

AMERICAN SOFTWARE INC  
Form 10-Q  
December 11, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended October 31, 2006

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: 0-12456

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**AMERICAN SOFTWARE, INC.**

(Exact name of registrant as specified in its charter)

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Georgia  
(State or other jurisdiction of

incorporation or organization)

470 East Paces Ferry Road, N.E., Atlanta, Georgia  
(Address of principal executive offices)

58-1098795  
(IRS Employer

Identification Number)

30305  
(Zip Code)

(404) 261-4381

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(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Classes	Outstanding at December 7, 2006
Class A Common Stock, \$.10 par value	25,235,250 Shares
Class B Common Stock, \$.10 par value	3,222,794 Shares

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AMERICAN SOFTWARE, INC. AND SUBSIDIARIES

Form 10-Q

Quarter ended October 31, 2006

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**Table of Contents****PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****American Software, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets (unaudited)**

(in thousands, except share data)

	October 31, 2006	April 30, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 31,763	\$ 29,425
Investments	33,342	32,724
Trade accounts receivable, less allowance for doubtful accounts of \$170 at October 31, 2006 and \$244 at April 30, 2006:		
Billed	12,972	11,302
Unbilled	4,502	4,514
Deferred income taxes		248
Prepaid expenses and other current assets	2,909	2,323
<b>Total current assets</b>	<b>85,488</b>	<b>80,536</b>
Investments - noncurrent	107	499
Property and equipment, net	7,362	7,669
Capitalized software, net	6,373	6,711
Goodwill	11,211	11,120
Other intangibles, net	1,732	1,893
Other assets	295	1,461
	<b>\$ 112,568</b>	<b>\$ 109,889</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,109	\$ 917
Accrued compensation and related costs	1,831	4,195
Dividends payable	1,967	1,712
Other current liabilities	4,592	3,358
Deferred income taxes	174	
Deferred revenue	17,321	15,306
<b>Total current liabilities</b>	<b>26,994</b>	<b>25,488</b>
Deferred income taxes	1,384	870
Minority interest	4,467	4,159
Shareholders' equity:		
Common stock:		
Class A, \$.10 par value. Authorized 50,000,000 shares:		
Issued 25,128,609 shares at October 31, 2006 and 24,918,930 shares at April 30, 2006	2,513	2,492
Class B, \$.10 par value. Authorized 10,000,000 shares:		
Issued and outstanding 3,239,694 shares at October 31, 2006 and 3,324,994 shares at April 30, 2006; convertible into Class A shares on a one-for-one basis	324	332
Additional paid-in capital	79,947	79,001

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Accumulated other comprehensive income	144	136
Retained earnings	17,300	17,916
Class A treasury stock, 3,782,185 shares at October 31, 2006 and April 30, 2006	(20,505)	(20,505)
Total shareholders' equity	79,723	79,372
Commitments and contingencies		
	\$ 112,568	\$ 109,889

See accompanying notes to condensed consolidated financial statements - unaudited.

**Table of Contents****American Software, Inc. and Subsidiaries****Condensed Consolidated Statements of Operations (unaudited)****(in thousands, except earnings per share data)**

	<b>Three Months Ended October 31,</b>		<b>Six Months Ended October 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Revenues:</b>				
License	\$ 4,333	\$ 4,989	\$ 8,706	\$ 8,433
Services and other	9,280	8,114	18,543	15,801
Maintenance	6,612	5,931	13,157	11,566
<b>Total revenues</b>	<b>20,225</b>	<b>19,034</b>	<b>40,406</b>	<b>35,800</b>
<b>Cost of revenues:</b>				
License	1,605	1,008	3,059	2,082
Services and other	6,300	5,964	12,944	11,493
Maintenance	1,791	1,639	3,568	3,207
<b>Total cost of revenues</b>	<b>9,696</b>	<b>8,611</b>	<b>19,571</b>	<b>16,782</b>
<b>Gross margin</b>	<b>10,529</b>	<b>10,423</b>	<b>20,835</b>	<b>19,018</b>
Research and development	1,726	1,601	3,445	3,112
Sales and marketing	3,523	3,524	7,040	6,636
General and administrative	3,470	3,329	6,735	6,411
Amortization of acquisition-related intangibles	87	87	175	175
(Recovery) provision for doubtful accounts	(43)	85		158
<b>Total operating expenses</b>	<b>8,763</b>	<b>8,626</b>	<b>17,395</b>	<b>16,492</b>
<b>Operating income</b>	<b>1,766</b>	<b>1,797</b>	<b>3,440</b>	<b>2,526</b>
<b>Other income:</b>				
Interest income	642	442	1,266	841
Other, net	824	(241)	805	477
<b>Earnings before income taxes</b>	<b>3,232</b>	<b>1,998</b>	<b>5,511</b>	<b>3,844</b>
<b>Income tax expense</b>	<b>(1,273)</b>	<b>(758)</b>	<b>(2,178)</b>	<b>(1,482)</b>
<b>Minority interest expense</b>	<b>(138)</b>	<b>(421)</b>	<b>(265)</b>	<b>(519)</b>
<b>Net earnings</b>	<b>\$ 1,821</b>	<b>\$ 819</b>	<b>\$ 3,068</b>	<b>\$ 1,843</b>
<b>Earnings per common share:</b>				
Basic	\$ 0.07	\$ 0.03	\$ 0.13	\$ 0.08
Diluted	\$ 0.07	\$ 0.03	\$ 0.12	\$ 0.07
Cash dividends declared per common share	\$ 0.08	\$ 0.07	\$ 0.15	\$ 0.14

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Shares used in the calculation of earnings per common share:				
Basic	24,534	23,992	24,529	23,981
Diluted	25,645	25,167	25,628	24,921

See accompanying notes to condensed consolidated financial statements - unaudited.

**Table of Contents****American Software, Inc. and Subsidiaries****Condensed Consolidated Statements of Cash Flows (unaudited)**

(in thousands)

	<b>Six Months Ended October 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities:</b>		
Net earnings	\$ 3,068	\$ 1,843
<b>Adjustments to reconcile net earnings to net cash provided by operating activities:</b>		
Depreciation and amortization	2,289	1,830
Stock-based compensation expense	442	
Bond amortization	(181)	(47)
Tax benefit of stock options exercised	191	
Excess tax benefits from stock-based compensation	(661)	
Net gain on investments	(162)	(369)
Minority interest in net earnings of subsidiary	265	519
Deferred income taxes	936	1,649
Investment impairment and other non-cash items		160
<b>Changes in operating assets and liabilities:</b>		
Purchases of trading securities	(14,229)	(12,617)
Proceeds from sale of trading securities	14,206	10,205
Proceeds from maturities of trading securities	1,400	
Accounts receivable, net	(1,658)	13
Prepaid expenses and other assets	(517)	(601)
Accounts payable and other liabilities	(843)	(748)
Deferred revenue	2,015	(301)
Other	9	
<b>Net cash provided by operating activities</b>	<b>6,570</b>	<b>1,536</b>
<b>Cash flows from investing activities:</b>		
Capitalized computer software development costs	(1,183)	(1,431)
Intangible assets	(110)	(189)
Goodwill	(90)	(584)
Purchases of property and equipment, net of disposals	(190)	(267)
Purchases of investments	(58,310)	(50,441)
Proceeds from maturities of investments	57,050	49,027
Proceeds from exercise of stock options by subsidiary	87	
Proceeds of cash surrender life insurance	1,097	
Purchases of common stock by subsidiary		(532)
<b>Net cash used in investing activities</b>	<b>(1,649)</b>	<b>(4,417)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from Dividend Reinvestment Plan and Stock Purchase Plan	13	23
Excess tax benefits from stock based compensation	661	
Proceeds from exercise of stock options	269	89
Dividends paid	(3,526)	(3,361)
<b>Net cash used in financing activities</b>	<b>(2,583)</b>	<b>(3,249)</b>



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Net change in cash and cash equivalents	2,338	(6,130)
Cash and cash equivalents at beginning of period	29,425	31,147
Cash and cash equivalents at end of period	\$ 31,763	\$ 25,017

See accompanying notes to condensed consolidated financial statements - unaudited.

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**AMERICAN SOFTWARE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements - Unaudited**

**October 31, 2006**

**A. Basis of Presentation**

The accompanying condensed consolidated financial statements are unaudited. Pursuant to the rules and regulations of the Securities and Exchange Commission (SEC), we have condensed or omitted certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles. You should review these condensed consolidated financial statements in conjunction with the consolidated financial statements and related notes contained in our Annual Report on Form 10-K for the fiscal year ended April 30, 2006, as filed with the SEC. The financial information we present in the condensed consolidated financial statements reflects all normal recurring adjustments, which are, in our opinion, necessary for a fair presentation of the period indicated. This information is not necessarily indicative of the results for the full year or for any other future period.

**B. Principles of Consolidation**

The consolidated financial statements include the accounts of American Software, Inc., and its wholly and majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

**C. Revenue Recognition**

We recognize revenue in accordance with Statement of Position No. 97-2: Software Revenue Recognition, (SOP 97-2) and Statement of Position No. 98-9: Modification of SOP 97-2, Software Revenue Recognition With Respect to Certain Transactions (SOP 98-9).

