

BOTTOMLINE TECHNOLOGIES INC /DE/  
Form 10-Q  
May 09, 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 March 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: 0-25259

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**Bottomline Technologies (de), Inc.**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

325 Corporate Drive

02-0433294  
(I.R.S. Employer

Identification No.)

03801-6808

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**Portsmouth, New Hampshire**  
(Address of principal executive offices)

(Zip Code)

**(603) 436-0700**

(Registrant's telephone number, including area code)

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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. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

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

The number of shares outstanding of the registrant's common stock as of April 30, 2006 was 23,507,375.

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Bottomline Technologies (de), Inc.****Unaudited Condensed Consolidated Balance Sheets**

(in thousands)

	March 31, 2006	June 30, 2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 36,107	\$ 20,789
Marketable securities	41,143	15,127
Accounts receivable, net of allowance for doubtful accounts and returns of \$1,928 at March 31, 2006 and \$1,830 at June 30, 2005	21,979	22,956
Other current assets	5,004	4,893
<b>Total current assets</b>	<b>104,233</b>	<b>63,765</b>
Property and equipment, net	6,787	6,940
Intangible assets, net	60,835	38,695
Other assets	762	1,041
<b>Total assets</b>	<b>\$ 172,617</b>	<b>\$ 110,441</b>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 8,152	\$ 6,094
Accrued expenses	8,328	9,381
Deferred revenue and deposits	19,202	20,738
<b>Total current liabilities</b>	<b>35,682</b>	<b>36,213</b>
Deferred revenue and deposits, non current	1,543	1,435
Deferred income taxes	2,587	
<b>Total liabilities</b>	<b>39,812</b>	<b>37,648</b>
Stockholders' equity:		
Common stock	23	19
Additional paid-in-capital	244,222	182,534
Accumulated other comprehensive income	1,164	2,350
Treasury stock	(686)	(1,149)
Retained deficit	(111,918)	(110,961)
<b>Total stockholders' equity</b>	<b>132,805</b>	<b>72,793</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 172,617</b>	<b>\$ 110,441</b>

See accompanying notes.



**Table of Contents****Bottomline Technologies (de), Inc.****Unaudited Condensed Consolidated Statements of Operations****(in thousands, except per share amounts)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Revenues:</b>		
Software licenses	\$ 2,543	\$ 4,629
Service and maintenance	18,750	15,540
Equipment and supplies	3,599	4,319
<b>Total revenues</b>	<b>24,892</b>	<b>24,488</b>
<b>Cost of revenues:</b>		
Software licenses	371	492
Service and maintenance <sup>(1)</sup>	8,597	6,931
Equipment and supplies	2,930	3,265
<b>Total cost of revenues</b>	<b>11,898</b>	<b>10,688</b>
<b>Gross profit</b>	<b>12,994</b>	<b>13,800</b>
<b>Operating expenses:</b>		
Sales and marketing <sup>(1)</sup>	6,090	6,012
Product development and engineering <sup>(1)</sup>	3,639	2,298
General and administrative <sup>(1)</sup>	4,655	3,042
Amortization of intangible assets	1,357	707
<b>Total operating expenses</b>	<b>15,741</b>	<b>12,059</b>
<b>Income (loss) from operations</b>	<b>(2,747)</b>	<b>1,741</b>
<b>Other income, net</b>	<b>780</b>	<b>108</b>
<b>Income (loss) before provision for income taxes</b>	<b>(1,967)</b>	<b>1,849</b>
<b>Provision for income taxes</b>	<b>205</b>	<b>84</b>
<b>Net income (loss)</b>	<b>\$ (2,172)</b>	<b>\$ 1,765</b>
<b>Net income (loss) per share:</b>		
Basic	\$ (0.09)	\$ 0.10
Diluted	\$ (0.09)	\$ 0.09
<b>Shares used in computing net income (loss) per share:</b>		
Basic	23,083	18,180
Diluted	23,083	19,464

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(1) Stock based compensation is allocated as follows:

	Three Months Ended	
	March 31, 2006	2005
Cost of revenues: service and maintenance	\$ 122	\$
Sales and marketing	693	
Product development and engineering	215	
General and administrative	851	
	\$ 1,881	\$

See accompanying notes.

**Table of Contents****Bottomline Technologies (de), Inc.****Unaudited Condensed Consolidated Statements of Operations**

(in thousands, except per share amounts)

	Nine Months Ended	
	March 31,	
	2006	2005
Revenues:		
Software licenses	\$ 9,414	\$ 13,649
Service and maintenance	54,883	44,724
Equipment and supplies	11,391	11,813
Total revenues	75,688	70,186
Cost of revenues:		
Software licenses	1,072	1,868
Service and maintenance <sup>(1)</sup>	23,927	19,028
Equipment and supplies	9,105	8,970
Total cost of revenues	34,104	29,866
Gross profit	41,584	40,320
Operating expenses:		
Sales and marketing <sup>(1)</sup>	18,629	17,806
Product development and engineering <sup>(1)</sup>	8,956	7,184
General and administrative <sup>(1)</sup>	13,364	9,349
Amortization of intangible assets	3,018	2,349
Total operating expenses	43,967	36,688
Income (loss) from operations	(2,383)	3,632
Other income, net	2,285	401
Income (loss) before provision for income taxes	(98)	4,033
Provision for income taxes	859	349
Net income (loss)	\$ (957)	\$ 3,684
Net income (loss) per share:		
Basic	\$ (0.04)	\$ 0.21
Diluted	\$ (0.04)	\$ 0.19
Shares used in computing net income (loss) per share:		
Basic	22,643	17,878
Diluted	22,643	18,911



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(1) Stock based compensation is allocated as follows:

	Nine Months Ended	
	March 31, 2006	2005
Cost of revenues: service and maintenance	\$ 368	\$
Sales and marketing	1,854	
Product development and engineering	653	14
General and administrative	2,407	
	\$ 5,282	\$ 14

See accompanying notes.

