EVOLVING SYSTEMS INC
Form 10-Q
August 06, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x	**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
	For the quarterly period ended June 30, 2008
	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: 0-24081

EVOLVING SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**84-1010843**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
9777 Pyramid Court, Suite 100 Englewood, Colorado	**80112**
(Address of principal executive offices)	(Zip Code)

(303) 802-1000

(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 x No o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of July 28, 2008 there were 19,383,018 shares outstanding of Registrant s Common Stock (par value $0.001 per share).

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EVOLVING SYSTEMS, INC.

Quarterly Report on Form 10-Q

June 30, 2008

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands except share data)

(unaudited)

	June 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,249	$ 7,271
Contract receivables, net of allowance of $36 at June 30, 2008 and $66 at December 31, 2007	6,004	10,959
Unbilled work-in-progress	1,261	922
Deferred income taxes	4	4
Prepaid and other current assets	1,752	1,331
Total current assets	16,270	20,487
Property and equipment, net	1,501	1,677
Amortizable intangible assets, net	3,920	4,687
Goodwill	26,398	26,417
Long-term restricted cash	100	100
Other long-term assets	308	359
Total assets	$ 48,497	$ 53,727
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of capital lease obligations	$ 20	$ 20
Current portion of long-term debt	2,000	2,500
Accounts payable and accrued liabilities	5,420	5,903
Deferred income taxes	30	34
Unearned revenue	8,829	10,635
Total current liabilities	16,299	19,092
Long-term liabilities:		
Capital lease obligations, net of current portion	71	79
Other long-term obligations	1,042	1,477
Long-term debt, net of current portion	5,883	8,686
Deferred foreign income taxes	753	878
Total liabilities	24,048	30,212
Commitments and contingencies (Note 10)		
Series B convertible redeemable preferred stock		5,587

Stockholders equity:				
Preferred stock, $0.001 par value; 2,000,000 shares authorized; 0 and 478,750 shares of Series B issued and outstanding as of June 30, 2008 and December 31, 2007, respectively (shown above)				
Common stock, $0.001 par value; 40,000,000 shares authorized; 19,373,507 and 17,914,770 shares issued and outstanding as of June 30, 2008 and December 31, 2007, respectively		19		18
Additional paid-in capital		81,395		75,317
Accumulated other comprehensive income		2,055		2,144
Accumulated deficit		(59,020)		(59,551)
Total stockholders equity		24,449		17,928
Total liabilities and stockholders equity	$	48,497	$	53,727

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

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EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands except per share data)

(unaudited)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
REVENUE				
License fees and services	$ 5,342	$ 4,742	$ 10,174	$ 8,733
Customer support	4,303	4,380	8,598	8,850
Total revenue	9,645	9,122	18,772	17,583
COSTS OF REVENUE AND OPERATING EXPENSES				
Costs of license fees and services, excluding depreciation and amortization	1,902	1,941	4,126	3,865
Costs of customer support, excluding depreciation and amortization	1,632	1,716	3,125	3,209
Sales and marketing	2,194	2,186	4,381	4,225
General and administrative	1,236	1,648	2,661	3,199
Product development	950	358	2,018	907
Depreciation	252	252	482	540
Amortization	379	392	759	780
Restructuring and other expense (recovery)				(1)
Total costs of revenue and operating expenses	8,545	8,493	17,552	16,724
Income from operations	1,100	629	1,220	859
Other income (expense):				
Interest income	39	81	117	145
Interest expense	(283)	(451)	(619)	(915)
Gain (loss) on extinguishment of debt			(290)	42
Foreign currency exchange gain (loss)	32	(104)	142	(162)
Other expense, net	(212)	(474)	(650)	(890)
Income (loss) before income taxes	888	155	570	(31)
Income tax expense	113	83	39	223
Net income (loss)	$ 775	$ 72	$ 531	$ (254)
Basic and diluted income (loss) per common share	$ 0.04	$ 0.00	$ 0.03	$ (0.01)
Weighted average basic shares outstanding	19,374	19,180	19,368	19,167
Weighted average diluted shares outstanding	19,845	19,604	19,840	19,167

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

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EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

AND COMPREHENSIVE INCOME

(in thousands, except share data)

(unaudited)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders Equity
	Shares	Amount				
Balance at December 31, 2007	17,914,770	$ 18	$ 75,317	$ 2,144	$ (59,551)	$ 17,928
Common stock issued pursuant to the Employee Stock Purchase Plan	22,487		36			36
Stock-based compensation expense			456			456
Preferred stock conversion	1,436,250	1	5,586			5,587
Comprehensive income:						
Net income					531	
Foreign currency translation adjustment				(89)		
Comprehensive income						442
Balance at June 30, 2008	19,373,507	$ 19	$ 81,395	$ 2,055	$ (59,020)	$ 24,449

