EDGEWATER TECHNOLOGY INC/DE/
Form 10-Q
May 15, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

---

x **Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2007

or

¨ **Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
for the transition period from ______ to ______

Commission file number: 0-20971

EDGEWATER TECHNOLOGY, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**71-0788538**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
20 Harvard Mill Square	
Wakefield, MA	**01880-3209**

(Address of Principal Executive Offices) **(Zip Code)**

Registrant s telephone number including area code: (781) 246-3343

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 ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).
Yes ¨ No x

The number of shares of Common Stock of the Registrant, par value $.01 per share, outstanding at May 3, 2007 was 11,953,888.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2007

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EDGEWATER TECHNOLOGY, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Per Share Data)

	March 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,773	$ 9,833
Marketable securities	24,731	23,308
Accounts receivable, net[1] of allowance of $300 and $318, respectively	12,681	10,883
Current portion of deferred income taxes, net	1,760	1,760
Prepaid expenses and other current assets	869	441
Total current assets	46,814	46,225
Property and equipment, net	4,132	3,391
Intangible assets, net	3,482	3,797
Goodwill	26,252	25,366
Deferred income taxes, net	16,292	16,789
Other assets	52	52
Total assets	$ 97,024	$ 95,620
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 3,332	$ 3,326
Accruals related to discontinued operations	561	588
Accrued contingent earnout consideration (Note 7)	886	
Accrued payroll and related liabilities	2,242	4,242
Deferred revenue and other liabilities	283	252
Capital lease obligations, current	213	184
Total current liabilities	7,517	8,592
Capital lease obligations	729	778
Total liabilities	8,246	9,370
Commitments and contingencies (Note 12)		
Stockholders equity:		
Preferred stock, $.01 par value; 2,000 shares authorized, no shares issued or outstanding		
Common stock, $.01 par value; 48,000 shares authorized, 29,736 shares issued as of March 31, 2007 and December 31, 2006, 11,804 and 11,522 shares outstanding as of March 31, 2007 and December 31, 2006, respectively	297	297
Paid-in capital	213,413	213,979

Treasury stock, at cost, 17,932 and 18,214 shares at March 31, 2007 and December 31, 2006, respectively	(134,666)	(136,923)
Retained earnings	9,734	8,897
Total stockholders equity	88,778	86,250
Total liabilities and stockholders equity	$ 97,024	$ 95,620

See notes to the unaudited condensed consolidated financial statements.

---

1 Includes related-party amounts of $1,263 and $8 as of March 31, 2007 and $1,407 and $4 as of December 31, 2006 due from Synapse and Loeb Enterprises, respectively.

3

Table of Contents

EDGEWATER TECHNOLOGY, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except Per Share Data)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Revenue:		
Service revenue [1]	$ 15,226	$ 13,502
Software revenue	375	293
Reimbursable expenses	672	513
Total revenue	16,273	14,308
Cost of revenue:		
Project and personnel costs **	8,530	8,368
Software costs	290	267
Reimbursable expenses	672	513
Total cost of revenue	9,492	9,148
Gross profit	6,781	5,160
Operating expenses:		
Selling, general and administrative **	5,160	4,352
Depreciation and amortization	567	345
Total operating expenses	5,727	4,697
Operating income	1,054	463
Interest income, net	407	299
Income before income taxes	1,461	762
Provision for income taxes	624	302
Net income	$ 837	$ 460
Earnings per share:		
Basic net income per share of common stock	$ 0.07	$ 0.04
Diluted net income per share of common stock	$ 0.07	$ 0.04
Shares used in computing basic net income per share of common stock	11,344	10,635
Shares used in computing diluted net income per share of common stock	12,449	11,335

** - The following amounts of stock-based compensation expense are included in each of the respective expense categories reported above:

	2007	2006
Project and personnel costs	$ 77	$ 93
Selling, general and administrative	180	150

Total stock-based compensation	$	257	$	243

See notes to the unaudited condensed consolidated financial statements.

---

[1] Includes related-party amounts of $1,941 and $19 for the three months ended March 31, 2007 and $2,236 and $31 for the three months ended March 31, 2006 due from Synapse and Loeb Enterprises, respectively.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 837	$ 460
Adjustments to reconcile net income to net cash (used in) provided by operating activities, net of acquisitions:		
Depreciation and amortization	567	345
Provision for bad debts	51	30
Deferred income taxes	497	257
Stock-based compensation expense	257	243
Amortization of marketable securities premiums, net	(44)	(46)
Changes in operating accounts:		
Accounts receivable	(1,849)	474
Prepaid expenses and other current assets	(428)	(74)
Other assets		11
Accounts payable and accrued liabilities	892	3,226
Accrued payroll and related liabilities	(2,000)	(3,481)
Deferred revenues and other liabilities	31	(45)
Net cash (used in) provided by operating activities	(1,189)	1,400
Net cash used in discontinued operating activities	(27)	(64)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Redemptions of marketable securities	11,078	10,808
Purchases of marketable securities	(12,457)	
Purchase of National Decision Systems, Inc., net of cash acquired	(886)	(6,773)
Purchase of Ranzal		(2,632)
Purchases of property and equipment	(993)	(153)
Net cash (used in) provided by investing activities	(3,258)	1,250
CASH FLOW FROM FINANCING ACTIVITES:		
Payments on capital leases	(20)	
Proceeds from employee stock plans and stock option exercises	1,434	362
Net cash provided by financing activities	1,414	362
Net (decrease) increase in cash and cash equivalents	(3,060)	2,948
CASH AND CASH EQUIVALENTS, beginning of period	9,833	6,225
CASH AND CASH EQUIVALENTS, end of period	$ 6,773	$ 9,173
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for income taxes	$ 116	$ 37

Cash receipts from related parties	$ 2,084	$ 2,166
Cash payments to related parties	$ 64	$ 62
Issuance of restricted stock awards	$	$ 788
Issuance of common stock for acquisition (Note 7)	$	$ 1,680

See notes to the unaudited condensed consolidated financial statements.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION:

Edgewater Technology, Inc. is an innovative technology management consulting firm providing a unique blend of premium information technology (IT) services. We provide our clients with a range of business and technology offerings. Headquartered in Wakefield, Massachusetts, as of March 31, 2007, our Company employed approximately 259 consulting professionals throughout our network of strategically positioned satellite offices.

In this Quarterly Report on Form 10-Q, we use the terms Edgewater Technology, we, our Company, the Company, our and us to refer to Edgewater Technology, Inc. and its wholly-owned subsidiaries. Our wholly-owned subsidiaries include: Edgewater Technology (Delaware), Inc. (Edgewater Delaware), a Delaware corporation that was incorporated in 1992 and acquired by our Company on May 17, 1999; Edgewater Technology (Virginia), Inc. (formerly known as Intelix, Inc.), a northern Virginia corporation that was incorporated in 1993, acquired by our Company on June 2, 2003 and merged into Edgewater Delaware during 2006; Edgewater Technology-Ranzal, Inc. (formerly known as Ranzal and Associates, Inc. and referred to in this Form 10-Q as Ranzal), a Delaware corporation that was incorporated in 2004 and acquired by our Company on October 4, 2004, and Edgewater New York Metro, Inc. (formerly known as National Decision Systems, Inc and referred to in this Form 10-Q as NDS), a New Jersey corporation that was acquired by our Company on February 15, 2006 (the NDS Acquisition).

2. BASIS OF PRESENTATION:

The accompanying unaudited condensed consolidated financial statements have been prepared by Edgewater Technology pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) regarding interim financial reporting. Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to those rules and regulations, although we believe that the disclosures made are adequate to ensure the information presented is not misleading.

The accompanying unaudited condensed consolidated financial statements reflect all adjustments (which were of a normal, recurring nature) that, in the opinion of management, are necessary to present fairly our financial position, results of operations and cash flows as of and for the interim periods presented. All intercompany transactions have been eliminated in the accompanying unaudited condensed consolidated financial statements. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in our 2006 Annual Report on Form 10-K as filed with the SEC on March 14, 2007.

The results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for any future period or the full fiscal year. Our revenue and earnings may fluctuate from quarter to quarter based on factors within and outside our control, including variability in demand for information technology professional services, the length of the sales cycle associated with our service offerings, the number, size and scope of our projects and the efficiency with which we utilize our employees.

3. REVENUE RECOGNITION AND ALLOWANCE FOR DOUBTFUL ACCOUNTS:

Our Company recognizes revenue from providing IT and management consulting services under written service contracts with our customers. The service contracts we enter into generally fall into three specific categories: time and materials, fixed-price and fixed-fee. Our revenues are generated from sources such as technical consulting (inclusive of design, application development, systems integration and infrastructure services such as assessment and remediation and IT due diligence), corporate performance management consulting (analytics, business intelligence and data services such as data integration/ETL, data management and data warehousing) and business consulting engagements (business process improvement, high level program management offerings, mergers and acquisitions consulting and strategy). Revenue from these services is recognized as the services are performed and amounts are earned. We consider amounts to be earned once evidence of an arrangement has been obtained, services are delivered, fees are fixed or determinable and collectibility is reasonably assured. Edgewater Technology engages in business activities under one operating segment, premium IT services, which combines strategic consulting, technical knowledge and industry-domain expertise to develop custom business process and technology solutions.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. REVENUE RECOGNITION AND ALLOWANCE FOR DOUBTFUL ACCOUNTS (Continued):

For the quarter ended March 31, 2007 and 2006, revenue from technical consulting, corporate performance management consulting and business consulting engagements represented the following:

Quarter Ended March 31,	Technical Consulting Engagements	Corporate Performance Management Consulting Engagements	Business Consulting Engagements
2007	55.6%	28.1%	16.3%
2006	59.4%	25.1%	15.5%

The Company derives a significant portion of its service revenue from time and materials-based contracts. Time and materials-based contracts represented 94.1% and 81.2% of service revenue for the three-month periods ended March 31, 2007 and 2006, respectively. Revenue under time and materials contracts is recognized as services are rendered and performed at contractually agreed upon rates.

Revenue pursuant to fixed-price contracts is recognized under the proportional performance method of accounting. Fixed-price contracts represented 2.9% and 12.5% of service revenue for the three-month periods ended March 31, 2007 and 2006, respectively. Over the course of a fixed-price contract, we routinely evaluate whether revenue and profitability should be recognized in the current period. To measure the performance and our ability to recognize revenue and profitability on fixed-price contracts, we compare actual direct costs incurred to the total estimated direct costs and determine the percentage of the contract that is complete. This percentage is multiplied by the estimated total contract value to determine the amount of net revenue that should be recognized in accordance with our revenue recognition policies and procedures, subject to any warranty provisions or other project management assessments as to the status of work performed. This method is used because reasonably dependable estimates of revenue and costs can be made, based on historical experience and milestones identified in any particular contract.

