PERFICIENT INC
Form 10-Q
May 10, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from__________ to__________

Commission file number: 001-15169

PERFICIENT, INC.
(Exact name of registrant as specified in its charter)

Delaware	**No. 74-2853258**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1120 South Capital of Texas Highway, Building 3, Suite 220
Austin, Texas 78746
(Address of principal executive offices)

(512) 531-6000
(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 during the past 90 days. þ Yes o 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 o Accelerated filer þ Non-accelerated filer o

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

Yes o No þ

As of May 7, 2007, there were 29,298,012 shares of Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Perficient, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)

	March 31, 2007	December 31, 2006
ASSETS	(In thousands)	
Current assets:		
Cash and cash equivalents	$ 996	$ 4,549
Accounts receivable, net	40,930	38,600
Prepaid expenses	681	1,171
Other current assets	2,071	2,799
Total current assets	44,678	47,119
Property and equipment, net	2,006	1,806
Goodwill	77,748	69,170
Intangible assets, net	14,620	11,886
Other non-current assets	1,017	1,019
Total assets	$ 140,069	$ 131,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,234	$ 5,025
Current portion of long-term debt	989	1,201
Other current liabilities	11,078	16,034
Total current liabilities	15,301	22,260
Long-term borrowings, net of current portion	1,900	137
Deferred income taxes	2,093	1,251
Total liabilities	19,294	23,648
Stockholders' equity:		
Common stock (par value $.001 per share; 50,000,000 shares authorized and 27,389,734 shares issued and outstanding as of March 31, 2007; 26,699,974 shares issued and outstanding as of December 31, 2006)	27	27
Additional paid-in capital	157,297	147,028
Accumulated other comprehensive loss	(131)	(125)
Accumulated deficit	(36,418)	(39,578)
Total stockholders' equity	120,775	107,352
Total liabilities and stockholders' equity	$ 140,069	$ 131,000

See accompanying notes to interim unaudited condensed consolidated financial statements.

Perficient, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
	(In thousands, except per share data)	
Revenues		
Services	$ 43,297	$ 25,606
Software	4,192	2,682
Reimbursable expenses	2,560	1,356
Total revenues	50,049	29,644
Cost of revenues (exclusive of depreciation and amortization, shown separately below)		
Project personnel costs	26,266	16,265
Software costs	3,486	2,288
Reimbursable expenses	2,560	1,356
Other project related expenses	685	447
Total cost of revenues	32,997	20,356
Gross margin	17,052	9,288
Selling, general and administrative	10,299	5,638
Depreciation	337	168
Amortization of intangible assets	846	425
Income from operations	5,570	3,057
Interest income	49	2
Interest expense	(50)	(84)
Other	6	59
Income before income taxes	5,575	3,034
Provision for income taxes	2,415	1,329
Net income	$ 3,160	$ 1,705
Basic net income per share	$ 0.12	$ 0.07
Diluted net income per share	$ 0.11	$ 0.07
Shares used in computing basic net income per share	27,081,425	23,537,534
Shares used in computing diluted net income per share	29,448,512	26,183,393

See accompanying notes to interim unaudited condensed consolidated financial statements.

Perficient, Inc.
Condensed Consolidated Statement of Stockholders' Equity
Three Months Ended March 31, 2007
(Unaudited)
(In thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2006	26,700	$ 27	$ 147,028	$ (125)	$ (39,578)	$ 107,352
E Tech acquisition	306	--	5,755	--	--	5,755
Stock options exercised	341	--	1,188	--	--	1,188
Purchases of stock from Employee Stock Purchase Plan	2	--	44	--	--	44
Tax benefit of stock option exercises	--	--	1,702	--	--	1,702
Stock compensation	--	--	1,580	--	--	1,580
Vested stock compensation	41	--	--	--	--	--
Foreign currency translation adjustment	--	--	--	(6)	--	(6)
Net income	--	--	--	--	3,160	3,160
Total comprehensive income						3,154
Balance at March 31, 2007	27,390	$ 27	$ 157,297	$ (131)	$ (36,418)	$ 120,775

See accompanying notes to interim unaudited condensed consolidated financial statements.