*License.* License revenue in connection with license agreements for standard proprietary software is recognized upon delivery of the software, providing collection is considered probable, the fee is fixed or determinable, there is evidence of an arrangement, and vendor specific objective evidence (VSOE) exists with respect to any undelivered elements of the arrangement. For multiple-element arrangements, we recognize revenue under the residual method as permitted by SOP 98-9, whereby (1) the total fair value of the undelivered elements, as indicated by VSOE, is deferred and subsequently recognized in accordance with SOP 97-2 and (2) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements. We record revenues from sales of third-party products net of royalties, in accordance with Emerging Issues Task Force Issue 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent (EITF 99-19). Furthermore, in accordance with EITF 99-19, we evaluate sales through our indirect channel on a case-by-case basis to determine whether the transaction should be recorded gross or net, including but not limited to assessing whether or not we: 1) act as principal in the transaction, 2) take title to the products, 3) have risks and rewards of ownership, such as the risk of loss for collection, delivery, or returns, and 4) act as an agent or broker with compensation on a commission or fee basis. Accordingly, our sales through the DMI channel are recorded on a gross basis.

*Maintenance.* Revenue derived from maintenance contracts primarily includes telephone consulting, product updates, and releases of new versions of products previously purchased by the customer, as well as error reporting and correction services. Typically, we sell maintenance contracts for a separate fee with initial contractual periods ranging from one to three years with renewal for additional periods thereafter. We generally bill maintenance fees annually in advance. We recognize maintenance ratably over the term of the maintenance agreement. In situations where we bundle all or a portion of the maintenance fee with the license fee, VSOE for maintenance is determined based on prices when sold separately.

*Services.* Revenue derived from services primarily includes consulting, implementation, and training. We primarily bill fees under time and materials arrangements and recognize them as services are performed. In accordance with the FASB's Emerging Issues Task Force Issue No. 01-14: Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred (EITF No. 01-14), we recognize amounts received for reimbursement of travel and other out-of-pocket expenses incurred as revenue in the consolidated statements of operations under services and other.

*Indirect Channel Revenue.* We recognized revenues for sales made through indirect channels principally when the distributor makes the sale to an end-user, when the license fee is fixed or determinable, the license fee is nonrefundable, and the sale meets all other conditions of SOP 97-2

and SOP 98-9.

*Deferred Revenue.* Deferred revenue represents advance payments or billings for software licenses, services, and maintenance billed in advance of the time revenue is recognized.

**Table of Contents****AMERICAN SOFTWARE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements - Unaudited****October 31, 2006****D. Major Customer**

No single customer accounted for more than 10% of our total revenues during the three months ended October 31, 2006. One customer accounted for approximately 11% of our total revenues for the six months ended October 31, 2006. One customer accounted for 13% and 14% each of our total revenues for the three and six months ended October 31, 2005. The related accounts receivable balance for these customers as of October 31, 2006 and 2005 was approximately \$1.1 and \$1.4 million, respectively.

**E. Declaration of Dividend Payable**

On August 29, 2006, our Board of Directors approved a 14% increase to the Company's quarterly dividend from \$0.07 per share to \$0.08 per share. In addition our Board of Directors declared a quarterly cash dividend of \$0.08 per share of American Software Class A and Class B common stock. The cash dividend is payable on December 8, 2006 to Class A and Class B shareholders of record at the close of business on November 20, 2006.

**F. Net Earnings Per Common Share**

We compute basic earnings per common share available to common shareholders based on the weighted-average number of Class A and B common shares outstanding, since we consider the two classes of common stock as one class for purposes of the per share computation. We base diluted net earnings per common share available to common shareholders on the weighted-average number of common shares outstanding and dilutive potential common shares, such as dilutive stock options.

We use the same numerator in calculating both basic and diluted net earnings per common share for a given period. We base the denominator on the number of common shares as shown in the following table:

	<b>Three Months Ended October 31, 2006      2005 (in thousands, except per share data)</b>		<b>Six Months Ended October 31, 2006      2005 (in thousands, except per share data)</b>	
<b>Common Shares:</b>				
Weighted average common shares outstanding:				
Class A Shares	21,294	20,502	21,218	20,491
Class B Shares	3,240	3,490	3,311	3,490
Basic weighted average common shares outstanding	24,534	23,992	24,529	23,981
Dilutive effect of outstanding Class A common stock options outstanding	1,111	1,175	1,099	940
	25,645	25,167	25,628	24,921
Total				
Net earnings	\$ 1,821	\$ 819	\$ 3,068	\$ 1,843
Net earnings per common share:				
Basic	\$ 0.07	\$ 0.03	\$ 0.13	\$ 0.08

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Diluted

\$ 0.07    \$ 0.03    \$ 0.12    \$ 0.07

For the three months ended October 31, 2006 and 2005, we excluded options to purchase 280,050 and 361,998 and for the six months ended October 31, 2006 and 2005, we excluded options to purchase 237,050 and 402,543 shares of common stock, respectively, from the computation of diluted earnings per share of common stock. We excluded these option share amounts because the exercise prices of those options were greater than the average market price of the common stock during the applicable period. As of October 31, 2006, we had a total of 3,278,502 options outstanding and as of October 31, 2005 we had a total of 3,496,146 options outstanding.

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**AMERICAN SOFTWARE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements - Unaudited**

**October 31, 2006**

**G. Acquisitions**

***Logility Share Repurchase***

On June 27, 2005, Logility, Inc., our approximately 88% owned subsidiary, purchased approximately 247,189 shares of its common stock for approximately \$1.5 million. In accordance with SFAS No. 141, Business Combinations, we have accounted for this transaction under the purchase method of accounting. The total amount allocated from this transaction was \$1.2 million, which includes approximately \$237,000 related to the non-cash tax effects of this treasury stock purchase. We have allocated the \$1.2 million to capitalized software development costs, totaling approximately \$197,000, intangible assets, totaling approximately \$189,000, and goodwill, totaling approximately \$821,000, based on management's estimates of fair value at the date of the transaction. The costs allocated to capitalized software development costs and intangible assets are being amortized ratably based on the projected revenues associated with the related assets of Logility, Inc. or on a straight-line basis over three to six years, whichever method results in a higher level of amortization. Amortization of these capitalized costs is included in the cost of license revenues and general and administrative costs in the accompanying consolidated statements of operations for capitalized software development costs and intangible assets, respectively.

**H. Stock-Based Compensation**

As of October 31, 2006, we had three stock-based employee compensation plans, which are described below. Prior to May 1, 2006, we accounted for these plans under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, as permitted by Statement of Financial Accounting Standards No. 123 (SFAS 123), Accounting for Stock-Based Compensation. Substantially no expense associated with employee stock options was recognized prior to May 1, 2006 as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

Effective May 1, 2006, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123(R) (SFAS 123(R)), Share-Based Payment using the modified prospective transition method. Under that transition method, compensation cost recognized on or after May 1, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of May 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted on or after May 1, 2006, based on the grant date fair value estimated in accordance with SFAS 123(R).

We recorded stock option compensation cost of \$225,000 and \$442,000 and related income tax benefits of \$105,000 and \$155,000 during the three and six months ended October 31, 2006, respectively. Compensation is recorded over the vesting period directly to additional paid-in capital.

Prior to the adoption of SFAS 123(R), we presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the consolidated statement of cash flows. SFAS 123(R) requires that cash flows resulting from the tax benefits generated by tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. During the six months ended October 31, 2006, we realized tax benefits from stock option net operating losses (NOLs) generated in previous periods resulting in approximately \$661,000 of excess tax benefits which are included as a component of cash flows from financing activities in the accompanying condensed consolidated statement of cash flows.

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The following table illustrates what our net earnings and earnings per share would have been using the fair value compensation model under SFAS 123 for the three and six months ended October 31, 2005 (in thousands, except per share amounts):

	<b>Three Months Ended October 31, 2005</b>	<b>Six Months Ended October 31, 2005</b>
<b>Net earnings:</b>		
<b>As reported</b>	\$ 819	\$ 1,843
Deduct: Stock-based compensation expense determined under fair value based method for all awards, net of income tax	(163)	(355)
<b>Pro forma net earnings</b>	\$ 656	\$ 1,488
<b>Basic earnings per share:</b>		
As reported	\$ 0.03	\$ 0.08
Pro forma in accordance with SFAS No. 123	\$ 0.03	\$ 0.06
<b>Diluted earnings per share:</b>		
As reported	\$ 0.03	\$ 0.07
Pro forma in accordance with SFAS No. 123	\$ 0.03	\$ 0.06

**I. Stock Option Plans**

The Company has outstanding stock options granted pursuant to three stock option plans. The 1991 Employee Stock Option Plan (the "Employee Option Plan") and the Directors and Officers Stock Option Plan (the "Directors and Officers Option Plan") were adopted in 1991. These Plans were terminated and replaced by the 2001 Stock Option Plan (the "2001 Option Plan") effective September 1, 2000. Options outstanding under the Employee Option Plan and the Directors and Officers Option Plan remain in effect, but no new options may be granted under those plans.

Under the 2001 Stock Option Plan, options to purchase Class A common shares are granted in the form of both incentive stock options and non-qualified stock options. The number of options granted under this plan is determined with each grant, except with respect to non-employee directors, who receive grants of non-qualified options to purchase 5,000 shares upon election and 3,000 shares at the end of each fiscal quarter. The exercise price of such grants is equal to the closing market price of the shares on the date of grant. Options are exercisable based on the terms of such options, but no more than 10 years after the date of grant (or 5 years for incentive stock options granted to any person who owns 10% or more of the combined voting power of all classes of capital stock of the Company at the time of grant). A total of 3,575,000 shares are authorized for issuance pursuant to options granted under this Plan. In February 2005, the Board amended the stock option grant forms to be used in connection with the 1997 Stock Plan for future grants to provide for a six year option life and a five year vesting period. In July 2005, the Board of Directors approved an amendment increasing the number of shares available for issuance by 600,000 shares.