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

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EVOLVING SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 531	$ (254)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	482	540
Amortization of intangible assets	759	780
Amortization of debt issuance costs	78	125
Equity compensation	456	381
Gain on disposal of property and equipment		(1)
(Gain) loss on extinguishment of debt	290	(42)
Foreign currency transaction (gains) losses, net	(142)	162
Benefit from foreign deferred income taxes	(127)	(65)
Change in operating assets and liabilities:		
Contract receivables	5,054	4,502
Unbilled work-in-progress	(339)	109
Prepaid and other current assets	(479)	(16)
Accounts payable and accrued liabilities	(386)	197
Unearned revenue	(1,807)	(657)
Other	(433)	343
Net cash provided by operating activities	3,937	6,104
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(393)	(322)
Reduction in restricted cash		200
Proceeds from sale of property and equipment		1
Earnout payments from business combinations		(24)
Net cash used in investing activities	(393)	(145)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Capital lease payments	(9)	(12)
Principal payments on long-term debt	(7,298)	(1,141)
Proceeds from issuance of long-term debt	4,000	
Payments for debt issuance costs	(282)	
Proceeds from issuance of common stock	36	55
Net cash used in financing activities	(3,553)	(1,098)
Effect of foreign exchange rate changes on cash	(13)	(39)
Net increase (decrease) in cash and cash equivalents	(22)	4,822
Cash and cash equivalents at beginning of period	7,271	5,076
Cash and cash equivalents at end of period	$ 7,249	$ 9,898

Supplemental disclosure of other cash and non-cash transactions:

Interest paid	$	1,095	$	460
Income taxes paid	$	294	$	27
Conversion of preferred stock into common stock	$	5,587	$	5,389

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

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EVOLVING SYSTEMS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

Organization We are a provider of software solutions and services to the wireless, wireline and IP carrier markets with long-standing relationships with many of the largest carriers worldwide. Our customers rely on us to develop, deploy, enhance, maintain and integrate complex, highly reliable software solutions for a range of Operations Support Systems (OSS). We offer software products and solutions in three core areas: service activation solutions used to activate complex bundles of voice, video and data services for traditional and next generation wireless and wireline networks; numbering solutions that enable carriers to comply with government-mandated requirements regarding number portability as well as providing phone number management and assignment capabilities; and mediation solutions supporting data collection for both service assurance and billing applications.

Interim Consolidated Financial Statements The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X and the related rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, we believe that the disclosures included in these financial statements are adequate to make the information presented not misleading. The unaudited condensed consolidated financial statements included in this document have been prepared on the same basis as the annual consolidated financial statements, and in our opinion, reflect all adjustments, which include normal recurring adjustments necessary for a fair presentation in accordance with GAAP and SEC regulations for interim financial statements. The results for the three and six months ended June 30, 2008 are not necessarily indicative of the results that we will have for any subsequent period. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes to those statements for the year ended December 31, 2007 included in our Annual Report on Form 10-K.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. We made estimates with respect to revenue recognition for estimated hours to complete projects accounted for using the percentage of completion method, allowance for doubtful accounts, income tax valuation allowance, fair values of long-lived assets, valuation of intangible assets and goodwill, useful lives for property, equipment and intangible assets, business combinations, capitalization of internal software development costs and fair value of stock-based compensation amounts. Actual results could differ from these estimates.

Foreign Currency Translation Our functional currency is the U.S. dollar. The functional currency of our foreign operations, generally, is the respective local currency for each foreign subsidiary. Assets and liabilities of foreign operations denominated in local currencies are translated at the spot rate in effect at the applicable reporting date. Our consolidated statements of operations are translated at the weighted average rate of exchange during the applicable period. The resulting unrealized cumulative translation adjustment, net of applicable income taxes, is recorded as a component of accumulated other comprehensive income (loss) in stockholders equity. Realized and unrealized transaction gains and losses generated by transactions denominated in a currency different from the functional currency of the applicable entity are recorded in other income (loss) in the period in which they occur.

Principles of Consolidation The consolidated financial statements include the accounts of Evolving Systems and subsidiaries, all of which are wholly owned. All significant intercompany transactions and balances have been eliminated in consolidation.

Goodwill Goodwill is the excess of acquisition cost of an acquired entity over the fair value of the identifiable net assets acquired. Goodwill is not amortized, but tested for impairment annually or whenever indicators of impairment exist. These indicators may include a significant change in the business climate, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business or other factors. For purposes of the goodwill evaluation, we compare the fair value of each of our reporting units to its respective carrying amount. If the carrying value of a reporting unit were to exceed its fair value, we would then compare the fair value of the reporting unit s goodwill to its carrying amount, and any excess of the carrying amount over the fair value would be charged to operations as an impairment loss.

Intangible Assets Amortizable intangible assets consist primarily of purchased software and licenses, customer contracts and relationships, trademark and tradenames, and business partnerships acquired in conjunction with our purchases of CMS Communications, Inc. (CMS), Telecom Software Enterprises, LLC (TSE) and Tertio Telecoms Ltd. (Evolving Systems U.K.). These finite life assets are amortized using the straight-line method over their estimated lives.