**Table of Contents****Bottomline Technologies (de), Inc.****Unaudited Condensed Consolidated Statements of Cash Flows****(in thousands)**

	<b>Nine Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2005</b>
Operating activities:		
Net income (loss)	\$ (957)	\$ 3,684
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Stock compensation expense	5,282	14
Amortization of intangible assets	3,018	2,349
Amortization of investment income	(7)	(40)
Depreciation and amortization of property and equipment	1,992	1,845
Acquisition related technology write-offs	189	
Provision for allowances on accounts receivable	94	121
Provision for allowances for obsolescence of inventory	77	4
Gain on foreign exchange	(3)	(50)
Deferred income tax benefit	(302)	
Changes in operating assets and liabilities:		
Accounts receivable	1,490	104
Inventory, prepaid expenses and other assets	350	128
Accounts payable, accrued expenses and deferred revenue and deposits	(2,450)	2,730
<b>Net cash provided by operating activities</b>	<b>8,773</b>	<b>10,889</b>
Investing activities:		
Purchases of available-for-sale securities	(41,150)	(14,600)
Purchases of held-to-maturity securities	(46)	(5,749)
Proceeds from sales of available-for-sale securities	13,100	4,050
Proceeds from sales of held-to-maturity securities	2,084	6,054
Purchases of property, plant and equipment	(1,791)	(1,515)
Acquisition of businesses and assets, net of cash acquired	(18,186)	
<b>Net cash used in investing activities</b>	<b>(45,989)</b>	<b>(11,760)</b>
Financing activities:		
Net proceeds from sale of common stock	46,769	
Proceeds from employee stock purchase plan and exercise of stock options	5,952	3,476
Payment of bank financing fees	(33)	
Proceeds from exercise of warrants		425
<b>Net cash provided by financing activities</b>	<b>52,688</b>	<b>3,901</b>
Effect of exchange rate changes on cash and cash equivalents	(154)	63
<b>Increase in cash and cash equivalents</b>	<b>15,318</b>	<b>3,093</b>
Cash and cash equivalents at beginning of period	20,789	20,724
<b>Cash and cash equivalents at end of period</b>	<b>\$ 36,107</b>	<b>\$ 23,817</b>

See accompanying notes.



**Table of Contents****Bottomline Technologies (de), Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****March 31, 2006****Note 1 Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation of the interim financial information have been included. Operating results for the three and nine months ended March 31, 2006 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending June 30, 2006. For further information, refer to the financial statements and footnotes included in the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission (SEC) on September 12, 2005.

**Note 2 Share Based Payments**

Effective July 1, 2005, the Company adopted Statement of Financial Accounting Standard No. 123 (revised 2004), Share Based Payment (SFAS 123R). Under SFAS 123R, the Company is required to recognize, as expense, the estimated fair value of all share based payments to employees. The Company records expense associated with its share based payment awards on a straight-line basis over the respective award vesting period. For the three and nine months ended March 31, 2006, the Company recorded expense of approximately \$1.9 million and \$5.3 million, respectively, in connection with its share-based payment awards.

The Company adopted SFAS 123R under the modified prospective method. Under this method, the Company recognized compensation cost for all share-based payments to employees based on the grant date estimate of fair value for those awards, beginning on July 1, 2005. Prior period financial information has not been restated.

For periods prior to the adoption of SFAS 123R, the Company had elected to follow Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees, (APB 25) and related Interpretations in accounting for its share based payment awards. Under APB 25, since the exercise price of the Company's employee stock options equaled the market price of the underlying stock on the date of the grant and, in the case of the Company's stock purchase plans, since the plans are non-compensatory, no compensation expense was recorded in the financial statements.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock Based Compensation, to its stock-based employee compensation for the three and nine months ended March 31, 2005.

	Three Months	Nine Months
	Ended	Ended
	March 31,	March 31,
	2005	2005
	(in thousands,	
	except per share amounts)	
Net income, as reported	\$ 1,765	\$ 3,684
Add: Stock-based employee compensation expense included in reported net income		14
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,648)	(4,294)

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Pro forma net income (loss)	\$ 117	\$ (596)
Net income per share, as reported:		
Basic	\$ 0.10	\$ 0.21
Diluted	\$ 0.09	\$ 0.19
Pro forma net income (loss) per share		
Basic and diluted	\$ 0.01	\$ (0.03)

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### ***Share Based Compensation Plans***

#### **Employee Stock Purchase Plan**

##### *2000 Employee Stock Purchase Plan*

On November 16, 2000, the Company adopted the 2000 Employee Stock Purchase Plan, which was amended on November 18, 2004 (2000 Stock Purchase Plan), and which provides for the issuance of up to a total of 1,500,000 shares of common stock to participating employees. Eligible employees may contribute between 1% and 10% of their base pay to the 2000 Stock Purchase Plan. At the end of a designated purchase period, which occurs every six months on March 31 and September 30, employees purchase shares of the Company's common stock with contributions accumulated via payroll deductions, at an amount equal to 85% of the lower of the fair market value of the common stock on the first day of each 24-month offering period or the last day of the applicable six-month purchase period.

The Company's employee stock purchase plan has several complex features that make determining fair value on the grant date impracticable. Accordingly, and as permitted by SFAS 123R, the Company measures the fair value of its awards under the employee stock purchase plan at intrinsic value (the value of the Company's common stock less the employee stock purchase plan exercise price) at the end of each reporting period. For the three and nine month periods ended March 31, 2006, the Company recorded compensation cost of approximately \$45,000 and \$190,000, respectively, associated with its employee stock purchase plan. As a result of the employee stock purchases on September 30, 2005 and March 31, 2006, the Company issued 57,790 shares of its common stock with an aggregate intrinsic value of approximately \$333,000.

#### ***Stock Incentive Plans***

##### *1998 Non-Employee Director Stock Option Plan*

On November 12, 1998, the Company adopted the 1998 Non-Employee Director Stock Option Plan (the Director Plan), which provides for the issuance of non-statutory stock options with a 10-year contractual term. The Company has reserved up to 300,000 shares of its common stock for issuance under the Director Plan. Under the terms of the Director Plan, each non-employee director was granted an option to purchase 15,000 shares of common stock upon his or her initial election to the Board of Directors. Such options vest over four years from the date of the grant, with 25% of the award vesting at the end of each year. Effective February 16, 2006, the Company determined that, in lieu of stock option awards, it will now grant restricted stock awards for 8,000 shares of the Company's common stock to each non-employee director upon his or her initial election to the Board of Directors, with such awards vesting over a four year period.

Additionally, until November 17, 2005, each non-employee director was granted an option to purchase 7,500 shares of common stock at each annual meeting of stockholders following the annual meeting of the initial year of their election. Such options vested one year from the date of the grant. Effective November 17, 2005, the Company determined that, in lieu of the annual stock option grants, it will now grant restricted stock awards for 3,000 shares of the Company's common stock to each non-employee director on the date of each annual meeting of stockholders, with such awards vesting over a one year period. Accordingly, 18,000 shares of restricted stock were issued by the Company in November 2005 to its non-employee directors, as compensation for their service as directors.