Typically, the Company provides warranty services on its fixed-price contracts related to providing customers with the ability to have any design flaws remedied and/or have our Company fix routine defects. The warranty services, as outlined in the respective contracts, are provided for a specific period of time after a project is complete. The Company values the warranty services based upon historical labor hours incurred for similar services at standard billing rates. In accordance with Securities and Exchange Commission Staff Accounting Bulletin (SAB) SAB No. 104, Revenue Recognition (SAB 104), revenue related to the warranty provisions within our fixed-price contracts is recognized as the services are performed and the revenue is earned. The warranty term is typically short term or for a 30-60 day period after the project is complete.

In the event we are unable to accurately estimate the resources required or the scope of work to be performed on a fixed-price contract, or we do not manage the project properly within the planned time period, then we may recognize a loss on a contract. Provisions for estimated losses on uncompleted projects are made on a contract-by-contract basis. Any known or probable losses on projects are charged to operations in the period in which such losses are determined. A formal project review process takes place quarterly, although most projects are evaluated on an ongoing basis. Management reviews the estimated total direct costs on each contract to determine if the estimated amounts are accurate, and estimates are adjusted as needed in the period revised estimates are made. We recognized insignificant losses on certain fixed price contracts during 2006. There were no loss contracts during the quarterly period ended March 31, 2007.

We also perform services on a fixed-fee basis under infrastructure service contracts, which include monthly hosting and support services. Fixed-fee contracts represented 3.0% and 6.3% of service revenue for the three-month periods ended March 31, 2007 and 2006, respectively. Revenue under fixed-fee contracts are recognized as fixed monthly amounts, for a specified period of time, as outlined within the respective contract.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. REVENUE RECOGNITION AND ALLOWANCE FOR DOUBTFUL ACCOUNTS (Continued):

When a customer enters into a time and materials, fixed-price contract or a fixed-fee contract, the related revenue is accounted for under SAB 104 and Emerging Issues Task Force Abstract (EITF) No. 00-21, Revenue Arrangement with Multiple Deliverables (EITF No. 00-21). For all arrangements, we evaluate the deliverables in each contract to determine whether they represent separate units of accounting. If the deliverables represent separate units of accounting, we then measure and allocate the consideration from the arrangement to the separate units, based on reliable evidence of the fair value of each deliverable.

From time to time, the Company may offer volume purchase arrangements as part of its time and materials contracts to its customers. In accordance with EITF No. 00-22, Accounting for Points and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future (EITF No. 00-22), the Company has deferred revenue related to invoiced and paid amounts based upon its current estimates of the actual discounts expected to be earned by the customers. As of March 31, 2007, $65 thousand in revenue was deferred related to one volume purchase arrangement. There were no deferred revenue amounts related to volume purchase arrangements as of December 31, 2006.

Client prepayments, even if nonrefundable, are deferred (classified as a liability) and recognized over future periods as services are performed. As of March 31, 2007 and December 31, 2006, the Company has recorded a deferred liability of approximately $11 thousand and $84 thousand, respectively, which is included in the financial statement caption of deferred revenue and other liabilities related to customer prepayments.

Software revenue represents the resale of certain third-party off-the-shelf software and is recorded on a gross basis provided we act as a principal in the transaction, whereby we have credit risk and we set the price to the end user. In the event we do not meet the requirements to be considered a principal in the software sale transaction and act as an agent, software revenue will be recorded on a net basis. Revenue from software resale arrangements represented 2.3% and 2.0% of total revenue for the three-month periods ended March 31, 2007 and 2006, respectively. Revenue and related costs are recognized and amounts are invoiced upon the customer s constructive receipt of purchased software. All related warranty and maintenance arrangements are performed by the primary software vendor and are not the obligation of the Company.

We recognize revenue for services where the collection from the client is probable and our fees are fixed or determinable. We establish billing terms at the time at which the project deliverables and milestones are agreed. Our standard payment terms are 30 days from invoice date. Out-of-pocket reimbursable expenses charged to customers are reflected as revenue.

Our revenue and earnings may fluctuate from quarter to quarter based on the number, size and scope of projects in which we are engaged, the contractual terms and degree of completion of such projects, any delays incurred in connection with a project, employee utilization rates, the adequacy of provisions for losses, the use of estimates of resources required to complete ongoing projects, general economic conditions and other factors. Certain significant estimates include those used for fixed-price contracts, such as deferrals related to our volume purchase agreements, warranty holdbacks, and allocations of fair value of elements under multiple element arrangements, and the valuation of our allowance for doubtful accounts.

The Company maintains an allowance for doubtful accounts related to its accounts receivables that have been deemed to have a high risk of collectibility. Management reviews its accounts receivables on a monthly basis to determine if any receivables will potentially be uncollectible. Management further analyzes historical collection trends and changes in its customer payment patterns, customer concentration, and credit worthiness when evaluating the adequacy of its allowance for doubtful accounts. The Company includes any receivable balances that are determined to be uncollectible, along with a general reserve, in its overall allowance for doubtful accounts. Based on the information available, management believes the allowance for doubtful accounts is adequate; however future write-offs could exceed the recorded allowance.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. STOCK-BASED COMPENSATION:

Overview

The Company accounts for stock-based compensation in accordance with Financial Accounting Standards Board (SFAS) No. 123R, Share-Based Payment (SFAS No. 123R). This statement is a revision of SFAS No. 123, Accounting for Stock-Based Compensation and supersedes Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock issued to Employees. SFAS No. 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. The statement requires entities to recognize compensation expense from all share-based payment transactions in the financial statements. SFAS No. 123R establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all companies to apply a fair-value-based measurement method in accounting for generally all share-based payment transactions with employees.

Share-Based Compensation Plans

The Company has three share-based compensation plans which are described below; the Amended and Restated 1996 Stock Option Plan (1996 Plan), the Amended and Restated 2000 Stock Option Plan (2000 Plan) and the 2003 Equity Incentive Plan (2003 Plan), collectively the Equity Plans. Specifics related to each plan are as follows:

1996 Plan: Grants for shares under the 1996 Plan were limited to 15% of our Company s outstanding common stock. The only grants outstanding under the 1996 Plan are non-qualified stock option grants, with total qualified stock option grants under the 1996 Plan were limited to 650,000 shares of the Company s common stock. No grants of qualified stock options were ever issued under the 1996 Plan. The 1996 Plan expired on June 30, 2006; thus, no further grants will be awarded after June 30, 2006, but options awarded prior to that date remain outstanding subject to the terms of the 1996 Plan and any related option agreements.

2000 Plan: The 2000 Plan provides for grants of non-qualified stock options of our Company s common stock. The 2000 Plan is limited to grants covering up to 4.0 million shares of our Company s common stock.

2003 Plan: The 2003 Plan provides for grants of non-qualified stock options and awards of restricted shares of our Company s common stock. The 2003 Plan is limited to stock option grants and restricted stock awards covering up to 500,000 shares of our Company s common stock.

As of March 31, 2007, there were 560,749 and 52,650 shares available for future grant under the 2000 Plan and 2003 Plan, respectively. No shares were available for issuance under the 1996 Plan, as it expired on June 30, 2006.

Option Plans (Excluding Restricted Share Awards)

The Company s Equity Plans authorize the granting of qualified and non-qualified stock options to officers, employees and certain persons who are not employees on the date of grant, including certain non-employee members of the Board of Directors. All such options are for shares of the Company s Common Stock.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. STOCK-BASED COMPENSATION (Continued):

The Equity Plans provide that the exercise price of the stock options will be determined based upon the fair market value of the Company s common stock on the NASDAQ Stock Market System as of the date of grant. Options granted to officers and employees generally vest in three, four or five year periods, dependent upon the plan, and expire on the tenth anniversary of the grant date. Options granted to non-employee members of the Company s Board of Directors vest immediately and expire on the fifth anniversary of the grant date, with the exception of option grants issued upon the initial election to the Company s Board of Directors, of which a portion vest immediately with the remainder vesting over a two-year period. The Company has elected to expense all compensation expense related to share-based awards issued under the Equity Plans on a straight-line basis over the vesting term of the award.

During the three month periods ended March 31, 2007 and 2006, the Company granted 3,000 and 277,500 stock options, respectively (excluding issuances of restricted share awards issued under the 2003 Plan), principally as part of the annual performance review process. The fair value of each option award is estimated on the date of grant using the Black-Sholes option valuation model that uses the assumptions noted in the following table. Expected volatility is based upon historical volatility of the Company s common stock. The expected life (estimated period of time outstanding) was estimated using the historical exercise behavior of employees. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. The Company applied an estimated forfeiture rate of 26.5% to the calculated fair value of each option. The applied forfeiture rate utilized by the Company was based upon the historical forfeiture experience of the Equity Plans.

	Three Months Ended March 31, 2007	2006
Expected volatility	44.6%	46.3%
Expected dividend yield	%	%
Expected life (in years)	3.76	4.12
Risk-free interest rate	4.7%	4.6% - 4.7%

The weighted-average grant-date fair value of all options granted (excluding restricted share awards) during the three-month periods ended March 31, 2007 and 2006, as valued under SFAS No. 123R, was $3.05 and $2.62, respectively.

A summary of stock option activity under the Equity Plans (excluding restricted share awards) as of March 31, 2007, and changes during the quarter then ended is presented below:

Stock Options:	Shares Under Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (000 s)
Outstanding at January 1, 2007	4,093,314	$ 5.70	4.80	$ 2,624
Granted	3,000	7.75		
Exercised	(261,149)	5.10		
Forfeited or expired	(27,098)	9.09		
Outstanding at March 31, 2007	3,808,067	$ 5.72	4.60	$ 10,616
Vested and expected to vest at March 31, 2007	3,686,247	$ 5.71	4.54	$ 10,307

Exercisable at March 31, 2007	3,349,062	$	5.69	4.13	$	9,440

The total intrinsic value of stock options exercised during the three-month periods ended March 31, 2007 and 2006 was approximately $694 thousand and $120 thousand, respectively.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. STOCK-BASED COMPENSATION: (Continued)

2003 Equity Incentive Plan Restricted Share Awards

The 2003 Plan also authorizes the granting of restricted share awards to officers, employees and certain non-employee members of the Board of Directors. Restricted share awards are made at prices determined by the Compensation Committee of the Company s Board of Directors (the Compensation Committee) and are compensatory in nature. Employees granted restricted share awards are required to provide consideration for the shares at the share price set by the Compensation Committee. Shares of restricted stock generally vest over a five-year period, during which time the Company has the right to repurchase any unvested shares at the amount paid if the relationship between the employee and the Company ceases. As of March 31, 2007, 272,120 restricted share awards were subject to repurchase by the Company under the restricted stock agreements. The Company records compensation expense related to restricted share awards on a straight-line basis over the vesting term of the award.

No restricted share awards were issued to employees during the three-month period ended March 31, 2007. During the three-month period ended March 31, 2006, the Company issued 126,400 restricted share awards to employees at a purchase price of $0.01 per share.

