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 March 31, 2006

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: 000-23265

BLACKBAUD, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**11-2617163**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2000 Daniel Island Drive
Charleston, South Carolina 29492
(Address of principal executive offices, including zip code)

(843) 216-6200
(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 o

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.

Large accelerated filer o   Accelerated filer ☑   Non-accelerated filer o

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

YES o NO ☑

The number of shares of the Registrant's Common Stock outstanding as of May 9, 2006 was 43,663,862.

BLACKBAUD, INC.

TABLE OF CONTENTS

		Page No.
PART I.	**FINANCIAL INFORMATION**	
Item 1. Financial Statements		
Consolidated Balance Sheets as of March 31, 2006 and December 31, 2005 (unaudited)		1
Consolidated Statements of Operations for the Three Months Ended March 31, 2006 and 2005 (unaudited)		2
Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2006 and 2005 (unaudited)		3
Consolidated Statements of Stockholders' Equity and Comprehensive Income for the Three Months Ended March 31, 2006 and the Years Ended December 31, 2005 and December 31, 2004 (unaudited)		4
Condensed Notes to Consolidated Financial Statements (unaudited)		5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations		16
Item 3. Quantitative and Qualitative Disclosures About Market Risk		27
Item 4. Controls and Procedures		27
PART II.	**OTHER INFORMATION**	
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds		28
Item 6. Exhibits		28
Signatures		29

PART I-FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Blackbaud, Inc.
Consolidated balance sheets
(Unaudited)

(in thousands, except share and per share amounts)	March 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 16,490	$ 22,683
Cash, restricted	504	—
Accounts receivable, net of allowance of $1,074 and $1,100, respectively	24,891	25,577
Prepaid expenses and other current assets	9,677	8,741
Deferred tax asset, current portion	10,315	7,600
Total current assets	61,877	64,601
Property and equipment, net	8,368	8,700
Deferred tax asset	66,940	71,487
Goodwill	2,224	2,208
Intangible assets, net	8,453	396
Other assets	89	106
Total assets	$ 147,951	$ 147,498
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	$ 3,330	$ 4,683
Accrued expenses and other current liabilities	12,664	15,806
Deferred acquisition costs, current portion	504	—
Deferred revenue	58,893	59,459
Total current liabilities	75,391	79,948
Deferred acquisition costs, long-term portion	267	—
Long-term deferred revenue	1,482	1,279
Total liabilities	77,140	81,227
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock; 20,000,000 shares authorized, none outstanding	—	—
Common stock, $.001 par value; 180,000,000 shares authorized, 48,192,407 and 47,529,836 shares issued at March 31, 2006 and December 31, 2005, respectively	48	48
Additional paid-in capital	75,250	73,583
Deferred compensation	—	(6,497)
Treasury stock, at cost; 4,631,913 and 4,267,313 shares at March 31, 2006 and December 31, 2005, respectively	(67,156)	(60,902)
Accumulated other comprehensive income	86	92
Retained earnings	62,583	59,947
Total stockholders' equity	70,811	66,271
Total liabilities and stockholders' equity	$ 147,951	$ 147,498

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

Blackbaud, Inc.
Consolidated statements of operations
(Unaudited)

(in thousands, except share and per share amounts)	Three months ended March 31, 2006	2005
Revenue		
License fees	$ 7,221	$ 6,468
Services	13,714	11,472
Maintenance	19,199	17,115
Subscriptions	2,308	1,465
Other revenue	1,290	883
Total revenue	43,732	37,403
Cost of revenue		
Cost of license fees	670	946
Cost of services (of which $140 and $91 in the three months ended March 31, 2006 and 2005, respectively, was stock based compensation expense)	8,111	6,527
Cost of maintenance (of which $29 and $11 in the three months ended March 31, 2006 and 2005, respectively, was stock based compensation expense)	3,207	2,640
Cost of subscriptions (of which $4 and $0 in the three months ended March 31, 2006 and 2005, respectively, was stock based compensation expense)	540	415
Cost of other revenue	1,090	770
Total cost of revenue	13,618	11,298
Gross profit	30,114	26,105
Operating expenses		
Sales and marketing (of which $220 and $74 in the three months ended March 31, 2006 and 2005, respectively, was stock based compensation expense)	9,284	7,755
Research and development (of which $191 and $55 in the three months ended March 31, 2006 and 2005, respectively, was stock based compensation expense)	6,024	5,102
General and administrative (of which $1,390 and $(7,871) in the three months ended March 31, 2006 and 2005, respectively, was stock based compensation expense (benefit))	5,461	(4,036)
Amortization	129	—
Total operating expenses	20,898	8,821
Income from operations	9,216	17,284
Interest income	149	253
Interest expense	(12)	(13)
Other expense, net	(29)	(112)
Income before provision for income taxes	9,324	17,412
Income tax provision	3,654	6,553
Net income	$ 5,670	$ 10,859
Earnings per share		
Basic	$ 0.13	$ 0.25
Diluted	$ 0.13	$ 0.23
Common shares and equivalents outstanding		
Basic weighted average shares	42,883,929	42,643,705
Diluted weighted average shares	44,600,235	47,555,533
Dividends per share	$ 0.07	$ 0.05

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

Blackbaud, Inc.
Consolidated statements of cash flows
(Unaudited)

(in thousands)	Three months ended March 31, 2006	2005
Cash flows from operating activities		
Net income	$ 5,670	$ 10,859
Adjustments to reconcile net income to net provided by operating activities		
Depreciation and amortization	846	668
Provision for doubtful accounts and sales returns	256	429
Stock-based compensation	1,974	(6,922)
Amortization of deferred financing fees	12	12
Deferred taxes	1,339	4,970
Excess tax benefit on exercise of stock options	—	2,606
Changes in assets and liabilities, net of acquisition		
Accounts receivable	411	780
Prepaid expenses and other assets	(929)	(158)
Trade accounts payable	(1,354)	(168)
Accrued expenses and other current liabilities	(3,151)	(5,182)
Deferred revenue	(1,814)	(537)
Total adjustments	(2,410)	(3,502)
Net cash provided by operating activities	3,260	7,357
Cash flows from investing activities		
Purchase of property and equipment	(264)	(85)
Purchase of net assets of acquired company	(6,081)	(49)
Net cash used in investing activities	(6,345)	(134)
Cash flows from financing activities		
Repayments on long-term debt and capital lease obligations	—	(37)
Proceeds from exercise of stock options	3,266	4,079
Excess tax benefit on exercise of stock options	2,922	—
Purchase of treasury stock	(6,254)	(7,969)
Dividend payments to stockholders	(3,034)	(2,151)
Net cash used in financing activities	(3,100)	(6,078)
Effect of exchange rate on cash and cash equivalents	(8)	(20)
Net (decrease) increase in cash and cash equivalents	(6,193)	1,125
Cash and cash equivalents, beginning of period	22,683	42,144
Cash and cash equivalents, end of period	$ 16,490	$ 43,269

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

Blackbaud, Inc.
Consolidated statements of stockholders' equity and comprehensive income
(Unaudited)

(in thousands, except share amounts)

	Comprehensive income	Common stock Shares	Common stock Amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive (loss) income	Deferred compensation	Retained earnings	Total stockholders' equity
Balance, December 31, 2004		42,549,056	$ 43	$ 55,292	$ —	$ 355	$ (1,064)	$ 35,163	$ 89,789
Exercise of stock options	$ —	3,103,790	3	15,554	—	—	—	—	15,557
Purchase of treasury shares	—	—	—	—	(60,902)	—	—	—	(60,902)
Payment of dividends	—	—	—	—	—	—	—	(8,517)	(8,517)
Translation adjustment, net of tax	(263)	—	—	—	—	(263)	—	—	(263)
Deferred compensation related to options issued to employees	—	—	—	(509)	—	—	818	—	309
Reversal of deferred compensation related to option cancellations	—	—	—	(55)	—	—	55	—	—
Amortization of deferred compensation	—	—	—	—	—	—	315	—	315
Tax impact of exercise of nonqualified stock options	—	—	—	8,589	—	—	—	—	8,589
Net option exercises	—	1,389,257	2	(11,909)	—	—	—	—	(11,907)
Restricted stock grants	—	487,733	—	6,621	—	—	(6,621)	—	—
Net income	33,301	—	—	—	—	—	—	33,301	33,301
Comprehensive income	$ 33,038								
Balance, December 31, 2005		47,529,836	48	73,583	(60,902)	92	(6,497)	59,947	66,271
Exercise of stock options	$ —	656,675	—	3,266	—	—	—	—	3,266
Purchase of treasury shares	—	—	—	—	(6,254)	—	—	—	(6,254)
Payment of dividends	—	—	—	—	—	—	—	(3,034)	(3,034)
Translation adjustment, net of tax	(6)	—	—	—	—	(6)	—	—	(6)
Reclassification due to change in accounting principle	—	—	—	(6,497)	—	—	6,497	—	—
Cumulative effect adjustment to assume historical forfeitures	—	—	—	(20)	—	—	—	—	(20)
Stock-based compensation	—	—	—	1,994	—	—	—	—	1,994
Tax impact of exercise of nonqualified stock options	—	—	—	2,924	—	—	—	—	2,924
Restricted stock grants	—	10,596	—	—	—	—	—	—	—
Restricted stock cancellations	—	(4,700)	—	—	—	—	—	—	—
Net income	5,670	—	—	—	—	—	—	5,670	5,670
Comprehensive income	$ 5,664								
Balance, March 31, 2006		48,192,407	$ 48	$ 75,250	$ (67,156)	$ 86	$ —	$ 62,583	$ 70,811

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

Blackbaud, Inc.
Condensed notes to consolidated financial statements
March 31, 2006
(Unaudited)

1. Organization

Blackbaud, Inc. (the "Company") is the leading global provider of software and related services designed specifically for nonprofit organizations and provides products and services that enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage their finances and optimize internal operations. As of March 31, 2006 the Company had more than 15,000 active customers distributed across multiple verticals within the nonprofit market including religion; education; foundations; health and human services; arts and cultural; public and societal benefits; environment and animal welfare; and international foreign affairs.