##### *2000 Employee Stock Incentive Plan*

On November 16, 2000, the Company adopted the 2000 Employee Stock Incentive Plan (the 2000 Plan), which provides for the issuance of stock options, non-statutory stock options and restricted stock. Stock option awards under this plan have a 10-year contractual term. The 2000 Plan is administered by the Board of Directors, which has the authority to determine to whom options may be granted, the period of exercise and what other restrictions, if any, should apply. Vesting for awards granted under the 2000 Plan is principally over four years from the date of the grant, with 25% of the award vesting after one year and 6.25% of the award vesting each quarter thereafter. The Company initially reserved 1,350,000 shares of its common stock for issuance under the 2000 Plan.

On the first day of each fiscal year, beginning in fiscal year 2001 and ending in fiscal year 2010, the number of shares of common stock authorized for issuance under the 2000 Plan will automatically increase, without additional Board or stockholder approval. The number of shares authorized for issuance will increase, when added to the remaining available shares, to total an amount equal to 12% of the number of shares of common stock outstanding on the first day of the fiscal year, or such lesser number as the Board of Directors may determine prior to such increase. The annual increase can never exceed 5,000,000 shares. Stock options issued under the 2000 Plan must be issued at an exercise price not less than 100% of the fair market value of the common stock at the date of grant.



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Compensation cost associated with stock options represented approximately \$1.4 million and \$4.3 million of the total share based payment expense recorded for the three and nine months ended March 31, 2006. The stock options were valued using a Black Scholes method of valuation, and the resulting fair value is recorded as compensation cost on a straight line basis over the option vesting period. The assumptions made for purposes of estimating fair value under the Black Scholes model for options granted during the nine months ended March 31, 2006 were as follows:

Dividend yield:	0%
Expected term of options (years):	4.85
Risk free interest rate:	4.11% - 4.61%
Volatility:	69% - 87%

The Company's estimate of an expected option term was derived based on a review of its historic option holding periods, including a consideration of the holding period inherent in currently vested but unexercised options. The estimated stock price volatility was derived based on a review of the Company's actual historic stock prices over the past five years. The specific stock option valuation assumptions used for awards granted prior to July 1, 2005 are as disclosed in the Company's prior annual reports on Form 10-K, as filed with the SEC.

A summary of stock option activity under the 2000 Plan for the three months ended March 31, 2006 is as follows:

	Shares (in thousands)	Weighted Average Exercise Price	Weighted - Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Options outstanding at December 31, 2005	4,784	11.94	6.66	\$ 8,821
Granted	124	12.13		
Exercised	(316)	7.27		
Forfeited or expired	(57)	18.50		
Options outstanding at March 31, 2006	4,535	12.19	6.52	\$ 15,666
Options exercisable at March 31, 2006	2,933	12.97	5.48	\$ 10,695

The weighted average grant date fair value of options granted during the three months ended March 31, 2006 and 2005 was \$7.24 and \$8.99, respectively. The total intrinsic value of options exercised during the three months ended March 31, 2006 and 2005 was approximately \$1.7 million and \$979,000, respectively. As of March 31, 2006, there was approximately \$10.9 million of unrecognized compensation cost related to stock option awards that is expected to be recognized as expense over a weighted average period of 2.6 years. The total fair value of stock options that vested during the three months ended March 31, 2006 and 2005 was approximately \$2.9 million and \$1.9 million, respectively.

A summary of stock option activity under the 2000 Plan for the nine months ended March 31, 2006 is as follows:

Shares	Weighted Average Exercise	Weighted- Average Remaining	Aggregate Intrinsic Value
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	(in thousands)	Price	Contractual Term (years)	(in thousands)
Options outstanding at June 30, 2005	5,284	\$ 11.41		
Granted	280	13.18		
Exercised	(784)	6.94		
Forfeited or expired	(245)	13.45		
Options outstanding at March 31, 2006	4,535	12.19	6.52	\$ 15,666

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The weighted average grant date fair value of options granted during the nine months ended March 31, 2006 and 2005 was \$8.48 and \$8.33, respectively. The total intrinsic value of options exercised during the nine months ended March 31, 2006 and 2005 was approximately \$5.4 million and \$2.9 million, respectively. The total fair value of stock options that vested during the nine months ended March 31, 2006 and 2005 was approximately \$5.9 million and \$4.7 million, respectively.

A summary of restricted stock activity for the three months ended March 31, 2006 is as follows:

	Aggregate	
	Shares	Intrinsic Value (in thousands)
Restricted stock outstanding at December 31, 2005	431	\$ 4,750
Granted		
Forfeited		
Restricted stock outstanding at March 31, 2006	431	\$ 5,918

Prior to the quarter ended September 30, 2005, the Company had not granted awards of restricted stock. The majority of the restricted stock awards vest over a four year period on a graded vesting schedule similar to the Company's employee stock options, however, restricted stock awards granted annually to the Company's non-employee directors vest over a one year period. The restricted stock awards were valued based on the closing price of the Company's common stock on the date of grant, and compensation cost is recorded on a straight line basis over the share vesting period. The Company recorded expense of approximately \$453,000 and \$796,000 associated with its restricted stock awards in the three and nine months ended March 31, 2006, respectively. As of March 31, 2006, there was approximately \$5.3 million of unrecognized compensation cost related to restricted stock awards that will be recognized as expense over a weighted average period of 3.4 years. None of the restricted stock awards were vested at March 31, 2006.

**Note 3 Business and Technology Acquisitions***Visibility, Inc.*

On December 31, 2005, the Company acquired all of the outstanding stock of Visibility, Inc. (Visibility), a provider of legal e-billing solutions specializing in the insurance industry. The initial purchase consideration for Visibility was \$11,500,000 in cash plus acquisition related costs. Subsequent to the payment of the initial purchase consideration, the Company recovered \$500,000 from the Visibility selling stockholders pursuant to the terms of the acquisition, and this recovery was recorded as a reduction to the amount of goodwill recorded as part of the acquisition.

The Company believes that Visibility complements the Company's existing Legal eXchange product and that the acquisition will strengthen its position as a leading provider of Web-based legal spend management services to the insurance industry. Visibility operating results are included in the Company's operating results from the acquisition date forward, as a component of the Outsourced Solutions segment.

At March 31, 2006, the allocation of the purchase price was preliminary as the Company was still in the process of obtaining information relating to the fair value of assets acquired and liabilities assumed, including the value that should be allocated to intangible assets. The Company was also still in the process of analyzing the tax basis of assets acquired and liabilities assumed. Based on the preliminary allocation of the purchase price, the Company has recorded intangible assets of approximately \$11.2 million. The intangible assets consist of acquired customer related assets of \$6.4 million, acquired technology of \$1.6 million and goodwill of \$3.2 million. The customer related assets and acquired technology are being amortized to expense over a period of five and three years, respectively. Goodwill will not be amortized, but will be evaluated periodically for impairment. The Company expects to finalize its purchase price allocation no later than June 30, 2006.