A summary of non-vested restricted share activity under the 2003 Plan as of March 31, 2007, and changes during the quarter then ended is presented below:

Restricted Share Awards:	Non-vested Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2007	297,400	$ 5.51
Granted		
Vested	(25,280)	6.23
Forfeited or expired		
Outstanding at March 31, 2007	272,120	$ 5.44
Vested and expected to vest at March 31, 2007	272,120	

The total fair value of stock awards vested during the three-month period ended March 31, 2007 was $158 thousand. No restricted share awards vested during the three-month period ended March 31, 2006.

Employee Stock Purchase Plan

The Edgewater Technology, Inc. Employee Stock Purchase Plan (ESPP) offers eligible employees the option to purchase the Company s Common Stock at 85% of the lower of the closing price, as quoted on NASDAQ, on either the first trading day or the last trading day of the quarterly purchase period. Enrollment periods occur on January 1 and July 1. Purchases occur every three months. The amount each employee can purchase is limited to the lesser of (i) 10% of an employees annual base salary or (ii) $25,000 of stock value on an annual basis. The ESPP is designed to qualify for certain tax benefits for employees under section 423 of the Internal Revenue Code. The ESPP allows a maximum of 700,000 shares to be purchased by employees and as of March 31, 2007, approximately 174,556 shares were available for future issuance.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. STOCK-BASED COMPENSATION: (Continued)

The fair value of each ESPP offering was estimated on the date of grant using the Black-Sholes option valuation model that uses the assumptions noted in the following table. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. Expected volatility was based on historical volatility and other factors.

	January 2007 ESPP Offering
Expected volatility	44.8%
Expected dividend yield	%
Expected life (in years)	1.67
Risk-free interest rate	4.7%

The issue price of the shares of the Company s common stock issued under the January 2007 ESPP offering was $4.85 per share, respectively, and the related weighted-average fair value of the compensation elements of the shares, based upon the assumptions in the preceding table, was $2.18 per share.

Compensation Expense

Stock-based compensation expense under all of the Company s share-based plans was $257 thousand and $243 thousand in the three-month periods ended March 31, 2007 and 2006, respectively. The total income tax benefit recognized in the unaudited condensed consolidated statements of operations for share-based compensation arrangements was $42 thousand and $54 thousand for the three-month periods ended March 31, 2007 and 2006, respectively.

Cash received from stock option and ESPP exercises under all share-based payment arrangements was $1.4 million and $362 thousand during the three-month periods ended March 31, 2007 and 2006, respectively. The related tax benefit (deficiency) was approximately $1 thousand and $(16) thousand for the three-month periods ended March 31, 2007 and 2006, respectively. The tax benefit and deficiency amounts are not disclosed in the accompanying unaudited condensed consolidated statements of cash flows as the Company has offset all recorded deferred tax asset activity not directly related to its existing federal net operating loss carryforwards through adjustments to its reported valuation allowance.

As of March 31, 2007, unrecognized compensation expense, net of estimated forfeitures, related to the unvested portion of all share-based compensation arrangements was approximately $2.0 million and is expected to be recognized over a period of 4.1 years.

The Company is using previously purchased treasury shares for all shares issued for options, restricted share awards and ESPP purchases. Shares may also be issued from unissued share reserves.

5. INCOME TAXES:

Income Tax Provision: In determining our current income tax provision, we assess temporary differences resulting from different treatments of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded in our consolidated balance sheets. A valuation allowance is provided to the extent tax assets are not likely to be recovered. The valuation allowance was established due to uncertainties related to the Company s ability to utilize some of its deferred tax assets, primarily consisting of certain net operating losses carried forward and foreign tax credits, before they expire. The Company considers scheduled reversals of deferred tax liabilities, projected future taxable income, ongoing tax planning strategies and other matters, including the period over which our deferred tax assets will be recoverable, in assessing the need for and the amount of the valuation allowance. In the event that actual results differ from these estimates or we adjust these estimates in future periods, an adjustment to the valuation allowance may be recorded, which could materially impact our financial position and net income (loss) in the period of the adjustment.

12

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. INCOME TAXES (Continued):

We have recorded a $6.5 million valuation allowance against our $24.6 million gross deferred tax assets as of March 31, 2007. The valuation allowance increased by $42 thousand during the first quarter of 2007 as a result of fully reserving increases to our deferred tax asset in connection with tax benefits recorded under SFAS No. 123R.

The Company recorded a tax provision of $0.6 million and $0.3 million for the three months ended March 31, 2007 and 2006, respectively. The tax provision for the first quarter of 2007 represents tax expense based upon an estimated effective income tax rate of 42.7%, which is inclusive of both federal and state income tax rates. The effective tax rate applied to income before taxes in the first quarter of 2006 was 39.7%. The current quarter increase in the applied effective income tax rate is reflective of our full utilization of certain state net operating loss carryforwards during 2006. The Company reduced its net deferred tax asset by approximately $0.5 million and $0.3 million during the three-month periods ended March 31, 2007, and 2006, respectively, solely related to the federal income tax portion of its tax provision, which portion was calculated at a 34% effective tax rate. This resulted in a remaining deferred tax asset of $18.1 million as of March 31, 2007. The Company does not anticipate having to expend cash for any federal income taxes, exclusive of alternative minimum tax, in 2007 because of the availability of our net operating loss carryforwards.

Adoption of FIN No. 48: In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 (FIN No. 48). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN No. 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on derecognition, classification, interest and penalties, and accounting in interim periods, disclosure, and transition. The provisions of FIN No. 48 are effective for fiscal years beginning after December 15, 2006.

The evaluation of a tax position in accordance with FIN No. 48 is a two-step process. The first step is a recognition process whereby the enterprise determines whether a tax position is more-likely-than not to be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the enterprise should presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is a measurement process whereby a tax position that meets the more-likely-than-not recognition threshold is calculated to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

The Company adopted the provisions of FIN No. 48 on January 1, 2007. We recognized no material adjustments in the liability for unrecognized income tax benefits as a result of our adoption. Additionally, at adoption, we did not have any unrecognized tax benefits and did not have any interest or penalties accrued.

We are subject to U.S. federal tax as well as income tax in multiple states and local jurisdictions. The Company s 2003, 2004, 2005 and 2006 tax years are subject to examination by these tax authorities. To our best knowledge we are no longer subject to U.S. federal and state and local tax examinations by tax authorities for years before 2002. Such examinations could result in challenges to tax positions taken and, accordingly, we may record adjustments to provisions based on the outcomes of such matters. However, we believe that the resolution of these matters will not have a material effect on our financial position or results of operations.

Our continuing practice is to recognize interest and penalties related to income tax matters as a selling, general and administrative expense.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6. MARKETABLE SECURITIES:

All marketable securities that have original maturities greater than three months, but less than one year, are considered to be current marketable securities. Our marketable securities are classified as held-to-maturity securities, which are recorded at amortized cost and consist of marketable instruments, which include but are not limited to government obligations, including agencies, and commercial paper. As of March 31, 2007 and December 31, 2006, we had $24.7 million and $23.3 million, respectively, in commercial paper. Amortized cost approximated fair value.

7. BUSINESS COMBINATIONS:

Acquisition of National Decision Systems, Inc.: On February 15, 2006, the Company acquired all of the outstanding capital stock of NDS, pursuant to the terms of a Stock Purchase Agreement. NDS provides Business Process Improvement, Program Management and Merger and Acquisition consulting services and is located in Stamford, CT. The acquisition expanded Edgewater Technology s service offerings and will provide a gateway into the New York/New Jersey market. The Company paid to the shareholders of NDS total consideration of approximately $10.2 million, consisting of an initial upfront payment at closing of approximately $7.1 million in cash, $1.4 million in assumed liabilities and 264,610 shares, valued at approximately $1.7 million, of Edgewater Technology s common stock, $0.01 par value per share (Common Stock), which is subject to a three-year lock-up agreement. The Company incurred $0.7 million of direct acquisition costs.

The Company engaged an independent third-party valuation firm to assist with the allocation of the purchase price between assets, liabilities and identified intangible assets. The initial allocation of the purchase price was as follows:

	Total (In Thousands)	Life (In Years)
Net book value of assets and liabilities acquired	$ 336	
Acquired intangible asset	3,500	4 Years
Goodwill (not deductible for tax purposes)	7,109	
Total purchase price	$ 10,945	

In connection with the NDS Acquisition, the Company established a $1.4 million deferred tax liability, which reduced the carrying value of the Company s net deferred tax assets. The NDS Acquisition was a stock purchase, and accordingly, the Company does not have a tax basis in the identified intangible assets recorded as part of the NDS Acquisition. In accordance with SFAS No. 141, Business Combinations, the establishment of the deferred tax liability resulted in an increase to the Company s goodwill asset.

In addition, an earnout agreement was entered into in connection with the NDS Acquisition, and it specifies additional earnout consideration that could be payable to the former NDS stockholders. Earnout payments are conditioned upon the attainment of certain performance measurements for the NDS business over a 12 to 24 month period from the date of the acquisition. On February 15, 2007, the NDS stockholders completed the first of two twelve month earnout periods, during which the required minimum performance measurements were achieved. The Company accrued $886 thousand payable to the NDS stockholders directly related to the completion of the first earnout period during the first quarter of 2007. Of this amount, approximately $709 thousand of the contingent earnout consideration will be payable in cash and $177 thousand will be payable in Common Stock. It is expected that the Company will issue 21,752 shares of Common Stock in connection with the first earnout period. This amount has been reported as an increase in goodwill in the Company s balance sheet as of March 31, 2007. The Company expects to pay the first earnout consideration to the former NDS stockholders during the second quarter of 2007. In addition, the Company may have to pay additional earnout consideration in the future and such additional earnout may be similar to the first earnout.

The NDS acquisition was accounted for as a purchase transaction, and accordingly, the results of operations, commencing from the acquisition date of February 15, 2006, are included in the Company s accompanying consolidated statements of operations. Pro forma financial information related to the NDS acquisition was not presented as the effect of this acquisition was not material to the Company.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

7. BUSINESS COMBINATIONS (Continued):

Acquisition of Ranzal and Associates, Inc.: On October 4, 2004, the Company acquired substantially all of the assets, operations and business of Ranzal and Associates, Inc. (Ranzal), a consulting firm specializing in the development of Business Intelligence and Corporate Performance Management solutions (the Ranzal Acquisition). The results of Ranzal s operations have been included in the Company s accompanying unaudited condensed consolidated statements of operations since the October 4, 2004 acquisition date. The initial purchase price was $5.7 million, including cash paid to the Ranzal stockholders of $5.2 million and direct acquisition costs incurred of $0.5 million. Additional earnout consideration of $3.7 million was paid in cash during 2005 and 2006 related to Ranzal s performance during an eighteen month earnout period following the date of the acquisition. There are no future contingent earnout amounts due to the former stockholders of Ranzal.