2. Summary of significant accounting policies

Unaudited interim financial statements

The interim consolidated financial statements as of March 31, 2006 and for the three months ended March 31, 2006 and 2005, respectively, have been prepared by the Company pursuant to the rules and regulations of the SEC for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to state fairly the consolidated balance sheets, consolidated statements of operations, consolidated statements of cash flows, and consolidated statements of stockholder's equity and comprehensive income for the periods presented in accordance with accounting principles generally accepted in the United States of America. The consolidated balance sheet at December 31, 2005 has been derived from the audited consolidated financial statements at that date. Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2006 or any other future period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the rules and regulations for interim reporting of the SEC. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions 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. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Areas of the financial statements where estimates may have the most significant effect include the allowance for sales returns and doubtful accounts, lives of tangible and intangible assets, impairment of long-lived assets, realization of deferred tax assets, stock-based compensation, revenue recognition, and provision for income taxes. Changes in the facts or circumstances underlying these estimates could result in material changes and actual results could differ from these estimates.

Reclassifications

Certain amounts in the prior year consolidated balance sheets, statements of operations, statements of cash flows and notes to the consolidated financial statements have been reclassified to conform to the 2006 presentation.

Revenue recognition

The Company's revenue is generated primarily by licensing its software products and providing support, training, consulting, technical, hosting and other professional services for those products. The Company recognizes revenue in accordance with the American Institute of Certified Public Accountants Statement of Position ("SOP") 97-2, "Software Revenue Recognition", as modified by SOPs 98-4 and 98-9, as well as Technical Practice Aids issued from time to time

by the American Institute of Certified Public Accountants, and in accordance with the SEC Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements".

Under these pronouncements, the Company recognizes revenue from the sale of software licenses when persuasive evidence of an arrangement exists, the product has been delivered, title and risk of loss have transferred to the customer, the fee is fixed or determinable and collection of the resulting receivable is probable. The Company uses a signed agreement as evidence of an arrangement. Delivery occurs when the product is delivered. The Company's typical license agreement does not include customer acceptance provisions. If acceptance provisions are provided, delivery is deemed to occur upon acceptance. The Company considers the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within the Company's standard payment terms. The Company considers payment terms greater than 90 days to be beyond its customary payment terms. The Company deems collection probable if the Company expects that the customer will be able to pay amounts under the arrangement as they become due. If the Company determines that collection is not probable, the Company postpones recognition of the revenue until cash collection. The Company sells software licenses with maintenance and, frequently, professional services. The Company allocates revenue to delivered components, normally the license component of the arrangement, using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to the Company. Fair value for the maintenance services associated with the Company's software licenses is based upon renewal rates stated in the Company's agreements, which vary according to the level of the maintenance program. Fair value of professional services and other products and services is based on sales of these products and services to other customers when sold on a stand-alone basis.

The Company recognizes revenue from maintenance services ratably over the contract term, which is principally one year. Maintenance revenue also includes the right to unspecified product upgrades on an if-and-when available basis. Subscription revenue includes fees for hosted solutions, data enrichment services and hosted online training programs. Subscription-based revenue and any related set-up fees are recognized ratably over the twelve-month service period of the contracts, as there is no discernible pattern of usage. Hosting revenues are recognized ratably over the thirty-six month period of the hosting contracts.

The Company's services, which include consulting, installation and implementation services, are generally billed based on hourly rates plus reimbursable travel and lodging related expenses. For small service engagements, less than approximately $10,000, the Company frequently contracts for and bills based on a fixed fee plus reimbursable travel and lodging related expenses. The Company recognizes this revenue upon completion of the work performed. When the Company's services include software customization, these services are provided to support customer requests for assistance in creating special reports and other minor enhancements that will assist with efforts to improve operational efficiency and/or to support business process improvements. These services are not essential to the functionality of the Company's software and rarely exceed three months in duration. The Company recognizes revenue as these services are performed. When the Company sells hosting separately from consulting, installation and implementation services, it recognizes that revenue ratably over the service period.

The Company sells training at a fixed rate for each specific class, at a per attendee price, or at a packaged price for several attendees, and revenue is recognized only upon the customer attending and completing training. During the second quarter of 2005, the Company introduced the Blackbaud Training Pass, which permits customers to attend unlimited training over a specified contract period, typically one year, subject to certain restrictions. This revenue is recognized ratably over the contract period that is typically one year. The Company recognizes revenue from donor prospect research and data modeling service engagements upon delivery.

To the extent that the Company's customers pay for the above-described services in advance of delivery, the amounts are recorded in deferred revenue.

Stock-based compensation

Effective January 1, 2006, the Company adopted the provisions of the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123(R), Share Based Payments ("SFAS No.123(R)"), using the modified prospective application method. SFAS No. 123(R) replaced SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB No. 25"). Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is the vesting period. Under the modified prospective application method, prior periods are not revised for comparative purposes. The provisions of SFAS No. 123(R) apply to grants made after the adoption date, awards modified, repurchased or cancelled after the adoption date, and existing grants which were partially unvested at that date. Compensation expense for grants outstanding on the date of adoption will be recognized over the remaining

service period using the grant date fair values and amortization methods determined previously for the SFAS No. 123 pro-forma disclosures.

Prior to January 1, 2006, the Company accounted for stock-based compensation under APB No. 25, which provided that no compensation expense should be recorded for stock options or other stock-based awards to employees that are granted with an exercise price that is equal to or greater than the estimated fair value per share of the Company's common stock on the grant date of the award. Certain of the Company's option grants were accounted for as variable awards under the provisions of APB No. 25, which required the Company to record deferred compensation, and recognize compensation expense over the requisite vesting period, for the difference between the exercise price and the fair market value of the stock at each reporting date.

The adoption of SFAS No. 123(R) resulted in the reclassification of $6,497,000 of unamortized deferred compensation that had previously been subject to variable accounting under APB No. 25, and a nominal cumulative effect adjustment to apply an assumed forfeiture rate to expense previously taken on options unvested as of the date of adoption.

The adoption of SFAS No. 123(R) had a material impact on our consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows. See Note 10 of these financial statements for further information regarding our stock-based compensation assumptions and expenses, including pro-forma disclosures for prior periods under the provisions of SFAS No. 123. No new stock options were issued in the quarters ended March 31, 2006 and March 31, 2005. The fair value of options issued in prior periods was determined using the Black-Scholes option-pricing model. The fair value of the restricted stock awards issued in the quarter ended March 31, 2006 was determined by using the closing price of the Company's shares as traded on the NASDAQ exchange on the day of grant. No restricted stock was issued in the quarter ended March 31, 2005.

Income taxes

Prior to October 13, 1999, the Company was organized as an S corporation under the Internal Revenue Code and, therefore, was not subject to federal income taxes. The Company historically made distributions to its stockholders to cover the stockholders' anticipated tax liability. In connection with the recapitalization agreement, the Company converted its U.S. taxable status from an S corporation to a C corporation and, accordingly, since October 14, 1999 has been subject to federal and state income taxes. Upon this conversion and as a result of the recapitalization, the Company recorded a one-time benefit of $107,000,000 to establish a deferred tax asset. This amount was recorded as a direct increase to equity in the statements of stockholders' equity. The Company has not recorded a valuation allowance against this item in its deferred tax asset as of March 31, 2006 or December 31, 2005, as the Company believes it will be able to utilize this benefit, which is dependent upon the Company's ability to generate taxable income.

Significant judgment is required in determining the provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. The Company records its tax provision at the anticipated tax rates based on estimates of annual pretax income. To the extent that the final results differ from these estimated amounts that were initially recorded, such differences will impact the income tax provision in the period in which such determination is made and could have an impact on the deferred tax asset. The Company's deferred tax assets and liabilities are recorded at an amount based upon a blended U.S. Federal income tax rate of 34.8%. This U.S. Federal income tax rate is based on the Company's expectation that the Company's deductible and taxable temporary differences will reverse over a period of years during which, except for 2006 due to current quarter stock option exercises and other reductions to income, the Company will have annual taxable income exceeding $10,000,000 per year. If the Company's results of operations fall below that threshold in the future, the Company will adjust its deferred tax assets and liabilities to an amount reflecting a reduced expected U.S. Federal income tax rate, consistent with the corresponding expectation of lower taxable income. If such change is determined to be appropriate, it will affect the provision for income taxes during the period that the determination is made.

New accounting pronouncements

In June 2005, the FASB issued SFAS Statement No. 154 "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements" ("SFAS No. 154"). SFAS No. 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any

existing accounting pronouncements. The Company does not believe the adoption of SFAS No. 154 will have a material effect on the Company's financial statements.

The American Jobs Creation Act of 2004 (the "AJCA") was enacted on October 22, 2004. The AJCA repeals an export incentive, creates a new deduction for qualified domestic manufacturing activities and includes a special one-time deduction of 85% of certain foreign earnings repatriated to the U.S. In December 2004, the FASB issued FASB Staff Position No. 109-1, "Application of FASB Statement No. 109 ("SFAS No. 109"), Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" ("FSP 109-1"). FSP 109-1 clarifies that the manufacturer's deduction provided for under the AJCA should be accounted for as a special deduction in accordance with SFAS 109 and not as a tax rate reduction. While the Company expects to be able to qualify for the new tax deduction in future years, due to an expectation of no taxable income it does not expect to qualify for the deduction in 2006. The Company has not completed the process of evaluating the impact in future years of adopting FSP 109-1 and is therefore unable to disclose the effect that adopting FSP 109-1 will have on its financial statements.

The FASB also issued FASB Staff Position No. 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" ("FSP 109-2"). The AJCA introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FSP 109-2 provides accounting and disclosure guidance for the repatriation provision. The Company did not make any repatriation of foreign earnings that qualified for this special tax treatment and adoption of FSP 109-2 will have no effect on the Company's financial statements.