Effective August 7, 1997, Logility Inc., a subsidiary of the Company, adopted the Logility, Inc. 1997 Stock Plan (Subsidiary Stock Plan). The Subsidiary Stock Plan provides for grants of incentive stock options and nonqualified stock options to certain key employees and directors of Logility, Inc. The Subsidiary Stock Plan also allows for stock appreciation rights in lieu of or in addition to stock options. Options to purchase a maximum of 1.6 million shares of common stock and a maximum of 300,000 units of Stock Appreciation Rights (SARs), as defined, may be granted under the Subsidiary Stock Plan. The options generally vest over a four-year period. The contractual terms of the options generally are for ten years. There have been no SARs granted to date. In March 2005, the Logility, Inc. Board amended the stock option grant forms to be used in connection with the 2001 Option Plan for future grants to provide for a six year award life and a five year vesting period. In July 2006, Logility's Board of Directors approved an amendment increasing the number of shares available for grant by 400,000 shares, to 1.6 million shares, which amendment was approved by shareholders in August 2006.





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A summary of changes in outstanding options for the six month period ended October 31, 2006 is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at May 1, 2006	3,018,968	\$ 4.04		
Granted	370,000	6.10		
Exercised	(102,848)	2.53		
Forfeited/cancelled	(7,618)	5.01		
Outstanding at October 31, 2006	3,278,502	\$ 4.32	4.6	\$ 9,825,325
Exercisable at October 31, 2006	2,460,863	\$ 3.79	4.3	\$ 8,773,069

The weighted-average grant date fair value of stock options granted during the six months ended October 31, 2006 and 2005, was \$1.71 and \$1.96, respectively. The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for the six months ended October 31, 2006 and 2005:

	2006	2005
Dividend yield	5.0%	5.1%
Expected volatility	42.9%	55.5%
Risk-free interest rate	4.9%	4.2%
Expected term	4.5 years	4.5 years

A summary of changes in outstanding options for the Subsidiary Stock Plan for the period ended October 31, 2006 is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at May 1, 2006	683,097	\$ 4.05		
Granted	111,000	8.14		
Exercised	(27,765)	3.13		
Forfeited/cancelled	(2,750)	4.00		
Outstanding at October 31, 2006	763,582	\$ 4.67	4.9	\$ 3,336,572
Exercisable at October 31, 2006	564,607	\$ 4.19	4.3	\$ 2,771,553

The weighted-average grant date fair value of stock options granted during the six months ended October 31, 2006 and 2005, was \$4.57 and \$3.39, respectively. The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for the six months ended October 31, 2006 and 2005:



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	<b>2006</b>	<b>2005</b>
Dividend yield	0%	0%
Expected volatility	64.7%	68.5%
Risk-free interest rate	5.0%	4.3%
Expected term	4.5 years	4.5 years

The expected volatility is based on the historical volatility and other factors. The Company uses historical data to estimate stock option exercise and forfeiture rates. The expected term represents the period over which the share-based awards are expected to be outstanding. It has been determined using the shortcut method described in SEC Staff Accounting Bulletin ( SAB ) No. 107. The dividend yield is an estimate of the expected dividend yield on the Company's stock. The risk-free rate is based on U.S. Treasury yields in effect at the time of the grant for the expected term of the stock options.

Options issued after May 1, 2006 with graded vesting are valued as a single award. The total value of the award is expensed on a straight line basis over the vesting period with the amount of compensation cost recognized at any date at least equal to the portion of the grant date value of the award that is vested at that date. During the six months ended October 31, 2006 and 2005, we issued 102,848 and 24,394 shares of common stock, respectively, resulting from the exercise of stock options. During the six months ended October 31, 2006 and 2005, our subsidiary issued 27,765 and 43,001 shares of common stock, respectively, resulting from the exercise of stock options. The total intrinsic value of options exercised during the six months ended October 31, 2006 and 2005 based on market value at the exercise dates was \$466,551 and \$59,345, respectively. The total intrinsic value of options exercised at our subsidiary during the six months ended October 31, 2006 and 2005 based on market value at the exercised dates was \$171,951 and \$127,800, respectively. As of October 31, 2006, unrecognized compensation cost related to unvested stock option awards approximated \$1.6 million and is expected to be recognized over a weighted average period of 1.9 years. As of October 31, 2006, unrecognized compensation cost related to unvested stock option awards at our subsidiary approximated \$871,000 and is expected to be recognized over a weighted average period of 2.1 years.

**J. Comprehensive Income**

We have adopted Statement of Financial Accounting Standards (SFAS) No. 130, Reporting Comprehensive Income. SFAS No. 130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. We have not included condensed consolidated statements of comprehensive income in the accompanying unaudited condensed consolidated financial statements since comprehensive income and net earnings presented in the accompanying condensed consolidated statements of operations would be substantially the same.

**K. Industry Segments**

We have adopted SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. We operate and manage our business in three segments based on software and services provided in three key product markets: (i) Enterprise Resource Planning, which automates customers' internal financing, human resources, and manufacturing functions; (ii) Collaborative Supply Chain Management, which provides business-to-business collaborative commerce solutions to optimize supply chain operations for manufacturers, distributors and retailers; and (iii) IT Consulting, which consists of IT staffing and consulting services. The Collaborative Supply Chain Management segment represents the business of our 88%-owned subsidiary Logility, Inc., including its subsidiary, DMI. In the following table, we have broken down the intersegment transactions applicable to the three and six months ended October 31, 2006 and 2005 (in thousands):

**Table of Contents****AMERICAN SOFTWARE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements - Unaudited****October 31, 2006**

	<b>Three Months Ended October 31,</b>		<b>Six Months Ended October 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Revenues:</b>				
Enterprise Resource Planning	\$ 5,248	\$ 5,414	\$ 10,895	\$ 10,544
Collaborative Supply Chain Management	10,018	9,275	19,612	17,178
IT Consulting	4,959	4,345	9,898	8,078
	\$ 20,225	\$ 19,034	\$ 40,405	\$ 35,800
<b>Operating income (loss) before intersegment eliminations:</b>				
Enterprise Resource Planning	\$ (29)	\$ 285	\$ 230	\$ 198
Collaborative Supply Chain Management	1,479	1,267	2,715	2,027
IT Consulting	316	245	493	301
	\$ 1,766	\$ 1,797	\$ 3,438	\$ 2,526
<b>Intersegment eliminations:</b>				
Enterprise Resource Planning	\$ (418)	\$ (386)	\$ (433)	\$ (789)
Collaborative Supply Chain Management	418	386	433	789
IT Consulting				
	\$	\$	\$	\$
<b>Operating income (loss) after intersegment eliminations:</b>				
Enterprise Resource Planning	\$ (447)	\$ (101)	\$ (203)	\$ (591)
Collaborative Supply Chain Management	1,897	1,653	3,148	2,816
IT Consulting	316	245	493	301
	\$ 1,766	\$ 1,797	\$ 3,438	\$ 2,526
<b>Capital expenditures:</b>				
Enterprise Resource Planning	\$ 36	\$ 30	\$ 85	\$ 179
Collaborative Supply Chain Management	56	25	106	88
IT Consulting				
	\$ 92	\$ 55	\$ 190	\$ 267
<b>Capitalized Software:</b>				
Enterprise Resource Planning	\$ 12	\$ (683)	\$ 12	\$ (220)
Collaborative Supply Chain Management	587	617	1,183	1,234
IT Consulting				
	\$ 599	\$ (66)	\$ 1,195	\$ 1,014
<b>Depreciation and amortization:</b>				
Enterprise Resource Planning	\$ 275	\$ 203	\$ 571	\$ 542

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Collaborative Supply Chain Management	896	645	1,717	1,287
IT Consulting		1	1	1
	\$ 1,171	\$ 849	\$ 2,289	\$ 1,830

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**AMERICAN SOFTWARE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements - Unaudited**

**October 31, 2006**

**L. Leases**

We have various operating and facilities leases. Expense under these operating and facilities leases approximated \$248,000 and \$471,000, respectively, for the three and six months ended October 31, 2006 and \$223,000 and \$452,000 for the three and six month ended October 31, 2005, respectively. A facility leased by a subsidiary of the Company included a lease incentive which was recorded as an increase in leasehold improvements and deferred rent.

The Company leases several floors of its headquarters in Atlanta, GA under various operating leases. Rental income for these leases approximated \$127,000 and \$286,000 for the three and six months ended October 31, 2006 and \$118,000 and \$234,000 for the three and six months ended October 31 2005, respectively. In addition the Company owns properties leased under various operating leases. Rental income for these leases approximated \$58,000 and \$115,000 for the three and six months ended October 31, 2006 and \$53,000 and \$106,000 for the three and six months ended October 31, 2005, respectively. The rental income is included as a component of other income in the accompanying condensed consolidated statement of operations.

**M. New Accounting Pronouncements**

During June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income taxes, and interpretation of FASB Statement No. 109, Accounting for Income Taxes. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements, and 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. The evaluation of a tax position in accordance with this Interpretation is based on a more likely than not approach. This interpretation is effective for fiscal years beginning after December 15, 2006.