Perficient, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
	(In thousands)	
OPERATING ACTIVITIES		
Net income	$ 3,160	$ 1,705
Adjustments to reconcile net income to net cash provided by (used in) operations:		
Depreciation	337	168
Amortization of intangibles	846	425
Non-cash stock compensation	1,580	724
Non-cash interest expense	--	5
Change in deferred income taxes	928	(572)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(140)	(158)
Other assets	1,643	896
Accounts payable	(1,791)	(1,123)
Other liabilities	(8,297)	(2,777)
Net cash used in operating activities	(1,734)	(707)
INVESTING ACTIVITIES		
Purchase of property and equipment	(406)	(278)
Capitalization of software developed for internal use	(50)	(47)
Purchase of businesses, net of cash acquired	(5,838)	--
Net cash used in investing activities	(6,294)	(325)
FINANCING ACTIVITIES		
Proceeds from short-term borrowings	9,100	--
Payments on short-term borrowings	(7,200)	(3,000)
Payments on long-term debt	(350)	(326)
Tax benefit on stock options	1,702	895
Proceeds from exercise of stock options and Employee Stock Purchase Plan	1,232	666
Proceeds from exercise of warrants	--	46
Net cash provided by financing activities	4,484	(1,719)
Effect of exchange rate on cash and cash equivalents	(9)	(9)
Change in cash and cash equivalents	(3,553)	(2,760)
Cash and cash equivalents at beginning of period	4,549	5,096
Cash and cash equivalents at end of period	$ 996	$ 2,336
Supplemental disclosures:		
Interest paid	$ 26	$ 111
Cash paid for income taxes	$ 177	$ 215
Non cash activities:		

Stock issued for Purchase of Business	$	5,755	$	--
Change in goodwill	$	(257)	$	62

See accompanying notes to interim unaudited condensed consolidated financial statements.

PERFICIENT, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements of Perficient, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States and are presented in accordance with the rules and regulations of the Securities and Exchange Commission applicable to interim financial information. Accordingly, certain footnote disclosures have been condensed or omitted. In the opinion of management, the unaudited interim condensed consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the periods presented. These financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto filed with the Securities and Exchange Commission in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, as amended. Operating results for the three months ended March 31, 2007 may not be indicative of the results for the full fiscal year ending December 31, 2007.

2. Summary of Significant Accounting Policies

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R (As Amended), *Share Based Payment* ("SFAS No. 123R"), using the modified prospective application transition method. Under this method, compensation cost for the portion of awards for which the requisite service has not yet been rendered that are outstanding as of the adoption date is recognized over the remaining service period. The compensation cost for that portion of awards is based on the grant-date fair value of those awards as calculated for pro forma disclosures under SFAS No. 123. All new awards and awards that are modified, repurchased, or cancelled after the adoption date are accounted for under the provisions of SFAS No. 123R. Prior periods are not restated under this transition method. The Company recognizes share-based compensation ratably using the straight-line attribution method over the requisite service period. In addition, pursuant to SFAS No. 123R, the Company is required to estimate the amount of expected forfeitures when calculating share-based compensation, instead of accounting for forfeitures as they occur, which was the Company's practice prior to the adoption of SFAS No. 123R.

Revenue Recognition

Revenues are primarily derived from professional services provided on a time and materials basis. For time and material contracts, revenues are recognized and billed by multiplying the number of hours expended in the performance of the contract by the established billing rates. For fixed fee projects, revenues are generally recognized using the proportionate performance method based on the ratio of hours expended to total estimated hours. Billings in excess of costs plus earnings are classified as deferred revenues. On many projects the Company is also reimbursed for out-of-pocket expenses such as airfare, lodging and meals. These reimbursements are included as a component of revenues. Revenues from software sales are recorded on a gross basis based on the Company's role as principal in the transaction. The Company is considered a "principal" if the Company is the primary obligor and bears the associated credit risk in the transaction. In the event the Company does not meet the requirements to be considered a principal in the software sale transaction and acts as an agent, the revenues would be recorded on a net basis.

Revenues are recognized when the following criteria are met: (1) persuasive evidence of the customer arrangement exists, (2) fees are fixed and determinable, (3) delivery and acceptance have occurred, and (4) collectibility is deemed probable. The Company's policy for revenue recognition in instances where multiple deliverables are sold contemporaneously to the same counterparty is in accordance with American Institute of Certified Public Accountants

(“AICPA”) Statement of Position 97-2, *Software Revenue Recognition,* Emerging Issues Task Force ("EITF") Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, and SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*. Specifically, if the Company enters into contracts for the sale of services and software, then the Company evaluates whether the services are essential to the functionality of the software and whether it has objective fair value evidence for each deliverable in the transaction. If the Company has concluded the services to be provided are not essential to the functionality of the software and can determine objective fair value evidence for each deliverable of the transaction, then it accounts for each deliverable in the transaction separately, based on the relevant revenue recognition policies. All deliverables of the Company’s multiple element arrangements meet these criteria. We follow very specific and detailed guidelines, discussed above, in determining revenues; however, certain judgments and estimates are made and used to determine revenues recognized in any accounting period. Material differences may result in the amount and timing of revenues recognized for any period if different conditions were to prevail.