3. Acquisition

In January 2006, Blackbaud acquired Campagne Associates, the New Hampshire-based provider of *GiftMaker Pro™* fundraising software for approximately $6,100,000. Included in this amount is $500,000 of purchase price that is contingent upon the seller satisfying certain conditions set forth in the purchase agreement, which has been classified in the consolidated balance sheets as restricted cash. The Company also agreed to pay additional contingent consideration of up to $2,000,000 based upon performance of the acquired business over the next two years. The transaction was accounted for in accordance with the FASB's Statement of Financial Accounting Standards No. 141, Business Combinations ("SFAS No. 141"), which requires that all acquisitions be accounted for under the purchase method. The purchase price has been allocated, on a preliminary basis, to the assets acquired and the liabilities assumed based upon their estimated fair values at the date of the acquisition. The fair values of the identified assets acquired and liabilities assumed exceeded the amount of the cash purchase price by $1,260,000 which, in accordance with SFAS No. 141, was recorded as a deferred acquisition cost. Simultaneously, we recognized a deferred tax liability on the acquisition in connection with the difference between depreciable book value and depreciable tax basis, for $489,000, which reduced the deferred acquisition costs by that amount. Of the remaining $771,000 deferred acquisition costs, approximately $500,000 has been classified as a current liability. Identifiable intangibles assets consisting of various items, including existing customer relationships, software, non-compete agreements and a trade name, with a value aggregating $8,182,000 were recorded as part of the purchase price allocation. These intangible assets will be amortized over their estimated useful lives, ranging from three to fifteen years. The Company is in the process of finalizing its valuation, which it expects to complete in the second quarter of 2006.

Amortization expense for the first quarter of 2006 related to this acquisition was $120,000. The aggregate amortization expense related to this acquisition for 2006 through 2010 is estimated to be approximately $723,000 per year. In addition, previously disclosed acquisitions completed in 2005 resulted in $9,000 of amortization expense in the first quarter of 2006.

4. Earnings per share

The Company computes earnings per common share in accordance with SFAS Statement No. 128, "Earnings per Share" ("SFAS No. 128"). Under the provisions of SFAS No. 128, basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares and dilutive potential common shares then outstanding. Diluted earnings per share reflects the assumed conversion of all dilutive securities, using the treasury stock method. Potential common shares consist of shares issuable upon the exercise of stock options and shares of non-vested restricted stock.

Diluted earnings per share for the quarters ended March 31, 2006 and 2005 includes the effect of 1,716,306 and 4,911,828 potential common shares as they are dilutive. Diluted earnings per share for the quarter ended March 31, 2005 does not include the effect of 25,000 potential common share equivalents as they are anti-dilutive. There were no antidilutive shares in the period ended March 31, 2006.

The following table sets forth the computation of basic and fully diluted earnings per share:

(in thousands, except share and per share amounts)	Three months ended March 31, 2006	2005
Numerator:		
Net income, as reported	$ 5,670	$ 10,859
Denominator:		
Weighted average common shares	42,883,929	42,643,705
Add effect of dilutive securities:		
Employee stock options and restricted stock	1,716,306	4,911,828
Weighted average common shares assuming dilution	44,600,235	47,555,533
Earnings per share:		
Basic	$ 0.13	$ 0.25
Diluted	$ 0.13	$ 0.23

5. Prepaid expenses and other current assets

Prepaid expenses and other current assets consisted of the following as of March 31, 2006 and December 31, 2005.

(in thousands)	March 31, 2006	December 31, 2005
Prepaid rent	$ 520	$ 469
Prepaid insurance	210	382
Prepaid software maintenance and royalties	720	639
Taxes, prepaid and receivable	7,573	6,734
Other	654	517
	$ 9,677	$ 8,741

6. Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following as of March 31, 2006 and December 31, 2005.

(in thousands)	March 31, 2006	December 31, 2005
Accrued bonuses	$ 2,229	$ 4,801
Accrued commissions and salaries	1,108	1,578
Customer credit balances	708	824
Taxes payable	4,114	3,699
Accrued accounting and legal costs	1,723	1,523
Accrued health care costs	875	839
Other	1,907	2,542
	$ 12,664	$ 15,806

7. Credit Agreement

On September 3, 2004, the Company entered into a $30.0 million revolving credit facility, which replaced its prior $15.0 million revolving credit facility that was canceled in July 2004. Amounts borrowed under the $30.0 million revolving credit facility bear interest, at the Company's option, at a variable rate based on either the prime rate, federal funds rate or LIBOR plus a margin of between 0.5% and 2.0% based on the Company's consolidated leverage ratio as defined. Amounts outstanding under the facility are not secured by a lien on the Company's assets, but are guaranteed by the Company's operating subsidiaries and the facility is subject to covenants, including a maximum leverage ratio, minimum interest coverage ratio and minimum net worth. There were no principal or interest amounts outstanding under the facility as of March 31, 2006. The termination date of the facility is September 30, 2007.

8. Commitments and contingencies

Lease agreement

On October 13, 1999, the Company entered into a lease agreement for office space with Duck Pond Creek, LLC, which is owned by certain current and former minority stockholders of the Company. The term of the lease is for ten years with two five-year renewal options by the Company. The annual base rent of the lease is $4,595,000 payable in equal monthly

installments. The base rate escalates annually at a rate equal to the change in the consumer price index, as defined in the agreement.

The Company has subleased a portion of its headquarters facility under various agreements extending through 2008. Under these agreements, rent expense was reduced by $121,000 and $118,000 for the three months ended March 31, 2006 and 2005, respectively. The operating lease commitments will be reduced by minimum aggregate sublease commitments of $484,000, $478,000, and $128,000 for the years 2006, 2007, and 2008, respectively. The Company has also received and expects to receive through 2015, quarterly South Carolina state incentive payments as a result of locating its headquarters facility in Berkeley County, South Carolina. These amounts are recorded as a reduction of rent expense and were $427,000 and $280,000 for the three months ended March 31, 2006 and 2005, respectively.

Other commitments

The Company has a commitment of $200,000 payable annually through 2009 for certain naming rights on a stadium in Charleston, South Carolina. The Company incurred expense under this agreement of $50,000 for each of the three-month periods ended March 31, 2006 and 2005.

The Company utilizes third party relationships in conjunction with its products. The contractual arrangements vary in length from one to three years. In certain cases, these arrangements require a minimum annual purchase commitment. The total minimum purchase commitment under these arrangements at March 31, 2006 is approximately $461,000 through 2008. The Company incurred expense under these arrangements of $129,000 and $224,000 for the three-month periods ended March 31, 2006 and 2005, respectively.

Legal contingencies

The Company is subject to legal proceedings and claims which have arisen in the ordinary course of business. The Company does not believe the amount of potential liability with respect to these actions will have a material adverse effect upon the Company's balance sheets or statements of operations.

9. Income taxes

Income taxes for the three-month period ended March 31, 2006 were calculated using the projected effective tax rate for fiscal 2006 in accordance with SFAS No. 109. The Company estimates that in the fiscal year ending December 31, 2006, it will have an effective tax rate of approximately 39.4%, which was applied as the effective rate for the quarter ended March 31, 2006. The Company's effective tax rate for the three-month period ended March 31, 2005 was 37.6%.

10. Stockholders' equity

Preferred stock

The Company has authorized 20,000,000 shares of preferred stock. No shares were issued and outstanding at March 31, 2006 and December 31, 2005. The Company's Board of Directors may fix the relative rights and preferences of each series of preferred stock in a resolution of the Board of Directors.

Dividends

On February 16, 2006, the Company's Board of Directors approved an increase to the Company's annual dividend from $0.20 per share to $0.28 per share and declared its first quarter dividend of $0.07 per share, which was paid on March 15, 2006 to stockholders of record on February 28, 2006.

Stock repurchase program

On July 26, 2005, the Company's Board of Directors approved a stock repurchase program that authorized the Company to buy back up to $35,000,000 of the Company's outstanding shares of common stock. The shares could be purchased in conjunction with a public offering of the Company's stock, from time to time on the open market or in privately negotiated transactions depending upon market conditions and other factors, all in accordance with the requirements of applicable law. Under the program, in the first quarter of 2006, the Company purchased 364,600 shares of its common stock at an average price of $17.15 per share. The Company accounts for purchases of treasury stock under the cost method which resulted in an increase to the treasury stock balance of approximately $6,254,000 in the quarter ended March 31, 2006.

Employee stock-based compensation plans

The Company has adopted four stock-based compensation plans: the 1999 Stock Option Plan (the "1999 Plan"), the 2000 Stock Option Plan (the "2000 Plan"), the 2001 Stock Option Plan (the "2001 Plan") and the 2004 Stock Plan (the "2004 Plan") on October 13, 1999, May 2, 2000, July 1, 2001, and March 23, 2004, respectively. The Company's Board of Directors administers the above plans and the stock-based awards are granted at terms determined by them. The total number of authorized stock-based awards under these plans is 10,069,269. All stock-based awards granted under these plans have a 10-year contractual term.

The option agreements under all of the plans, except the 2004 Plan with the exception of the options granted to the current CEO, provide that all unvested options vest upon a change in control of the Company, as defined.

The Company granted options under the 1999 Plan to purchase shares of common stock at an exercise price of $4.80 per share, of which 506,541 were outstanding at March 31, 2006. The options granted under this plan have two vesting schedules. Options totaling 310,001 vested 37.5% after one and a half years following the grant date and the remaining 62.5% vested ratably over two and a half years at six-month intervals. The 196,540 remaining options vested ratably over four years at six-month intervals. All options under the 1999 Plan were fully vested as of March 31, 2006.

The Company granted options under the 2000 Plan to purchase shares of common stock at an exercise price of $4.80 per share, of which none were outstanding at March 31, 2006.

The Company has granted options under the 2001 Plan to purchase shares of common stock at an exercise price of $4.80, $5.44, $7.20, $8.00 and $9.04 per share, of which 1,016,704, 493,688, 54,701, 27,157, and 13,274, respectively, were outstanding at March 31, 2006. The options vest in equal annual installments over four years from the date of grant. The option grants under this plan include a provision whereby the Company has the right to call shares exercised under the grants at a discount from fair market value if the employee is terminated for cause, as defined. This provision expired upon the Company's initial public offering. The inclusion of this provision required the Company to account for all options issued under this plan after January 18, 2001 as variable awards and record compensation expense for the difference between the exercise price and the fair market value of the stock at each reporting date. There were 562,506 options under the 2001 Plan unvested at March 31, 2006.

The Company adopted the 2004 Plan on March 23, 2004. The Company has granted options under the 2004 Plan to purchase shares of common stock at an exercise price of $8.00, $8.60, $10.59, $13.05 and $16.10 per share, of which 42,500, 214,142, 91,250, 15,000 and 800,000, respectively, were outstanding at March 31, 2006. The options vest in equal annual installments over four years from the grant date, with the exception of 800,000 options which vest 25% on the first anniversary from the date of grant and the remaining 75% in 12 equal quarterly installments. There were 1,101,840 options under the 2004 Plan unvested at March 31, 2006.