8. GOODWILL AND INTANGIBLE ASSETS:

Under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), goodwill and certain intangible assets are deemed to have indefinite lives and are no longer amortized, but are reviewed at least annually for impairment. Other identifiable intangible assets are amortized over their estimated useful lives. SFAS No. 142 requires that goodwill be tested for impairment at the reporting unit level upon adoption and at least annually thereafter, utilizing the fair value methodology. The Company evaluates the fair value of its reporting unit utilizing various valuation techniques and engages an outside valuation firm to provide valuation analysis each year on December 2, which is our selected annual measurement date.

Our net goodwill as of March 31, 2007 and December 31, 2006 was $26.3 million and $25.4 million, respectively. The increase in goodwill from December 31, 2006 was directly related to the contingent earnout consideration payable to the former stockholders of NDS in connection with the completion of NDS first earnout period, which ended on February 15, 2007. During the three-month period ended March 31, 2007, the Company accrued approximately $886 thousand directly related to the earnout consideration payable to the NDS former stockholders. Other net intangibles amounted to $3.5 million and $3.8 million as of March 31, 2007 and December 31, 2006, respectively. The current quarter decrease is solely a result of amortization on the existing identified intangible assets.

Goodwill and intangible assets consisted of the following as of:

	March 31, 2007			December 31, 2006		
	Goodwill	Other Intangibles	Total	Goodwill	Other Intangibles	Total
	(In Thousands)					
Cost basis	$ 35,372	$ 7,260	$ 42,632	$ 34,486	$ 7,260	$ 41,746
Less: Accumulated amortization	9,120	3,778	12,898	9,120	3,463	12,583
Net reported value	$ 26,252	$ 3,482	$ 29,734	$ 25,366	$ 3,797	$ 29,163

Total amortization expense was $314 thousand and $217 thousand during the three-month periods ended March 31, 2007 and 2006, respectively. This amortization expense relates to certain non-competition covenants and customer lists, which will expire from 2007 through 2010.

15

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

9. CAPITAL LEASE OBLIGATIONS:

In December 2006, the Company entered into lease financing arrangements (the Capital Lease Arrangements) with a bank related to certain property and equipment. Payments under the Capital Lease Arrangements are to be made over a period of 48 to 60 months and have a blended interest rate of 6.03% per annum on the outstanding principle balances. As of March 31, 2007, our outstanding obligations under our Capital Lease Arrangements totaled $942 thousand. Of this amount, $213 thousand, which is due and payable within the next twelve months, has been classified as a current capital lease obligation in the accompanying balance sheet.

During the quarter ended March 31, 2007, the Company made payments of principle and interest totaling $23 thousand under the Capital Lease Arrangements. No payments related to capital lease obligations were made during the quarter ended March 31, 2006.

10. EARNINGS PER SHARE:

A reconciliation of net income and weighted average shares used in computing basic and diluted earnings per share is as follows:

	Three Months Ended March 31,	
	2007	2006
	(In Thousands, Except Per Share Data)	
Basic earnings per share:		
Net income applicable to common shares	$ 837	$ 460
Weighted average common shares outstanding	11,344	10,635
Basic income per share of common stock	$ 0.07	$ 0.04
Diluted earnings per share:		
Net income applicable to common shares	$ 837	$ 460
Weighted average common shares outstanding	11,344	10,635
Dilutive effect of stock options	1,105	700
Weighted average common shares, assuming dilutive effect of stock options	12,449	11,335
Diluted earnings per share of common stock	$ 0.07	$ 0.04

Share-based awards, inclusive of all grants made under the Company s Equity Plans, for which either the stock option exercise price, or the fair value of the restricted share award, exceeds the average market price over the period, have an anti-dilutive effect on earnings per share, and accordingly, are excluded from the diluted computations for all periods presented. Had such shares been included, shares for the diluted computation would have increased by approximately 0.2 million in each of the three-month periods ended March 31, 2007 and 2006. As of March 31, 2007 and 2006, there were approximately 4.1 million and 4.7 million share-based awards outstanding under the Company s Equity Plans, respectively.

Table of Contents

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

11. RELATED PARTIES:

Synapse. The Synapse Group, Inc. (Synapse) is considered a related party as its former President and Chief Executive Officer, Michael Loeb, is also a member of our Board of Directors. Mr. Loeb, who resigned as the President and Chief Executive Officer of Synapse during 2005, remains a member of Synapse s board of directors. Mr. Loeb joined Edgewater Technology s Board of Directors in April 2000. Synapse has been an Edgewater Technology customer since 1996. Revenue from Synapse amounted to $1.9 million and $2.2 million in the three-month periods ended March 31, 2007 and 2006, respectively. Accounts receivable balances from Synapse were $1.3 million and $1.4 million as of March 31, 2007 and December 31, 2006, respectively, which amounts were on customary business terms. The Company provides services to Synapse related to infrastructure services, custom software development and systems integration. Services are provided on both a fixed-fee and time and materials basis. Our contracts with Synapse, including all terms and conditions, have been negotiated on an arm s length basis and on market terms similar to those we have with our other customers. In January of 2007, our Company entered into a new one-year service contract with Synapse. It is anticipated that Synapse will purchase approximately $7.0 million in professional services during fiscal 2007. There are no commitments beyond the twelve-month term of the agreement.

Loeb Enterprises. Loeb Enterprises is considered a related party as its founder and President is Michael Loeb. As discussed above, Mr. Loeb is a member of our Board of Directors. Loeb Enterprises has been an Edgewater Technology customer since 2006. Revenue from Loeb Enterprises amounted to $19 thousand and $31 thousand in the three-month periods ended March 31, 2007 and 2006, respectively. Accounts receivable balances from Loeb Enterprises were $18 thousand and $4 thousand as of March 31, 2007 and December 31, 2006, respectively, which amounts were on customary business terms. The Company provides Loeb Enterprises with hosting and support services. These services are provided on both a fixed-fee and time and materials basis. Our contracts with Loeb Enterprises, including all terms and conditions, have been negotiated on an arm s length basis and on market terms similar to those we have with our other customers.

Lease Agreement. Our Company entered into a lease agreement in 1999, which was modified in June 2000, with a stockholder who is a former officer and director. The lease pertains to certain parcels of land and buildings in Fayetteville, Arkansas for its former corporate headquarters that were included in our Company s discontinued operations. Rent payments related to these facilities totaled approximately $64 thousand and $62 thousand for the three-month periods ended March 31, 2007 and 2006, respectively. As our Company s corporate headquarters moved to Wakefield, Massachusetts during 2001, the Company entered into a sublease agreement on July 1, 2002 with a third party to occupy our Fayetteville office facility. The sublease commenced on July 15, 2002 and will end on June 30, 2007. Sublease payments received by the Company totaled approximately $45 thousand and for each of the three-month periods ended March 31, 2007 and 2006.

12. COMMITMENTS AND CONTINGENCIES:

Commitments. On May 4, 2006, the Company executed and made effective an amendment to its Second Amendment to Lease agreement with Harvard Mills Limited Partnership (the Third Amendment to Lease Agreement). The Third Amendment to Lease Agreement pertains to the Company expanding its current office space at its corporate headquarters in Wakefield, Massachusetts by an additional 35,568 square feet (the New Space). The Third Amendment to Lease Agreement extends the existing lease term related to our corporate headquarters located in Wakefield, Massachusetts for an additional three years, up to and until July 31, 2016. The Company occupied the New Space during the first quarter of 2007. Rental payment and rent expense related to the New Space commenced at the beginning of the fourth quarter of 2006 (the New Lease Commencement Date).

As of the New Lease Commencement Date, base rent for the entire premises under the Third Amendment to Lease Agreement, inclusive of the existing space, as outlined in the Company s Second Amendment to Lease agreement, and the New Space, will be $1.2 million per year for the first three-year period ending July 31, 2009, $1.3 million per year for the subsequent four-year period ending July 31, 2013 and $1.4 million per year for the final three-year period ending July 31, 2016. The Third Amendment to Lease Agreement also provides for the payment of certain common operating expenses.

EDGEWATER TECHNOLOGY, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

12. COMMITMENTS AND CONTINGENCIES (Continued):

Rent payments under operating leases, including amounts paid to related parties for discontinued operations, was approximately $0.5 million and $0.3 million for the three-month periods ended March 31, 2007 and 2006, respectively.

In addition to the initial purchase price consideration paid to the former stockholders of NDS, the stockholders are also eligible to receive additional earnout consideration. Any future earnout payments are conditioned upon the attainment of certain performance measurements for the NDS business over the 12- to 24-month periods following the February 15, 2006 acquisition date. As more fully described in Note 7, the former stockholders of NDS are scheduled to receive contingent earnout consideration of $886 thousand related to the completion of the first NDS earnout period, which ended on February 15, 2007. The former stockholders of NDS are eligible for additional contingent earnout consideration in connection with their second and final earnout period, which will be completed on February 15, 2008. Currently, the company expects that any future earnout consideration will be similar to the first earnout consideration.

Contingencies. We are sometimes a party to litigation incidental to our business. We believe that these routine legal proceedings will not have a material adverse effect on our financial position. We maintain insurance in amounts with coverages and deductibles that we believe are reasonable. However, there can be no assurance that such coverages will continue to be available on reasonable terms or will be available in sufficient amounts to cover possible claims that may arise in the future, or that our insurers will not disclaim coverage as to any future claim. The successful assertion of one or more claims against the Company that exceed available insurance coverages or changes in the Company s insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, would have a material adverse effect on the Company s business, results of operations and financial condition.

13. RECENT ACCOUNTING PRONOUNCEMENTS:

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the impact that SFAS No. 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of SFAS No. 115 (SFAS No. 159). SFAS No. 159 permits companies to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that SFAS No. 159 will have on our consolidated financial statements.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following information should be read in conjunction with the information contained in the Unaudited Condensed Consolidated Financial Statements and notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, as filed with the SEC on March 14, 2007. This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. See Risk Factors and Special Note Regarding Forward-Looking Statements included elsewhere herein. We use the terms we, our, us, Edgewater Technology and the Company in this report to refer to Edgewater Technology, Inc. and its wholly-owned subsidiaries.

Business Overview

Edgewater Technology, Inc. is an innovative technology management consulting firm providing a unique blend of premium IT services. We provide our clients with a range of business and technology offerings focused on assisting them in three primary areas:

- envisioning and realizing strategic business solutions:
  - optimizing business processes to improve the delivery of products and services;
  - maximizing and unlocking the value of corporate data assets; and
  - providing program and project management.
- implementing corporate performance management solutions:
  - providing dashboard and data cube design and build;
  - providing data warehouse and ETL tool strategies and implementations; and
  - combining all components into a comprehensive analytics solution.
- leveraging line business with technology:
  - providing design, architectural, and strategic build services;
  - melding advanced business analysis with workflow enhancement; and
  - evaluating and leveraging infrastructure services.

Our primary target is the middle market whose needs span the full spectrum of our offerings. We also provide specialized premium services to divisions of Global 2000 companies. We go to market by vertical industry and currently serve clients in the following industries: Consumer Packaged Goods/Manufacturing; Financial Services (Retail Banking, Portfolio/Asset Management/Student Lending); Healthcare

(Payor/Managed Care)/Life Sciences; Higher Education; Hospitality; Insurance; Retail; and various Emerging Markets.