Revenues are presented net of taxes assessed by governmental authorities. Sales taxes are generally collected and subsequently remitted on all software sales and certain services transactions as appropriate.

Intangible Assets

Goodwill represents the excess purchase price over the fair value of net assets acquired, or net liabilities assumed, in a business combination. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company performs an annual impairment test of goodwill. The Company evaluates goodwill at the enterprise level as of October 1 each year or more frequently if events or changes in circumstances indicate that goodwill might be impaired. As required by SFAS No.142, the impairment test is accomplished using a two-step approach. The first step screens for impairment and, when impairment is indicated, a second step is employed to measure the impairment. The Company also reviews other factors to determine the likelihood of impairment. During the three months ended March 31, 2007, there were no triggering events that may indicate an impairment of goodwill has occurred.

Other intangible assets include customer relationships, customer backlog, non-compete arrangements and internally developed software, and are being amortized over the assets' estimated useful lives using the straight-line method. Estimated useful lives range from four months to eight years. Amortization of customer relationships, customer backlog, non-compete arrangements and internally developed software are considered operating expenses and are included in “Amortization of intangible assets” in the accompanying consolidated Statements of Operations. The Company periodically reviews the estimated useful lives of its identifiable intangible assets, taking into consideration any events or circumstances that might result in a lack of recoverability or revised useful life.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 periods. Actual results could differ from those estimates, and such differences could be material to the financial statements.

3. Stock-Based Compensation

Stock Option Plans

In May 1999, the Company's Board of Directors and stockholders approved the 1999 Stock Option/Stock Issuance Plan (the “1999 Plan”). The 1999 Plan contains programs for (i) the discretionary granting of stock options to employees, non-employee board members and consultants for the purchase of shares of the Company's commons stock, (ii) the discretionary issuance of common stock directly to eligible individuals, and (iii) the automatic issuance of stock options to non-employee board members. The Compensation Committee of the Board of Directors administers the 1999 Plan, and determines the exercise price and vesting period for each grant. Options granted under the 1999 Plan have a maximum term of 10 years. In the event that the Company is acquired, whether by merger or asset sale or board-approved sale by the stockholders of more than 50% of the Company's voting stock, each outstanding option under the discretionary option grant program which is not to be assumed by the successor corporation or otherwise continued will automatically accelerate in full, and all unvested shares under the discretionary option grant and stock issuance programs will immediately vest, except to the extent the Company's repurchase rights with respect to those shares are to be assigned to the successor corporation or otherwise continued in effect. The Compensation Committee may grant options under the discretionary option grant program that will accelerate in the acquisition even if the options are assumed or that will accelerate if the optionee's service is subsequently terminated.

The Compensation Committee may grant options and issue shares that accelerate in connection with a hostile change in control effected through a successful tender offer for more than 50% of the Company's outstanding voting stock or by proxy contest for the election of board members, or the options and shares may accelerate upon a subsequent termination of the individual's service.

Total share-based compensation cost recognized for the three months ended March 31, 2007 and 2006 was approximately $1.6 million and $0.7 million, respectively, and the associated current and future income tax benefits recognized for the three months ended March 31, 2007 and 2006 was approximately $0.5 million and $0.1 million, respectively. As of March 31, 2007, there was $18.9 million of total unrecognized compensation cost related to non-vested share-based awards. This cost is expected to be recognized over a weighted-average period of 2.5 years.

Stock option activity for the three months ended March 31, 2007 was as follows (in thousands, except exercise price information):

	Shares		Range of Exercise Prices		Weighted-Average Exercise Price
Options outstanding at January 1, 2007	3,552	$	0.02 - $16.94	$	4.03
Options granted	--		--		--
Options exercised	(341)	$	0.03 - $16.94	$	3.47
Options canceled	--		--	$	--
Options outstanding at March 31, 2007	3,211	$	0.02 - $16.94	$	4.09
Options vested at March 31, 2007	2,223	$	0.02 - $16.94	$	3.72

Restricted stock activity for the three months ended March 31, 2007 was as follows (in thousands, except fair value information):

	Shares		Weighted-Average Grant Date Fair Value
Restricted stock awards outstanding at January 1, 2007	1,429	$	12.74
Awards granted	16	$	19.70
Awards vested	(41)	$	7.13
Awards canceled	(6)	$	13.50
Restricted stock awards outstanding at March 31, 2007	1,398	$	12.98

4. Net Income per Share

The following table presents the calculation of basic and diluted net income per share (in thousands, except per share information):