The Company has also granted shares of common stock subject to certain restrictions under the 2004 Plan. Restricted stock grants vest in equal annual installments over four years from the grant date, except for 12,825 shares which vest after one year. The fair market value of the stock at the time of the grant is amortized on a straight-line basis to expense over the period of vesting. Recipients of restricted stock have the right to vote such shares and receive dividends. Income tax benefits resulting from the vesting of restricted stock, including a deduction for the excess, if any, of the fair market value of restricted stock at the time of the vesting over their fair market value at the time of the grants, are credited to additional paid-in capital. There were 493,629 shares of restricted stock outstanding and unvested at March 31, 2006.

The Company recognizes compensation expense associated with options over the vesting period on an accelerated basis consistent with the approach prior to adoption of SFAS 123(R). The Company recognizes compensation expense associated with restricted stock over the vesting period on a straight-line basis.

Stock-based compensation

Beginning on January 1, 2006, the Company adopted SFAS No. 123(R). See Note 2 for a description of the Company's adoption. The adoption of SFAS No. 123(R) had a significant impact on the Company's results of operations. The Company's consolidated statement of operations for the three months ended March 31, 2006 and March 31, 2005 includes $2.0 million of stock-based compensation expense and $7.6 million of stock-based compensation benefit, respectively.

Prior to the adoption of SFAS No. 123(R), the Company accounted for options under APB No. 25. Because of certain provisions in certain of the option agreements, the Company was required to account for these options under variable accounting. Variable accounting requires marking these options to the market price on the reporting date and recognizing a corresponding expense or benefit in the financial statements. The net stock-based compensation benefit for the three months ended March 31, 2005 was principally the result of marking to market the 3.5 million options held by the Company's former CEO from the closing price of $14.64 per share at December 31, 2004 to the closing price of

$12.60 per share at March 31, 2005; this resulted in a stock-based compensation benefit of $7,900,000. Offsetting this amount was stock option compensation expense of approximately $260,000 related to amortization of deferred compensation associated with options held by employees, previously subject to variable accounting, which became fixed upon completion of the initial public offering.

The Company issues new common stock from its pool of authorized stock upon exercise of stock options or upon granting of restricted stock.

The adoption of SFAS No. 123(R) resulted in the reclassification of $6,497,000 of unamortized deferred compensation that had previously been subject to variable accounting under APB No. 25, and a nominal cumulative effect adjustment to apply an assumed forfeiture rate to expense previously taken on options unvested as of the date of adoption.

Unrecognized stock-based compensation expense expected to be recognized over an estimated weighted-average amortization period of 1.42 years was $14.0 million at March 31, 2006. We expect to expense an additional $5.5 million of that total in the remaining nine months of 2006.

SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as previously required under EITF Issue No. 00-15, "Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option". This requirement reduced the Company's net operating cash flows and increased its net financing cash flows by $2.9 million in the quarter ended March 31, 2006. However, the modified prospective transition method requires the prior year presentation to remain unchanged, and as such, for the first quarter of 2005 those tax deductions in excess of recognized compensation cost are reported as operating cash flows in the statements of cash flows.

For the quarter ended March 31, 2006, the effects of applying the provisions of SFAS 123(R) on our operating results were as follows:

	Three months ended March 31, 2006		
(in thousands, except share and per share amounts)	As if under APB 25	SFAS 123(R) Adjustments	As Reported
Income from operations	$ 10,630	$ (1,414)	$ 9,216
Income before income taxes	10,738	(1,414)	9,324
Net income	7,564	(1,894)	5,670
Cash flow from operating activities	6,182	(2,922)	3,260
Cash flow from financing activities	(6,022)	2,922	(3,100)
Earnings per share:			
Basic	$ 0.18	$ (0.05)	$ 0.13
Diluted	$ 0.17	$ (0.04)	$ 0.13

The following table sets forth the summary of option activity under the Company's stock option program for the three months ended March 31, 2006:

	Shares	Weighted-average exercise price
Outstanding options at December 31, 2005	3,931,632	$ 7.69
Exercised	(656,675)	$ 4.97
Outstanding options at March 31, 2006	3,274,957	$ 8.23

The total intrinsic value of options exercised during the quarters ended March 31, 2006 and 2005 was $8.7 million and $7.1 million, respectively. There were no options granted during either quarter. All options granted by the Company had a fair market value assigned at grant date, or since adjusted, based on the use of the Black-Scholes option

pricing model. Significant assumptions used in that model will continue to be monitored and will be disclosed in periods where options are granted.

Information regarding the stock options outstanding at March 31, 2006 is summarized below:

Range of Exercise Prices		Outstanding as of 3/31/2006	Weighted average remaining contractual life (in years)	Weighted average exercise price		Exercisable as of 3/31/2006	Weighted average exercise price	
$	4.80	1,523,245	4.5	$	4.80	1,408,712	$	4.80
$	5.44	493,688	6.9	$	5.44	120,454	$	5.44
$	7.20	54,701	7.5	$	7.20	7,825	$	7.20
$	8.00	69,657	8.2	$	8.00	14,344	$	8.00
$	8.60	214,142	8.3	$	8.60	30,427	$	8.60
$	9.04	13,274	7.9	$	9.04	8,849	$	9.04
$	10.59	91,250	8.5	$	10.59	16,250	$	10.59
$	13.05	15,000	8.7	$	13.05	3,750	$	13.05
$	16.10	800,000	9.7	$	16.10	—		—
		3,274,957	6.7	$	8.23	1,610,611	$	5.06

The aggregate intrinsic value of options outstanding and options exercisable as of March 31, 2006 was $42.4 million and $26.0 million, respectively. The intrinsic value is calculated as the difference between the market value as of March 31, 2006 and the exercise price of the shares.

A summary of unvested restricted stock as of March 31, 2006, and changes during the three months then ended, is as follows:

	Shares	Weighted-average fair value	
Unvested restricted stock at December 31, 2005	487,733	$	14.52
Granted	10,596	$	17.58
Forfeited	(4,700)	$	14.39
Unvested restricted stock at March 31, 2006	493,629	$	14.59

No restricted stock vested during the quarter ended March 31, 2006. The first shares of restricted stock granted under the 2004 Plan will vest in the second quarter of 2006.

For the quarter ended March 31, 2005, had the Company accounted for all employee stock-based compensation based on the fair value method as prescribed by SFAS No. 123, the Company's net income and net income per share would have been the following pro-forma amounts:

(in thousands, except share amounts)		Three months ended March 31, 2005
Net income, as reported	$	10,859
Total stock option compensation (benefit) expense, net of related tax effects included in the determination of net income as reported		(5,608)
Total stock option compensation benefit (expense), net of related tax effects that would have been included in the determination of net income if the fair value method had been applied to all awards		4,130
Pro forma net income	$	9,381
Earnings per share:		
Basic, as reported	$	0.25
Basic, pro forma	$	0.22
Diluted, as reported	$	0.23
Diluted, pro forma	$	0.20

11. Segment information

The Company has adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS No. 131"). SFAS No. 131 establishes standards for the reporting by business enterprises of information about operating segments, products and services, geographic areas and major customers. The method of determining what information is reported is based on the way that management organizes the operating segments within the Company for making operational decisions and assessments of financial performance. The Company has determined that its reportable segments are those that are based upon internal financial reports that disaggregate operating information into various reportable segments. The Company's chief operating decision maker, as defined in SFAS No. 131, is its chief executive officer, or CEO. The CEO uses the information contained in these reports to evaluate performance and assist in making decisions about the allocation of resources.

In the first quarter of 2006, as part of the continued refinement of its business strategy, the Company identified two modifications to its previous approach to segment reporting under SFAS No. 131. At the beginning of 2006 the Company combined its consulting and training businesses under one managerial structure and began reporting the results of operations of these business units to the CEO as a combined entity. Additionally, as result of the increased significance of its subscription revenue, the Company began to report the operating results from this segment separately to the CEO. Accordingly, the Company has amended its segment disclosure from the prior year below to reflect these changes.

The CEO uses the information presented in these reports to make certain operating decisions. The CEO does not review any report presenting segment balance sheet information. The segment revenues and direct controllable costs, which include salaries, related benefits, third party contractors, data expense and classroom rentals, for the three months ended March 31, 2006 and 2005 were as follows:

(in thousands)	License fees	Consulting and education services(1)	Analytic services(2)	Maintenance	Subscriptions	Other	Total
Three months ended March 31, 2006							
Revenue	$ 7,221	$ 12,548	$ 1,166	$ 19,199	$ 2,308	$ 1,290	$ 43,732
Direct controllable costs	670	6,314	819	2,609	478	1,086	11,976
Segment income	6,551	6,234	347	16,590	1,830	204	31,756
Corporate costs not allocated							1,642
Operating expenses							20,898
Interest (income) expense							(137)
Other expense (income), net							29
Income before provision for income taxes							$ 9,324
Three months ended March 31, 2005							
Revenue	$ 6,468	$ 10,177	$ 1,295	$ 17,115	$ 1,465	$ 883	$ 37,403
Direct controllable costs	946	4,687	826	2,115	356	763	9,693
Segment income	5,522	5,490	469	15,000	1,109	120	27,710
Corporate costs not allocated							1,605
Operating expenses							8,821
Interest (income) expense							(240)
Other expense (income), net							112
Income before provision for income taxes							$ 17,412

(1) This segment consists of consulting, installation and implementation, document imaging, customer training and other education services.

(2) This segment consists of donor prospect research and data modeling services.

12. Subsequent events

On May 8, 2006, the Company declared a second quarter dividend of $0.07 per share, payable on June 15, 2006 to stockholders of record on May 28, 2006.

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 our consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements reflect our current view with respect to future events and financial performance and are subject to risks and uncertainties, including those set forth under "Cautionary statement" included in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report, that could cause actual results to differ materially from historical or anticipated results.

Overview

We are the leading global provider of software and related services designed specifically for nonprofit organizations. Our products and services enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage its finances and optimize internal operations. We have focused solely on the nonprofit market since our incorporation in 1982 and have developed our suite of products and services based upon our extensive knowledge of the operating challenges facing nonprofit organizations. As of March 31, 2006 we had more than 15,000 customers. Our customers operate in multiple verticals within the nonprofit market, including religion, education, foundations, health and human services, arts and cultural, public and societal benefits, environment and animal welfare, and international foreign affairs.

