or regulations relating to the financial services industry and the protection of consumer personal information belonging to financial institutions that affect our business, such as requiring us or our clients to comply with data, record keeping and processing and other requirements. It is possible that laws and regulations may be enacted or modified with respect to the Internet, covering issues such as end-user privacy, pricing, content, characteristics, taxation and quality of services and products. Adoption of these laws, rules or regulations could render our business or operations more costly and burdensome or less efficient and could require us to modify our current or future products or services.

Our limited ability to protect our proprietary technology and other rights may adversely affect our ability to compete.

We rely on a combination of copyright, trademark and trade secret laws, as well as licensing agreements, third-party nondisclosure agreements and other contractual provisions and technical measures to protect our intellectual property rights. There can be no assurance that these protections will be adequate to prevent our competitors from copying or reverse-engineering our products, or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology. To protect our trade secrets and other proprietary information, we require employees, consultants, advisors and collaborators to enter into confidentiality agreements. We cannot assure you that these agreements will provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information. We do not include in our products any mechanism to prevent unauthorized copying and any such unauthorized copying could have a material adverse effect on our business, financial condition and results of operations. We have no patents, and existing copyright laws afford only limited protection for our intellectual property rights and may not protect such rights in the event competitors independently develop products similar to ours. In addition, the laws of certain countries in which our products are or may be licensed do not protect our products and intellectual property rights to the same extent as the laws of the United States.

If we are found to infringe the proprietary rights of others, we could be required to redesign our products, pay royalties or enter into license agreements with third parties.

Although we have never been the subject of a material intellectual property dispute, there can be no assurance that a third party will not assert that our technology violates its intellectual property rights in the future. As the number of software products in our target market increases and the functionality of these products further overlap, we believe that software developers may become increasingly subject to infringement claims. Any claims, whether with or without merit, could:

§ be expensive and time consuming to defend,

§ cause us to cease making, licensing or using products that incorporate the challenged intellectual property,

§ require us to redesign our products, if feasible,

§ divert management's attention and resources, and

§ require us to enter into royalty or licensing agreements in order to obtain the right to use necessary technologies. There can be no assurance that third parties will not assert infringement claims against us in the future with respect to our current or future products or that any such assertion will not require us to enter into royalty arrangements (if available) or litigation that could be costly to us.

We may not have sufficient funds available to pay amounts due under our senior subordinated convertible notes.

We will be required to pay cash to holders of our senior subordinated convertible notes:

§ upon purchase of the notes by us at the option of holders on February 2 in each of 2012, 2015, 2020, 2025 and 2030, in an amount equal to the issue price and accrued original issue discount plus accrued and unpaid cash interest and liquidated damages, if any

§

upon purchase of the notes by us at the option of holders upon some changes of control, in an amount equal to the issue price and accrued original issue discount plus accrued and unpaid cash interest and liquidated damages, if any,

§ at maturity of the notes, in an amount equal to the entire outstanding principal amount, and

§ in the event that we elect to pay cash in lieu of the delivery of shares of common stock upon conversion of the notes, upon conversion, in an amount up to the conversion value of the notes.

We may not have sufficient funds available or may be unable to arrange for additional financing to satisfy these obligations. A failure to pay amounts due under the notes upon repurchase, at maturity or upon conversion in the event we elect to pay cash in lieu of shares of common stock upon conversion, would constitute an event of default under the indenture, which could, in turn, constitute a default under the terms of any other indebtedness.

Table of Contents

We face risks associated with our Canadian operations that could harm our financial condition and results of operations.

In 2004, we acquired Datawest Solutions Inc., now known as Open Solutions Canada, a provider of banking and payment technology solutions located in Vancouver, British Columbia, Canada. As is the case with most international operations, the success and profitability of such operations are subject to numerous risks and uncertainties that include, in addition to the risks our business as a whole faces the following:

- § difficulties and costs of staffing and managing foreign operations,
- § differing regulatory and industry standards and certification requirements,
- § the complexities of foreign tax jurisdictions,
- § currency exchange rate fluctuations, and
- § import or export licensing requirements.

To service our indebtedness, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control.

Our ability to make payments on and to refinance our indebtedness, including our convertible notes and the additional debt we incurred in connection with our acquisition of BISYS's Information Services Group (BISYS Acquisition Financing) and to fund planned capital expenditures and product development efforts will depend on our ability to generate cash in the future. Our ability to generate cash in the future, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us in an amount sufficient to enable us to pay our indebtedness, including the notes and BISYS Acquisition Financing, or to fund our other liquidity needs. We may need to refinance all or a portion of our indebtedness, including the notes and BISYS Acquisition Financing, on or before maturity. We cannot assure you that we will be able to refinance any of our indebtedness, including the notes and BISYS Acquisition Financing, on commercially reasonable terms or at all.

If we fail to effectively manage our growth, our financial results could be adversely affected.