We assess the impairment of identifiable intangibles if events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. Factors that we consider significant which could trigger an impairment analysis include the following:

- Significant under-performance relative to historical or projected future operating results;

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- Significant changes in the manner of use of the acquired assets or the strategy of the overall business;

- Significant negative industry or economic trends; and/or

- Significant decline in our stock price for a sustained period.

If, as a result of the existence of one or more of the above indicators of impairment, we determine that the carrying value of intangibles and/or long-lived assets may not be recoverable, we compare the estimated undiscounted cash flows expected to result from the use of the asset and its eventual disposition to the asset s carrying amount. If an amortizable intangible or long-lived asset is not deemed to be recoverable, we will recognize an impairment loss representing the excess of the asset s carrying value over its estimated fair value.

Revenue Recognition We recognize revenue from two primary sources: license fees and services, and customer support, in accordance with Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended and interpreted by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, provides further interpretive guidance for public companies on the recognition, presentation and disclosure of revenue in financial statements. In addition to the criteria described below, we generally recognize revenue when an agreement is signed, the fee is fixed or determinable and collectibility is reasonably assured.

The majority of our license fees and services revenue is generated from fixed-price contracts, which provide for licenses to our software products and services to customize such software to meet our customers use. When the services are determined to be essential to the functionality of the delivered software, we recognize revenue using the percentage-of-completion method of accounting, in accordance with SOP 97-2 and SOP 81-1, Accounting for Long-Term Construction Type Contracts. The percentage of completion for each contract is estimated based on the ratio of direct labor hours incurred to total estimated direct labor hours. Since estimated direct labor hours, and changes thereto, can have a significant impact on revenue recognition, these estimates are critical and are reviewed regularly. Amounts billed in advance of services being performed are recorded as unearned revenue. Unbilled work-in-progress represents revenue earned but not yet billable under the terms of the fixed-price contracts. All such amounts are expected to be billed and collected within 12 months.

We may encounter budget and schedule overruns on fixed price contracts caused by increased labor or overhead costs. Adjustments to cost estimates are made in the periods in which the facts requiring such revisions become known. Estimated losses, if any, are recorded in the period in which current estimates of total contract revenue and contract costs indicate a loss.

In arrangements where the services are not essential to the functionality of the software, we recognize license revenue upon delivery. To the extent that Vendor-Specific Objective Evidence (VSOE) of the fair value of undelivered elements exists, fees from multiple element arrangements are unbundled and recorded as revenue as the elements are delivered. If VSOE for the undelivered elements does not exist, fees from such arrangements are deferred until the earlier of the date that VSOE does exist on the undelivered elements or all of the elements have been delivered.

We recognize services revenue from fixed-price contracts using the proportional performance method of accounting, which is similar to the percentage of completion method described above. Revenue from professional services provided pursuant to time-and-materials based contracts and training services are recognized as the services are performed, as that is when our obligation to our customers under such arrangements is fulfilled.

We recognize customer support, including maintenance revenue, ratably over the service contract period. When maintenance is bundled with the original license fee arrangement, its fair value, based upon VSOE, is deferred and recognized during the periods when services are provided.

Stock-based Compensation We account for stock-based compensation under Statement of Financial Accounting Standards No. 123(Revised), Share-Based Payment (SFAS 123R). This statement replaced SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123) and superseded APB Opinion No. 25, Accounting for Stock Issued to Employees. Under SFAS 123R, we apply a fair-value-based measurement method to account for share-based payment transactions with employees and directors and record compensation cost for all stock awards granted after January 1, 2006 and awards modified, repurchased, or cancelled after that date. In addition, we record compensation costs associated with the vesting of unvested options outstanding at January 1, 2006 using the guidance under SFAS 123. Stock-based compensation is a non-cash expense because we settle these obligations by issuing shares of our common stock instead of settling such obligations with cash payments. We recognized compensation cost for options on a straight-line basis over the vesting period using an estimated forfeiture rate. Effective January 1, 2006, stock option grants and employee stock purchase plan purchases were accounted for under SFAS 123R. We used the Black-Scholes model to estimate the fair value of each option grant on the date of grant. This model requires the use of estimates for expected term of the options and expected volatility of the price of our common stock.

Reclassifications Certain prior period balances have been reclassified to conform to the current year s presentation.