We derive revenue from licensing software products and providing a broad offering of services, including consulting, training, installation, implementation, and donor prospect research and modeling services, as well as ongoing customer support and maintenance. Consulting, training and implementation are generally not essential to the functionality of our software products and are sold separately. Accordingly, we recognize revenue from these services separately from license fees.

Critical accounting policies and estimates

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenue and expenses during the reporting period and related disclosures of contingent assets and liabilities. The most significant estimates and assumptions relate to our allowance for sales returns and doubtful accounts, lives of tangible and intangible assets, impairment of long-lived assets, stock-based compensation, revenue recognition, and provision for income taxes and realization of deferred tax assets. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. On an ongoing basis, we reconsider and evaluate our estimates and assumptions. We are not aware of any circumstances in the past that have caused these estimates and assumptions to be materially wrong. Furthermore, we are not currently aware of any material changes in our business that might cause these assumptions or estimates to differ significantly. In our discussion below of deferred taxes, the most significant asset subject to such assumptions and estimates, we have described the sensitivity of these assumptions or estimates to potential deviations in actual results. Actual results could differ from any of our estimates under different assumptions or conditions.

We believe the critical accounting policies listed below affect significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition

Our revenue is generated primarily by licensing its software products and providing support, training, consulting, technical, hosting and other professional services for those products. We recognize revenue in accordance with the American Institute of Certified Public Accountants Statement of Position ("SOP") 97-2, "Software Revenue Recognition", as modified by SOPs 98-4 and 98-9, as well as Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants, and in accordance with the SEC Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements".

We recognize revenue from the sale of software licenses when persuasive evidence of an arrangement exists, the product has been delivered, title and risk of loss has transferred to the customer, the fee is fixed or determinable and collection of

the resulting receivable is probable. Delivery occurs when the product is delivered. Our typical license agreement does not include customer acceptance provisions. If acceptance provisions are provided, delivery is deemed to occur upon acceptance. We consider the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable with our standard payment terms. We consider payment terms greater than 90 days to be beyond our customary payment terms. We deem collection probable if we expect that the customer will be able to pay amounts under the arrangement as they become due. If we determine that collection is not probable, we postpone recognition of the revenue until cash collection. We sell software licenses with maintenance and, frequently, professional services. We allocate revenue to delivered components, normally the license component of the arrangement, using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to our company. Fair value for the maintenance services associated with our software licenses is based upon renewal rates stated in our agreements, which vary according to the level of the maintenance program. Fair value of professional services and other products and services is based on sales of these products and services to other customers when sold on a stand-alone basis.

We recognize revenue from maintenance services ratably over the contract term, which is usually one year. Maintenance revenue also includes the right to unspecified product upgrades on an if-and-when available basis. Subscription revenue includes fees for hosted solutions, data enrichment services and hosted online training programs. Subscription-based revenue and any related set-up fees are recognized ratably over the twelve-month service period of the contracts. Hosting revenues are recognized ratably over the thirty-six month period of the hosting contracts.

Our services, which include consulting, installation and implementation services, are generally billed based on hourly rates plus reimbursable travel and lodging related expenses. For small service engagements, less than approximately $10,000, we frequently contract for and bill based on a fixed fee plus reimbursable travel and lodging related expenses. We recognize this revenue upon completion of the work performed. When our services include software customization, these services are provided to support customer requests for assistance in creating special reports and other minor enhancements that will assist with efforts to improve operational efficiency and/or to support business process improvements. These services are not essential to the functionality of our software and rarely exceed three months in duration. We recognize revenue as these services are performed. When we sell hosting separately from consulting, installation and implementation services, we recognize that revenue ratably over the service period.

We sell training at a fixed rate for each specific class, at a per attendee price, or at a packaged price for several attendees, and revenue is recognized only upon the customer attending and completing training. During the second quarter of 2005, we introduced the Blackbaud Training Pass, which permits customers to attend unlimited training over a specified contract period, typically one year, subject to certain restrictions. This revenue is recognized ratably over the contract period that is typically one year. We recognize revenue from donor prospect research and data modeling service engagements upon delivery.

To the extent that our customers pay for the above-described services in advance of delivery, we record those amounts in deferred revenue.

Sales returns and allowance for doubtful accounts

We provide customers a 30-day right of return and maintain a reserve for returns. We estimate the amount of this reserve based on historical experience. Provisions for sales returns are charged against the related revenue items.

We maintain an allowance for doubtful accounts at an amount we estimate to be sufficient to provide adequate protection against losses resulting from extending credit to our customers. In judging the adequacy of the allowance for doubtful accounts, we consider multiple factors including historical bad debt experience, the general economic environment, the need for specific customer reserves and the aging of our receivables. Any necessary provision is reflected in general and administrative expense. A considerable amount of judgment is required in assessing these factors and if any receivables were to deteriorate, an additional provision for doubtful accounts could be required.

Valuation of long-lived and intangible assets and goodwill

We review identifiable intangible and other long-lived assets for impairment when events change or circumstances indicate the carrying amount may not be recoverable. Events or changes in circumstances that indicate the carrying amount may not be recoverable include, but are not limited to, a significant decrease in the market value of the business or asset acquired, a significant adverse change in the extent or manner in which the business or asset acquired is used or significant adverse change in the business climate. If such events or changes in circumstances occur, we use the undiscounted cash flow method to determine whether the asset is impaired. Cash flows would include the estimated terminal value of the asset and exclude any interest charges. To the extent that the carrying value of the asset exceeds the undiscounted cash flows over the estimated remaining life of the asset, we measure the impairment using discounted cash

flows. The discount rate utilized would be based on our best estimate of our risks and required investment returns at the time the impairment assessment is made.

In accordance with the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 142, Goodwill and Other Intangible Assets ("SFAS No. 142"), we test goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test compares the fair value of the reporting unit with its carrying amount. If the carrying amount exceeds its fair value, impairment is indicated. The impairment is measured as the excess of the recorded goodwill over its fair value, which could materially adversely impact our financial position and results of operations. All of the goodwill is assigned to a single reporting unit.

Stock-based compensation

Effective January 1, 2006, we adopted the provisions of the FASB's Statement No. 123 (revised 2004) "Share-Based Payment" ("SFAS No. 123(R)"), using the modified prospective application method. SFAS No. 123(R) replaced SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"). Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is the vesting period. Under the modified prospective application method, prior periods are not revised for comparative purposes. The provisions of SFAS No. 123(R) apply to grants made after the adoption date, and existing grants which were partially unvested at that date. Compensation expense for grants outstanding on the date of adoption will be recognized over the remaining service period using the grant date fair values and amortization methods determined previously for the SFAS No. 123 pro-forma disclosures.

Prior to January 1, 2006, we previously accounted for stock-based compensation under APB No. 25, which provided that no compensation expense should be recorded for stock options or other stock-based awards to employees that are granted with an exercise price that is equal to or greater than the estimated fair value per share of our common stock on the grant date of the award. Certain of our option grants were accounted for as variable awards under the provisions of APB No. 25, which required us to record deferred compensation, and recognize compensation expense over the requisite vesting period, for the difference between the exercise price and the fair market value of the stock at each reporting date.

The adoption of SFAS No. 123(R) resulted in the reclassification of $6.5 million of unamortized deferred compensation that had previously been subject to variable accounting under APB No. 25, and a nominal cumulative effect adjustment to apply and assumed forfeiture rate to expense previously taken on options unvested as of the date of adoption. The adoption of SFAS 123(R) did not cause us to modify any existing awards, change any terms of existing awards, or otherwise modify our share-based compensation plans.

The adoption of SFAS No. 123(R) had a material impact on our consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows. See Note 10 of our financial statements for further information regarding our stock-based compensation assumptions and expenses, including pro-forma disclosures for prior periods under the provisions of SFAS No. 123. No new stock options were issued in the quarters ended March 31, 2006 and March 31, 2005. The fair value of options issued in prior periods was determined using the Black-Scholes option-pricing model. The fair value of the restricted stock awards issued in the quarter ended March 31, 2006 was determined using the closing price of our shares as traded on the NASDAQ exchange on the day of grant. No restricted stock was issued in the quarter ended March 31, 2005.

We have separately disclosed stock-based compensation throughout this discussion and in our financial statements because, in managing our operations, we believe such costs significantly affect our ability to better understand and manage other operating expenses and cash needs.

Deferred taxes

We account for income taxes using the asset and liability approach as prescribed by SFAS No. 109, "Accounting for Income Taxes". This approach requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements or income tax returns. Using the enacted tax rates in effect for the year in which the differences are expected to reverse, deferred tax assets and liabilities are determined based on the differences between the financial reporting and the tax basis of an asset or liability. A valuation allowance is recorded when it is more likely than not that the deferred tax asset will not be realized.

Significant judgment is required in determining our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in a net deferred tax asset, which is included on our consolidated balance sheet. The final tax outcome of these matters might be different than that which is reflected in our historical income tax provisions, benefits and accruals. Any difference could have a material effect on our income tax provision and net income in the period in which such a determination is made.

Prior to October 13, 1999, we were organized as an S corporation under the Internal Revenue Code and, therefore, were not subject to federal income taxes. In addition, the Company was not subject to income tax in many of the states in which it operated as a result of its S corporation status. We historically made distributions to our stockholders to cover the stockholders' anticipated tax liability. In connection with the Recapitalization Agreement (See Note 1 to the financial statements), we converted our U.S. taxable status from an S corporation to a C corporation. Accordingly, since October 14, 1999 we have been subject to federal and state income taxes. Upon the conversion and in connection with the Recapitalization, we recorded a one-time benefit of $107.0 million to establish a deferred tax asset as a result of the Recapitalization Agreement.

We must assess the likelihood that the net deferred tax asset will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance, we must include an expense within the tax provision in the statement of operations. Except with respect to certain state income tax credits as discussed in the 2005 Form 10-K filing, we have not recorded a valuation allowance as of March 31, 2006 and December 31, 2005, because we expect to be able to utilize our entire net deferred tax asset. The ability to utilize our net deferred tax asset is solely dependent on our ability to generate future taxable income. Based on current estimates of revenue and expenses, we expect future taxable income will be more than sufficient to recover the annual amount of additional tax deductions permitted. Even if actual results are significantly below our current estimates, the recovery still remains likely and no valuation allowance would be necessary.