	Three months ended March 31,			
		2007		2006
Net income	$	3,160	$	1,705
Basic:				
Weighted-average shares of common stock outstanding		27,081		23,537
Shares used in computing basic net income per share		27,081		23,537
Effect of dilutive securities:				
Stock options		2,004		2,385
Warrants		8		125
Restricted stock subject to vesting		356		136
Shares used in computing diluted net income per share		29,449		26,183
Basic net income per share	$	0.12	$	0.07

Diluted net income per share	$	0.11	$	0.07

5. Commitments and Contingencies

The Company leases its office facilities and certain equipment under various operating lease agreements. The Company has the option to extend the term of certain of its office facilities leases. Future minimum commitments under these lease agreements are as follows (table in thousands):

		Operating Leases
2007 remaining	$	1,098
2008		1,313
2009		1,164
2010		768
2011		340
Thereafter		61
Total minimum lease payments	$	4,744

In connection with certain of its acquisitions, the Company was required to establish various letters of credit totaling $400,000 with Silicon Valley Bank to serve as collateral to secure facility leases. These letters of credit reduce the borrowings available under the Company's accounts receivable line of credit. One letter of credit for $250,000 expires in June 2007 and the other for $150,000 expires in October 2009.

6. Balance Sheet Components

The components of accounts receivable are as follows (in thousands):

		March 31, 2007		December 31, 2006
Accounts receivable	$	25,605	$	29,461
Unbilled revenue		15,786		9,846
Allowance for doubtful accounts		(461)		(707)
Total	$	40,930	$	38,600

The components of other current assets are as follows (in thousands):

		March 31, 2007		December 31, 2006
Income tax receivable	$	1,438	$	2,150
Receivables associated with the E Tech acquisition		187		--
Miscellaneous receivables		194		16
Deferred current tax assets		134		43
Other current assets		118		590
Total	$	2,071	$	2,799

The components of other current liabilities are as follows (in thousands):

		March 31, 2007		December 31, 2006
Accrued bonus	$	3,970	$	9,851

Accrued subcontractor fees		1,962		1,803
Deferred revenue		1,296		1,318
Payroll related costs		883		805
Accrued medical claims expense		609		--
Accrued vacation		424		453
Accrued acquisition costs related to Insolexen		287		311
Sales and use taxes		47		326
Other accrued expenses		1,600		1,167
Total	$	11,078	$	16,034

Property and equipment consist of the following (in thousands):

	March 31, 2007		December 31, 2006	
Computer Hardware (useful life of 2 years)	$	4,434	$	3,933
Furniture & Fixtures (useful life of 5 years)		985		980
Leasehold Improvements (useful life of 3 years)		295		275
Software (useful life of 1 year)		714		702
Less: Accumulated Depreciation		(4,422)		(4,084)
Total	$	2,006	$	1,806

7. Business Combinations

Acquisition of Bay Street Solutions, Inc.

On April 7, 2006, the Company acquired Bay Street Solutions, Inc. ("Bay Street"), a national customer relationship management consulting firm, for approximately $9.8 million. The purchase price consists of approximately $4.1 million in cash, transaction costs of $636,000, and 464,569 shares of the Company's common stock valued at approximately $12.18 per share (approximately $5.7 million worth of the Company's common stock) less the discount ascribed to those shares subject to a lapse acceleration right of approximately $630,000, as determined by a third party valuation firm. The total purchase price has been allocated to the assets acquired, including identifiable intangible assets, based on their respective fair values at the date of acquisition. Goodwill is assigned at the enterprise level. The purchase price was allocated to intangibles based on management's estimate and an independent valuation. Management expects to finalize the purchase price allocation within twelve months of the acquisition date as certain initial accounting estimates are resolved. The results of Bay Street's operations have been included in the Company's consolidated financial statements since April 7, 2006.

The preliminary purchase price allocation is as follows (in millions):

Intangibles:		
Customer relationships	$	1.6
Customer backlog		0.2
Non-compete agreements		0.1
Goodwill		6.4
Tangible assets acquired:		
Accounts receivable		2.4
Other assets		0.6
Property and equipment		0.1
Accrued expenses		(1.6)
Net assets acquired	$	9.8

The Company estimates that the intangible assets acquired have useful lives of four months to six years.

Acquisition of Insolexen, Corp.