During the three-month period ended March 31, 2007, we generated total revenue of approximately $16.3 million from a total of 136 clients. Headquartered in Wakefield, Massachusetts, our Company employed approximately 259 consulting professionals as of March 31, 2007.

Our ability to generate revenue is affected by the level of business activity of our clients, which in turn is affected by the level of economic activity occurring in the industries and markets that they serve. A decline in the level of business activity of our clients could have a material adverse effect on our revenue and profit margin. To counter-balance any such decline, in the past we have implemented, as necessary, and could implement if necessary in the future, cost-savings initiatives to manage our expenses as a percentage of revenue as appropriate.

Our consulting professionals represent the largest portion of our operating expenses. Project personnel expenses consist of payroll costs and related benefits associated with our professional staff. Other related expenses include travel, subcontracting, third-party vendor payments and non-billable costs associated with the delivery of services to our clients. We consider the relationship between project personnel expenses and revenue to be an important measure of our operating performance. The relationship between project personnel expenses and revenue is driven largely by the chargeability of our consultant base, the prices we charge our clients and the non-billable costs associated with securing new client engagements and developing new service offerings. The remainder of our recurring operating expenses is comprised of expenses associated with the development of our business and the support of our client-serving professionals, such as professional development and recruiting, marketing and sales, and management and administrative support. Professional development and recruiting expenses consist primarily of recruiting and training content development and delivery costs. Marketing and sales expenses consist primarily of the costs associated with the development and maintenance of our marketing materials and programs.

Table of Contents

Management and administrative support expenses consist primarily of the costs associated with operations including finance, information systems, human resources, facilities (including the rent of office space), and other administrative support for project personnel.

We regularly review our fees for services, professional compensation and overhead costs to ensure that our services and compensation are competitive within our industry, and that our overhead costs are balanced with our revenue level. In addition, we monitor the progress of client projects with client senior management. We manage the activities of our professionals by closely monitoring engagement schedules and staffing requirements for new engagements.

The Company s management monitors and assesses its operating performance by evaluating key metrics and indicators. For example, we review information related to new customer accounts, annualized revenue per billable consultant, periodic consultant utilization rates, gross profit margins and billable employee headcount. This information, along with other operating performance metrics, is used in evaluating our overall performance. These metrics and indicators are discussed in more detail under Results for the Three Months Ended March 31, 2007, Compared to Results for the Three Months Ended March 31, 2006, included elsewhere in this Quarterly Report on Form 10-Q.

Results for the Three Months Ended March 31, 2007, Compared to Results for the Three Months Ended March 31, 2006

The financial information that follows has been rounded in order to simplify its presentation. The amounts and percentages below have been calculated using the detailed financial information contained in the unaudited condensed consolidated financial statements, the notes thereto, and the other financial data included in this Quarterly Report on Form 10-Q.

The following table sets forth the percentage of total revenue of items included in our unaudited condensed consolidated statements of operations:

	Three Months Ended March 31,	
	2007	2006
Revenue:		
Service revenue	93.6%	94.4%
Software revenue	2.3%	2.0%
Reimbursable expenses	4.1%	3.6%
Total revenue	100.0%	100.0%
Cost of revenue:		
Project and personnel costs	52.4%	58.4%
Software costs	1.8%	1.9%
Reimbursable expenses	4.1%	3.6%
Total cost of revenue	58.3%	63.9%
Gross Profit	41.7%	36.1%
Operating expenses:		
Selling, general and administrative	31.7%	30.5%
Depreciation and amortization	3.5%	2.4%
Total operating expenses	35.2%	32.9%
Operating income	6.5%	3.2%
Interest income, net	2.5%	2.1%
Income before income taxes	9.0%	5.3%
Provision for income taxes	3.9%	2.1%

Net income	5.1%	3.2%

Revenue. Total revenue increased by $2.0 million, or 13.7%, to $16.3 million for the three months ended March 31, 2007 from $14.3 million for the three months ended March 31, 2006.

Table of Contents

Of the $2.0 million increase in total revenue during the 2007 three-month period, service revenue, excluding software and reimbursable expense revenue, increased by $1.7 million, or 12.8%, to $15.2 million, as compared to service revenue of $13.5 million during the comparative three-month period in 2006. The incremental quarter-over-quarter increase in service revenue was primarily related to an increase in revenue related to our core business offerings and the full quarter affect of the NDS acquisition. Service revenue related to our core business offerings increased by $1.0 million in connection with continued customer acceptance of our business strategy to deliver premium IT services to the middle market and improved market demand for our offerings. Service revenue related to NDS increased by $0.7 million during the three-month period ended March 31, 2007, when compared to the first quarter of 2006. The Company completed the NDS acquisition on February 15, 2006 (the NDS Acquisition) and accordingly, one and one-half months of NDS operations were included in the Company s operating results during the three-months ended March 31, 2006.

Service revenue from Synapse, our largest customer, amounted to $1.9 million and $2.2 million during the three-month periods ended March 31, 2007 and 2006, respectively. In January of 2007, our Company entered into a new one-year service contract with Synapse. It is anticipated that Synapse will purchase approximately $7.0 million in professional services during 2007. There are no commitments beyond the twelve-month term of the agreement.

Software revenue, which is directly attributable to our Corporate Performance Management offering, increased by $82 thousand, to $375 thousand in the first quarter of 2007, as compared to $293 thousand in the first quarter of 2006. Software sales have been affected in both of the 2007 and 2006 quarterly periods by customer demand for such software in relation to CPM-related services. Gross profit margins are generally much lower on the resale of software when compared to gross margins on consulting services.

Generally, we are reimbursed for our out-of-pocket expenses incurred in connection with our customer s consulting projects. Reimbursed expense revenue increased approximately $0.2 million during the first quarter of 2007, to $0.7 million, as compared to $0.5 million in the first quarter of 2006. The aggregate amount of reimbursed expenses will fluctuate from quarter-to-quarter depending on the location of our customers, the general fluctuation of travel costs, such as airfare, and the number of our projects that require travel.

Our annualized revenue per billable consultant, adjusted for utilization, increased to $292 thousand during the three months ended March 31, 2007, as compared to $268 thousand during the comparative 2006 three-month period. The improvement is due to incremental increases in our average consultant billing rates across all of our service offerings. During the first quarter of 2007, the Company increased the number of customers it served to 136, as compared to 122 customers in the first quarter of 2006. During the first quarter of 2007, service revenue from our five largest customers, including Synapse, increased slightly to 51.7% of our total service revenue, as compared to 50.4% in the first quarter of 2006.

Cost of Revenue. Cost of revenue primarily consists of project personnel costs principally related to salaries, payroll taxes, employee benefits and travel expenses for personnel dedicated to customer projects. These costs represent the most significant expense we incur in providing our services. In total, cost of revenue increased by $0.3 million, or 3.8%, to $9.5 million in the three-month period ended March 31, 2007, as compared to $9.2 million in the three-month period ended March 31, 2006. The 2007 quarterly increase in cost of revenue is attributable to an increase of $0.5 million, or 58.1%, in project and personnel costs related to the full quarter affect of NDS. Only one and one-half months of NDS operations were included in the Company s first quarter of 2006 results of operations in connection with the February 15, 2006 acquisition date.

Software costs increased by $23 thousand, to $290 thousand, during the first quarter of 2007 compared to $267 thousand in the first quarter of 2006. Software costs are expected to fluctuate from quarter-to-quarter depending on our customers demand for CPM-related software. Reimbursable expenses, which increased in the three months ended March 31, 2007 by $0.2 million, to $0.7 million, as compared to $0.5 million in the three-month period ended March 31, 2006, were a direct result of the Company s increased customer base and associated travel-related expenses incurred during the comparative quarterly periods.

Gross Profit. Gross profit increased by $1.6 million, or 31.4%, to $6.8 million in three months ended March 31, 2007, as compared to $5.2 million in the three months ended March 31, 2006. Gross profit, as a percentage of total revenue, increased to 41.7% in first quarter of 2007, as compared to 36.1% in the first quarter of 2006. Gross profit related to service revenue increased to 44.0% in the first quarter of 2007 from 38.0% in the first quarter of 2006.

Table of Contents

The improvement, on an absolute dollar basis, in gross profit during the 2007 quarterly period is directly related to the cumulative effects of growth within our core business, which increased gross profit by $1.4 million in the three months ended March 31, 2007, representing 90.1% of the quarter-over-quarter increase in gross profit, combined with incremental gross profit of $0.2 million provided by three full months of NDS operations in the first quarter of 2007, which represented 9.9% of the quarter-over-quarter increase. Positive factors influencing this growth include an overall increase in customer base and improved average daily billing rates, which are discussed above.

Fluctuations in gross profit, as a percentage of total revenue and service revenue, in the 2007 and 2006 quarterly periods were favorably influenced by the Company s billable consultant utilization rate during the respective quarterly periods. Billable consultant utilization increased to 82.2% in the first quarter of 2007 compared to 78.8% in the first quarter of 2006. The Company s management operates the business with a targeted utilization rate of 78.0% to 82.0%.

Selling, General and Administrative Expense (SG&A). SG&A expenses increased by $0.8 million, or 18.6%, to $5.2 million in the three-month period ended March 31, 2007, as compared to SG&A expenses of $4.4 million in the three months ended March 31, 2006. The increase in SG&A expenses during first quarter of 2007 was primarily due to additions of support personnel to accommodate our overall growth and related recruiting needs, relatively higher commissions due to our revenue growth, increases in the current quarter bonus expense in connection with the Company s 2007 performance-based bonus plan and additional rent related to our facilities expansion.

SG&A expense as a percentage of service revenue, excluding reimbursed expenses, increased to 33.9% for the quarter ended March 31, 2007 from 32.2% for the quarter ended March 31, 2006. The increase in SG&A expenses as a percentage of service revenue is the primarily the result of the comparative quarterly expense increases described above.

As more fully described in Note 12 of the Notes to Unaudited Condensed Consolidated Financial Statements included elsewhere herein, on May 4, 2006, the Company executed and made effective the 2006 Lease Amendment. Additional future annual rent expense to be recognized by the Company under the 2006 Lease Amendment will be approximately $0.7 million per year. The Company began paying rent on the new office space covered under the 2006 Lease Amendment during the fourth quarter of 2006.

Depreciation and Amortization Expense. Depreciation and amortization expense increased 64.1% to $0.6 million in the quarter ended March 31, 2007, as compared to $0.3 million in the quarter ended March 31, 2006. The Company reported a 95.7% increase in comparative depreciation expense during the current quarter due to current and prior quarter asset purchases related to the build out of the lease space related to the 2006 Lease Amendment.

Amortization expense increased by $0.1 million in the first quarter of 2007, as compared to the first quarter of 2006. The current year increase is directly related to the full quarter amortization of intangible assets identified in connection with the NDS Acquisition. Current quarter amortization expense on NDS intangible assets amounted to $314 thousand as compared to amortization expense of $217 thousand during the first quarter of 2006.