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Recent Accounting Pronouncements In December 2007, the SEC issued Staff Accounting Bulletin 110, *Share-Based Payment* (SAB 110), which amends Staff Accounting Bulleting 107 (SAB 107), *Share-Based Payment*, to permit public companies, under certain circumstances, to use the simplified method of SAB 107 for employee option grants after December 31, 2007. Use of the simplified method after December 31, 2007 is permitted only for companies whose historical data about their employees exercise behavior does not provide a reasonable basis for estimating the expected term of the options. We currently use the simplified method to estimate expected term for employee option grants as adequate historical experience is not available to provide a reasonable estimate. SAB 110 is effective for employee options granted after December 31, 2007. We adopted SAB 110 effective January 1, 2008 and will continue to apply the simplified method until adequate historical experience is readily available to provide a reasonable estimate of the expected term for employee option grants.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 permits entities to choose to measure eligible items at fair value at specific election dates (the fair value option). Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting period. This accounting standard is effective for us beginning January 1, 2008. We have elected not to apply the fair value option allowed under SFAS 159.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. In February 2008, the FASB issued Staff Position No. 157-2, which delayed the effective date of SFAS 157 to fiscal years ending after November 15, 2008 for non-financial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption of SFAS 157 did not have a material effect on our consolidated financial statements.

NOTE 2 GOODWILL AND INTANGIBLE ASSETS

We recorded goodwill as a result of three acquisitions which occurred over the period from November 2003 to November 2004. We acquired CMS in November 2003, TSE in October 2004 and Evolving Systems U.K. in November 2004.

Changes in the carrying amount of goodwill by reporting unit are as follows (in thousands):

	License and Services		Customer Support		Total
	U.S.	U.K.	U.S.	U.K.	Goodwill
Balance as of December 31, 2007	$	$ 9,118	$ 6,033	$ 11,266	$ 26,417
Effects of changes in foreign currency exchange rates		(8)		(11)	(19)
Balance as of June 30, 2008	$	$ 9,110	$ 6,033	$ 11,255	$ 26,398

We conducted our annual goodwill impairment test as of July 31, 2007, and we determined that goodwill was not impaired as of the test date. From July 31, 2007 through June 30, 2008, no events have occurred that we believe may have impaired goodwill.

Identifiable intangible assets are amortized on a straight-line basis over estimated lives ranging from one to seven years and include the cumulative effects of foreign currency exchange rates. As of June 30, 2008 and December 31, 2007, identifiable intangibles are as follows (in thousands):

	June 30, 2008			December 31, 2007			
	(1) Gross Amount	Accumulated Amortization	Net Carrying Amount	Gross Amount	Accumulated Amortization	Net Carrying Amount	Weighted-Average Amortization Period
Purchased software	$ 2,070	$ 929	$ 1,141	$ 2,072	$ 700	$ 1,372	4.7 yrs
Purchased licenses	227	194	33	227	146	81	2.3 yrs
Trademarks and tradenames	895	256	639	896	192	704	7.0 yrs
Business partnerships	146	58	88	146	44	102	5.0 yrs
Customer relationships	3,705	1,686	2,019	3,707	1,279	2,428	5.6 yrs
	$ 7,043	$ 3,123	$ 3,920	$ 7,048	$ 2,361	$ 4,687	5.4 yrs

(1) Changes in intangible values as of June 30, 2008 compared to December 31, 2007 are the direct result of changes in foreign currency exchange rates for the periods then ended.

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Amortization expense of identifiable intangible assets was $0.4 million and $0.8 million for each of the three and six month periods ended June 30, 2008 and 2007, respectively. As Evolving Systems U.K. uses the Great British pound as its functional currency, the amount of future amortization actually recorded will be based upon exchange rates in effect at that time. Expected future amortization expense related to identifiable intangibles based on our carrying amount as of June 30, 2008 is as follows (in thousands):

Twelve months ending June 30,		
2009	$	1,129
2010		900
2011		887
2012		502
2013		502
Thereafter		
	$	3,920

NOTE 3 EARNINGS PER COMMON SHARE

Basic earnings per share (EPS) is computed by dividing net income or loss available to common stockholders by the weighted average number of shares outstanding during the period, including common stock issuable under participating securities, such as the Series B Convertible Redeemable Preferred Stock (Series B Preferred Stock). Diluted EPS is computed using the weighted average number of shares outstanding, including participating securities, plus all potentially dilutive common stock equivalents. Common stock equivalents consist of stock options and shares held in escrow. The following is the reconciliation of the denominator of the basic and diluted EPS computations (in thousands):

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2008	**2007**	**2008**	**2007**
Weighted average common shares outstanding	19,374	17,665	19,120	17,180
Participating securities		1,515	248	1,987
Basic weighted average shares outstanding	19,374	19,180	19,368	19,167
Effect of dilutive securities	471	424	472	
Diluted weighted average common shares outstanding	19,845	19,604	19,840	19,167

Weighted average options to purchase 2.7 million shares of common stock were excluded from the dilutive stock calculation for each of the three and six month periods ended June 30, 2008 because their exercise prices were greater than the average fair value of our common stock for the period.

Weighted average options to purchase 1.1 million shares of common stock were excluded from the dilutive stock calculation for the six months ended June 30, 2007, as their effect would have been anti-dilutive as a result of the net loss for the period. Weighted average options to purchase 2.3 million and 2.9 million shares of common stock were excluded from the dilutive stock calculation for the three and six months ended June 30, 2007 because their exercise prices were greater than the average fair value of our common stock for the period.