On May 31, 2006, the Company acquired Insolexen, Corp. (“Insolexen”), a business integration consulting firm, for approximately $15.1 million. The purchase price consists of approximately $7.7 million in cash, transaction costs of $695,000, and 522,944 shares of the Company's common stock valued at approximately $13.72 per share (approximately $7.2 million worth of the Company's common stock) less the discount ascribed to those shares subject to a lapse acceleration right of approximately $613,000, as determined by a third party valuation firm. The total purchase price has been allocated to the assets acquired, including identifiable intangible assets, based on their respective fair values at the date of acquisition. Goodwill is assigned at the enterprise level. The purchase price was allocated to intangibles based on management's estimate and an independent valuation. Management expects to finalize the purchase price allocation within twelve months of the acquisition date as certain initial accounting estimates are resolved. The results of Insolexen's operations have been included in the Company's consolidated financial statements since May 31, 2006.

The preliminary purchase price allocation is as follows (in millions):

Intangibles:		
Customer relationships	$	2.8
Customer backlog		0.4
Non-compete agreements		0.1
Goodwill		10.5
Tangible assets and liabilities acquired:		
Accounts receivable		3.9
Other assets		2.1
Accrued expenses		(4.7)
Net assets acquired	$	15.1

The Company estimates that the intangible assets acquired have useful lives of seven months to six years.

Acquisition of the Energy, Government and General Business (EGG) division of Digital Consulting & Software Services, Inc.

On July 21, 2006, the Company acquired the Energy, Government and General Business (“EGG”) division of Digital Consulting & Software Services, Inc., a systems integration consulting business, for approximately $13.1 million. The purchase price consists of approximately $6.4 million in cash, transaction costs of approximately $275,000, and 511,382 shares of the Company's common stock valued at approximately $12.71 per share (approximately $6.5 million worth of the Company's common stock) less the discount ascribed to those shares subject to a lapse acceleration right of approximately $92,000, as determined by a third party valuation firm. The total purchase price has been allocated to the assets acquired, including identifiable intangible assets, based on their respective fair values at the date of acquisition. Goodwill is assigned at the enterprise level. The purchase price was allocated to intangibles based on management's estimate and an independent valuation. Management expects to finalize the purchase price allocation within twelve months of the acquisition date as certain initial accounting estimates are resolved. The results of EGG's operations have been included in the Company's consolidated financial statements since July 21, 2006.

The preliminary purchase price allocation is as follows (in millions):

Intangibles:		
Customer relationships	$	3.7

Customer backlog		0.5
Non-compete agreements		0.1
Goodwill		6.2
Tangible assets and liabilities acquired:		
Accounts receivable		3.8
Other assets		0.4
Accrued expenses		(1.6)
Net assets acquired	$	13.1

The Company estimates that the intangible assets acquired have useful lives of five months to six years.

Acquisition of the E Tech Solutions, Inc.

On February 20, 2007, the Company acquired e tech solutions, Inc. (“E Tech”), a solutions-oriented IT consulting firm, for approximately $12.3 million. The purchase price consists of approximately $5.8 million in cash, transaction costs of approximately $663,000, and 306,247 shares of the Company's common stock valued at approximately $20.34 per share (approximately $6.2 million worth of the Company's common stock) less the value of those shares subject to a lapse acceleration right of approximately $474,000, as determined by a third party valuation firm. The total purchase price has been allocated to the assets acquired, including identifiable intangible assets, based on their respective fair values at the date of acquisition. Goodwill is assigned at the enterprise level. The purchase price was allocated to intangibles based on management's estimate and an independent valuation. Management expects to finalize the purchase price allocation within twelve months of the acquisition date as certain initial accounting estimates are resolved. The results of E Tech’s operations have been included in the Company's consolidated financial statements since February 20, 2007.

The preliminary purchase price allocation is as follows (in millions):

Intangibles:		
Customer relationships	$	3.0
Customer backlog		0.5
Non-compete agreements		0.1
Goodwill		8.9
Tangible assets and liabilities acquired:		
Accounts receivable		2.2
Property and equipment		0.1
Other assets		0.1
Accrued expenses		(2.6)
Net assets acquired	$	12.3

The Company estimates that the intangible assets acquired have useful lives of ten months to eight years.