In connection with the acquisition, the Company accrued approximately \$154,000 and \$203,000 related to involuntary termination costs of Visibility employees and facility exit costs, respectively. At March 31, 2006 the remaining severance accrual was approximately \$29,000 which the Company expects will be fully paid by June 30, 2006. The accrual for facility exit costs relates to rental costs of a Visibility leased facility that the Company will be exiting prior to lease expiration and the Company anticipates that this amount will be paid ratably during the period of May 2006 through November 2006.



**Table of Contents***Tranmit Plc.*

On January 24, 2006, the Company acquired all of the outstanding stock of Tranmit Plc (Tranmit). Tranmit is a UK-based company that provides Web-based purchase-to-pay automation solutions. The purchase consideration for Tranmit was approximately \$6.0 million of cash, \$4.2 million (316,970 shares) of the Company's common stock, as valued on the date of acquisition, and acquisition related costs. The Company believes the addition of Tranmit's invoice management capabilities further enhance the Company's ability to provide global organizations with comprehensive hosted, licensed and outsourced solutions for improving the overall efficiency and productivity of the accounts payable function. Tranmit operating results are included in the Company's operating results from the acquisition date forward, as a component of the Outsourced Solutions segment.

At March 31, 2006, the allocation of the purchase price was preliminary as the Company was still in the process of obtaining information relating to the fair value of assets acquired and liabilities assumed, including the value that should be assigned to intangible assets. The Company was also still in the process of analyzing the tax basis of assets acquired and liabilities assumed. Based on the preliminary allocation of the purchase price, the Company has recorded intangible assets of approximately \$12.2 million. The intangible assets consist of acquired customer related assets of \$3.3 million, acquired technology of \$1.5 million, a below market lease arrangement of \$81,000, and goodwill of \$7.3 million. The customer related assets, acquired technology and below market lease are being amortized to expense over periods of five, three and two years, respectively. Goodwill will not be amortized but will be evaluated periodically for impairment. The Company expects to finalize the purchase price allocation no later than June 30, 2006.

*Legal e-billing Patent*

On January 25, 2006, the Company acquired a patent that addresses the process of online budgeting and evaluation of legal invoices. The purchase price for the patent was \$935,000 in cash plus acquisition related costs. Per the terms of the patent purchase, the Company will be obligated to make certain earn-out payments should the Company recover royalty payments from third parties or, beginning in fiscal 2009, should specific legal billing product revenues of the Company exceed \$12.5 million on a per annum basis. The patent costs are being amortized over the remaining legal life of the patent, which expires in June 2019.

*Pro-forma Information*

The following unaudited pro-forma financial information presents the combined results of operations of the Company, Visibillity and Tranmit as if the acquisitions had occurred as of July 1, 2005 and July 1, 2004, after giving effect to certain adjustments such as increased amortization expense of acquired intangible assets, a decrease in interest income as a result of cash paid for the acquisitions and the dilutive effect of common stock issued by the Company. This pro-forma financial information does not necessarily reflect the results of operations that would have actually occurred had the Company and the acquired entities been a single entity during these periods.

	Pro-forma			
	Three Months Ended March 31, 2006		Nine Months Ended March 31, 2006	
	(Unaudited)			
	(in thousands)			
Revenues	\$ 25,183	\$ 26,455	\$ 79,980	\$ 75,759
Net income (loss)	\$ (2,216)	\$ 998	\$ (2,773)	\$ 1,099
Net income (loss) per basic and diluted share	\$ (0.9)	\$ 0.05	\$ (0.12)	\$ 0.06

**Note 4 Net Income Per Share**

The following table sets forth the computation of basic and diluted net income (loss) per share:

	Three Months Ended	Nine Months Ended
	March 31,	March 31,

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	2006	2005	2006	2005
	(in thousands, except per share amounts)			
<b>Numerator:</b>				
Net income (loss)	\$ (2,172)	\$ 1,765	\$ (957)	\$ 3,684
<b>Denominator:</b>				
Weighted average shares outstanding used in computing income (loss) per share:				
Basic	23,083	18,180	22,643	17,878
Diluted	23,083	19,464	22,643	18,911
<b>Net income (loss) per share:</b>				
Basic	\$ (0.09)	\$ 0.10	\$ (0.04)	\$ 0.21
Diluted	\$ (0.09)	\$ 0.09	\$ (0.04)	\$ 0.19

**Table of Contents****Note 5 Comprehensive Income or Loss**

Comprehensive income or loss represents net income or loss plus the results of certain stockholders' equity changes not reflected in the unaudited condensed consolidated statements of operations. The components of comprehensive income or loss, net of tax, are as follows:

	Three Months Ended		Nine Months Ended	
	March 31, 2006	2005	March 31, 2006	2005
	(in thousands)			
Net income (loss)	\$ (2,172)	\$ 1,765	\$ (957)	\$ 3,684
Other comprehensive income (loss):				
Foreign currency translation adjustments	11	(306)	(1,186)	881
Comprehensive income (loss)	\$ (2,161)	\$ 1,459	\$ (2,143)	\$ 4,565

**Note 6 Operations by Segments and Geographic Areas***Segment Information*

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

The Company's operating segments are organized principally by the type of products or services offered, and to a lesser degree, by geography. As of July 1, 2005, the Company consolidated the structure of its internal operating segments and changed the nature of the financial information that is provided to and used by the Company's chief operating decision makers. The change in segment composition on July 1, 2005 resulted in the consolidation of the Licensed Technology and Tailored Solutions segments into a single segment, Licensed Technology, and this change is reflected for all periods presented.

*Licensed Technology.* The Company's Licensed Technology segment is a supplier of licensed software products that provide a range of financial business process management solutions including making and collecting payments, sending and receiving invoices, and generating and storing business documents. The Licensed Technology segment also provides solutions designed for banking and financial institution customers, which typically involve longer implementation periods and a significant level of professional resources. This segment also provides an array of standard professional services and equipment and supplies that complement and enhance the Company's core software products. Revenue associated with this segment is generally recorded upon delivery, except in situations where a customized software solution is being delivered, in which case revenue is normally recorded on a percentage of completion basis.

*Outsourced Solutions.* The Outsourced Solutions segment provides customers with outsourced or hosted solutions offerings that facilitate payment processing and invoice receipt and presentment. Revenue for this segment is generally recognized on a per transaction basis or proportionately over the estimated life of the contract.