NOTE 4 SHARE-BASED COMPENSATION

We adopted SFAS 123R effective January 1, 2006 using the modified prospective method. We recognized $0.2 million and $0.5 million of compensation expense in the consolidated statements of operations for the three and six months ended June 30, 2008, respectively, with respect to our stock-based compensation plans. We recognized $0.1 million and $0.4 million of compensation expense in the consolidated statements of operations for the three and six months ended June 30, 2007, respectively, with respect to our stock-based compensation plans. The following table summarizes stock-based compensation expenses recorded in the statement of operations (in thousands):

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	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cost of license fee and services, excluding depreciation and amortization	$ 13	$ 12	$ 30	$ 34
Cost of customer support, excluding depreciation and amortization	2	1	4	(1)
Sales and marketing	41	29	83	67
General and administrative	152	84	298	268
Product development	20	6	41	13
	$ 228	$ 132	$ 456	$ 381

The negative amount in the table above for the six months ended June 30, 2007 resulted from the true-up of estimated forfeitures to actual forfeitures.

Stock Option Plan

In January 1996, our stockholders approved an Amended and Restated Stock Option Plan (the Option Plan). Under the Option Plan, as amended, 8,350,000 shares were reserved for issuance. Options issued under the Option Plan were at the discretion of the Board of Directors, including the vesting provisions of each stock option granted. Options were granted with an exercise price equal to the closing price of our common stock on the date of grant, generally vest over four years and expire no more than ten years from the date of grant. The Option Plan terminated on January 18, 2006; options granted before that date were not affected by the plan termination. At June 30, 2008, 3,855,198 options remained outstanding under the Option Plan.

In March 2007, upon the hiring of our Vice President of World Wide Sales and Marketing, in accordance with NASDAQ Marketplace Rule 4350(i)(1)(a)(iv), the board of directors approved an inducement award under a stand-alone equity incentive plan. We granted 100,000 non-qualified options to purchase shares of our common stock at an exercise price equal to the closing price of our common stock on the date of grant. The options vest over four years and expire ten years from the date of grant.

In June 2007, our stockholders approved the 2007 Stock Incentive Plan (the 2007 Stock Plan). A maximum of 2,000,000 shares may be issued under the 2007 Stock Plan. Awards permitted under the 2007 Stock Plan include: Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Awards and Other Stock-Based Awards. Awards issued under the 2007 Stock Plan are at the discretion of the Board of Directors. As applicable, awards are granted with an exercise price equal to the closing price of our common stock on the date of grant, generally vest over four years and expire no more than ten years from the date of grant.

In December 2007, under the 2007 Stock Plan, we awarded a total of 137,500 shares of restricted stock to members of our board of directors and senior management. The fair market value for share-based compensation expensing is equal to the closing price of our common stock on the date of grant. The restrictions on the stock award are released over four years for awards granted to employees and over one year for awards granted to members of the board of directors.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes model. The Black-Scholes model uses four assumptions to calculate the fair value of each option grant. The expected term of share options granted is derived using the simplified method as prescribed by the SEC Staff Accounting Bulletin 107 (SAB 107), Share-Based Payment. In January 2008, we adopted the provisions of Staff Accounting Bulletin 110, Share-Based Payment, which allows us to continue to calculate the expected term of share options granted using the simplified method as prescribed under SAB 107. The risk-free interest rate is based upon the rate currently available on zero-coupon U.S. Treasury instruments with a remaining term equal to the expected term of the stock options. The expected volatility is based upon historical volatility of our common stock over a period equal to the expected term of the stock options. The expected dividend yield is zero and is based upon historical and anticipated payment of dividends. The weighted-average assumptions used in the fair value calculations are as follows:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2008	**2007**	**2008**	**2007**
Expected term (years)	*	6.3	6.2	6.2
Risk-free interest rate	*	5.03%	2.7%	4.71%
Expected volatility	*	108.1%	101.9%	108.0%
Expected dividend yield	*	0%	0%	0%

* None granted.

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The following is a summary of stock option activity under the three stock incentive plans for the six months ended June 30, 2008:

	Number of Shares (in thousands)		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)		Aggregate Intrinsic Value (in thousands)
Options outstanding at December 31, 2007	4,534	$	3.02			
Options granted	80	$	2.06			
Less options forfeited	(67)	$	2.28			
Less options expired	(46)	$	5.20			
Less options exercised		$				
Options outstanding at June 30, 2008	4,501	$	2.99	5.56	$	1,104
Options exercisable at June 30, 2008	3,647	$	3.18	4.85	$	998

The weighted-average grant-date fair value of stock options granted during the six months ended June 30, 2008 was $1.67. No options were granted during the three months ended June 30, 2008.

As of June 30, 2008, there were approximately $1.6 million of total unrecognized compensation costs related to unvested stock options. These costs are expected to be recognized over a weighted average period of 1.4 years.