We have expanded our operations rapidly in recent years. For example, our aggregate annual revenues increased from approximately \$27.3 million in 2001 to approximately \$193.8 million in 2005. As of June 30, 2006, we had approximately 1,692 employees, up from approximately 600 as of December 31, 2003. In addition, we continue to explore ways to extend our target markets, including to larger financial institutions, international clients, and clients in the payroll services, insurance and brokerage industries. Our growth may place a strain on our management systems, information systems and resources. Our ability to successfully offer products and services and implement our business plan requires adequate information systems and resources and oversight from our senior management.

We will need to continue to improve our financial and managerial controls, reporting systems and procedures as we continue to grow and expand our business. As we grow, we must also continue to hire, train, supervise and manage new employees. We may not be able to hire, train, supervise and manage sufficient personnel or develop management and operating systems to manage our expansion effectively. If we are unable to manage our growth, business, operating results and financial condition could be adversely affected.

The requirements of being a public company may strain our resources and distract management.

As a public company, we are subject to the reporting requirements of the Exchange Act and the Sarbanes-Oxley Act of 2002. These requirements may place a strain on our systems and resources. The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and financial condition. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal controls for financial reporting. In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting, significant resources and management oversight will be required. As a result, management's attention may be diverted from other business concerns, which could have a

material adverse effect on our business, financial condition, results of operations and cash flows. In addition, we will need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge and we cannot assure you that we will be able to do so in a timely fashion.

Table of Contents**Failure to continue to comply with all of the requirements imposed by Section 404 of the Sarbanes-Oxley Act of 2002 could result in a negative market reaction.**

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we establish and maintain an adequate internal control structure and procedures for financial reporting and assess on an on-going basis the design and operating effectiveness of our internal control structure and procedures for financial reporting. Our independent registered public accounting firm is required to audit both the design and operating effectiveness of our internal control over financial reporting and management's assessment of the design and the effectiveness of its internal control over financial reporting. If we do not continue to comply with all of the requirements of Section 404 or if our internal controls are not designed or operating effectively, it could result in a negative market reaction.

The design of other core vendors' software or their use of financial incentives may make it more difficult for clients to use our complementary products.

Currently, some core software vendors design their software so that it is difficult or infeasible to use third-party complementary products, including ours. Some core software vendors use financial incentives to encourage their core software clients to purchase their proprietary complementary products. For example, in the past a core software vendor has charged disproportionately high fees to integrate third-party complementary products such as ours, thereby providing a financial incentive for clients of that vendor's core software to use its complementary products. We have responded to this practice by emphasizing to prospective clients the features and functionality of our products, lowering our price or offering to perform the relevant integration services ourselves. We cannot assure you that these competitors, or other vendors of core software, will not begin or continue to construct technical, or implement financial, obstacles to the purchase of our products. These obstacles could make it more difficult for us to sell our complementary products and could have a material adverse effect on our business and results of operations.

Operational failures in our outsourcing centers could cause us to lose clients.

Damage or destruction that interrupts our provision of outsourcing services could damage our relationship with our clients and may cause us to incur substantial additional expense to repair or replace damaged equipment. Although we have installed back-up systems and procedures to prevent or reduce disruption, we cannot assure you that we will not suffer a prolonged interruption of our data processing services. In the event that an interruption of our network extends for more than several hours, we may experience data loss or a reduction in revenues by reason of such interruption. In addition, a significant interruption of service could have a negative impact on our reputation and could lead our present and potential clients to choose service providers other than us.

Unauthorized disclosure of data, whether through breach of our computer systems or otherwise, could expose us to protracted and costly litigation or cause us to lose clients.

In our outsourcing centers, we collect and store sensitive data, including names, addresses, social security numbers, checking and savings account numbers and payment history records, such as account closures and returned checks. If a person penetrates our network security or otherwise misappropriates sensitive data, we could be subject to liability or our business could be interrupted. Penetration of the network security of our outsourcing centers could have a negative impact on our reputation and could lead our present and potential clients to choose service providers other than us.

We may need additional capital in the future, which may not be available to us, and if we raise additional capital, it may dilute your ownership in us.

We may need to raise additional funds through public or private debt or equity financings in order to meet various objectives, such as:

- § taking advantage of growth opportunities, including more rapid expansion,
- § acquiring businesses and products,
- § making capital improvements to increase our servicing capacity,
- § paying amounts due under our senior subordinated convertible notes or other indebtedness

§ developing new services or products, and

§ responding to competitive pressures.

In addition, we may need additional financing if we decide to undertake new sales and/or marketing initiatives, if we are required to defend or enforce our intellectual property rights, or if sales of our products do not meet our expectations.

Table of Contents

Any debt incurred by us could impair our ability to obtain additional financing for working capital, capital expenditures or further acquisitions. Covenants governing any indebtedness we incur would likely restrict our ability to take specific actions, including our ability to pay dividends or distributions on, or redeem or repurchase, our capital stock, enter into transactions with affiliates, merge, consolidate or sell our assets or make capital expenditure investments. In addition, the use of a substantial portion of the cash generated by our operations to cover debt service obligations and any security interests we grant on our assets could limit our financial and business flexibility. Any additional capital raised through the sale of equity or convertible debt securities may dilute your ownership percentage in us. Furthermore, any additional debt or equity financing we may need may not be available on terms favorable to us, or at all. If future financing is not available or is not available on acceptable terms, we may not be able to raise additional capital, which could significantly limit our ability to implement our business plan. In addition, we may have to issue securities, including debt securities that may have rights, preferences and privileges senior to our common stock.