Each operating segment has separate sales forces and periodically a sales person in one operating segment will sell products and services that are typically sold within a different operating segment. In such cases, the transaction is generally recorded by the operating segment to which the sales person is assigned. Accordingly, segment results can include the results of transactions that have been allocated to a specific segment based on the contributing sales resources, rather than the nature of the product or service. Conversely, a transaction can be recorded by the operating segment primarily responsible for delivery to the customer, even if the sales person is assigned to a different operating segment. Such decisions are made by the Company's chief operating decision makers.

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The Company's chief operating decision makers assess performance based on segment revenue and a segment measure of profit or loss. Each segment's measure of profit or loss is on a pre-tax basis, and excludes stock compensation expense and acquisition-related expenses such as amortization of intangible assets and charges related to acquired in-process research and development. There are no inter-segment sales; accordingly the measure of segment revenue and profit or loss reflects only revenues from external customers. The costs of certain corporate level expenses, primarily general and administrative expenses, are allocated to the Company's operating segments at predetermined rates that approximate cost.

The Company does not track or assign its assets by operating segment.

The following represents a summary of the Company's reportable segments:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2006	2005	2006	2005
	(in thousands)			
<b>Revenues:</b>				
Licensed Technology	\$ 18,036	\$ 20,944	\$ 57,656	\$ 59,456
Outsourced Solutions	6,856	3,544	18,032	10,730
<b>Total revenues</b>	<b>\$ 24,892</b>	<b>\$ 24,488</b>	<b>\$ 75,688</b>	<b>\$ 70,186</b>
<b>Segment measure of profit</b>				
Licensed Technology	\$ 502	\$ 2,162	\$ 3,204	\$ 5,055
Outsourced Solutions	178	286	2,902	940
<b>Total measure of segment profit</b>	<b>\$ 680</b>	<b>\$ 2,448</b>	<b>\$ 6,106</b>	<b>\$ 5,995</b>

A reconciliation of the measure of segment profit to GAAP operating income before provision for income taxes is as follows:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2006	2005	2006	2005
	(in thousands)			
Segment measure of profit	\$ 680	\$ 2,448	\$ 6,106	\$ 5,995
Less:				
Amortization of intangible assets	(1,357)	(707)	(3,018)	(2,349)
Stock compensation expense	(1,881)		(5,282)	(14)
Acquisition related technology write-offs	(189)		(189)	
Other income, net	780	108	2,285	401
<b>Income before provision for income taxes</b>	<b>\$ (1,967)</b>	<b>\$ 1,849</b>	<b>\$ (98)</b>	<b>\$ 4,033</b>

The following depreciation expense amounts are included in the segment measure of profit:

	Three Months Ended	Nine Months Ended
	March 31,	March 31,

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	2006	2005	2006	2005
	(in thousands)			
Depreciation expense:				
Licensed Technology	\$ 410	\$ 414	\$ 1,167	\$ 1,262
Outsourced Solutions	295	191	825	583
Total depreciation expense	\$ 705	\$ 605	\$ 1,992	\$ 1,845



**Table of Contents***Geographic Information*

Revenues, based on the point of sales, not the location of the customer, by geographic area were as follows:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2006	2005	2006	2005
	(in thousands)			
Revenues from unaffiliated customers:				
United States	\$ 13,142	\$ 11,538	\$ 39,981	\$ 33,850
United Kingdom	11,196	12,592	34,261	35,150
Australia	554	358	1,446	1,186
<b>Total revenues from unaffiliated customers</b>	<b>\$ 24,892</b>	<b>\$ 24,488</b>	<b>\$ 75,688</b>	<b>\$ 70,186</b>

Long-lived assets, which are based on geographical designation, were as follows:

	March 31,	June 30,
	2006	2005
	(in thousands)	
Long-lived assets:		
United States	\$ 4,112	\$ 4,173
United Kingdom	3,211	3,675
Australia	226	133
<b>Total long-lived assets</b>	<b>\$ 7,549</b>	<b>\$ 7,981</b>

**Note 7 Income Taxes**

In the three and nine month periods ended March 31, 2006, the Company recorded tax expense of \$205,000 and \$859,000, respectively. The provision for income taxes in the three months ended March 31, 2006 consists of a provision for income taxes in Australia and the UK. The provision for income taxes for the nine months ended March 31, 2006 consists of a provision for income taxes in Australia and the UK, as well as a small amount of US state income tax which will be incurred irrespective of the Company's net operating loss position in the US. The Company has provided a valuation allowance for its deferred tax assets as it has concluded that it is more likely than not that these assets will not be realized. A portion of the valuation allowance pertains to deferred tax assets established in connection with purchase business combinations. To the extent that this portion of the valuation allowance is reduced in the future, goodwill will be proportionately reduced.

**Note 8 Goodwill and Other Intangible Assets**

The following tables set forth the information for intangible assets subject to amortization and for intangible assets not subject to amortization:

	Gross Carrying Amount	As of March 31, 2006	
		Accumulated Amortization	Net Carrying Value
		(in thousands)	
Amortized intangible assets:			
Acquired technology	\$ 19,588	\$ (14,327)	\$ 5,261
Customer related	21,047	(5,601)	15,446

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Below market lease	81	(7)	74
<b>Total</b>	<b>\$ 40,716</b>	<b>\$ (19,935)</b>	<b>20,781</b>

Unamortized intangible assets:

Goodwill			40,054
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<b>Total intangible assets</b>			<b>\$ 60,835</b>
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	<b>Gross Carrying Amount</b>	<b>As of June 30, 2005 Accumulated Amortization (in thousands)</b>	<b>Net Carrying Value</b>
<b>Amortized intangible assets:</b>			
Acquired technology	\$ 15,685	\$ (13,559)	\$ 2,126
Customer related	11,606	(3,553)	8,053
<b>Total</b>	<b>\$ 27,291</b>	<b>\$ (17,112)</b>	<b>10,179</b>
<b>Unamortized intangible assets:</b>			
Goodwill			28,516
<b>Total intangible assets</b>			<b>\$ 38,695</b>

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Estimated amortization expense for the current fiscal year, and subsequent fiscal years, is as follows:

	<b>In thousands</b>
2006	\$ 4,458
2007	5,531
2008	5,036
2009	3,899
2010	2,836
2011 and thereafter	2,039

The increase in the carrying value of goodwill since June 30, 2005 is due to the acquisition of Visibillity and Tranmit, partially offset by a decrease in foreign currency exchange rates.

**Note 9 Credit Facility**

In December 2005, the Company's subsidiary, Bottomline Europe, renewed through December 31, 2006 its Committed Overdraft Facility (Overdraft Facility), to provide for borrowings of up to 500,000 British Pound Sterling. Borrowings under this Overdraft Facility are secured by substantially all assets of Bottomline Europe, bear interest at the bank's base rate (4.5% at March 31, 2006) plus 2% and are due on the expiration date of the Overdraft Facility. There were no outstanding borrowings under this Overdraft Facility at March 31, 2006.