The Company does not expect this Interpretation to have a material impact on its financial statements.

During June 2006 the Emerging Issues Task Force ( EITF ) issued Issue 06-03: How Taxes Collected for Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross Versus Net Presentation). The task force reached a tentative conclusion on issue one that the scope of this issue includes any tax assessed by a governmental authority this is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise tax. The task force also reached a tentative conclusion on issue two that the presentation of taxes within the scope of issue one on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed pursuant to Accounting Principles Board ( APB ) Opinion No. 22, Disclosure of Accounting Policy. In addition, for any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. The disclosure of those taxes can be done on an aggregate basis. The task force also reached a tentative conclusion that this Issue should be applied to financial reports for Interim and annual periods beginning after December 15, 2006.

The Company does not expect this Issue to have a material impact on its financial statements.

In September 2006, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin ( SAB ) Topic 1N, Financial Statements - Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements ( SAB 108 ), which expresses the Staff's views regarding the process of quantifying financial statement misstatements due to the current diversity in practice. SAB 108 will require companies to use two approaches when quantifying financial statement misstatements. We are required to adopt SAB 108 for the fiscal year ending April 30, 2007.

We are currently evaluating the impact of adopting SAB 108 on our Consolidated Financial Statements.

**M. Subsequent Event**

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On November 22, 2006, our Board of Directors declared a quarterly cash dividend of \$0.08 per share of American Software Class A and Class B common stock. The cash dividend is payable on March 10, 2007 to Class A and Class B shareholders of record at the close of business on February 23, 2007.

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

#### **FORWARD-LOOKING STATEMENTS**

This report on Form 10-Q contains forward-looking statements relating to our future financial performance, business strategy, financing plans and other future events that involve uncertainties and risks. You can identify these statements by forward-looking words such as anticipate, intend, plan, continue, could, grow, may, potential, predict, strive, will, seek, estimate, believe, expect, and similar words. Forward-looking statements are subject to the uncertainty of future events or outcomes. Any forward-looking statements we make herein are pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements concerning future:

results of operations;

liquidity, cash flow and capital expenditures;

demand for and pricing of our products and services;

acquisition activities and the effect of completed acquisitions;

industry conditions and market conditions; and

general economic conditions.

Although we believe that the goals, plans, expectations, and prospects that our forward-looking statements reflect are reasonable in view of the information currently available to us, those statements are not guarantees of performance. There are many factors that could cause our actual results to differ materially from those anticipated by forward-looking statements made herein. These factors include, but are not limited to, continuing economic uncertainty, the timing and degree of business recovery, unpredictability and the irregular pattern of future revenues, competitive pressures, delays and other risks associated with new product development, the difficulty of predicting the effectiveness and duration of third-party marketing agreements, undetected software errors, and risks associated with market acceptance of our products and services. We discuss certain factors in greater detail in Business Overview, below. The terms fiscal 2007 and fiscal 2006 refer to our fiscal years ending April 30, 2007 and 2006, respectively.

#### **ECONOMIC OVERVIEW**

Corporate capital spending trends and commitments are the primary determinants of the size of the market for business software. Corporate capital spending is, in turn, a function of general economic conditions in the U.S. and abroad. In recent years, the weakness in the overall world economy, and the U.S. economy in particular, has resulted in reduced expenditures in the business software market. Overall information technology spending continues to be relatively weak when compared to the period prior to 2001.

However, we believe information technology spending has incrementally improved in Fiscal 2007 and will continue to improve as increased global competition forces companies to improve productivity by upgrading their technology environment systems. Although this improvement could slow or regress at any time, we believe that our organizational and financial structure will enable us to take advantage of any sustained economic rebound. While our sales pipelines have improved in the last several quarters, customers continue to take longer to evaluate discretionary software purchases than generally was the case prior to 2001.

#### **BUSINESS OVERVIEW**

American Software, Inc. (American Software or the Company) was incorporated as a Georgia corporation in 1970. We develop, market and support a portfolio of software and services that deliver enterprise management and collaborative supply chain solutions to the global



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marketplace. We have designed our software and services to bring business value to enterprises by supporting their operations over intranets, extranets, client/servers or the Internet. References to the Company, our products, our software, our services and similar references include the appropriate business unit actually providing the product or service.

We provide our software solutions through three major business segments, which are further broken down into a total of four major product and service groups. The three business segments are (1) Enterprise Resource Planning ( ERP ), (2) Collaborative Supply Chain Management ( SCM ), and (3) Information Technology ( IT ) Consulting. The Collaborative Supply Chain Management segment consists of Logility, Inc., an 88% owned subsidiary that provides collaborative supply chain solutions to streamline and optimize the production, distribution and management of products

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between trading partners. The ERP segment consists of (i) American Software ERP, which provides purchasing and materials management, customer order processing, financial, e-commerce, Flow Manufacturing and traditional manufacturing solutions, and (ii) New Generation Computing (NGC), which provides industry specific business software to both retailers and manufacturers in the Apparel, Sewn Products and Furniture industries. The IT Consulting segment consists of The Proven Method, an IT staffing and consulting services firm.

On September 30, 2004, Logility acquired certain assets and the distribution channel of privately-held Demand Management, Inc. (DMI), a St. Louis-based provider of supply chain planning systems marketed under the Demand Solutions® brand. The acquisition provided more than 800 active customers, which brought the Logility customer base to approximately 1,100 companies, located in 70 countries, and gives Logility what we believe to be the largest installed base of supply chain planning customers among application software vendors. Since the acquisition, Logility has continued to market and sell the Demand Solutions product line through Demand Management's existing value-added reseller (VAR) distribution network. Logility also continues to offer the Logility Voyager Solutions suite to its traditional target market of upper-midsize to Fortune 1000 companies with distribution-intensive supply chains.

We derive revenues primarily from three sources: software licenses, services and other, and maintenance. We generally determine software license fees based on the number of modules, servers, users and/or sites licensed. Services and other revenues consist primarily of fees from software implementation, training, consulting and customization services. We primarily bill under time and materials arrangements and recognize revenues as we perform services. We typically enter into maintenance agreements for a one- to three-year term at the time of the initial product license. We generally bill maintenance fees annually in advance and then recognize the resulting revenues ratably over the term of the maintenance agreement. Deferred revenues represent advance payments or billings for software licenses, services and maintenance billed in advance of the time we recognize the related revenues.

Our cost of revenue for licenses includes amortization of capitalized computer software development costs, salaries and benefits, and royalties paid to third-party software vendors as well as agent commission expenses related to license revenues generated by the indirect channel primarily from DMI. Costs for maintenance and services include the cost of personnel to conduct implementations and customer support, consulting, and other personnel-related expenses as well as agent commission expenses related to maintenance revenues generated by the indirect channel primarily from DMI. We account for the development costs of software intended for sale in accordance with SFAS No. 86, *Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*. We monitor the net realizable value of our capitalized software on a quarterly basis based on an estimate of future product revenues. We currently expect to fully recover the value of the capitalized software asset recorded on our consolidated balance sheet; however, if future product revenues are less than management's current expectations, we may incur a write-down of capitalized software costs.

Our selling expenses generally include the salary and commissions paid to our sales professionals, along with marketing, promotional, travel and associated costs. Our general and administrative expenses generally include the salary and benefits paid to executive, corporate and support personnel, as well as facilities related costs, utilities, communications expenses, and various professional fees. DMI sells its products primarily through indirect channels.

We currently view the following factors as the primary opportunities and risks associated with our business:

Strategic Relationships. We intend to expand the depth and number of strategic relationships with leading enterprise software, systems integrators and service providers to integrate our solutions into their services and products and to create joint marketing opportunities. We have a number of marketing alliances, including those with SAP and IBM. In addition, we have developed a network of international agents who assist in the sale and support of our products. We intend to utilize these and future relationships with software and service organizations to enhance our sales and marketing position.

Dependence on Capital Spending Patterns. There is risk associated with our dependence on, and the risks associated with, the capital spending patterns of U.S. and international businesses, which in turn are functions of economic trends and conditions over which we have no control.

Acquisition Opportunities. There are opportunities for select acquisitions or investments to provide opportunities to expand our sales distribution channels and/or broaden our product offering by providing additional solutions for our target markets.

Acquisition Risks. There are risks associated with acquisitions of complementary companies, products and technologies, including the risks that we will not achieve the financial and strategic goals that we contemplate at the time of the transaction. More specifically, in any acquisition we will face risks and challenges associated with the uncertain value of the acquired business or assets, the difficulty of assimilating operations and personnel, integrating acquired technologies and products and maintaining the loyalty of the customers of the acquired business.



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**Competitive Technologies.** There is a risk that our competitors may develop technologies that are substantially equivalent or superior to our technology.

**Competition in General.** There are risks inherent in the market for business application software and related services, which has been and continues to be intensely competitive; for example, some of our competitors may become more aggressive with their prices and/or payment terms, which may adversely affect our profit margins.

**Sarbanes-Oxley Section 404.** Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include our assessment of the effectiveness of our internal control over financial reporting in our annual reports. Our independent registered public accounting firm is also required to attest to whether or not our assessment is fairly stated in all material respects and to separately report on whether or not they believe that we maintained, in all material respects, effective internal control over financial reporting. If for any fiscal year we fail to timely complete this assessment, or if our independent registered public accounting firm cannot timely attest to our assessment, we could be subject to regulatory sanctions and a possible loss of public confidence in the reliability of our financial reporting. Such a failure, as well as difficulties in implementing required new or improved controls, could result in our inability to provide timely and reliable financial information and could adversely affect our business.