Significant judgment is required in determining the provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We record our tax provision at the anticipated tax rates based on estimates of annual pretax income. To the extent that the final results differ from these estimated amounts that were initially recorded, such differences will impact the income tax provision in the period in which such determination is made and could have an impact on the deferred tax asset. Our deferred tax assets and liabilities are recorded at an amount based upon a blended U.S. Federal income tax rate of 34.8%. This U.S. Federal income tax rate is based on our expectation that our deductible and taxable temporary differences will reverse over a period of years during which, except for 2006 due to anticipated stock option exercises and other reductions in income, we will have annual taxable income exceeding $10.0 million per year. If our results of operations fall below that threshold in the future, we will adjust our deferred tax assets and liabilities to an amount reflecting a reduced expected U.S. Federal income tax rate, consistent with the corresponding expectation of lower taxable income. If such change is determined to be appropriate, it will affect the provision for income taxes during the period that the determination is made.

Contingencies

We are subject to the possibility of various loss contingencies in the normal course of business. We accrue for loss contingencies when a loss is estimable and probable.

Results of operations

The following table sets forth our statements of operations data expressed as a percentage of total revenue for the periods indicated.

	Three months ended March 31,	
	2006	2005
Revenue		
License fees	16.5%	17.3%
Services	31.4	30.7
Maintenance	43.9	45.8
Subscriptions	5.3	3.9
Other revenue	2.9	2.3
Total revenue	100.0%	100.0%
Cost of revenue		
Cost of license fees	1.5	2.5
Cost of services	18.6	17.4
Cost of maintenance	7.3	7.1
Cost of subscriptions	1.2	1.1
Cost of other revenue	2.5	2.1
Total cost of revenue	31.1	30.2
Gross profit	68.9	69.8
Operating expenses		
Sales and marketing	21.2	20.8
Research and development	13.8	13.6
General and administrative	12.5	(10.8)
Amortization	0.3	0.0
Total operating expenses	47.8	23.6
Income from operations	21.1	46.2
Interest income	0.3	0.6
Interest expense	0.0	0.0
Other expense, net	0.0	(0.3)
Income before provision for income taxes	21.4	46.5
Income tax provision	8.4	17.5
Net income	13.0%	29.0%

Comparison of the three months ended March 31, 2006 and 2005

Revenue

First quarter of 2006 total revenue of $43.7 million increased by $6.3 million, or 16.8% compared with $37.4 million in the comparable period in 2005. The increase is due in part to growth in services and license fees to new and existing customers. Also contributing to the growth is revenue from new maintenance contracts associated with the license agreements and revenue from our subscription offerings.

License fees

We derive revenue from license fees by selling rights to use our software products, typically under a perpetual license agreement. Revenue from license fees of $7.2 million in the first quarter of 2006 increased by $0.7 million, or 10.8%, compared with $6.5 million in the comparable period in 2005. These amounts represent 16.5% and 17.3% of total revenue for the first quarter of 2006 and 2005, respectively. The increase in license fees in the three months ended March 31, 2006 is attributable to a $0.9 million increase in product sales to new customers and a $0.2 million decrease in product sales to our installed customer base. The license fees charged for our software products have remained unchanged for this period.

Of the overall $0.7 million increase in license fees, $0.4 million came from sales of our core product families and $0.3 million came from sales of our ticketing product.

Services

Revenue from services includes fees received from customers for consulting, installation, implementation, training, donor prospect research and data modeling services. First quarter revenue from services of $13.7 million in 2006 increased by $2.2 million, or 19.1% compared with $11.5 million in the first quarter of 2005. These amounts represent 31.4% and 30.7% of total revenue for the first quarter of 2006 and 2005, respectively. The revenue increase is principally the result of increased volume of services provided and to a lesser extent the result of rate increases in the second half of 2005. Consulting, installation, training and implementation services involve converting data from a customer's existing system, assistance in file set-up and system configuration, requisite product training, and/or process re-engineering. These services account for $12.5 million and $10.2 million in the first quarter of 2006 and 2005, respectively, representing 91.5% and 88.7%, respectively, of total services revenue. Donor prospect research and data modeling services involve the performance of assessments of customer donor (current and prospective) information, which enables the customer to more effectively target its fundraising activities. We perform these assessments using our proprietary analytical and data enrichment tools. These services account for $1.2 million and $1.3 million in the first quarter of 2006 and 2005, respectively, and represent 8.5% and 11.3%, respectively, of total services revenue for the first quarter.

Maintenance

Revenue from maintenance is comprised of annual fees derived from maintenance contracts associated with new software licenses and annual renewals of existing maintenance contracts. These contracts provide customers updates, enhancements, upgrades to our software products, and online, telephone and email support. Maintenance revenue of $19.2 million in the first quarter of 2006 increased $2.1 million, or 12.3%, compared with $17.1 million in the first quarter of 2005. These amounts represent 43.9% and 45.8% of our total revenue for the first quarter of 2006 and 2005, respectively. The increase in maintenance revenue in the first quarter of 2006 over the first quarter of 2005 is comprised of $2.2 million from new maintenance contracts associated with new license agreements, including new products, and $0.7 million from maintenance contract inflationary rate adjustments, offset by $0.8 million of maintenance contracts that were not renewed.

Subscriptions

Revenue from subscriptions is principally comprised of revenue from hosted fundraising software solutions, certain data services, our online subscription training offerings, and hosting of client internet sites. Subscriptions revenue of $2.3 million in the first quarter of 2006 increased $0.8 million, or 53.3%, compared with $1.5 million in the first quarter of 2005. These amounts represent 5.3% and 3.9% of our total revenue for the first quarter of 2006 and 2005, respectively. The increase in subscriptions revenue in the first quarter of 2006 over the first quarter of 2005 is comprised of a $0.3 million increase in our online tracking solutions, a $0.2 million increase in our online analytics products, a $0.2 million increase in our hosting activities, and a $0.1 million increase in our address change service.

Other revenue

Other revenue includes the sale of business forms that are used in conjunction with our software products; reimbursement of travel and related expenses, primarily incurred during the performance of services at customer locations; fees from user conferences; and sale of hardware in conjunction with The Patron Edge. Other revenue of $1.3 million in the first quarter of 2006 increased $0.4 million, or 44.4%, compared with $0.9 million in the first quarter 2005. These amounts represent 2.9% and 2.3% of our total revenue for the first quarter of 2006 and 2005, respectively. The increase in revenue is from higher reimbursable travel costs related to our services business.

Cost of revenue

Cost of license fees

Cost of license fees includes third-party software royalties, variable reseller commissions and costs of shipping software products to our customers. Cost of license fees of $0.7 million for the first quarter of 2006 decreased by $0.2 million, or 22.2%, compared with $0.9 million in the first quarter of 2005. These amounts represent 9.3% and 14.6% of license fee revenue in 2006 and 2005, respectively. Reseller commissions have declined by $0.3 million as a result of the discontinued use of those sales channels, partially offset by higher royalty payments from increased sales of Patron Edge, our ticketing software, which was developed by a third party.

Cost of services

Cost of services is principally comprised of salary and benefits, including stock-based compensation charges, third-party contractor expenses, data expenses and classroom rentals. Additionally, cost of services includes an allocation of facilities and depreciation expense and other costs incurred in providing consulting, installation, implementation, donor prospect research and data modeling services and customer training. Cost of services of $8.1 million in the first quarter of 2006, including $0.1 million in stock-based compensation, increased $1.6 million, or 24.6%, compared with $6.5 million in the first quarter of 2005, which included $0.1 million in stock-based compensation. Excluding stock-based compensation, these amounts represent 58.1% and 56.1% of total services revenue for the first quarter of 2006 and 2005, respectively. Compared with the first quarter of 2005, salary, benefit, and bonus expense increased $1.2 million. Travel expense in the first quarter of 2006 increased by $0.3 million compared with the same period in the prior year.

Further analysis of cost of services is provided below; however, the costs presented are before the inclusion of various allocable corporate costs and stock-based compensation. For a tabular presentation of the revenues and direct costs associated with our consulting and education services and analytic services operating segments, see Note 12 of the Notes to the unaudited consolidated financial statements.

Cost of revenue in providing consulting, installation, implementation, and customer training (consulting and education) was $7.2 million and $5.5 million in the first quarter of 2006 and 2005, respectively. These amounts represent 57.5% and 54.2% of the related revenue in the first quarters of 2006 and 2005, respectively. The increased cost of consulting and education services is primarily the result of a $1.3 million increase over the first quarter of 2005 for salary, benefit and bonus expense, as we added headcount to meet increased customer demand for these services.

Cost of revenue in providing donor prospect research and data modeling services (analytic services) was $0.9 million and $1.0 million in the first quarter of 2006 and 2005, respectively. These amounts represent 77.1% and 78.5% of related revenues for the first quarter of 2006 and 2005, respectively. The decreased expense of analytic services is due to a small reduction in salary, benefit and bonus expense of $0.1 million compared to the first quarter of 2005 due to a change in our method of allocation for some shared personnel.

Cost of maintenance

Cost of maintenance is primarily comprised of salary and benefits, including stock-based compensation, third-party contractor expenses, proprietary software and data expenses, an allocation of our facilities and depreciation expenses, and other costs incurred in providing support and services to our customers. Cost of maintenance of $3.2 million in the first quarter of 2006 increased $0.6 million, or 23.1%, compared with $2.6 million in the first quarter of 2005. Excluding stock-based compensation, these amounts represent 16.6% and 15.4% of maintenance revenue for the first quarter of 2006 and 2005, respectively. Compared with the first quarter of 2005, salary, benefit, and bonus expense increased $0.4 million due to increased headcount required to support the higher volumes of these services.

Cost of subscriptions

Cost of subscriptions is primarily comprised of salary and benefits, including stock-based compensation, proprietary software and data expenses, hosting expenses, an allocation of our facilities and depreciation expenses, and other costs incurred in providing support and services to our customers. Cost of subscriptions of $0.5 million in the first quarter of 2006 increased $0.1 million, or 25.0%, compared with $0.4 million in the first quarter of 2005. Excluding stock-based compensation, these amounts represent 23.2% and 28.3% of subscriptions revenue for the first quarter of 2006 and 2005, respectively. Compared with the first quarter of 2005, salary, benefit, and bonus expense increased $0.1 million in the first quarter of 2006.