**Note 10 Commitments and Contingencies**

In December 2004, Bottomline Europe entered into a contract with a vendor to provide software installation services to certain Bottomline Europe customers. Under the terms of the arrangement, Bottomline Europe agreed to a minimum purchase commitment of £450,000 (approximately \$774,000) from this vendor. The services procured by Bottomline Europe were used to supplement the Company's existing professional services team with respect to UK product installations. As of December 31, 2005, Bottomline Europe had expended the full amount of this commitment.

**Note 11 Stock Offering**

In July 2005, the Company completed a follow-on offering of its common stock. In connection with this offering, the Company issued 3,560,000 shares of stock and generated proceeds, after underwriting discounts, of approximately \$47 million. General Atlantic, an existing stockholder, sold 1,500,000 shares of the Company's common stock in connection with this offering. The Company did not receive any proceeds for the shares sold by General Atlantic.

The Company expects to use the offering proceeds for general corporate purposes, including working capital, product development and capital expenditures. The Company has used, and may in the future continue to use, a portion of the proceeds to acquire other complementary products, technologies or businesses, however, there are currently no commitments or agreements with respect to any such transactions.

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

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. The statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Without limiting the foregoing, the words may, will, should, could, expects, plans, anticipates, believes, estimates, predicts, and similar expressions are intended to identify forward-looking statements. All forward-looking statements included in this Quarterly Report on Form 10-Q are based on information available to us up to, and including, the date of this document, and we assume no obligation to update any such forward-looking statements, even if our estimates change. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth below under Management's Discussion and Analysis of Financial Condition and Results of Operations and Certain Factors That May Affect Future Results and elsewhere in this Form 10-Q. You should carefully review those factors and also carefully review the risks outlined in other documents that we file from time to time with the SEC.

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### **Overview**

We provide software products and services for business payments and invoice management. Our solutions enable organizations to automate, manage, standardize and control transaction-based processes across the enterprise, particularly those that involve making payments, sending and receiving invoices, receiving payments, generating business documents and conducting electronic banking. We offer software designed to run on-site at the customer's location as well as hosted solutions. Historically, our software has been sold predominantly on a perpetual license basis. A large part of our focus going forward will be on selling subscription and transaction based product offerings.

Our software applications address the global payment and related process requirements of business enterprises, permitting them to achieve greater operating efficiency, increase visibility of the cash cycle and better comply with applicable regulations and standards. We support a broad range of global networks and payment standards, including Automated Clearing House (ACH), Financial Electronic Data Interchange (EDI), Fed Wire transfer, BACS (ACH for the UK), BACSTEL-IP and SWIFT, as well as new and evolving standards.

For the first nine months of fiscal 2006, our revenue increased to \$75.7 million from \$70.2 million in the same period of the prior year. This increase was primarily attributable to growth in our subscription and transaction revenues, driven by the contribution of revenue from HMSL, a company we acquired in April 2005, increases in revenue from our Legal eXchange product in North America complemented by the revenue contribution from Visibility which we acquired in December 2005, and the contribution of revenue from Transmit which we acquired in January 2006. The increase in revenue was offset in part by a decrease in BACSTEL-IP software license revenues in the UK, as the technology adoption date of December 2005 passed. In the first nine months of fiscal 2006, we derived approximately one half of our revenue through our international operations, of which the majority was attributable to our Bottomline Europe subsidiary. We expect future revenue growth from increased purchases by both new and existing financial institution customers in North America, the continued market adoption of our Legal eXchange product in the US, the contribution of revenue from our recent acquisitions and the contribution of revenue from our subscription and transaction based products. However, we believe that our operating results for the next several fiscal quarters will approximate the results of our March 31, 2006 quarter.

We incurred a net loss of \$957,000 in the nine months ended March 31, 2006 compared to net income of \$3.7 million in the nine months ended March 31, 2005. For the nine months ended March 31, 2006, our operating results were significantly impacted, in the form of additional expense, by the adoption of SFAS 123R, *Share Based Payment*. As a result of the adoption of SFAS 123R, the fair value of all stock-based compensation is now recorded as expense in our financial statements, rather than as a footnote disclosure. Accordingly, we recorded approximately \$5.3 million in stock compensation expense for the nine months ended March 31, 2006. Additionally, the decrease in software license revenues for the nine months ended March 31, 2006 compared to the same period in 2005 significantly impacted our operating results in the form of reduced gross profit.

### **Critical Accounting Policies**

We believe that several accounting policies are important to understanding our historical and future performance. We refer to these policies as *critical* because these specific areas generally require us to make judgments and estimates about matters that are uncertain at the time we make the estimate, and different estimates which also would have been reasonable could have been used, which would have resulted in different financial results.

The critical accounting policies we identified in our most recent Annual Report on Form 10-K for the fiscal year ended June 30, 2005 related to revenue recognition, goodwill and intangible assets and valuation of acquired intangible assets. With the adoption of SFAS 123R on July 1, 2005, we have identified the estimates and assumptions that accompany the fair value determination of our stock option awards as critical, as discussed below. It is important that the discussion of our operating results that follows be read in conjunction with the critical accounting policies discussed below as well as those disclosed in our Annual Report on Form 10-K, as filed with the SEC on September 12, 2005.

#### *Stock-Based Compensation*

Effective July 1, 2005, we adopted accounting rules (SFAS 123R, *Share-Based Payment*) requiring the expense recognition of the estimated fair value of all share-based payments issued to employees. Prior to this, the estimated fair value associated with such awards was not recorded as an expense, but rather was disclosed in a footnote to our financial statements. For the three and nine month periods ended March 31, 2006, we recorded approximately \$1.9 million and \$5.3 million of expense, respectively, associated with share-based payments, with the majority of this expense, approximately \$1.4 million and \$4.3 million, attributable to employee stock options in the three and nine month periods ended March 31, 2006, respectively.



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The valuation of employee stock options is an inherently subjective process, since market values are generally not available for long-term, non-transferable employee stock options. Accordingly, an option pricing model is utilized to derive an estimated fair value. In calculating the estimated fair value of our stock options, we used a Black-Scholes pricing model which requires the consideration of the following variables for purposes of estimating fair value:

the stock option exercise price,

the expected term of the option,

the grant date price of our common stock,

the expected volatility of our common stock,

expected dividends on our common stock (we do not anticipate paying dividends for the foreseeable future), and

the risk free interest rate for the expected option term.