A discussion of a number of additional risk factors associated with our business is included in our Annual Report on Form 10-K for the fiscal year ended April 30, 2006.

## **Recent Developments**

**Adoption of SFAS 123(R).** Prior to May 1, 2006, we accounted for our employee stock option plan under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, as permitted by SFAS 123, *Accounting for Stock-Based Compensation*. Substantially no stock-based employee compensation cost related to stock options was recognized in the consolidated statements of operations for periods prior to May 1, 2006, as all stock options granted had an exercise price equal to the market value of the underlying common stock on the date of grant.

Effective May 1, 2006, we adopted the fair value recognition provisions of SFAS 123(R) using the modified prospective transition method. Under that transition method, compensation cost recognized on or after May 1, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of May 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to May 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Prior to the adoption of SFAS 123(R), we presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the consolidated statement of cash flows. SFAS 123(R) requires that cash flows resulting from the tax benefits generated by tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

As a result of adopting SFAS 123(R) on May 1, 2006, our net income for the three and six months ended October 31, 2006 were \$120,000 and \$287,000, respectively, net of related income tax benefit of \$105,000 and \$155,000, respectively, lower than if we had continued to account for share-based compensation under APB Opinion No. 25.

The fair value of options granted is estimated on the date of grant using the Black-Scholes option pricing model based on certain assumptions, including the expected term of the option, the expected volatility of the price of the underlying share for the expected term of the option, the expected dividends on the underlying share for the expected term, and the risk-free interest rate for the expected term of the option. Effective May 1, 2006, expected volatilities are based on historical volatility of our stock. Previously, we had relied exclusively on historical volatility, disregarding periods of time in which our share price was extraordinarily volatile because of circumstances that were not expected to recur. We applied the short cut method as prescribed in SAB No. 107 to estimate the term that options are expected to be outstanding and used historical data to estimate the forfeiture rate of options granted. The risk-free interest rate is based on the U.S. Treasury yields in effect at the time of the grant with a term approximating the expected term. Options issued after May 1, 2006 with graded vesting are valued as a single award. The total value of the award is expensed on a straight line basis over the vesting period with the amount of compensation cost recognized at any date at least equal to the portion of the grant date value of the award that is vested at that date. During the six months ended October 31, 2006 and 2005, we issued 102,848 and 24,394 shares of common stock, respectively, resulting from the exercise of stock options. During the six months ended October 31, 2006 and 2005, our subsidiary issued 27,765 and 43,001 shares of common stock, respectively, resulting from the exercise of stock options. The total intrinsic value of options exercised during the six months ended October 31, 2006 and 2005 based on



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market value at the exercise dates was \$466,551 and \$59,345, respectively. The total intrinsic value of options exercised at our subsidiary during the six months ended October 31, 2006 and 2005 based on market value at the exercised dates was \$171,951 and \$127,800, respectively. As of October 31, 2006, unrecognized compensation cost related to unvested stock option awards approximated \$1.6 million and is expected to be recognized over a weighted average period of 1.9 years. As of October 31, 2006, unrecognized compensation cost related to unvested stock option awards at our subsidiary approximated \$871,000 and is expected to be recognized over a weighted average period of 2.1 years.

**COMPARISON OF RESULTS OF OPERATIONS**

**Three-Month Comparisons.** The following table sets forth certain revenue and expense items as a percentage of total revenues and the percentage changes in those items for the three months ended October 31, 2006 and 2005:

	Percentage of Total Revenues		Pct. Change in Dollars 2006 vs 2005
	2006	2005	
<b>Revenues:</b>			
License	21%	26%	(13)%
Services and other	46	43	14
Maintenance	33	31	11
<b>Total revenues</b>	<b>100</b>	<b>100</b>	<b>6</b>
<b>Cost of revenues:</b>			
License	8	5	59
Services and other	31	31	6
Maintenance	9	9	9
<b>Total cost of revenues</b>	<b>48</b>	<b>45</b>	<b>13</b>
<b>Gross margin</b>	<b>52</b>	<b>55</b>	<b>1</b>
Research and development	9	8	8
Sales and marketing	17	19	nm
General and administrative	17	17	4
Amortization of acquisition-related intangibles			nm
Provision for doubtful accounts			nm
<b>Total operating expenses</b>	<b>43</b>	<b>44</b>	<b>2</b>
Operating income	9	11	(2)
<b>Other income:</b>			
Interest income	3	2	45
Other, net	4	(1)	nm
Earnings before income taxes	16	12	62
Income tax expense	(6)	(4)	68
Minority interest expense	(1)	(2)	(67)
<b>Net earnings</b>	<b>9%</b>	<b>6%</b>	<b>122%</b>

nm - not meaningful



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**Six-Month Comparisons.** The following table sets forth certain revenue and expense items as a percentage of total revenues and the percentage changes in those items for the six months ended October 31, 2006 and 2005:

	Percentage of Total Revenues		Pct. Change in Dollars
	2006	2005	2006 vs 2005
<b>Revenues:</b>			
License	21%	24%	3%
Services and other	46	44	17
Maintenance	33	32	14
<b>Total revenues</b>	<b>100</b>	<b>100</b>	<b>13</b>
<b>Cost of revenues:</b>			
License	8	6	47
Services and other	31	32	13
Maintenance	9	9	11
<b>Total cost of revenues</b>	<b>48</b>	<b>47</b>	<b>17</b>
<b>Gross margin</b>	<b>52</b>	<b>53</b>	<b>10</b>
Research and development	9	9	11
Sales and marketing	17	19	6
General and administrative	17	18	5
Amortization of acquisition-related intangibles			nm
Provision for doubtful accounts			nm
<b>Total operating expenses</b>	<b>43</b>	<b>46</b>	<b>5</b>
Operating income	9	7	36
<b>Other income:</b>			
Interest income	3	2	51
Other, net	4	1	69
Earnings before income taxes	16	10	43
Income tax expense	(6)	(4)	47
Minority interest expense	(1)	(1)	(49)
<b>Net earnings</b>	<b>9%</b>	<b>5%</b>	<b>66%</b>

nm - not meaningful



**Table of Contents****COMPARISON OF RESULTS OF OPERATIONS FOR THE THREE AND SIX MONTHS ENDED****OCTOBER 31, 2006 AND 2005:****REVENUES:**

For the three months ended October 31, 2006, the increase in revenues from the three months ended October 31, 2005 was attributable to an increase in services and maintenance revenues. This was partially offset by a decrease in license fees revenue. For the six months ended October 31, 2006, the increase in revenues from the six months ended October 31, 2005 was attributable to an increase in maintenance and services revenues, and to a lesser extent an increase in license fees. International revenues represented approximately 10% of total revenues in the three and six months ended October 31, 2006, respectively. International revenues represented approximately 9% of total revenues in the three and six months ended October 31, 2005, respectively. Our revenues in particular our international revenues may fluctuate substantially from period to period primarily because we derive most of our license fee revenues from a relatively small number of customers in a given period.

**LICENSES.** For the three months ended October 31, 2006, license fee revenues decreased 13% when compared to the same period in the prior year, due to timing of closing license fees sales from our Logility and ERP subsidiaries. For the six months ended October 31, 2006, license fee revenues increased 3% when compared to the same periods in the prior year, due primarily to increased license fees from our Logility subsidiary due to an improved selling environment and better sales execution. In the six months ended October 31, 2006, license fee revenues from Logility increased 10% to \$6.6 million, of which DMI contributed \$2.2 million. Logility constituted 77% and 76% of total license fee revenues for the three and six months ended October 31, 2006, compared to 72% and 71% for the three and six months ended October 31, 2005.

The direct sales channel provided approximately 65% and 72% of license fee revenues for the three and six months ended October 31, 2006, compared to approximately 85% and 81% in the three and six months ended October 31, 2005. This decrease was due primarily to improved sales execution and sales environment within our indirect channel. For the three months ended October 31, 2006, our margins after commissions on direct sales were approximately 84%, and our margins after commissions on indirect sales were approximately 46%. For the three months ended October 31, 2005, our margins after commissions on direct sales were approximately 87%, and our margins after commissions on indirect sales were approximately 49%. These margin calculations include only commission expense for comparative purposes and do not include other costs of license fees such as amortization of capitalized software.

**SERVICES AND OTHER.** For the three and six months ended October 31, 2006, the increase in services and other revenues were due primarily to increased services revenues from all three of our business segments, Logility, ERP and IT Consulting. For the three and six months ended October 31, 2006, services and other revenues from Logility increased 19% and 8% when compared to the three and six months ended October 31, 2005. These increases were due primarily to timing of implementation projects from the increase in license fee sales in recent the prior quarters. For the three and six months ended October 31, 2006, our ERP segment's services and other revenues increased 12% and 14%, respectively, when compared to the prior year quarter due to increased implementation services. For the three and six months ended October 31, 2006, our IT Consulting segment's revenues increased 14% and 23%, respectively, when compared to the prior year periods due to increases in project work. We have observed that there is a tendency for services and other revenues, other than IT Consulting, to lag changes in license revenues by one to three quarters, as new licenses in one quarter often involve implementation and consulting services in subsequent quarters, for which we recognize revenues only as we perform those services.