The total intrinsic value of stock option exercises for the three months ended June 30, 2008 and 2007 was $0 and $23,000, respectively. The total fair value of stock options vested during the three months ended June 30, 2008 and 2007 was $0.3 million and $0.2 million, respectively.

The total intrinsic value of stock option exercises for the six months ended June 30, 2008 and 2007 was $0 and $23,000, respectively. The total fair value of stock options vested during the six months ended June 30, 2008 and 2007 was $0.5 million and $0.3 million, respectively.

The deferred income tax benefits from stock option expense related to Evolving Systems U.K. totaled approximately $14,000 and $8,000 for the three months ended June 30, 2008 and 2007, respectively. The deferred income tax benefits from stock option expense related to Evolving Systems U.K. totaled approximately $29,000 and $19,000 for the six months ended June 30, 2008 and 2007, respectively.

Cash received from stock option exercises for the three months ended June 30, 2008 and 2007 was $0 and $19,000, respectively. Cash received from stock option exercises for the six months ended June 30, 2008 and 2007 was $0 and $19,000, respectively.

Employee Stock Purchase Plan

Under the Employee Stock Purchase Plan (ESPP), we are authorized to issue up to 1,100,000 shares of our common stock to full-time employees, nearly all of whom are eligible to participate. Under the terms of the ESPP, employees may elect to have up to 15% of their gross compensation withheld through payroll deduction to purchase our common stock, capped at $25,000 annually. The purchase price of the stock is 85% of the lower of the closing price on the first day or the last day of each three-month participation period. As of June 30, 2008, there were 270,000 shares available for purchase. For each of the three and six month periods ended June 30, 2008 and 2007, we recorded compensation expense of $5,000 and $11,000, respectively, associated with grants under the ESPP which includes the fair value of the look-back feature of each grant as well as the 15% discount on the purchase price. This expense fluctuates each period based upon employee participation.

The fair value of each grant made under our ESPP is estimated on the date of grant using the Black-Scholes model. The Black-Scholes model uses four assumptions to calculate the fair value of each option grant. The expected term of each grant is based upon the three-month participation period of each grant. The risk-free interest rate is based upon the rate currently available on zero-coupon U.S. Treasury instruments with a remaining term equal to the expected term of each grant. The expected volatility is based upon historical volatility of our common stock. The expected dividend yield is based upon historical and anticipated payment of dividends. The weighted average assumptions used in the fair value calculations are as follows:

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	Three Months Ended June 30, 2008	2007	Six Months Ended June 30, 2008	2007
Expected term (years)	0.25	0.25	0.25	0.25
Risk-free interest rate	1.9%	5.0%	1.6%	5.1%
Expected volatility	68.9%	70.1%	69.8%	70.1%
Expected dividend yield	0%	0%	0%	0%

Cash received from employee stock plan purchases for the three months ended June 30, 2008 and 2007 was 20,000 and $19,000, respectively. Cash received from employee stock plan purchases for each of the six month periods ended June 30, 2008 and 2007 was $36,000.

NOTE 5 CONCENTRATION OF CREDIT RISK

For the three and six months ended June 30, 2008, two significant customers (defined as contributing at least 10%) accounted for 29% (18% and 11%) and 27% (15% and 12%), respectively, of total revenue. These customers are large telecommunications operators located in the U.S. and U.K., respectively. For the three and six months ended June 30, 2007, two significant customers accounted for 37% (22% and 15%) and 36% (22% and 14%), respectively, of total revenue. These customers are large telecommunications operators located in the U.S. and U.K., respectively.

As of June 30, 2008, four significant customers accounted for approximately 58% (18%, 16%, 13% and 11%) of contract receivables. These customers are large telecommunications operators located in Germany, Chile, Pakistan and the U.K., respectively. At December 31, 2007, one significant customer accounted for approximately 42% of contract receivables. This customer is a large telecommunications operator located in the U.S.

NOTE 6 LONG-TERM DEBT

Long-term debt consists of the following (in thousands):

	June 30, 2008	December 31, 2007
Senior term loan with financial institution, interest at a fixed rate of 8.25%, principal installments and interest payments are due monthly with final maturity on February 22, 2010. The loan is secured by substantially all of our assets.	$ 3,333	$
Senior note payable to financial institution, interest at the one-month London InterBank Offered Rate (LIBOR) plus a margin of 5.25% at December 31, 2007; however, the LIBOR rate cannot be less than 3.75%, interest rate was 10.25% at December 31, 2007. In February 2008, this		4,419

note payable was replaced by our new $4.0 million senior term loan.				
$4.5 million senior revolving credit facility payable to financial institution, interest at one-month LIBOR plus 4.0%; however, the LIBOR rate cannot be less than 3.75%; interest rate was 9.00% at December 31, 2007. In February 2008, this revolver was replaced with our $6.0 million senior revolving credit facilities.				2,000
Long-term unsecured subordinated notes payable, interest ranges from 11-14% with a weighted average rate of 12.60% and 12.82% at June 30, 2008 and December 31, 2007, respectively, accrued interest and principal are due in full May 16, 2011.		4,550		4,767
Total debt		7,883		11,186
Less current portion		(2,000)		(2,500)
Long-term debt, excluding current portion	$	5,883	$	8,686

On February 22, 2008, we replaced our existing senior term note and senior revolving facility with a new $4.0 million senior term loan, a $1.0 million U.S. revolving credit facility (U.S. Revolving Facility) and a $5.0 million U.K. revolving credit facility (U.K. Revolving Facility).