Pro forma Results of Operations

The following presents the unaudited pro forma combined results of operations of the Company with Bay Street, Insolexen, EGG, and E Tech for the three months ended March 31, 2007 and 2006, after giving effect to certain pro forma adjustments related to the amortization of acquired intangible assets. These unaudited pro forma results are not necessarily indicative of the actual consolidated results of operations had the acquisitions actually occurred on January 1, 2007 and January 1, 2006 or of future results of operations of the consolidated entities (in thousands, except per share information):

	Three Months Ended March 31,			
	2007		2006	
Revenues	$	51,730	$	43,750
Net income	$	3,033	$	1,996
Basic net income per share	$	0.11	$	0.08

Diluted net income per share	$	0.10	$	0.07

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8. Intangible Assets

Intangible Assets with Indefinite Lives

The changes in the carrying amount of goodwill for the three months ended March 31, 2007 are as follows (in thousands):

Balance at December 31, 2006	$	69,170
E Tech Acquisition		8,932
Miscellaneous adjustments to Insolexen and EGG goodwill		(97)
Adjustment to goodwill related to deferred taxes associated with acquisitions		(257)
Balance at March 31, 2007	$	77,748

Intangible Assets with Definite Lives

Following is a summary of Company's intangible assets that are subject to amortization (in thousands):

	March 31, 2007			December 31, 2006		
	Gross Carrying Amounts	**Accumulated Amortization**	**Net Carrying Amounts**	**Gross Carrying Amounts**	**Accumulated Amortization**	**Net Carrying Amounts**
Customer relationships	$ 15,850	$ (3,425)	$ 12,425	$ 12,860	$ (2,808)	$ 10,052
Non-compete agreements	2,473	(1,222)	1,251	2,393	(1,094)	1,299
Customer backlog	460	(59)	401	--	--	--
Internally developed software	806	(263)	543	755	(220)	535
Total	$ 19,589	$ (4,969)	$ 14,620	$ 16,008	$ (4,122)	$ 11,886

The estimated useful lives of acquired identifiable intangible assets are as follows:

Customer relationships	3 - 8 years
Non-compete agreements	2 - 5 years
Customer backlog	4 months to 1 year
Internally developed software	5 years

9. Line of Credit and Long-Term Debt

On June 29, 2006, the Company entered into an Amended and Restated Loan and Security Agreement with Silicon Valley Bank and KeyBank National Association. The amended agreement increased the total size of the Company's senior bank credit facilities from $28.5 million to $51.0 million by increasing the accounts receivable line of credit from $15 million to $25 million and increasing the acquisition term line of credit from $13.5 million to $26.0 million.

The accounts receivable line of credit, which expires in June 2009, provides for a borrowing capacity equal to all eligible accounts receivable, including 80% of unbilled revenues, subject to certain borrowing base calculations as defined in the agreement, but in no event more than $25 million. Borrowings under this line of credit bear interest at the bank's prime rate (8.25% at March 31, 2007). As of March 31, 2007, there was $1.9 million outstanding under the accounts receivable line of credit and $22.7 million of available borrowing capacity.

The Company's $26.0 million term acquisition line of credit provides an additional source of financing for certain qualified acquisitions. As of March 31, 2007, the balance outstanding under this acquisition line of credit was approximately $1.0 million. Borrowings under this acquisition line of credit bear interest equal to the four year U.S. Treasury note yield plus 3% based on the spot rate on the day the draw is processed (7.5% at March 31, 2007). Borrowings under this acquisition line are repayable in thirty-six equal monthly installments after the initial interest only period which continues through June 29, 2007. Draws under this acquisition line may be made through June 29, 2008. As of March 31, 2007, the balance outstanding under this acquisition line of credit of $1.0 million had an average interest rate of 7.0%. The Company currently has approximately $25.0 million of available borrowing capacity under this acquisition line of credit.

The Company is required to comply with various financial covenants under the $51.0 million credit facility. Specifically, the Company is required to maintain a ratio of after tax earnings before interest, depreciation and amortization, and other non-cash charges, including but not limited to stock and stock option compensation expense on trailing three months annualized, to current maturities of long-term debt and capital leases plus interest of at least 1.50 to 1.00, a ratio of cash plus eligible accounts receivable including 80% of unbilled revenues less principal amount of all outstanding advances on accounts receivable line of credit to advances under the term acquisition line of credit of at least 0.75 to 1.00, and a maximum ratio of all outstanding advances under the entire credit facility to earnings before taxes, interest, depreciation, amortization and other non-cash charges, including but not limited to, stock and stock option compensation expense including pro forma adjustments for acquisitions on a trailing twelve month basis of no more than 2.50 to 1.00. As of March 31, 2007, the Company was in compliance with all covenants under this facility. This credit facility is secured by substantially all assets of the Company.

10. Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2005. The Internal Revenue Service (IRS) has completed examinations of the Company's U.S. income tax returns for 2002, 2003 and 2004. As of March 31, 2007, the IRS has proposed no significant adjustments to any of the Company's tax positions.

The Company adopted the provisions of FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* ("FIN 48"), on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no increases or decreases in the total amount of previously unrecognized tax benefits. As of January 1, 2007, the Company had no unrecognized tax benefits.