**MAINTENANCE.** For the three and six months ended October 31, 2006, maintenance revenues increased 11% and 14% when compared to the same period in the prior year. This increase was primarily from Logility which increased 17% and 19%, respectively, for the three and six months ended October 31, 2006 compared to the same period in the prior year. Logility constituted 77% and 75%, respectively, of total maintenance revenues for the three and six month period ended October 31, 2006, compared to 73% and 72%, respectively, of total maintenance for the corresponding prior year periods. The increases in maintenance revenues for the three and six months ended October 31, 2006 were due primarily to increased license fees in prior periods resulting in new maintenance revenue in the current period. Typically, our maintenance revenues have had a direct relationship to current and historic license fee revenues, since new licenses are the potential source of new maintenance customers.

**Table of Contents****GROSS MARGIN:**

The following table provides both dollar amounts and percentage measures of gross margin:

(\$000 s omitted)	Three months ended				Six months ended			
	October 31,		October 31,		October 31,		October 31,	
	2006	2005	2006	2005	2006	2005	2006	2005
Gross margin on license fees:	\$ 2,728	63%	\$ 3,981	80%	\$ 5,647	65%	\$ 6,351	75%
Gross margin on services and other:	2,980	32%	2,150	26%	5,599	30%	4,308	27%
Gross margin on maintenance:	4,821	73%	4,292	72%	9,589	73%	8,359	72%
Total gross margin:	\$ 10,529	52%	\$ 10,423	55%	\$ 20,835	52%	\$ 19,018	53%

For the three and six months ended October 31, 2006, total gross margin percentage was primarily flat when compared to the same period in the prior year.

**LICENSES.** The decrease in gross margin percentage on license fees for the three and six months ended October 31, 2006 were due to an increase in expense related to amortization of capitalized software development costs when compared to the same period in the prior year and to a lesser extent increased indirect sales, which resulted in an increase in indirect commission expense. License fee gross margin percentage tends to be directly related to the level of license fee revenues due to the relatively fixed cost of computer software amortization expense and amortization of acquired software, which are the primary components of cost of license fees. To a lesser degree, our license fee gross margin percentage in a given period is related to the variable expense of DMI's agent commissions, and the proportion of license fees represented by DMI in that period.

**SERVICES AND OTHER.** For the three and six months ended October 31, 2006, the gross margin percentage for services and other increased when compared to the same period in the prior fiscal year due to increased software implementation work from license fee sales in recent prior quarters. Services and other gross margin normally is directly related to the level of services and other revenues. The primary component of cost of services and other revenues is services staffing, which is relatively fixed in the short term.

**MAINTENANCE.** Maintenance gross margin percentage was slightly higher for three and six months ended October 31, 2006 when compared to the same periods last year due to the increase in overall maintenance revenue.

**Table of Contents****EXPENSES****Research and Development**

Gross product research and development costs include all non-capitalized and capitalized software development costs. A breakdown of the research and development costs is as follows:

	Three months ended (in thousands)		
	October 31, 2006	Percent Change	October 31, 2005
Total capitalized computer software development costs	\$ 587	(5)%	\$ 617
Percentage of gross product research and development costs	25%		36%
Purchase accounting impact on share repurchases by subsidiary and related tax effect		nm	(683)
Percentage of total revenues	0%		(4)%
Total research and development expense	1,726	8%	1,601
Percentage of total revenues	9%		8%
Total research and development expense and capitalized computer software development costs	\$ 2,313	51%	\$ 1,535
Percentage of total revenues	11%		8%
Total amortization of capitalized computer software development costs *	\$ 664	43%	\$ 465

nm: not meaningful

	Six months ended (in thousands)		
	October 31, 2006	Percent Change	October 31, 2005
Total capitalized computer software development costs	\$ 1,183	(4)%	\$ 1,234
Percentage of gross product research and development costs	26%		29%
Purchase accounting impact on share repurchases by subsidiary and related tax effect		nm	(220)
Percentage of total revenues	0%		(1)%
Total research and development expense	3,446	11%	3,112
Percentage of total revenues	9%		9%
Total research and development expense and capitalized computer software development costs	\$ 4,629	12%	\$ 4,126
Percentage of total revenues	11%		12%
Total amortization of capitalized computer software development costs *	\$ 1,407	33%	\$ 1,054

nm: not meaningful

\* Included in cost of license fees

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For the three and six months ended October 31, 2006, gross product research and development costs increased when compared to the same periods last year and capitalized software development costs decreased when compared to the same periods last year. These changes were primarily due to increased research and development costs in our Logility and ERP

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segment. We expect capitalized product development costs to be lower in coming quarters as a result of fewer capitalizable R&D projects; however, we expect capitalized software amortization expense to remain relatively consistent when compared to the three and six months ended October 31, 2006.

Capitalized computer software development costs include the effects of applying purchase accounting as a result of Logility, Inc.'s share repurchases.

### ***Sales and Marketing***

For the three months ended October 31, 2006, sales and marketing expenses when compared to the same period a year ago were relatively flat. For the six months ended October 31, 2006, sales and marketing expenses increased slightly compared to the same period a year ago due to increase in sales commission from increase in license fee sales. We generally include commissions on indirect sales in cost of sales.

### ***General and Administrative***

For the three and six months ended October 31, 2006, general and administrative expenses when compared to the same period a year ago were relatively flat. During the three months ended October 31, 2006, we incurred approximately \$111,000 of restructuring expenses related to the closure of our French operations. We expect to incur approximately \$200,000 in additional expenses during fiscal year 2007. At October 31, 2006, the total number of employees was 294 compared to 308 at October 31, 2005.

### ***Other Income***

Other income is comprised of interest and dividend income, rental income and realized and unrealized gains and losses from investments. For both the three and six months ended October 31, 2006, the increase in other income was due primarily to realized/unrealized gains on investments compared to a loss in the same period of the prior year and to an increase in the average cash balance and improved yield on interest rates, particularly on money market accounts when compared to the prior year periods. For the three and six months ended October 31, 2006, these investments generated an annualized yield of approximately 5.44% and 5.46%, respectively, compared to approximately 3.95% and 3.72%, respectively, for the three and six months ended October 31, 2005. For the three and six months ended October 31, 2005, these investment earnings were partially offset by a write-down of a minority investment of \$160,000.

### ***Income Taxes***

In the three and six months ended October 31, 2006, we recorded income tax expense of approximately \$1.3 million and \$2.2 million compared to \$758,000 and \$1.5 million recorded in the three and six month period ended October 31, 2005 due to increased pretax income. We recognize deferred tax assets and liabilities based on the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their tax bases. We measure deferred tax assets and liabilities using statutory tax rates in effect in the year in which we expect the differences to reverse. We establish a deferred tax asset for the expected future benefit of net operating loss and credit carry-forwards. Under Statement of Financial Accounting Standards No. 109 (SFAS No. 109), Accounting for Income Taxes, we cannot recognize a deferred tax asset for the future benefit of our net operating losses, tax credits and temporary differences unless we can establish that it is more likely than not that the deferred tax asset would be realized. We expect the Company's effective rate to range between 38% and 40% during fiscal year 2007.

### ***Minority Interest***

Minority interest is a function of our majority-owned subsidiaries' earnings or losses, with minority interest losses recorded when these subsidiaries have earnings, and minority interest earnings recorded when they have losses. Due to Logility's net earnings, we recorded minority interest expenses of approximately \$138,000 and \$265,000, respectively, for the three and six months ended October 31, 2006 and \$421,000 and \$519,000, respectively, for the three and six months ended October 31, 2005.

## **LIQUIDITY, CAPITAL RESOURCES AND FINANCIAL CONDITION**

### ***Sources and Uses of Cash***

We have historically funded, and continue to fund, our operations and capital expenditures primarily with cash generated from operating activities. The changes in net cash that our operating activities provide generally reflect the changes in net earnings and non-cash operating items

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plus the effect of changes in operating assets and liabilities, such as investment trading securities, trade accounts receivable, trade accounts payable, accrued expenses and deferred revenue. We have no debt obligations or off-balance sheet financing arrangements, and therefore we used no cash for debt service purposes.

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The following tables show information about our cash flows and liquidity positions during the six months ended October 31, 2006 and 2005. You should read this table and the discussion that follows in conjunction with our condensed consolidated statements of cash flows contained in Item 1. Financial Statements in Part I of this report and in our Annual Report on Form 10-K for the fiscal year ended April 30, 2006.

	Six Months Ended	
	October 31,	
	(in thousands)	
	2006	2005
Net cash provided by operating activities	\$ 6,570	\$ 1,536
Net cash used in investing activities	(1,649)	(4,417)
Net cash used in financing activities	(2,583)	(3,249)
 Net change in cash and cash equivalents	 \$ 2,338	 \$ (6,130)

For the six months ended October 31, 2006, the net increase in cash provided by operating activities when compared to the same period last year was due primarily to the increases in net earnings, deferred revenue, depreciation and amortization and stock option compensation expense. This was partially offset by an increase in our customer accounts receivable. The decrease in cash used in investing activities when compared to the same period in the prior year was due primarily to reduce purchases of treasury shares by our subsidiary in the current year and proceeds from cancellation of an executive life insurance policy in the six months ended October 31, 2006. Cash used in financing activities decreased when compared to the same period in the prior year, due primarily to excess tax benefits from stock based compensation and higher proceeds from exercise of stock options in the six months ended October 31, 2006 when compared to the same period in the prior year. This was partially offset by higher dividend payments in the six months ended October 31, 2006.