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We used proceeds from the $4.0 million senior term loan to pay down our existing senior term note balance of approximately $3.8 million. The $4.0 million senior term loan bears interest at a fixed rate of 8.25% and is payable in 24 equal monthly installments of principal, plus all accrued interest, beginning March 10, 2008, with final maturity on February 22, 2010. The senior term loan is secured by substantially all assets of Evolving Systems, Inc. and subjects us to certain affirmative and negative covenants, including financial covenants related to maintaining a specified ratio of debt to EBITDA, as defined, minimum EBITDA, minimum liquidity, and a specified fixed charge ratio.

The remaining scheduled principal payments as of June 30, 2008 on our senior term loan are as follows (in thousands):

Year ending December 31,		
2008	$	1,000
2009		2,000
2010		333
	$	3,333

Additionally, we obtained a new $1.0 million U.S. Revolving Facility that bears interest at Prime Rate plus 0.5%. Prime Rate was 5.00% as of June 30, 2008. Borrowings under the senior revolving facilities are limited to a percentage of our eligible accounts receivable and cash. The U.S. Revolving Facility is secured by all assets of Evolving Systems, Inc. and is subject to the same covenants as the senior term loan. All accrued interest on outstanding borrowings under the U.S. Revolving Facility is paid monthly, with any outstanding balance due with a final maturity of February 22, 2011. As of June 30, 2008, we had $1.0 million in availability, but no borrowing outstanding under this U.S. Revolving Facility.

We also entered into a $5.0 million U.K. Revolving Facility that bears interest at Prime Rate plus 0.5%. Prime Rate was 5.00% as of June 30, 2008. Borrowings under the U.K. Revolving Facility are limited to a percentage of our eligible accounts receivable and cash. The U.K. Revolving Facility is secured by all assets of Evolving Systems Holdings Ltd and Evolving Systems Limited and is subject to the same covenants as the Senior Term Loan. All accrued interest on outstanding borrowings under the Senior Revolving Facility is paid monthly, with any outstanding balance due with a final maturity of February 22, 2011. As of June 30, 2008, we had $4.3 million in availability, but no borrowing outstanding under this U.K. Revolving Facility,

In connection with the replacement of our existing senior term note and senior revolving facility with the new senior term loan and U.S. Revolving Facility and the U.K. Revolving Facility, we recorded a write-off of debt issuance costs associated with the retired senior debt of approximately $0.3 million. Additionally, we capitalized debt issuance costs related to our new senior debt of approximately $0.3 million. These newly capitalized debt issuance costs will be amortized over the term of the new senior debt.

On February 22, 2008, we paid $272,000 to retire $279,000 of subordinated debt and related accrued interest held by two of our subordinated note holders. The retirements included principal of $217,000 and accrued interest of $62,000. The $7,000 gain on extinguishment of this debt is reflected within our other income (expense) on the consolidated statement of operations. On February 22, 2008, we also paid $728,000 in accrued interest to the remaining subordinated note holders.

We were in compliance with all of our debt covenants as of June 30, 2008.

NOTE 7 INCOME TAXES

We recorded net income tax expense of $113,000 and $83,000 for the three months ended June 30, 2008 and 2007, respectively. The net expense during the three months ended June 30, 2008 consisted of current income tax expense of $175,000, partially offset by a deferred tax benefit of $62,000, both of which were primarily related to our U.K.-based operations. The net expense during the three months ended June 30, 2007 consisted of current income tax expense of $72,000 and deferred tax expense of $11,000, both of which were primarily related to our U.K.-based operations.

We recorded net income tax expense of $39,000 and $223,000 for the six months ended June 30, 2008 and 2007, respectively. The net expense during the six months ended June 30, 2008 consisted of current income tax expense of $180,000, partially offset by a deferred tax benefit of $141,000, both of which were primarily related to our U.K.-based operations. The net expense during the six months ended June 30, 2007 consisted of current income tax expense of $262,000, partially offset by a deferred tax benefit of $39,000, both of which were primarily related to our U.K.-based operations.

Effective April 2007, our Indian subsidiary was subject to a 10% minimum alternative tax. This tax did not have a material impact on our results for the three and six months ended June 30, 2008, and we do not expect this tax to have a material impact on future results.