The price of our common stock may be volatile.

In the past few years, technology stocks listed on the NASDAQ National Market have experienced high levels of volatility. The price of our common stock depends on many factors, some of which are beyond our control and may not be related to our operating performance. The factors that could cause fluctuations in the trading price of our common stock include, but are not limited to, the following:

- § price and volume fluctuations in the overall stock market from time to time,
- § significant volatility in the market price and trading volume of financial service companies,
- § actual or anticipated changes in our earnings or fluctuations in our operating results or in the expectations of securities analysts,
- § general economic conditions and trends,
- § major catastrophic events,
- § loss of a significant client or clients,
- § sales of large blocks of our stock, or
- § departure of key personnel.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been brought against that company. Due to the potential volatility of our stock price, we may therefore be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business.

If a substantial number of shares of our common stock become available for sale and are sold in a short period of time, the market price of our common stock could decline significantly.

If our stockholders sell substantial amounts of our common stock in the public market, the market price of our common stock could decrease significantly. The perception in the public market that our stockholders might sell shares of common stock could also depress the market price of our common stock.

In addition, as of June 30, 2006, we had options to purchase a total of 3,613,947 shares of our common stock outstanding under our stock incentive plans, of which 1,713,141 were vested. We have filed Form S-8 registration statements to register all of the shares of our common stock issuable under these plans. A decline in the price of shares of our common stock might impede our ability to raise capital through the issuance of additional shares of our common stock or other equity securities, and may cause you to lose part or all of your investment in our shares of common stock.

Table of Contents

Some provisions in our certificate of incorporation and by-laws may deter third parties from acquiring us.

Our restated certificate of incorporation and our amended and restated by-laws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors, including the following:

- § our board of directors is classified into three classes, each of which serves for a staggered three year term,
- § only our board of directors, the chairman of our board of directors or our president may call special meetings of our stockholders,
- § our stockholders may take action only at a meeting of our stockholders and not by written consent,
- § we have authorized undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval,
- § our stockholders have only limited rights to amend our by-laws, and
- § we impose advance notice requirements for stockholder proposals.

These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and cause us to take other corporate actions you desire.

Section 203 of the Delaware General Corporation Law may delay, defer or prevent a change in control that our stockholders might consider to be in their best interest.

We are subject to Section 203 of the Delaware General Corporation Law which, subject to certain exceptions, prohibits business combinations between a publicly-held Delaware corporation and an interested stockholder, which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation's voting stock for a three-year period following the date that such stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring or preventing a change in control of our company that our stockholders might consider to be in their best interests.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

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

On May 16, 2006, we held our 2006 Annual Meeting of Stockholders (the Annual Meeting). The following matters were voted upon at the Annual Meeting, for which there were no broker non-votes:

1. Louis Hernandez, Jr. and Dennis F. Lynch were elected to serve as Class III Directors. The remaining terms of Douglas K. Anderson, Howard L. Carver, Samuel F. McKay, Carlos P. Naudon and Richard P. Yanak continued after the meeting. The results of the vote with respect to each nominee for director were as follows:

	For	Withheld
Louis Hernandez, Jr.	18,858,885	276,248
Dennis F. Lynch	18,860,372	274,761

2. The ratification of the selection by the Audit Committee of our Board of Directors of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the year ending December 31, 2006 was approved. The votes were cast as follows: 19,032,495 shares of common stock were voted for the ratification, 97,832 shares of common stock were voted against the ratification and 4,806 shares of common stock abstained from the vote.

Item 5. Other Information.

None.

Item 6. Exhibits.

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q.

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.

OPEN SOLUTIONS INC.

Dated: August 9, 2006

/s/ Louis Hernandez, Jr.

Louis Hernandez, Jr.
Chairman of the Board and Chief Executive
Officer
(Principal Executive Officer)

Dated: August 9, 2006

/s/ Kenneth J. Saunders

Kenneth J. Saunders
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)

38

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description
10.1	Current Form of Incentive Stock Option Agreement for the Registrant's 2000 Stock Incentive Plan
10.2	Current Form of Nonstatutory Stock Option Agreement for the Registrant's 2000 Stock Incentive Plan
31.1	Certification of Louis Hernandez, Jr., Chairman of the Board and Chief Executive Officer, pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Kenneth J. Saunders, Executive Vice President and Chief Financial Officer, pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Louis Hernandez, Jr., Chairman of the Board and Chief Executive Officer, pursuant to 18 U.S.C. section 1350
32.2	Certification of Kenneth S. Saunders, Executive Vice President and Chief Financial Officer, pursuant to 18 U.S.C. section 1350