The following table shows net changes in total cash, cash equivalents, and investments, which is one measure management uses to view net total cash generated by our activities:

	As of October 31,	
	(in thousands)	
	2006	2005
Cash and cash equivalents	\$ 31,763	\$ 25,017
Short and Long-Term Investments	33,449	32,155
 Total cash and short and long-term investments	 \$ 65,212	 \$ 57,172
 Net increase (decrease) in total cash and investments (six months ended October 31)	 \$ 2,564	 \$ (1,889)

Our total activities used cash and investments during the six months ended October 31, 2006, when compared to the prior year period, due primarily to the changes in operating assets and liabilities noted above.

Days Sales Outstanding in accounts receivable were 79 days as of October 31, 2006, compared to 61 days as of October 31, 2005. This increase was due primarily to timing of closing license fees sales toward the end of the current quarter which resulted in an increase in the accounts receivable balance. Our current ratio on both October 31, 2006 and 2005 was 3.2 to 1.

As a result of the positive cash flow from operations our business has generated in recent periods, and because we have \$65.2 million in cash and investments with no debt, we believe that our sources of liquidity and capital resources will be sufficient to satisfy our presently anticipated requirements during at least the next twelve months for working capital, capital expenditures and other corporate needs. However, at some future date we may need to seek additional sources of capital to meet our requirements. If such need arises, we may be required to raise additional funds through equity or debt financing. Neither we nor Logility currently have a bank line of credit. We can provide no assurance that bank lines of credit or other financing will be available on terms acceptable to us. If available, such financing may result in dilution to our shareholders or higher interest expense.

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The sources of free cash flow that we have used for dividend payments include cash we generate through our operations (exclusive of cash that Logility generates), supplemented by our cash and investments (exclusive of Logility's cash and investments).

On August 22, 2002, our Board of Directors approved a resolution authorizing the repurchase of up to 2.0 million shares of our Class A common stock. These repurchases have been and will be made through open market purchases at prevailing market prices. The timing of any repurchases will depend upon market conditions, the market price of our common stock and management's assessment of our liquidity and cash flow needs. For this repurchase plan, through December 8, 2006, we have repurchased 247,232 shares of common stock at a cost of approximately \$1.1 million. We did not make any repurchases of our common stock in the quarter ended October 31, 2006.



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On December 15, 1997, Logility Board of Directors approved a resolution authorizing Logility to repurchase up to 350,000 shares of our common stock through open market purchases at prevailing market prices. Logility completed this repurchase plan in November 1998, at which time Logility adopted an additional repurchase plan for up to 800,000 shares. In February 2003, Logility's Board of Directors approved a resolution authorizing it to repurchase an additional 400,000 shares for a total authorized repurchase amount of 1,550,000 shares. The timing of any repurchases depends on market conditions, the market price of Logility's common stock and Logility's assessment of its liquidity and cash flow needs. For all repurchase authorizations, through December 8, 2006, Logility had purchased a cumulative total of 1,296,104 shares at a total cost of \$7.8 million. In the second quarter of fiscal 2007, Logility purchased 15,000 shares under this program for an average price of \$7.45 per share. See Part II, Item 2 for a table summarizing stock repurchases in the last quarter and the number of remaining shares available for purchase under the Company's and Logility's existing repurchase program.

**RECENT ACCOUNTING PRONOUNCEMENTS**

During June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, and interpretation of FASB Statement No. 109, Accounting for Income Taxes. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements, and 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. The evaluation of a tax position in accordance with this Interpretation is based on a more likely than not approach. This interpretation is effective for fiscal years beginning after December 15, 2006.

The Company does not expect this Interpretation to have a material impact on its financial statements.

During June 2006 the Emerging Issues Task Force (EITF) issued Issue 06-03: How Taxes Collected for Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross Versus Net Presentation). The task force reached a tentative conclusion on issue one that the scope of this issue includes any tax assessed by a governmental authority this is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise tax. The task force also reached a tentative conclusion on issue two that the presentation of taxes within the scope of issue one on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed pursuant to Accounting Principles Board (APB) Opinion No. 22, Disclosure of Accounting Policy. In addition, for any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. The disclosure of those taxes can be done on an aggregate basis. The task force also reached a tentative conclusion that this Issue should be applied to financial reports for Interim and annual periods beginning after December 15, 2006.

The Company does not expect this Issue to have a material impact on its financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) Topic 1N, Financial Statements - Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108), which expresses the Staff's views regarding the process of quantifying financial statement misstatements due to the current diversity in practice. SAB 108 will require companies to use two approaches when quantifying financial statement misstatements. We are required to adopt SAB 108 for the fiscal year ending April 30, 2007.

We are currently evaluating the impact of adopting SAB 108 on our Consolidated Financial Statements.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

We have based the following discussion and analysis of financial condition and results of operations on our financial statements, which we have prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Note 1 in the Notes to the Consolidated Financial Statements for the year ended April 30, 2006, describes the significant accounting policies that we have used in preparing our financial statements. On an ongoing basis, we evaluate our estimates, including, but not limited to those related to revenue/vendor specific object evidence (VSOE), bad debts, capitalized software costs, goodwill, intangible asset impairment, stock-based compensation, income taxes and contingencies. We base our estimates on historical experience and on various other

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assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results could differ from these estimates under different assumptions or conditions.

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

*Revenue Recognition.* We recognize revenue in accordance with Statement of Position (SOP) 97-2, Software Revenue Recognition, and SOP 98-9, Software Revenue Recognition with Respect to Certain Transactions. We recognize license revenues in connection with license agreements for standard proprietary software upon delivery of the software, provided we deem collection to be probable, the fee is fixed or determinable, there is evidence of an arrangement, and vendor specific objective evidence exists with respect to any undelivered elements of the arrangement. We generally bill maintenance fees annually in advance and recognize the resulting revenues ratably over the term of the maintenance agreement. We derive revenues from services which primarily include consulting, implementation, and training. We bill for these services primarily under time and materials arrangements and recognize fees as we perform the services. Deferred revenues represent advance payments or billings for software licenses, services, and maintenance billed in advance of the time we recognize revenues. We record revenues from sales of third-party products net of royalties, in accordance with Emerging Issues Task Force Issue 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent (EITF 99-19). Furthermore, in accordance with EITF 99-19, we evaluate sales through our indirect channel on a case-by-case basis to determine whether the transaction should be recorded gross or net, including but not limited to assessing whether or not the Company 1) acts as principal in the transaction, 2) takes title to the products, 3) has risks and rewards of ownership, such as the risk of loss for collection, delivery, or returns, and 4) acts as an agent or broker with compensation on a commission or fee basis. Accordingly, our sales through the DMI channel are typically recorded gross.

Generally, our software products do not require significant modification or customization. Installation of the products is routine and is not essential to the functionality of the product. Our sales frequently include maintenance contracts and professional services with the sale of our software licenses. We have established vendor-specific objective evidence of fair value (VSOE) for our maintenance contracts and professional services. We determine fair value based upon the prices we charge to customers when we sell these elements separately. We defer maintenance revenues, including those sold with the initial license fee, based on VSOE, and recognize the revenue ratably over the maintenance contract period. We recognize consulting and training service revenues, including those sold with license fees, as we perform the services based on their established VSOE. We determine the amount of revenue we allocate to the licenses sold with services or maintenance using the residual method of accounting. Under the residual method, we allocate the total value of the arrangement first to the undelivered elements based on their VSOE and allocate the remainder to license fees.

*Allowance for Doubtful Accounts.* We maintain allowances for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. If the financial condition of these customers were to deteriorate, resulting in an impairment of their ability to make payments, we may require additional allowances or we may defer revenue until we determine that collectibility is probable. We specifically analyze accounts receivable and historical bad debts, customer creditworthiness, current economic trends and changes in customer payment terms when we evaluate the adequacy of the allowance for doubtful accounts.

*Valuation of Acquired Business.* In fiscal 2005, Logility made a business acquisition. We are required to allocate the purchase price of an acquired business to the assets acquired and liabilities assumed based on their fair values at date of acquisition. Prior to this allocation, we are required to identify intangible assets and assign a value to these intangible assets based on their fair value. Determining the fair value of identifiable intangible assets requires management to estimate future cash flows for the related assets and the useful life of such assets. We recognize the excess of the cost of the acquired business over the net of the amounts assigned to assets acquired and liabilities assumed as goodwill. We amortize intangible assets over their useful lives and evaluate goodwill on an annual basis. Consequently, our estimates determine the timing and the amount of expense recognized in our financial statements.

*Valuation of Long-Lived and Intangible Assets.* In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ( SFAS No. 142 ), we do not amortize goodwill and other intangible assets with indefinite lives. Our goodwill is subject to annual impairment tests, which require us to estimate the fair value of our business compared to the carrying value. The impairment reviews require an analysis of future projections and assumptions about our operating performance. Should such review indicate the assets are impaired, we would record an expense for the impaired assets.

In accordance with Financial Accounting Standards Board Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, ( SFAS No. 144 ), long-lived assets, such as property and equipment and intangible assets,



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are reviewed for impairment whenever events or changes in circumstances indicated that the carrying amount of an asset may not be recoverable. Recoverability would be measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. The determination of estimated future cash flows, however, requires management to make estimates. Future events and changes in circumstances may require us to record a significant impairment charge in the period in which such events or changes occur. Impairment testing requires considerable analysis and judgment in determining results. If other assumptions and estimates were used in our evaluations, the results could differ significantly.