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in its tax accruals. The Company had no amounts accrued for the payment of interest or penalties at January 1, 2007, respectively.

The Company's effective tax rate was 43.3% for the three months ended March 31, 2007 compared to 43.8% for the three months ended March 31, 2006. The difference between the Company's federal statutory rate of 35% and effective tax rate relates primarily to state income taxes, net of the federal benefit, and non-deductible expense related to incentive stock options. The decrease in the Company's effective tax rate was due to a larger number of disqualifying dispositions of stock options for which the Company receives a tax deduction. The Company has deferred tax assets resulting from net operating losses and capital loss carry forwards of acquired companies amounting to approximately $2.3 million, for which a valuation allowance of $1.8 million is recorded. Additionally, the Company has deferred tax assets of $1.2 million related to fixed assets, reserves and accruals. Deferred tax assets net of the valuation allowance total $1.7 million and are offset by deferred tax liabilities of $3.8 million related to identifiable intangibles and cash to accrual adjustments from current and prior acquisitions. Any reversal of the valuation allowance on the deferred tax assets will be adjusted against goodwill and will not have an impact on our statement of operations. All of the net operating losses and capital loss carry forwards relate to acquired entities, and as such are subject to annual limitations on usage under the "change in control" provisions of the Internal Revenue Code.

11. Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 will be applied prospectively and will be effective for periods beginning after November 15, 2007. The Company is currently evaluating the effect, if any, of SFAS 157 on the Company's condensed consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, treatment of interest and penalties, and disclosure of such positions. The Company adopted the provisions of FIN 48 on January 1, 2007 as required and discussed in Note 10 to the condensed consolidated financial statements.

In June 2006, the EITF ratified EITF Issue 06-3, *How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)* (“EITF 06-3”). A consensus was reached that entities may adopt a policy of presenting taxes in the income statement on either a gross or net basis. An entity should disclose its policy of presenting taxes and the amount of any taxes presented on a gross basis should be disclosed, if significant. The Company adopted EITF 06-3 on January 1, 2007. There was no effect of the adoption on the condensed consolidated financial statements as of March 31, 2007. The Company presents revenues net of taxes as disclosed in Note 2 to the condensed consolidated financial statements.

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

Statements made in this Report on Form 10-Q, including without limitation this Management's Discussion and Analysis of Financial Condition and Operations, other than statements of historical information, are forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements may sometimes be identified by such words as "may," "will," "expect," "anticipate," "believe," "estimate" and "continue" or similar words. We believe that it is important to communicate our future expectations to investors. However, these forward-looking statements involve many risks and uncertainties. Our actual results could differ materially from those indicated in such forward-looking statements as a result of certain factors, including but not limited to, those set forth under Risk Factors in our Annual Report on Form 10-K previously filed with the Securities and Exchange Commission and elsewhere in this Report on Form 10-Q. We are under no duty to update any of the forward-looking statements after the date of this Report on Form 10-Q to conform these statements to actual results.

Overview

We are an information technology consulting firm serving Global 2000 and large enterprise companies throughout the United States and Canada. We help clients gain competitive advantage by using Internet-based technologies to make their businesses more responsive to market opportunities and threats, strengthen relationships with customers, suppliers and partners, improve productivity and reduce information technology costs. Our solutions enable these benefits by integrating, automating and extending business processes, technology infrastructure and software applications end-to-end within an organization and with key partners, suppliers and customers. This provides real-time access to critical business applications and information and a scalable, reliable, secure and cost-effective technology infrastructure.

Services Revenues

Services revenues are derived from professional services performed developing, implementing, integrating, automating and extending business processes, technology infrastructure and software applications. Most of our projects are performed on a time and materials basis, and a smaller amount of revenues is derived from projects performed on a fixed fee basis. Fixed fee engagements represented approximately 14% of our services revenues for the three months ended March 31, 2007 and approximately 4% of our services revenues for the three months ended March 31, 2006. For time and material projects, revenues are recognized and billed by multiplying the number of hours our professionals expend in the performance of the project by the established billing rates. For fixed fee projects, revenues are generally recognized using the proportionate performance method. Amounts invoiced to clients in excess of revenues recognized are classified as deferred revenues. The Company's average bill rates increased slightly in 2006. The Company is anticipating modest additional increases in 2007. On most projects, we are also reimbursed for out-of-pocket expenses such as airfare, lodging and meals. These reimbursements are included as a component of revenues. The aggregate amount of reimbursed expenses will fluctuate depending on the location of our customers, the total number of our projects that require travel, and whether our arrangements with our clients provide for the reimbursement of travel and other project-related expenses.