Operating Income. The Company s operating income increased 127.8% to $1.1 million in the three-month period ended March 31, 2007, as compared to operating income of $0.5 million in the three-month period ended March 31, 2006. The increase in current quarter operating income is attributable to an increase in comparative service revenue and relatively lower growth in SG&A expenses. Each of these items is explained in further detail above.

Interest Income, Net. We earned net interest income of $0.4 million in the first quarter of 2007, as compared to net interest income of $0.3 million in the first quarter of 2006. Interest income has increased as a result of improved yields on our investments during the first quarter of 2007, as compared to those achieved in during the first quarter of 2006. Average maturity and yield rates as of March 31, 2007 were approximately 78 days and 5.4%, respectively, as compared to 92 days and 4.3%, respectively, as of March 31, 2006.

Provision for Income Taxes. The Company accrues a provision for federal and state income taxes at the applicable statutory rates, adjusted for non-deductible expenses. Our current quarter tax provision totaled $0.6 million, or 42.7% of income before taxes, as compared to a provision of $0.3 million, or 39.7% of income before taxes in the first quarter of 2006. The current quarter increase in our effective income tax rate is reflective of our full utilization of certain state net operating loss carryforwards during 2006.

We have deferred tax assets resulting primarily from federal net operating losses and capital loss carryforwards amounting to $24.6 million for which we have a valuation allowance of $6.5 million. Our federal income tax amounts are charged directly against our deferred tax asset and will not result in cash outlays by the Company. The Company s significant operating loss carryforwards are scheduled to expire on or before 2020.

Net Income. We reported net income of $0.8 million during the quarterly period ended March 31, 2007, as compared to $0.5 million during the comparative 2005 quarterly period. The current year increase in income is a cumulative result of our growth in revenue, gross profit and the full quarter contributions of the NDS Acquisition, which are discussed above.

Liquidity and Capital Resources

The following table summarizes our cash flow activities for the periods indicated:

	Three Months Ended March 31, 2007	2006
	(In Thousands)	
Cash flows (used in) provided by:		
Operating activities	$ (1,189)	$ 1,400
Investing activities	(3,258)	1,250
Financing activities	1,414	362
Discontinued operating activities	(27)	(64)
Total cash (used) provided during the period	$ (3,060)	$ 2,948

As of March 31, 2007, we had cash, cash equivalents, marketable securities and accrued interest income of $31.6 million, a $1.6 million, or 4.8% decrease from the December 31, 2006 balance of $33.2 million. Working capital, which is defined as current assets less current liabilities, increased $1.7 million, to $39.3 million, as of March 31, 2007, as compared to $37.6 million as of December 31, 2006. The $1.6 million decrease in cash, cash equivalents and marketable securities is primarily attributable to cash outflows related to the first quarter payments on the 2006 performance-based bonus plan, an outflow of $1.0 million related to current quarter capital expenditures, and payments related to the renewal of corporate insurance policies. These outflows were offset by an inflow of $1.4 million in proceeds from the employee stock purchase plan and stock option exercises, $0.8 million in current quarter net income and collections on outstanding account receivable balances.

Our primary historical sources of funds have been from operations and the proceeds from equity offerings, as well as sales of businesses in fiscal years 2000 and 2001. Our principal historical uses of cash have been to fund working capital requirements, capital expenditures and acquisitions. We generally pay our employees bi-weekly for their services, while receiving payments from customers 30 to 60 days from the date of the invoice.

Historically, a significant portion of the Company s cash flows from operations have been derived from its largest customer, Synapse, which is considered a related party. Payments received by the Company for services rendered to Synapse totaled approximately $2.1 million and $2.2 million in the three-month periods ended March 31, 2007 and 2006, respectively. All receivable amounts were collected within our normal business terms and our contracts with Synapse are typically for a period of one year or more. In the event there is a loss of revenue related to Synapse, it would be expected that such a loss would have an adverse impact upon the Company s operations and cash flows. However, we believe such an impact could be mitigated through the management of employee headcount and through the redeployment of existing Synapse-related resources on to other consulting projects.

Cash (used in) provided by operating activities was $(1.2) million and $1.4 million for the three months ended March 31, 2007 and 2006, respectively. The cash used during the three months ended March 31, 2007 was largely attributable to the current quarter payout of the Company s 2006 performance-based bonus plan, a $1.8 million increase in accounts receivable balances and a $0.4 million increase in prepaid expense related to the Company s annual renewal of its corporate insurance policies. These outflows were offset by cash inflows related to reported current quarter net income of $0.8 million and an increase in accounts payable and accrued expenses of $0.9 million, which was primarily related to the current quarter accrual of the contingent earnout consideration payable to the former stockholders of NDS. Additional positive cash flow items in the current quarter related to the Company s utilization of its deferred tax asset of $0.5 million, stock-based compensation expense of $0.3 million, and depreciation and amortization expense of $0.6 million.

23

Net cash provided by operating activities was $1.4 million for the three months ended March 31, 2006 and 2005. The cash provided during the three months ended March 31, 2006 was largely attributable to inflows of $3.2 million in accrued expenses and other liabilities, of which $2.6 million related to the Company s accrual of earnout consideration to be paid to the former shareholders of Ranzal based upon the successful completion of the second and final earnout period, $0.5 million in collections of outstanding accounts receivable balances and $0.5 million generated from income from continuing operations. These inflows were offset primarily by a cash outflow of $3.5 million related to accrued payroll and related liabilities, which included the Company s payout of its 2005 performance-based bonuses.

Net cash (used in) provided by investing activities was $(3.6) million and $1.3 million for the three months ended March 31, 2007 and 2006, respectively. Cash used in investing activities for the three months ended March 31, 2007 was attributable to $1.4 million in net purchases of marketable securities, the Company s accruing of $0.9 million in earnout consideration, payable to the former stockholders of NDS, directly related to the completion of the first twelve-month earnout period and capital expenditures of $1.0 million. Cash provided by investing activities for the three months ended March 31, 2006 was attributable to redemptions of marketable securities of $10.8 million, which were offset by a cash outflow of $6.8 million related to the NDS Acquisition and $2.6 million in earnout consideration, payable to the former stockholders of Ranzal, directly related to the successful completion of the second and final earnout period.

As of March 31, 2007, our primary material future liquidity requirements should consist of earnout payments described under Acquisitions, Earnout Payments and Commitments, increased lease payments associated with our lease obligations, including the New Space, and capital expenditure and fit-out expenditures related to the 35,568 square feet of New Space. See Off Balance Sheet Arrangements, Contractual Obligations and Contingent Liabilities and Commitments.

Net cash provided by financing activities was $1.4 million and $0.3 million for the three months ended March 31, 2007 and 2006, respectively. The net cash provided by financing activities in each of the reported three-month periods is directly attributable to the cash received from stock option exercises and proceeds from the employee stock purchase program.

Net cash used in discontinued operations was $27 thousand and $64 thousand for the three months ended March 31, 2007 and 2006, respectively. Net cash used in each of the presented three-month periods related to payments on previously accrued tax matters, associated professional services and net payments on lease arrangements.

Our combined cash and cash equivalents increased by $1.6 million and $2.9 million during the three-month periods ended March 31, 2007 and 2006, respectively. These net changes to the Company s reported cash and cash equivalent balances are reflective of the sources and uses of cash described above. The aggregate of cash, cash equivalents and marketable securities was $31.5 million and $25.6 million as of March 31, 2007 and 2006, respectively.

We believe that our current cash balances and cash flows from operations will be sufficient to fund our short-term operating and liquidity requirements, at least for the next twelve-month period, and our long-term operating and liquidity requirements, based on our current business model. We periodically reassess the adequacy of our liquidity position, taking into consideration current and anticipated requirements. The pace at which we will either generate or consume cash will be dependent upon future operations and the level of demand for our services on an ongoing basis.

Acquisitions, Earnout Payments and Commitments

Acquisition of National Decision Systems, Inc.: In connection with the NDS acquisition, the Company paid to the shareholders of NDS total consideration of approximately $10.2 million, consisting of an initial upfront payment at closing of approximately $8.5 million in cash and assumed liabilities and 264,610 shares of Edgewater s common stock, $0.01 par value per share (Common Stock), which is subject to a three-year lock-up agreement. The Company incurred $0.7 million of direct acquisition costs.

Table of Contents

In addition to the initial cash consideration, the former stockholders of NDS were eligible to receive additional earnout consideration based upon the attainment of certain performance measurements. On February 15, 2007, the NDS stockholders completed their first earnout period, during which the required minimum performance measurements were achieved. The Company has accrued $886 thousand payable to the NDS stockholders directly related to the completion of the first earnout period. Of this amount, approximately $709 thousand of the contingent earnout consideration will be payable in cash and $177 thousand will be payable in Common Stock. It is expected that the Company will issue 21,752 shares of Common Stock in connection with the first earnout period. This amount has been reported as an increase in goodwill in the Company s balance sheet as of March 31, 2007. The Company expects to pay the contingent earnout consideration to the former NDS stockholders during the second quarter of 2007.

The former stockholders of NDS are also eligible for additional contingent earnout consideration in connection with their second and final earnout period, which will be completed on February 15, 2008. Currently, the company expects that any future earnout consideration will be similar to the first earnout consideration.

Acquisition of Ranzal and Associates, Inc.: In connection with the Ranzal acquisition, the initial purchase price consideration was $5.7 million, including cash paid to the Ranzal stockholders of $5.2 million and direct acquisition costs incurred of $0.5 million. Additional earnout of $3.7 million was paid during 2005 & 2006 related to Ranzal s performance during an eighteen month earnout period following the acquisition. There are no future contingent earnout amounts due to the former stockholders of Ranzal.

Off Balance Sheet Arrangements, Contractual Obligations and Contingent Liabilities and Commitments

On May 4, 2006, the Company executed and made effective the 2006 Lease Amendment. The 2006 Lease Amendment pertains to the Company expanding its current office space at its corporate headquarters in Wakefield, Massachusetts by an additional 35,568 square feet (the New Space). The 2006 Lease Amendment extends the existing lease term related to our corporate headquarters located in Wakefield, Massachusetts for an additional three years, up to and until July 31, 2016. The Company occupied the New Space during the first quarter of 2007. Rent on the New Space commenced at the beginning of the fourth quarter of 2006 (the New Lease Commencement Date).

As of the New Lease Commencement Date, base rent for the entire premises under the 2006 Lease Amendment, inclusive of the existing space, as outlined in the Company s Second Amendment to Lease agreement, and the New Space, will be $1.2 million per year for the first three-year period ending July 31, 2009, $1.3 million per year for the subsequent four-year period ending July 31, 2013 and $1.4 million per year for the final three-year period ending July 31, 2016. The 2006 Lease Amendment also provides for the payment of certain common operating expenses. Rent expense related solely to our Wakefield facility was $307 thousand and $123 thousand during the three months ended March 31, 2007 and 2006, respectively.