Annual tests or other future events could cause us to conclude that impairment indicators exist and that our goodwill is impaired. For example, if we had reason to believe that our recorded goodwill and intangible assets had become impaired due to decreases in the fair market value of the underlying business, we would have to take a charge to income for that portion of goodwill or intangible assets that we believed was impaired. Any resulting impairment loss could have a material adverse impact on our financial position and results of operations. At October 31, 2006, our goodwill balance was \$11.2 million and our intangible assets with definite lives balance was \$1.7 million, net of accumulated amortization.

*Valuation of Capitalized Software Assets.* We capitalize certain computer software development costs in accordance with SFAS No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed. Costs incurred internally to create a computer software product or to develop an enhancement to an existing product are charged to expense when incurred as research and development expense until technological feasibility for the respective product is established. Thereafter, all software development costs are capitalized and reported at the lower of unamortized cost or net realizable value. Capitalization ceases when the product or enhancement is available for general release to customers. We make ongoing evaluations of the recoverability of our capitalized software projects by comparing the amount capitalized for each product to the estimated net realizable value of the product. If such evaluations indicate that the unamortized software development costs exceed the net realizable value, we write off the amount by which the unamortized software development costs exceed net realizable value. We amortize capitalized computer software development costs ratably based on the projected revenues associated with the related software or on a straight-line basis over three years, whichever method results in a higher level of amortization. Amortization of capitalized computer software development costs is included in the cost of license revenues in the consolidated statements of operations.

*Stock-Based Compensation.* Effective May 1, 2006, we adopted the fair value recognition provisions of SFAS 123(R) using the modified prospective transition method. Under that transition method, compensation cost recognized on or after May 1, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of May 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted on or after May 1, 2006, based on the grant date fair value estimated in accordance with SFAS 123(R). Results for prior periods have not been restated. SFAS 123(R) requires that cash flows resulting from the tax benefits generated by tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

Management judgments and assumptions related to volatility, the expected term and the forfeiture rate are made in connection with the calculation of stock compensation expense. We periodically review all assumptions used in our stock option pricing model. Changes in these assumptions could have a significant impact on the amount of stock compensation expense.

*Income Taxes.* We provide for the effect of income taxes on our financial position and results of operations in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Under this accounting pronouncement, income tax expense is recognized for the amount of income taxes payable or refundable for the current year and for the change in net deferred tax assets or liabilities resulting from events that are recorded for financial reporting purposes in a different reporting period than recorded in the tax return. Management must make significant assumptions, judgments and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities and any valuation allowance to be recorded against our net deferred tax asset. Our judgments, assumptions and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws, allowable deductions, projected tax credits and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Changes in tax law or our interpretation of tax laws and the resolution of current and future tax audits could significantly impact the amounts provided for income taxes in our financial position and results of operations. Our assumptions, judgments and estimates relative to the value of our net deferred tax asset take into account our expectations of the amount and category of future taxable income. Actual operating results and the underlying amount and category of income in future years, which could significantly increase tax expense, could render inaccurate our current assumptions, judgments and estimates of recoverable net deferred taxes.

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### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*Foreign Currency.* In the three and six months ended October 31, 2006, we generated approximately 10% of our revenues outside the United States. We typically make international sales through our foreign subsidiaries or our Logility subsidiary and denominate those sales typically in U.S. Dollars, British Pounds Sterling or Euros. However, expenses incurred in connection with these sales are typically denominated in the local currencies. For the three and six months ended October 31, 2006, we recorded an exchange rate gain of \$35,000 and \$27,000 compared to an exchange rate loss of \$47,000 for the three months ended October 31, 2005 and a loss of \$78,000 for the six months ended October 31, 2005. We estimate that a 10% movement in foreign currency rates would have up to \$639,000 exchange gain or loss on our financial condition or results of operations. We have not engaged in any hedging activities.

*Interest rates and other market risks.* We manage our interest rate risk by maintaining an investment portfolio of trading and held-to-maturity investments with high credit quality and relatively short average maturities. These instruments include, but are not limited to, money-market instruments, bank time deposits, and taxable and tax-advantaged variable rate and fixed rate obligations of corporations, municipalities, and national, state, and local government agencies, in accordance with an investment policy approved by our Board of Directors. These instruments are denominated in U.S. dollars. The fair market value of securities as of October 31, 2006 was approximately \$63.6 million.

We also hold cash balances in accounts with commercial banks in the United States and foreign countries. These cash balances represent operating balances only and are invested in short-term time deposits of the local bank. Such operating cash balances held at banks outside the United States are denominated in the local currency and are minor.

Many of our investments carry a degree of interest rate risk. When interest rates fall, our income from investments in variable-rate securities declines. When interest rates rise, the fair market value of our investments in fixed-rate securities declines. In addition, our investments in equity securities are subject to stock market volatility. Due in part to these factors, our future investment income may fall short of expectations or we may suffer losses in principal if forced to sell securities, which have seen a decline in market value due to changes in interest rates. We attempt to mitigate risk by holding fixed-rate securities to maturity, but, if our liquidity needs force us to sell fixed-rate securities prior to maturity, we may experience a loss of principal.

*Inflation.* Although we cannot accurately determine the amounts attributable thereto, we have been affected by inflation through increased costs of employee compensation and other operational expenses. To the extent permitted by the marketplace for our products and services, we attempt to recover increases in costs by periodically increasing prices.

### **Item 4. Controls and Procedures**

#### **Management's Report on Internal Control Over Financial Reporting**

As of the end of the period covered by this report, our management evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) under the supervision and with the participation of our chief executive officer and chief financial officer. Based on and as of the date of such evaluation, the aforementioned officers have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

Our chief executive officer and chief financial officer, with the assistance of our Disclosure Committee, have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of October 31, 2006. We perform this evaluation on a quarterly basis so that the conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our annual report on Form 10-K and quarterly reports on Form 10-Q. Based on this evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective as of October 31, 2006.

We believe our financial statements fairly present in all material respects our financial position, results of operations and cash in our quarterly report on Form 10-Q.

#### **Changes in Internal Control over Financial Reporting**

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



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We are not currently involved in legal proceedings requiring disclosure under this item.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors as described in our Annual Report on Form 10-K for our fiscal year ended April 30, 2006.

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

The following table summarizes repurchases of our stock in the three months ended October 31, 2006:

<b>Fiscal Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs*</b>
August 1, 2006 through August 31, 2006	0	\$ 0.00	0	1,752,768
September 1, 2006 through September 30, 2006	0	\$ 0.00	0	1,752,768
October 1, 2006 through October 31, 2006	0	\$ 0.00	0	1,752,768
Total Fiscal 2007 Second Quarter	0	\$ 0.00	0	1,752,768

\* Our Board of Directors approved the above share purchase authority on August 19, 2002, when the Board approved a resolution authorizing the Company to repurchase up to 2.0 million shares of Class A common stock. This action was announced on August 22, 2002. The authorization has no expiration date.

The following table summarizes repurchases of stock made by our Logility subsidiary in the three months ended October 31, 2006:

<b>Fiscal Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs*</b>
August 1, 2006 through August 31, 2006	0	\$ 0.00	0	268,896
September 1, 2006 through September 30, 2006	15,000	\$ 7.45	15,000	253,896
October 1, 2006 through October 31, 2006	0	\$ 0.00	0	253,896
Total Fiscal 2007 Second Quarter	15,000	\$ 7.45	15,000	253,896

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\* The Logility Board of Directors approved the above share purchase authority in December 1997, November 1998 and February 2003, when the Logility Board approved resolutions authorizing Logility to repurchase an aggregate of up to 1.6 million shares of common stock. The authorizations have no expiration dates.



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**Item 3. Defaults Upon Senior Securities**

Not applicable.

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

The Company held its 2006 Annual Meeting of Shareholders on August 28, 2006. At the meeting, a Class A shareholders vote was taken with respect to the re-election of W. Dennis Hogue, John J. Jarvis and James B. Miller as directors for a one-year term. There were no other nominees. The results of that shareholder vote were as follows:

Election of W. Dennis Hogue

Votes For: 19,118,738; Withholding Authority to Vote For: 552,390.

Election of John J. Jarvis

Votes For: 19,120,547; Withholding Authority to Vote For: 550,581.

Election of James B. Miller

Votes For: 18,520,295; Withholding Authority to Vote For: 1,150,832.

The Class B shareholders unanimously re-elected James C. Edenfield, J. Michael Edenfield, Thomas L. Newberry and Thomas L. Newberry, V as Directors.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

Exhibits 31.1-31.2. Rule 13a-14(a)/15d-14(a) Certifications

Exhibit 32.1. Section 906 Certifications

**SIGNATURES**

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

AMERICAN SOFTWARE, INC.

Date: December 11, 2006

By: /s/ James C. Edenfield  
James C. Edenfield  
President, Chief Executive Officer and Treasurer

Date: December 11, 2006

By: /s/ Vincent C. Klinges  
Vincent C. Klinges  
Chief Financial Officer

Date: December 11, 2006

By: /s/ Herman L. Moncrief

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Herman L. Moncrief  
Controller and Principal Accounting Officer

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