Of the variables above, the selection of an expected term and expected stock price volatility are the most subjective. For purposes of calculating an estimated expected term, we reviewed our historic option activity, considered the underlying option holding period (including the holding period inherent in currently vested but unexercised options) and estimated an expected term of 4.9 years. In estimating our stock price volatility, we analyzed our historical volatility for a period equal to the expected term of our stock option awards, and, by reference to actual stock prices during this period, calculated an estimated volatility ranging from 69% to 87%. We believe that each of these estimates, both expected term and volatility, is reasonable in light of the historic data we analyzed. However, as with any estimate, the ultimate accuracy of these estimates is only verifiable over time.

The specific valuation assumptions noted above were applied to stock options that we granted subsequent to our adoption of SFAS 123R, however, the majority of the stock option expense recorded in the three and nine month periods ended March 31, 2006 relates to the continued vesting of stock options that were granted prior to July 1, 2005. In accordance with the transition provisions of SFAS 123R, the grant date estimates of fair value associated with prior awards, which were also calculated using a Black-Scholes option pricing model, have not been changed. The specific valuation assumptions that were utilized for purposes of deriving an estimate of fair value at the time that prior awards were issued are as disclosed in our prior annual reports on Form 10-K, as filed with the SEC.

Upon the adoption of SFAS 123R, we were also required to estimate the level of award forfeitures expected to occur, and record compensation cost only for those awards that are ultimately expected to vest. This requirement applies to all awards that are not yet vested, including awards granted prior to July 1, 2005. Accordingly, we performed a historical analysis of option awards that were forfeited (such as by employee separation) prior to vesting, and ultimately recorded total stock option expense that reflected this estimated forfeiture rate. Our annual forfeiture estimate was calculated at 3.6%. From a sensitivity perspective, had we estimated our forfeiture rate at 0%, the stock option expense for the three and nine month periods ended March 31, 2006 would have increased by \$218,000 and \$678,000, respectively.

**Three Months Ended March 31, 2006 Compared to the Three Months Ended March 31, 2005**

**Revenues by segment**

As of July 1, 2005, we consolidated the structure of our internal operating segments and changed the nature of the financial information that is provided to and used by our chief operating decision makers. We have aggregated similar operating segments into two reportable segments, Licensed Technology and Outsourced Solutions. The change in segment composition on July 1, 2005 resulted in the consolidation of our Licensed Technology and Tailored Solutions segments into a single segment, Licensed Technology, and that change is reflected for all financial periods presented. The following table represents our revenues by segment:



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	Three Months Ended March 31,				Increase (Decrease) Between Periods 2006 Compared to 2005	
	2006		2005		(in thousands)	%
	(in thousands)	As % of total Revenues	(in thousands)	As % of total Revenues		
Licensed Technology	\$ 18,036	72.5	\$ 20,944	85.5	\$ (2,908)	(13.9)
Outsourced Solutions	6,856	27.5	3,544	14.5	3,312	93.5
	\$ 24,892	100.0	\$ 24,488	100.0	\$ 404	1.6

*Licensed Technology.* The revenue decrease for the three months ended March 31, 2006 was primarily attributable to decreases in software license revenue as a result of the conclusion of the BACSTEL-IP conversion in the UK. This decrease was offset in part by increases in professional services revenue in the US. We expect revenue for the Licensed Technology segment to remain relatively consistent with revenues reported for the quarter ended March 31, 2006, for the remainder of the fiscal year.

*Outsourced Solutions.* The revenue increase for the three months ended March 31, 2006 was primarily due to increases in our subscription and transaction based revenues due to the revenue contribution from HMSL, which we acquired in April 2005, increases in revenue from our Legal eXchange product in the US, including the contribution of revenue from our acquisition of Visibillity in December 2005, and the revenue contribution from Transmit, which we acquired in January 2006. We expect revenue for the Outsourced Solutions segment to increase slightly from the March 2006 quarterly levels during the quarter ending June 30, 2006.

**Revenues by category**

	Three Months Ended March 31,				Increase (Decrease) Between Periods 2006 Compared to 2005	
	2006		2005		(in thousands)	%
	(in thousands)	As % of total Revenues	(in thousands)	As % of total Revenues		
Revenues:						
Software licenses	\$ 2,543	10.2	\$ 4,629	18.9	\$ (2,086)	(45.1)
Service and maintenance	18,750	75.3	15,540	63.5	3,210	20.7
Equipment and supplies	3,599	14.5	4,319	17.6	(720)	(16.7)
Total revenues	\$ 24,892	100.0	\$ 24,488	100.0	\$ 404	1.6

*Software Licenses.* The decrease in software license revenues was due principally to a decrease in software license sales in the UK as the BACSTEL-IP initiative ended, and a decrease in the foreign currency exchange rate in the UK. We expect software license revenues to remain relatively consistent with the March 31, 2006 quarterly results during the remainder of the fiscal year, as a result of our focus on subscription and transaction based offerings.

*Service and Maintenance.* The increase in service and maintenance revenues was primarily due to the revenue contribution from HMSL, which we acquired in April 2005, increases in revenues associated with our Legal eXchange product in the US, including the contribution of revenue from Visibillity, which we acquired in December 2005, and the contribution of revenue from Transmit, which we acquired in January 2006. We expect that service and maintenance revenues will increase slightly from the March 2006 quarterly levels during the quarter ending June 30, 2006. Going forward a large part of our focus will be on growing the revenue contribution from our subscription and transaction based product offerings, currently reported as a component of service and maintenance revenues.

*Equipment and Supplies.* The decrease in equipment and supplies revenues was a result of revenue decreases in both the US and UK. The decrease was caused by a decline in order flow, in part driven by our continued de-emphasis of this revenue stream, and a decrease in the foreign currency exchange rate in the UK.





**Table of Contents****Cost of revenues by category**

	Three Months Ended March 31,				Increase (Decrease) Between Periods 2006 Compared to 2005	
	2006		2005		(in thousands)	%
	(in thousands)	As % of total Revenues	(in thousands)	As % of total Revenues		
Cost of revenues:						
Software licenses	\$ 371	1.5	\$ 492	2.0	\$ (121)	(24.6)
Service and maintenance	8,475	34.0	6,931	28.3	1,544	22.3
Stock compensation expense	122	0.5		0.0	122	
Equipment and supplies	2,930	11.8	3,265	13.3	(335)	(10.3)
Total cost of revenues	\$ 11,898	47.8	\$ 10,688	43.6	\$ 1,210	11.3
Gross profit	\$ 12,994	52.2	\$ 13,800	56.4	\$ (806)	(5.8)

*Software Licenses.* Software license costs consist of expenses incurred by us to manufacture, package and distribute our software products and related documentation and costs of licensing third party software that is incorporated into or sold with certain of our products. Software license costs increased to 15% of software license revenues in the three months ended March 31, 2006 compared to 11% in the three months ended March 31, 2005. The increase in software license cost of revenues in percentage terms was due to specific third party software costs associated with our UK operations. We expect that software license costs will decrease slightly, as a percentage of software license revenues, during the remainder of the fiscal year.