Cost of other revenue

Cost of other revenue includes salaries and benefits, costs of business forms, hardware costs, reimbursable expenses relating to the performance of services at customer locations, and an allocation of facilities and depreciation expenses. Cost of other revenue of $1.1 million in the first quarter of 2006 increased $0.3 million, or 37.5%, compared with $0.8 million in the first quarter of 2005. These amounts represent 84.5% and 87.2% of other revenue for the first quarter of 2006 and 2005, respectively. Compared with the first quarter of 2005, billable travel costs increased $0.3 million in the first quarter of 2006.

Operating expenses

Sales and marketing

Sales and marketing expenses include salaries and related human resource costs of our sales and marketing organizations, travel and entertainment expenses, sales commissions, advertising and marketing materials, public relations, non-cash stock-based compensation charges, and an allocation of facilities and depreciation expenses. Sales and marketing costs increased $1.5 million, or 19.2%, from $7.8 million in the first quarter of 2005, including $0.1 million of stock-based compensation, to $9.3 million in the first quarter of 2006, including $0.2 million in stock-based compensation. Excluding stock-based compensation costs, sales and marketing expenses represent 20.7% and 20.5% of total revenue in the first quarter of 2006 and 2005, respectively. Compared with the first quarter of 2005, salary, benefit, and bonus expense increased $1.0 million due to increases in the size and skill set of our sales force. Additionally, we paid $0.3 million more in the first quarter of 2006 than the same period in 2005 related to higher commissionable sales, and incurred $0.2 million additional travel expenses.

Research and development

Research and development expenses include salaries and related human resource costs, third-party contractor expenses, software development tools, non-cash stock-based compensation charges, an allocation of facilities and depreciation expenses and other expenses in developing new products and upgrading and enhancing existing products. Research and development costs of $6.0 million in the first quarter of 2006, including $0.2 million of stock-based compensation, increased $0.9 million or 17.7% over first quarter 2005 costs of $5.1 million, including $0.1 million in stock-based compensation. Excluding stock-based compensation costs, research and development expenses represented 13.3% and 13.5% of total revenue in the first quarter of 2006 and 2005, respectively. Compared with the first quarter of 2005, salary, benefit, and bonus expense increased $0.6 million as a result of headcount increases to support enhancements to our existing products and development of new product offerings, and were coupled with $0.2 million increase in offshore development and other costs.

General and administrative

General and administrative expenses consist primarily of salaries and related human resource costs for general corporate functions, including finance, accounting, legal, human resources, senior executives, facilities and corporate development; third-party professional fees; offering costs; bad debt; insurance; non-cash stock-based compensation charges; and other administrative expenses. General and administrative expenses were $5.5 million in the first quarter of 2006, including $1.4 million of stock-based compensation expense. In the first quarter of 2005, we showed a net benefit of $4.0 million in general and administrative expenses due to a stock-based compensation benefit of $7.9 million. Excluding stock-based compensation, our first quarter 2006 general and administrative expenses of $4.1 million increased by $0.3 million, or 7.9%, over the first quarter of 2005 expense of $3.8 million. Excluding the stock-based compensation expense, general and administrative expenses represent 9.3% and 10.3% of total revenue in the first quarter of 2006 and 2005, respectively. The increase in general and administrative costs in absolute dollars is principally due to $0.4 million in increased salary, benefit and bonus expense as we increased headcount in support of our growth, coupled with $0.2 million in increased expenses associated with operating as a public company, offset by lower professional fees and other administrative costs.

Stock-based compensation

Beginning on January 1, 2006, we adopted SFAS No. 123(R), using the modified prospective transition method. The adoption of SFAS No. 123(R) had a significant impact on our results of operations. Our consolidated statements of operations for the three months ended March 31, 2006 and 2005 includes $2.0 million of stock-based compensation expense and $7.6 million of stock-based compensation benefit, respectively, illustrated below:

(in thousands)	Three months ended March 31, 2006	Three months ended March 31, 2005
Cost of services	$ 140	$ 91
Cost of maintenance	29	11
Cost of subscriptions	4	—
Sales and marketing	220	74
Research and development	191	55
General and administrative	1,390	(7,871)
Total expense (benefit)	$ 1,974	$ (7,640)

Prior to the adoption of SFAS No. 123(R), we accounted for options under APB No. 25. Because of certain provisions in certain of the option agreements, we were required to account for these options under variable accounting. Variable accounting required marking these options to the market price on the reporting date and recognizing a corresponding expense or benefit in our financial statements. The net stock-based compensation benefit for the three months ended March 31, 2005 was principally the result of marking to market the 3.5 million options held by our former CEO from the closing price of $14.64 per share at December 31, 2004 to the closing price of $12.60 per share at March 31, 2005; this resulted in a stock-based compensation benefit of $7.9 million. Offsetting this amount was stock-based compensation expense of approximately $0.3 million related to amortization of deferred compensation associated with options held by employees, previously subject to variable accounting, which became fixed upon completion of the initial public offering.

We have separately disclosed stock-based compensation throughout this discussion and in our financial statements and we have shown a reconciliation of stock-based compensation as it relates to all affected categories of expenses above. We have discussed our segment costs on a basis excluding stock-based compensation, because we believe this presentation allows investors better understandability and comparability of our operating expenses. Had stock-based compensation been included in each segment discussed above, the results as a percentage of segment revenue and as a percentage of total revenue would have been as follows:

	First quarter 2006			First quarter 2005		
	Without stock-based compensation	Impact of stock-based compensation	With stock-based compensation	Without stock-based compensation	Impact of stock-based compensation	With stock-based compensation
(as a percentage of segment revenue)						
Cost of license fees	9.3%	—%	9.3%	14.6%	—%	14.6%
Cost of services	58.1	1.0	59.1	56.1	0.8	56.9
Cost of maintenance	16.6	0.1	16.7	15.4	—	15.4
Cost of subscriptions	23.2	0.2	23.4	28.3	—	28.3
Cost of other revenue	84.5	—	84.5	87.2	—	87.2
(as a percentage of total revenue)						

Sales and marketing	20.7%	0.5%	21.2%	20.5%	0.3%	20.8%
Research and development	13.3	0.5	13.8	13.5	0.1	13.6
General and administrative	9.3	3.2	12.5	10.3	(21.1)	(10.8)

Interest expense

Our only interest expense during the first quarters of 2006 and 2005 was solely related to the amortization of deferred financing fees associated with our revolving credit facility which we had not utilized as of March 31, 2006.

Other expense, net

Other expense consists of foreign exchange gains and losses and miscellaneous non-operating income and expense items. Other expense, from foreign exchange activity, was nominal in the first quarter of 2006 compared to a loss of $0.1 million in the same period of 2005.

Income tax provision

We record income tax expense in our consolidated financial statements based on an estimated annual effective income tax rate. Based on our current assessment of our tax position, we expect an annual effective tax rate of 39.4% in 2006, which has been used in the period ended March 31, 2006. We had an effective tax rate of 28.6% in 2005, which differed from our quarterly rates due to the booking of estimated tax credits and offsetting valuation allowances in certain quarters. The effective tax rate for the period ended March 31, 2005 was 37.6%.

Significant judgment is required in determining the provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We account for income taxes using the asset and liability approach as prescribed by SFAS No. 109, "Accounting for Income Taxes". This approach requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements or income tax returns. Using the enacted tax rates in effect for the year in which the differences are expected to reverse, deferred tax assets and liabilities are determined based on the differences between the financial reporting and the tax basis of an asset or liability. A valuation allowance is recorded when it is more likely than not that the deferred tax asset will not be realized. If a change in the effective tax rate to be applied to the timing differences or a change in a valuation reserve is determined to be appropriate, it will affect the provision for income taxes during the period that the determination is made.

Our deferred tax assets and liabilities are recorded at an amount based upon a blended U.S. Federal income tax rate of 34.8%. This U.S. Federal income tax rate is based on our expectation that our deductible and taxable temporary differences will reverse over a period of years during which, except for 2006 due to anticipated stock option exercises and other reductions in income, we will have annual taxable income exceeding $10.0 million per year. If our results of operations fall below that threshold in the future, we will adjust our deferred tax assets and liabilities to an amount reflecting a reduced expected U.S. Federal income tax rate, consistent with the corresponding expectation of lower taxable income. If such change is determined to be appropriate, it will affect the provision for income taxes during the period that the determination is made.

Liquidity and capital resources

At March 31, 2006, cash and cash equivalents totaled $16.5 million, compared to $22.7 million at December 31, 2005. The $6.2 million decrease in cash and cash equivalents during the first three months of 2006 is principally the result of $6.3 million used to purchase our stock, $6.1 million used in the acquisition of Campagne Associates and $3.0 million in dividends paid to stockholders, partially offset by $6.2 million in proceeds and tax benefits from the exercise of stock options and $3.3 million of cash generated from operations.

On September 30, 2004, we closed a new $30.0 million revolving credit facility, which replaced our prior $15.0 million revolving credit facility that was terminated in July 2004. Amounts borrowed under this facility are available for working capital and general corporate purposes. No amounts were drawn under the facility at closing and there is no outstanding balance as of the date of this filing. Amounts borrowed under the new $30.0 million revolving credit facility bear interest, at our option, at a variable rate based on either the prime rate, federal funds rate or LIBOR plus a margin of between 0.5% and 2.0% based on our consolidated leverage ratio. Amounts outstanding under the new facility are guaranteed by our operating subsidiaries and the facility is subject to restrictions on certain types of transactions and certain covenants including a maximum leverage ratio, minimum interest coverage ratio and minimum net worth. Additionally, the credit facility restricts our ability to declare and pay dividends and repurchase our common stock. When there are no outstanding amounts under the credit facility, we may pay dividends to stockholders and/or repurchase our common stock in an aggregate amount of up to 100% of cash on hand as of the most recent fiscal quarter end. When there are

outstanding amounts under the credit facility, we may pay dividends and/or repurchase our common stock in an aggregate amount of up to (1) 35% of cash on hand as of the most recent fiscal quarter end, if the ratio of total indebtedness to EBITDA (as calculated under the credit facility) as of the most recent quarter end is less than 1.00 to 1.00, or (2) 25% of cash on hand as of the most recent fiscal quarter end, if such ratio is equal to or greater than 1.00 to 1.00. Additionally, in order to pay dividends and/or repurchase our common stock, we must be in compliance with the credit facility, including each of the financial covenants and we must have cash on hand of at least $3,000,000, each after giving effect to the payment of dividends and/or the repurchase of our common stock. The credit facility has a three-year term expiring September 30, 2007.