In December 2006, the Company entered into lease financing arrangements (the Capital Lease Arrangements) with a bank related to certain property and equipment. Payments under the Capital Lease Arrangements are to be made over a period of 48 to 60 months and have a blended interest rate of 6.03% per annum on the outstanding principle balances. As of March 31, 2007, our outstanding obligations under our Capital Lease Arrangements totaled $942 thousand. Of this amount, $213 thousand, which is due and payable within the next twelve months, has been classified as a current capital lease obligation in the accompanying balance sheet. During the quarter ended March 31, 2007, the Company made payments of principle and interest totaling $23 thousand under the Capital Lease Arrangements. No payments related to capital lease obligations were made during the quarter ended March 31, 2006.

Critical Accounting Policies and Estimates

We prepare our unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. Except for the adoption of FIN No. 48, as described in Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements, we reaffirm the critical accounting policies and estimates as reported in our 2006 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 14, 2007.

Table of Contents

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the impact that SFAS No. 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of SFAS No. 115 (SFAS No. 159). SFAS No. 159 permits companies to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that SFAS No. 159 will have on our consolidated financial statements.

Risk Factors

In addition to other information contained in this Form 10-Q, the following risk factors should be carefully considered in evaluating Edgewater Technology and its business because such factors could have a significant impact on our business, operating results and financial condition. These risk factors could cause actual results to materially differ from those projected in any forward-looking statements.

Our success depends on a limited number of significant customers, and our results of operations and financial condition could be negatively affected by the loss of a major customer or significant project or the failure to collect a large account receivable. We generate a significant portion of our service revenue from a limited number of customers. As a result, if we were to lose a major customer or large project, our service revenue could be materially and adversely affected. During the three months ended March 31, 2007, our five largest customers accounted for 51.7% of our service revenue. During the three months ended March 31, 2006, our five largest customers accounted for 50.2% of our service revenue. We perform varying amounts of work for specific customers from year-to-year. A major customer in one year may not use our services in another year. In addition, we may derive revenue from a major customer that constitutes a large portion of a particular quarter s total revenue. If we lose any major customers or any of our customers cancel or significantly reduce a large project s scope, including but not limited to Synapse, our results of operations and financial condition could be materially and adversely affected. Further, if we fail to collect a large accounts receivable balance, we could be subjected to a material financial expense and a decrease in cash flow.

Our lack of long-term customer contracts reduces the predictability of our revenues because these contracts may be canceled on short notice and without penalty. Our customers generally retain us on a project-by-project basis, rather than under long-term contracts. As a result, a customer may not engage us for further services once a project is complete. If a significant customer, or a number of customers, terminate, significantly reduce, or modify their contracts with us, our results of operations would be materially and adversely affected. Consequently, future revenue should not be predicted or anticipated based on the number of customers we have or the number and size of our existing projects. If a customer were to postpone, modify, or cancel a project, including but not limited to Synapse, we would be required to shift our consultants to other projects to minimize the impact on our operating results. We cannot provide assurance that we will be successful in efficiently and effectively shifting our consultants to new projects in the event of project terminations, which could result in reduced service revenue and lower gross margins. If we experience unexpected changes or variability in our revenue, we could experience variations in our quarterly operating results and our actual results may differ materially from the amounts planned and our operating profitability may be reduced or eliminated.

If we fail to satisfy our customers expectations, our existing and continuing business could be adversely affected. Our sales and marketing strategy emphasizes our belief that we have highly referenceable accounts. Therefore, if we fail to satisfy the expectations of our customers, we could damage our reputation and our ability to retain existing customers and attract new customers. In addition, if we fail to deliver and perform on our engagements, we could be liable to our customers for breach of contract. Although most of our contracts limit the amount of any damages to the fees we receive, we could still incur substantial cost, negative publicity, and diversion of management resources to defend a claim, and as a result, our business results could suffer.

Table of Contents

We may have lower margins, or lose money, on fixed-price contracts. As part of our strategy, we intend to continue to grow our business with time-and-materials contracts, fixed-price contracts, and fixed-fee contracts. During the three months ended March 31, 2007, fixed-price contracts represented approximately 2.9% of our service revenue. We assume greater financial risk on fixed-price contracts than on time-and-materials or fixed-fee engagements, and we cannot assure you that we will be able to successfully price our larger fixed-price contracts. If we fail to accurately estimate the resources and time required for an engagement, fail to manage customer expectations effectively or fail to complete fixed-price engagements within planned budgets, on time and to our customers satisfaction, we could be exposed to cost overruns, potentially leading to lower gross profit margins, or even losses on these engagements.

Competition in the IT and management consulting services market is intense and, therefore, we may lose projects to, or face pricing pressure from, our competitors or prospective customers internal IT departments or international outsourcing firms. The market for IT and management consulting providers is highly competitive. In many cases, we compete for premium IT services work with in-house technical staff, software product companies with extended service organizations and other international IT and management consulting firms, including offshore outsourcing firms. In addition, there are many small, boutique technology management consulting firms who have developed services similar to those offered by us. We believe that competition will continue to be strong and may increase in the future, especially if our competitors reduce their price for IT and management consulting services, reduce their blended costs for such services and/or enhance the quality or range of services. Such pricing pressure could have a material impact on our revenues and margins and limit our ability to provide competitive services.

Our target market is rapidly evolving and is subject to continuous technological change. As a result, our competitors may be better positioned to address these developments or may react more favorably to these changes, which could have a material adverse effect on our business. We compete on the basis of a number of factors, many of which are beyond our control. Existing or future competitors may develop or offer IT and management consulting services that provide significant technological, creative, performance, price or other advantages over the services we offer.

See Item 1 Business Competition in our 2006 Annual Report on Form 10-K, as filed with the SEC on March 14, 2007, for a representative list of competitors in the IT and management consulting services space.

Some of our competitors have longer operating histories and significantly greater financial, technical, marketing and managerial resources than we do. There are relatively low barriers of entry into our business. We have no patented or other proprietary technology that would preclude or inhibit competitors from entering the IT services market. Therefore, we must rely on the skill of our personnel and the quality of our customer service. The costs to start an IT and management consulting services firm are low. We expect that we will continue to face additional competition from new entrants into the market in the future, offshore providers and larger integrators and we are subject to the risk that our employees may leave us and may start competing businesses. Any one or more of these factors could have a material impact on our business.

Because we rely on highly-trained and experienced personnel to design and build complex systems for our customers, an inability to retain existing employees and attract new qualified employees would impair our ability to provide our services to existing and new customers. Our future success depends in large part on our ability to attract new qualified employees and retain existing highly-trained and experienced technical consultants, project management consultants, business analysts and sales and marketing professionals of various experience levels. If we fail to attract new employees or retain our existing employees, we may be unable to complete existing projects or bid for new projects of similar size, which could adversely affect our revenues. While attracting and retaining experienced employees is critical to our business and growth strategy, maintaining our current employee base may also be particularly difficult. Even if we are able to grow and expand our employee base, the additional resources required to attract new employees and retain existing employees may adversely affect our operating margins.

We depend on our key personnel, and the loss of their services may adversely affect our business. We believe that our success depends on the continued employment of the senior management team and other key personnel. This dependence is particularly important to our business because personal relationships are a critical element in obtaining and maintaining customer engagements. If one or more members of the senior management team or other key personnel were unable or unwilling to continue in their present positions, our business could be seriously harmed. Furthermore, other companies seeking to develop in-house business capabilities may hire away some of our key personnel.

Table of Contents

Past or future business combination transactions or other strategic alternatives could disrupt our ongoing business, distract our management and employees, increase our expenses and adversely affect our business. We realized recent growth, in part, through acquisitions, and we anticipate that a portion of our future growth may be accomplished through one or more business combination transactions or other strategic alternatives. The ultimate success of any such transactions will depend upon, among other things, our ability to integrate acquired personnel, operations, products and technologies into our organization effectively, to retain and motivate key personnel of acquired businesses and to retain customers of acquired businesses. We cannot assure you that we will be successful in this regard or that we will be able to identify suitable opportunities, continue to successfully grow acquired businesses, integrate acquired personnel and operations successfully or utilize our cash or equity securities as acquisition currency on acceptable terms to complete any such business combination transactions. These difficulties could disrupt our ongoing business, distract our management and employees, increase our expenses and materially and adversely affect our results of operations. Any such transactions would involve certain other risks, including the reduction of cash and/or working capital, the assumption of additional liabilities, potentially dilutive issuances of equity securities and diversion of management s attention from operating activities.

Volatility of our stock price could result in expensive class action litigation. If our common stock suffers from volatility like the securities of other technology and consulting companies, we could be subject to securities class action litigation similar to that which has been brought against other companies following periods of volatility in the market price of their common stock. The process of defending against these types of claims, regardless of their merit, is costly and often creates a considerable distraction to senior management. Any future litigation could result in substantial additional costs and could divert our resources and senior management s attention. This could harm our productivity and profitability and potentially adversely affect our stock price.

We may not be able to protect our intellectual property rights or we may infringe upon the intellectual property rights of others, which could adversely affect our business. Our future success will depend, in part, upon our intellectual property rights and our ability to protect these rights. We do not have any patents or patent applications pending. Existing trade secret and copyright laws afford us only limited protection. Third parties may attempt to disclose, obtain or use our solutions or technologies. This is particularly true in foreign countries where laws or law enforcement practices may not protect our proprietary rights as fully as in the United States. Others may independently develop and obtain patents or copyrights for technologies that are similar or superior to our technologies. If that happens, we may need to license these technologies and we may not be able to obtain licenses on reasonable terms, if at all. If we are unsuccessful in any future intellectual property litigation, we may be forced to do one or more of the following:

Cease selling or using technology or services that incorporate the challenged intellectual property;

Obtain a license, which may not be available on reasonable terms or at all, to use the relevant technology;

Configure services to avoid infringement; and

Refund license fees or other payments that we have previously received.

Generally, we develop software applications for specific customer engagements. Issues relating to ownership of and rights to use software applications and frameworks can be complicated. Also, we may have to pay economic damages in these disputes, which could adversely affect our results of operations and financial condition.

Fluctuations in our quarterly revenues and operating results may lead to reduced prices for our stock. Our quarterly revenues and operating results can sometimes be volatile. We believe comparisons of prior period operating results cannot be relied upon as indicators of future performance. If our revenues or our operating results in any future period fall below the expectations of securities analysts and investors, the market price of our securities would likely decline.

Factors that may cause our quarterly results to fluctuate in the future include the following:

Variability in market demand for IT and management consulting services;

Length of the sales cycle associated with our service offerings;

Unanticipated variations in the size, budget, number or progress toward completion of our engagements;

Unanticipated termination of a major engagement, a customer s decision not to proceed with an engagement we anticipated or the completion or delay during a quarter of several major customer engagements;

Efficiency with which we utilize our employees, or utilization, including our ability to transition employees from completed engagements to new engagements;

Our ability to manage our operating costs, a large portion of which are fixed in advance of any particular quarter;

Changes in pricing policies by us or our competitors;

Table of Contents

- Seasonality and cyclicality, including the effects of lower utilization rates during periods with disproportionately high holiday and vacation usage experience;

- Timing and cost of new office expansions;

- The timing of customer year-end periods and the impact of spending relative to such year-end periods;

- Our ability to manage future growth; and

- Costs of attracting, retaining and training skilled personnel.