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In conjunction with the acquisition of Evolving Systems U.K., we recorded certain identifiable intangible assets. Since the amortization of these identifiable intangibles is not deductible for income tax purposes, we established a long-term deferred tax liability of $4.6 million at the acquisition date for the expected difference between what would be expensed for financial reporting purposes and what would be deductible for income tax purposes. As of June 30, 2008 and December 31, 2007, this component of the deferred tax liability was $1.0 million and $1.2 million, respectively. This deferred tax liability relates to Evolving Systems U.K., and has no impact on our ability to recover U.S.-based deferred tax assets. This deferred tax liability will be recognized as a reduction of deferred income tax expense as the identifiable intangibles are amortized.

As of June 30, 2008 and December 31, 2007 we continued to maintain a full valuation allowance on the domestic net deferred tax asset as we have determined it is more likely than not that we will not realize our domestic deferred tax assets. Such assets primarily consist of certain net operating loss carryforwards. We assessed the realizability of our domestic deferred tax assets using all available evidence. In particular, we considered both historical results and projections of profitability for the reasonably foreseeable future periods. We are required to reassess our conclusions regarding the realization of our deferred tax assets at each financial reporting date. A future evaluation could result in a conclusion that all or a portion of the valuation allowance is no longer necessary which could have a material impact on our results of operations and financial position.

Effective January 1, 2007, the company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. There was not a material impact on the company s consolidated financial position and results of operations as a result of the adoption of the provisions of FIN 48.

On January 1, 2007, we recorded a FIN 48 transition adjustment consisting of a $0.4 million decrease in our deferred tax assets related to Research and Development Tax Credits that was offset by a corresponding decrease in our valuation allowance because we determined that it was not more likely than not that our deferred tax assets will be realized. As of June 30, 2008 and December 31, 2007, we had no liability for unrecognized tax benefits. We do not believe there will be any material changes our unrecognized tax positions over the next twelve months.

We conduct business globally and, as a result, Evolving Systems, Inc. or one or more of our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, we are subject to examination by taxing authorities throughout the world, including the U.S., the U.K., Germany and India.

NOTE 8 STOCKHOLDERS EQUITY

On February 25, 2008, holders of 461,758 shares of Series B Preferred Stock with a carrying value of $5.4 million, or approximately 96% of the outstanding preferred stock, converted their shares of preferred stock into 1,385,274 shares of our common stock in accordance with the conversion provisions of the Series B Preferred Stock. On March 19, 2008, a holder of 16,992 shares of Series B Preferred Stock with a carrying value of $0.2 million, which represented the remainder of the outstanding preferred stock, converted his shares of preferred stock into 50,976 shares of our common stock in accordance with the conversion provisions of the Series B Preferred Stock. As we previously included the Series B Convertible Preferred Stock as a participating security for basic EPS purposes, these conversions did not change our basic or diluted EPS calculations.

NOTE 9 SEGMENT INFORMATION

In accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, we define operating segments as components of an enterprise for which separate financial information is reviewed regularly by the chief operating decision-making group to evaluate performance and to make operating decisions. We have identified our Chief Executive Officer and Chief Financial Officer as our chief operating decision-makers (CODM). These chief operating decision makers review revenues by segment and review overall results of operations.

We currently operate business as two operating segments based on revenue type: license fees and services revenue and customer support revenue (as shown on the consolidated statements of operations). License fees and services (L&S) revenue represents the fees received from the license of software products and those services directly related to the delivery of the licensed products, as well as fees for custom development, integration services and time and materials work. Customer support (CS) revenue includes annual support fees, recurring maintenance fees, fees for maintenance upgrades and warranty services. Warranty services that are similar to software maintenance services are typically bundled with a license sale. Total assets by segment have not been disclosed as the information is not available to the chief operating decision-making group.

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Segment information is as follows (in thousands):

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Revenue				
License fees and services	$ 5,342	$ 4,742	$ 10,174	$ 8,733
Customer support	4,303	4,380	8,598	8,850
	9,645	9,122	18,772	17,583
Revenue less cost of revenue, excluding depreciation and amortization				
License fees and services	3,440	2,801	6,048	4,868
Customer support	2,671	2,664	5,473	5,641
	6,111	5,465	11,521	10,509
Unallocated costs				
Other operating expenses	4,380	4,192	9,060	8,331
Depreciation and amortization	631	644	1,241	1,320
Restructuring and other				(1)
Interest income	(39)	(81)	(117)	(145)
Interest expense	283	451	619	915
(Gain) loss on debt extinguishment			290	(42)
Foreign currency exchange (gain) loss	(32)	104	(142)	162
Income (loss) before income taxes	$ 888	$ 155	$ 570	$ (31)

Geographic Regions

We are headquartered in Englewood, a suburb of Denver, Colorado. We use customer locations as the basis for attributing revenues to individual countries. We provide products and services on a global basis through our headquarters and our London-based Evolving Systems U.K. subsidiary. Additionally, personnel in Bangalore, India provide software development services to our global operations. Financial information relating to operations by geographic region is as follows (in thousands):

Three Months Ended June 30,				
2008			2007	
L&S	CS	Total	L&S	