Our principal source of liquidity is our operating cash flow, which depends on continued customer renewal of our maintenance and support agreements and market acceptance of our products and services. Based on current estimates of revenue and expenses, we believe that the currently available sources of funds and anticipated cash flows from operations will be adequate to finance our operations and anticipated capital expenditures for the foreseeable future. Dividend payments are not guaranteed and our board of directors may decide, in its absolute discretion, at any time and for any reason, not to declare or pay further dividends and/or repurchase our common stock.

Operating cash flow

Net cash provided by operating activities of $3.3 million in the three-month period ended March 31, 2006 decreased by $4.1 million, or 55.4% compared with $7.4 million reported in the three-month period ended March 31, 2005. Throughout both periods, our cash flows from operations were derived principally from: (i) our earnings from on-going operations prior to non-cash (benefits) expenses such as depreciation and amortization; (ii) the tax benefit associated with our deferred tax asset, which reduces our cash outlay for income tax expense; (iii) adjustments to our provision for sales returns and allowances; and (iv) changes in our working capital, which are primarily composed of net collections of accounts receivable and increases in deferred revenue (collectively representing an increase in working capital of $1.4 million in the first three months of 2006 and $0.2 million decrease in the first three months of 2005), together with changes in our balances of accounts payable, accrued expenses, accrued liabilities and other current assets (collectively representing an increase in working capital of $5.9 million and $5.5 million in the three-month periods ended March 31, 2006 and 2005, respectively) due to timing of payments. In addition, under the modified prospective method of implementing SFAS 123(R), which we adopted in the first quarter of 2006, the tax benefits on the exercise of stock options are shown as a financing inflow rather than as an operating inflow in the current quarter. However, as required under that transition method, prior periods are not restated to conform to the current presentation.

Investing cash flow

Net cash used in the three-month period ended March 31, 2006 for investing activities was $6.3 million compared to $0.1 million of net cash used in investing activities during the three-month period ended March 31, 2005. The increase is principally due to the acquisition of Campagne Associates, a New Hampshire-based provider of fundraising software in January 2006. Along with assets acquired and liabilities assumed based on their estimated fair values, we also acquired an identifiable intangible asset consisting of several items, including existing customer relationships, software, non-compete agreements and the trade name of their primary product.

Financing cash flow

Net cash used in financing activities for the three-month period ended March 31, 2006 was $3.1 million, comprised of $6.3 million for purchases of our stock and a dividend payment of $3.0 million to stockholders, offset by proceeds of $3.3 million from the exercise of stock options and $2.9 million of tax benefits on those exercises. Comparatively, net cash used in financing activities for the three-month period ended March 31, 2005 was $6.1 million, comprised of $8.0 million for purchases of our stock and a dividend payment of $2.2 million to stockholders, offset by proceeds of $4.1 million from the exercise of stock options.

Commitments and contingencies

As of March 31, 2006, we had no outstanding debt.

At March 31, 2006 we had future minimum lease commitments of $22.2 million as follows (amounts in thousands):

	Payments due by period				
	2006	2007	2008-2009	2010 and after	Totals
Operating leases	$ 3,890	$ 4,927	$ 10,180	$ 3,153	$ 22,150

These commitments have not been reduced by the future minimum lease commitments under various sublease agreements extended through 2008.

In addition, we have a commitment of $200,000 payable annually through 2009 for certain naming rights on a stadium in Charleston, South Carolina. We incurred expense under this agreement of $50,000 for each of the three-month periods ended March 31, 2006 and 2005.

We utilize third party relationships in conjunction with our products. The contractual arrangements vary in length from one to three years. In certain cases, these arrangements require a minimum annual purchase commitment. The total minimum purchase commitment under these arrangements is approximately $0.5 million through 2008. We incurred expense under these arrangements of $129,000 and $224,000 for the three months ended March 31, 2006 and 2005, respectively.

Foreign currency exchange rates

Approximately 11.9% of our total net revenue for the three-month period ended March 31, 2006 was derived from operations outside the United States. We do not have significant operations in countries in which the economy is considered to be highly inflationary. Our financial statements are denominated in U.S. dollars and, accordingly, changes in the exchange rate between foreign currencies and the U.S. dollar will affect the translation of our subsidiaries' financial results into U.S. dollars for purposes of reporting our consolidated financial results. The accumulated currency translation adjustment, recorded as a separate component of stockholders' equity, was $0.1 million at both March 31, 2006 and 2005.

The vast majority of our contracts are entered into by our U.S. or U.K. entities. The contracts entered into by the U.S. entity are almost always denominated in U.S. dollars and contracts entered into by our U.K. subsidiary are generally denominated in pounds sterling. In recent years, the U.S. dollar has weakened against many non-U.S. currencies, including the pound. During this period, our revenues generated in the United Kingdom have increased. Though we do not believe our increased exposure to currency exchange rates has had a material impact on our results of operations or financial position, we intend to continue to monitor such exposure and take action as appropriate.

Cautionary statement

We operate in a highly competitive environment that involves a number of risks, some of which are beyond our control. The following statement highlights some of these risks.

Statements contained in this Form 10-Q, which are not historical facts, are or might constitute forward-looking statements under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Although we believe the expectations reflected in such forward-looking statements are based on reasonable assumptions, we can give no assurance that our expectations will be attained. Forward-looking statements involve known and unknown risks that could cause actual results to differ materially from expected results. Factors that could cause actual results to differ materially from our expectations expressed in the report include, among others: the ability to attract and retain key personnel; risks associated with our dividend policy and stock repurchase programs; continued success in sales growth; adoption of our products and services by nonprofits; uncertainty regarding increased business and renewals from existing customers; risk associated with product concentration; lengthy sales and implementation cycles; economic conditions and seasonality; competition; risks associated with management of growth; risks associated with acquisitions; technological changes that make our products and services less competitive; and the other risk factors set forth from time to time in our SEC filings.

New accounting pronouncements

In June 2005, the FASB issued SFAS Statement No. 154 "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements" ("SFAS No. 154"). SFAS No. 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements. We do not believe the adoption of SFAS No. 154 will have a material effect on our financial statements.

The American Jobs Creation Act of 2004 (the "AJCA") was enacted on October 22, 2004. The AJCA repeals an export incentive, creates a new deduction for qualified domestic manufacturing activities and includes a special one-time

deduction of 85% of certain foreign earnings repatriated to the U.S. In December 2004, the FASB issued FASB Staff Position No. 109-1, "Application of FASB Statement No. 109 ("SFAS 109"), Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" ("FSP 109-1"). FSP 109-1 clarifies that the manufacturer's deduction provided for under the AJCA should be accounted for as a special deduction in accordance with SFAS 109 and not as a tax rate reduction. While we expect to be able to qualify for the new tax deduction in future years, due to a projected tax loss we do not expect to qualify for the deduction in 2006. We have not completed the process of evaluating the impact in future years of adopting FAS 109-1 and are therefore unable to disclose the effect that adopting FSP 109-1 will have on our financial statements.

The FASB also issued FASB Staff Position No. 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" ("FSP 109-2"). The AJCA introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FSP 109-2 provides accounting and disclosure guidance for the repatriation provision. We did not make any repatriation of foreign earnings that qualified for this special tax treatment and the adoption of FSP 109-2 will have no effect on our financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Due to the nature of our short-term investments and our lack of material debt, we have concluded that we currently face no material interest risk exposure. Therefore, no quantitative tabular disclosures are required. For further discussion, see the "Foreign currency exchange rates" section beginning on page 26.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) are designed only to provide reasonable assurance that they will meet their objectives. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e)) pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to provide the reasonable assurance discussed above.

Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

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

(a) Information about shares of common stock repurchased during the first quarter of 2006 under our stock repurchase program announced on July 26, 2005 appears in the table below.

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plans or programs	(d) Approximate dollar value of shares that may yet be purchased under the plan or programs (1)
January 1, 2006 through January 31, 2006	254,300	$ 16.92	254,300	$23,729,631
February 1, 2006 through February 28, 2006	110,300	$ 17.68	110,300	$21,779,841
March 1, 2005 through March 31, 2006	—	—	—	$21,779,841
Total	364,600	$ 17.15	364,600	$21,779,841

(1) On July 26, 2005, our Board of Directors approved a stock repurchase program that authorizes us to repurchase up to $35.0 million of our outstanding shares of common stock. The shares may be purchased in conjunction with a public offering of our common stock, from time to time on the open market or in privately negotiated transactions depending upon market condition and other factors, all in accordance with the requirements of applicable law. There is no set termination date for this repurchase program.

Item 6. Exhibits

Exhibits:

31.1 Certification by the Chief Executive Officer pursuant to Section 240.13a-14 or section 240.15d-14 of the Securities and Exchange Act of 1934, as amended.

31.2 Certification by the Chief Financial Officer pursuant to Section 240.13a-14 or section 240.15d-14 of the Securities and Exchange Act of 1934, as amended.

32.1 Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification by the Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

		BLACKBAUD, INC.
Date: May 10, 2006	By:	/s/ Marc E. Chardon
		Marc E. Chardon President and Chief Executive Officer
Date: May 10, 2006	By:	/s/ Timothy V. Williams
		Timothy V. Williams Vice President and Chief Financial Officer

EXHIBIT 31.1

CERTIFICATION

I, Marc E. Chardon, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Blackbaud, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2006

By: /s/ Marc E. Chardon
Marc E. Chardon
President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

I, Timothy V. Williams, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Blackbaud, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
   b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2006

By: /s/ Timothy V. Williams
Timothy V. Williams
Vice President and Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Blackbaud, Inc. (the "Company") for the period ended March 31, 2006 as filed with the Securities and Exchange Commission on or about the date hereof (the "Report"), I, Marc E. Chardon, President and Chief Executive Officer, hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Report.

Date: May 10, 2006

By: /s/ Marc E. Chardon
Marc E. Chardon
President and Chief Executive Officer

EXHIBIT 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Blackbaud, Inc. (the "Company") for the period ended March 31, 2006 as filed with the Securities and Exchange Commission on or about the date hereof (the "Report"), I, Timothy V. Williams, Vice President and Chief Financial Officer, hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Report.

Date: May 10, 2006

By: /s/ Timothy V. Williams
Timothy V. Williams
Vice President and Chief Financial Officer