Some of these factors are within our control, while others are outside of our control.

Anti-takeover provisions in our charter documents, our stockholder rights plan and/or Delaware law could prevent or delay a change in control of our Company. Our Board of Directors can issue preferred stock in one or more series without stockholder action. The existence of this blank-check preferred stock provision could render more difficult or discourage an attempt to obtain control by means of a tender offer, merger, proxy contest or otherwise. In addition, our Company has a stockholder rights plan, commonly referred to as a poison pill, that may discourage an attempt to obtain control by means of a tender offer, merger, proxy contest or otherwise. If a person acquires 20% or more of our outstanding shares of common stock, except for certain institutional stockholders, who may acquire up to 25% of our outstanding shares of common stock, then rights under this plan would be triggered, which would significantly dilute the voting rights of any such acquiring person. Certain provisions of the Delaware General Corporation Law may also discourage someone from acquiring or merging with us.

If clients view offshore development as a viable alternative to our service offerings, our pricing, revenue, margins and profitability may be negatively affected. A trend has developed whereas international IT service firms have been founded in countries such as India and China, which have well-educated and technically-trained workforces available at wage rates that are substantially lower than U.S. wage rates. While traditionally we have not competed with offshore development, presently this form of software development is experiencing rapid and increasing acceptance in the market. To counteract this trend, we are focusing towards premium service offerings, including design and strategy consulting engagements, which are more difficult for offshore development firms to replicate. If we are unable to continually evolve our service offerings or the rate of acceptance of offshore development advances even faster than we expect, then our pricing and revenue could be adversely affected.

We may be required to record additional goodwill impairment charges in future quarters. As of March 31, 2007, we had recorded goodwill and related intangible assets with a net book value of $29.7 million related to prior acquisitions. We test for impairment at least annually and whenever evidence of impairment exists. We performed our annual goodwill impairment test as of December 2, 2007 and 2006 and determined that the goodwill and related intangible assets were not impaired. We have in the past recorded impairments to our goodwill, however. In January 2002, we recorded as a change in accounting principle, a non-cash impairment charge of $12.5 million related to our goodwill. We recorded an additional non-cash charge of $7.4 million, related to a further impairment in December 2002. See Item 8 Financial Statements and Supplementary Data Notes 2 and 7 in our 2006 Annual Report on Form 10-K as filed with the SEC on March 14, 2007. As goodwill values are measured using a variety of factors, including values of comparable companies and using overall stock market and economic data, in addition to our own future financial performance, we may be required in the future to record additional impairment charges that could have a material adverse effect on our reported results.

We may not generate enough income this year or in future periods to maintain the current net carrying value of our deferred tax asset. We have a deferred tax asset of approximately $18.1 million, net of an applicable valuation allowance, as of March 31, 2007. If we are unable to generate enough income this year or in future periods, the valuation allowance relating to our deferred tax asset may have to be revised upward, which would reduce the carrying value of this asset on our balance sheet under generally accepted accounting principles. An increase in the valuation allowance and a related reduction in the carrying value of this asset would increase our provision for income taxes, thereby reducing net income or increasing net loss, and could reduce our total assets (depending on the amount of any such change or changes). An increase in the valuation allowance could otherwise have a material adverse effect on our results of operations and/or our stockholders equity and financial position.

29

Table of Contents

Material changes to our strategic relationship with Hyperion Solutions Corporation (Hyperion). The Ranzal business, which we acquired in October of 2004, derives a substantial portion of its revenues from a channel relationship with Hyperion. This relationship involves Hyperion assisted lead generation support with respect to the business intelligence services provided by Ranzal. This relationship is governed by a Consulting Reseller Partner Agreement, which is subject to annual renewal and is scheduled to expire in October of 2007. A failure to renew this relationship, or a material modification or change in Hyperion s partner approach or its contract terms, for any reason, could have a material adverse impact on our results of operations.

Our reliance upon Synapse. Synapse is considered both a significant customer and a related party. Revenues from Synapse amounted to $1.9 million, or 12.7% of service revenues, and $2.2 million, or 25.2% of service revenues, for the three months ended March 31, 2007 and 2006, respectively. The Company provides services to Synapse related to infrastructure support, custom software development and systems integration. Services are provided on both a fixed-fee and time and materials basis. Our contracts with Synapse, including all terms and conditions, are consistent with those we have with our other customers and are negotiated on an annual basis. In January of 2007, our Company entered into a new one-year service contract with Synapse. It is anticipated that Synapse will purchase approximately $7.0 million in professional services during fiscal 2007. There are no commitments beyond the twelve-month term of the agreement. There is no guarantee that the Company will be able to successfully negotiate a new contract with Synapse at the end of the current contract period. Additionally, there is no guarantee that revenues related to Synapse services will be comparable to those generated in the past.

Table of Contents

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

Some of the statements in this Quarterly Report on Form 10-Q and elsewhere constitute forward-looking statements under Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements made with respect to significant customers, revenue, backlog, competitive and strategic initiatives, growth plans, potential stock repurchases, future results, tax consequences and liquidity needs. These statements involve known and unknown risks, uncertainties and other factors that may cause results, levels of activity, growth, performance, tax consequences or achievements to be materially different from any future results, levels of activity, growth, performance, tax consequences or achievements expressed or implied by such forward-looking statements. Such factors include, among other things, those listed below, as well as those further set forth under the heading Business Factors Affecting Finances, Business Prospects and Stock Volatility in our 2006 Annual Report on Form 10-K as filed with the SEC on March 14, 2007.

The forward-looking statements included in this Form 10-Q and referred to elsewhere are related to future events or our strategies or future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, should, believe, anticipate, future, forward, potential, estimate, encourage, opportunity, goal, objective, quality, growth, leader, could , expect, focus, build, through, strategy, expiration, provide, offer, maximize, allow, allowed, represent, commitment, create, increase, add, establish, pursue, feel, work, perform, make, continue, can, ongoing, include or the negative of such terms or comparable terminology. These forward-looking statements inherently involve certain risks and uncertainties, although they are based on our current plans or assessments which are believed to be reasonable as of the date of this Form 10-Q. Factors that may cause actual results, goals, targets or objectives to differ materially from those contemplated, projected, forecasted, estimated, anticipated, planned or budgeted in such forward-looking statements include, among others, the following possibilities: (1) inability to execute upon growth objectives, including growth in entities acquired by our Company; (2) failure to obtain new customers or retain significant existing customers; (3) the loss of one or more key executives and/or employees; (4) changes in industry trends, such as a decline in the demand for Business Intelligence (BI) and Corporate Performance Management (CPM) solutions, custom development and system integration services and/or delays in industry-wide information technology (IT) spending, whether on a temporary or permanent basis and/or delays by customers in initiating new projects or existing project milestones; (5) adverse developments and volatility involving geopolitical or technology market conditions; (6) unanticipated events or the occurrence of fluctuations or variability in the matters identified under Critical Accounting Policies; (7) failure of our sales pipeline to be converted to billable work and recorded as revenue; (8) failure of the middle market and the needs of middle-market enterprises for business services to develop as anticipated; (9) inability to recruit and retain professionals with the high level of information technology skills and experience needed to provide our services; (10) failure to expand outsourcing services to generate additional revenue; (11) any changes in ownership of the Company or otherwise that would result in a limitation of the net operating loss carryforward under applicable tax laws; (12) the failure of the marketplace to embrace CPM or BI services; and/or (13) the failure to obtain remaining predecessor entity tax records that are not in our control. In evaluating these statements, you should specifically consider various factors described above as well as the risks outlined under Item I Business Factors Affecting Finances, Business Prospects and Stock Volatility in our 2006 Annual Report on Form 10-K filed with the SEC on March 14, 2007. These factors may cause our actual results to differ materially from those contemplated, projected, anticipated, planned or budgeted in any such forward-looking statements.

Although we believe that the expectations in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, growth, earnings per share or achievements. However, neither we nor any other person assumes responsibility for the accuracy and completeness of such statements. We are under no duty to update any of the forward-looking statements after the date of this Form 10-Q to conform such statements to actual results.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our primary financial instruments include investments in money market funds, short-term municipal bonds, commercial paper and U.S. government securities that are sensitive to market risks and interest rates. The investment portfolio is used to preserve our capital until it is required to fund operations, strategic acquisitions or distributions to stockholders. None of our market-risk sensitive instruments are held for trading purposes. We did not purchase derivative financial instruments in the three-month periods ended March 31, 2007 and 2006. Should interest rates on the Company s investments fluctuate by 10% the impact would not be material to the financial condition, results of operations or cash flows.

The impact of inflation and changing prices has not been material on revenue or income from continuing operations during the three-month periods ended March 31, 2007 and 2006.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, which we have designed to ensure that material information related to the Company, including our consolidated subsidiaries, is properly identified and evaluated on a regular basis and disclosed in accordance with all applicable laws and regulations. In response to recent legislation and proposed regulations, we reviewed our disclosure controls and procedures. We also established a disclosure committee which consists of certain members of our senior management. The President and Chief Executive Officer and the Chief Financial Officer of Edgewater Technology, Inc. (its principal executive officer and principal financial officer, respectively) have concluded, based on their evaluations as of the end of the period covered by this Report, that the Company s disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by it under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company s management as appropriate to allow timely decisions regarding required disclosure.

Changes in Controls and Procedures

There were no significant changes in the Company s internal controls, or in other factors that could significantly affect these internal controls, subsequent to the date of our most recent evaluation.

Table of Contents

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are sometimes a party to litigation incidental to our business. We maintain insurance in amounts, with coverages and deductibles, which we believe are reasonable. As of the date of the filing of this Form 10-Q, our Company is not a party to any existing material litigation matters.

ITEM 1A. RISK FACTORS

A restated description of the risk factors associated with our business is included under Risk Factors in Management s Discussion and Analysis of Financial Condition and Results of Operations, contained in Item 2 of Part I of this quarterly report. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Item 1A of our 2006 Annual Report on Form 10-K and is incorporated herein by reference.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable as our Company does not have any senior securities issued or outstanding.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

31.1 13a-14 Certification President and Chief Executive Officer*

31.2 13a-14 Certification Chief Financial Officer*

32 Section 1350 Certification*

---

* - Filed herein.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	EDGEWATER TECHNOLOGY, INC.
Date: May 15, 2007	/s/ SHIRLEY SINGLETON Shirley Singleton President and Chief Executive Officer
Date: May 15, 2007	/s/ KEVIN R. RHODES Kevin R. Rhodes Chief Financial Officer (principal financial and accounting officer)