Software Revenues

Software revenues are derived from sales of third-party software. Revenues from sales of third-party software are recorded on a gross basis provided we act as a principal in the transaction. In the event we do not meet the requirements to be considered a principal in the software sale transaction and act as an agent, the revenues are recorded on a net basis. Software revenues are expected to fluctuate from quarter-to-quarter depending on our customers' demand for software products.

If we enter into contracts for the sale of services and software, Company management evaluates whether the services are essential to the functionality of the software and whether the Company has objective fair value evidence for each deliverable in the transaction. If management concludes the services to be provided are not essential to the functionality of the software and can determine objective fair value evidence for each deliverable of the transaction, then we account for each deliverable in the transaction separately, based on the relevant revenue recognition policies. All deliverables of our multiple element arrangements meet these criteria.

Cost of revenues

Cost of revenues consists primarily of cash and non-cash compensation and benefits associated with our technology professionals and subcontractors. Non-cash compensation includes stock compensation expenses arising from restricted stock and option grants to employees. Cost of revenues also includes third-party software costs, reimbursable expenses and other unreimbursed project related expenses. Project related expenses will fluctuate generally depending on outside factors including the cost and frequency of travel and the location of our customers. Cost of revenues does not include depreciation or amortization of assets used in the production of revenues.

Gross Margins

Our gross margins for services are affected by the utilization rates of our professionals, defined as the percentage of our professionals' time billed to customers divided by the total available hours in the respective period, the salaries we pay our consulting professionals and the average billing rate we receive from our customers. If a project ends earlier than scheduled or we retain professionals in advance of receiving project assignments, or if demand for our services declines, our utilization rate will decline and adversely affect our gross margins. Subject to fluctuations resulting from our acquisitions, we expect these key metrics of our services business to remain relatively constant for the foreseeable future assuming there are no further declines in the demand for information technology software and services. Gross margin percentages of third party software sales are typically lower than gross margin percentages for services and the mix of services and software for a particular period can significantly impact total combined gross margin percentage for such period. In addition, gross margin for software sales can fluctuate due to pricing and other competitive pressures.

Selling, General and Administrative Expenses

Selling, general and administrative expenses (“SG&A”) consist of salaries, bonuses, non-cash compensation, office costs, recruiting, professional fees, sales and marketing activities, training, and other miscellaneous expenses. Non-cash compensation includes stock compensation expenses related to restricted stock and option grants to employees and non-employee directors. We work to minimize selling costs by focusing on repeat business with existing customers and by accessing sales leads generated by our software business partners, most notably IBM, whose products we use to design and implement solutions for our clients. These partnerships enable us to reduce our selling costs and sales cycle times and increase win rates through leveraging our partners' marketing efforts and endorsements. A substantial portion of our SG&A costs are relatively fixed. As a result, we expect SG&A costs as a percentage of revenue to decline for the full year as we continue to increase revenues in 2007.

Plans for Growth and Acquisitions

Our goal is to continue to build one of the leading independent information technology consulting firms in North America by expanding our relationships with existing and new clients, leveraging our operations to expand nationally and continuing to make disciplined acquisitions. We believe the United States represents an attractive market for growth, primarily through acquisitions. As demand for our services grows, we believe we will attempt to increase the number of professionals in our 16 North American offices and to add new offices throughout the United States, both organically and through acquisitions. In addition, we believe our track record for identifying acquisitions and our ability to integrate acquired businesses helps us complete acquisitions efficiently and productively, while continuing to offer quality services to our clients, including new clients resulting from the acquisitions.

Consistent with our strategy of growth through disciplined acquisitions, we consummated six acquisitions since January 1, 2005, including one in February 2007.

Results of Operations

Three months ended March 31, 2007 compared to three months ended March 31, 2006

Revenues. Total revenues increased 69% to $50.0 million for the three months ended March 31, 2007 from $29.6 million for the three months ended March 31, 2006.

	Financial Results			Explanation for Increases Over Prior Year Period			
	For the Three Months Ended March 31, 2007	For the Three Months Ended March 31, 2006	Total Increase Over Prior Year Period	Revenue Attributable to Acquired Companies	Revenue Attributable to Base Business	% Increase in Total Revenue Attributable to Base Business	Total Increase Over Prior Year Period
Services Revenues	$ 43,297	$ 25,606	$ 17,691	$ 12,234	$ 5,457	21%	$ 17,691
Software Revenues	4,192	2,682	1,510	227	1,283	48%	1,510
Reimbursable Expenses	2,560	1,356	1,204	644	560	41%	1,204
Total Revenues	$ 50,049	$ 29,644	$ 20,405	$ 13,105	$ 7,300	25%	$