*Service and Maintenance.* Service and maintenance costs include salaries and other related costs for our customer service, maintenance and help desk support staffs, as well as expenses associated with third party contractors used to complement our professional services team. Service and maintenance costs remained consistent at 45% of service and maintenance revenues in the three months ended March 31, 2006 and 2005. The increase in service and maintenance costs in dollar terms was consistent with the increase in service and maintenance revenues, including an increase in the costs associated with the operations of HMSL, Visibillity and Tranmit. We expect that service and maintenance costs will remain relatively consistent, as a percentage of service and maintenance revenues, during the remainder of the fiscal year.

*Equipment and Supplies.* Equipment and supplies costs include the costs associated with equipment and supplies that we resell, as well as freight, shipping and postage costs associated with the delivery of our products. Equipment and supplies costs increased to 81% of equipment and supplies revenues in the three months ended March 31, 2006 compared to 76% of equipment and supplies revenues in the three months ended March 31, 2005. The increase in equipment and supplies costs as a percentage of equipment and supplies revenues was attributable primarily to higher third party costs in the UK. We expect that equipment and supplies costs will improve slightly, as a percentage of equipment and supplies revenues, during the remainder of the fiscal year.

**Operating Expenses**

	Three Months Ended March 31,				Increase (Decrease) Between Periods 2006 Compared to 2005	
	2006		2005		(in thousands)	%
	(in thousands)	As % of total revenues	(in thousands)	As % of total revenues		
Operating expenses:						
Sales and marketing	\$ 5,397	21.7	\$ 6,012	24.5	\$ (615)	(10.2)
Stock compensation expense	693	2.8			693	
Product development and engineering	3,424	13.7	2,298	9.4	1,126	49.0

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Stock compensation expense	215	0.9			215	
General and administrative	3,804	15.3	3,042	12.4	762	25.1
Stock compensation expense	851	3.4			851	
Amortization of intangible assets	1,357	5.4	707	2.9	650	91.9
<b>Total operating expenses</b>	<b>15,741</b>	<b>63.2</b>	<b>12,059</b>	<b>49.2</b>	<b>\$ 3,682</b>	<b>30.5</b>

*Sales and Marketing.* Sales and marketing expenses consist primarily of salaries and other related costs for sales and marketing personnel, sales commissions, travel, public relations and marketing materials and trade show participation. The decrease in sales and marketing expenses was attributable to decreases in commission and personnel related costs, and a

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decrease in the foreign currency exchange rate in the UK. These decreases were partially offset by increases in expenses associated with the operations of HMSL, Visibility and Transmit. We expect that sales and marketing expenses will remain relatively consistent as a percentage of revenues during the remainder of the fiscal year.

*Product Development and Engineering.* Product development and engineering expenses consist primarily of personnel costs to support product development, which continues to be focused on enhancements and revisions to our products based on customer feedback and general marketplace demands. Product development and engineering expenses increased in the US as a result of increases in contract employee costs associated with development efforts on certain of our banking products. Costs also increased as a result of a write-off of certain third party technology costs that had been capitalized and were deemed to be impaired as a result of superior technology that we acquired in the Transmit acquisition. We expect that product development and engineering expenses will remain relatively consistent, as a percentage of revenues, during the remainder of the fiscal year.

*General and Administrative.* General and administrative expenses consist primarily of salaries and other related costs for operations and finance employees and legal and accounting services. The increase in general and administrative expenses was attributable to increases in expenses associated with the operations of HMSL, Visibility and Transmit and an increase in employee and contract labor costs in the US and in the UK, partially offset by a decrease in the foreign currency exchange rate in the UK. We expect that general and administrative expenses will remain relatively consistent, as a percentage of revenues, during the remainder of the fiscal year.

*Stock Compensation Expense.* During the three months ended March 31, 2006, we recorded approximately \$1.9 million of expense associated with share-based payments in connection with our adoption of SFAS 123R on July 1, 2005. The expense associated with these awards is recorded as expense within the same functional expense category as cash compensation for the respective employee is recorded. For the three months ended March 31, 2006, stock compensation expense was allocated as follows:

	<b>In Thousands</b>
Cost of revenues: service and maintenance	\$ 122
Sales and marketing	693
Product development and engineering	215
General and administrative	851
	<b>\$ 1,881</b>

We expect that stock compensation expense will continue to have a material impact on our financial results for the remainder of the fiscal year. For the remainder of fiscal 2006, we expect to incur quarterly expenses that are relatively consistent with the level of expense recorded in the quarter ended March 31, 2006.

*Amortization of Intangible Assets.* Amortization expense increased for the quarter ended March 31, 2006 as compared to the same period in 2005. The increase was due to the amortization of intangible assets arising from our acquisitions of HMSL, Visibility, Transmit and a patent. We expect that total amortization expense for fiscal 2006 will approximate \$4.5 million.

*Provision for Income Taxes.* Our provision for income taxes was \$205,000 for the three months ended March 31, 2006 compared to \$84,000 for the three months ended March 31, 2005. The increase in income tax expense was due principally to an increase in the income tax expense associated with our UK and Australian operations. A large portion of the increase in the UK tax expense results from certain expenses that are not deductible for UK tax purposes. We have several tax planning initiatives in process that we hope will ultimately result in reduced tax expense associated with our UK operations. However, there can be no assurance that these initiatives will ultimately be successful in reducing tax expense in subsequent periods.

**Nine Months Ended March 31, 2006 Compared to the Nine Months Ended March 31, 2005****Revenues by segment**

As of July 1, 2005, we consolidated the structure of our internal operating segments and changed the nature of the financial information that is provided to and used by our chief operating decision makers. We have aggregated similar operating segments into two reportable segments, Licensed Technology and Outsourced Solutions. The change in segment composition on July 1, 2005 resulted in the consolidation of our Licensed Technology and Tailored Solutions segments into a single segment, Licensed Technology, and is reflected for all financial periods

presented. The following table represents our revenues by segment:

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	Nine Months Ended March 31,				Increase (Decrease)	
	2006		2005		Between	
	(in thousands)	As % of total Revenues	(in thousands)	As % of total Revenues	(in thousands)	%
Licensed Technology	\$ 57,656	76.2	\$ 59,456	84.7	\$ (1,800)	(3.0)
Outsourced Solutions	18,032	23.8	10,730	15.3	7,302	68.1
	\$ 75,688	100.0	\$ 70,186	100.0	\$ 5,502	7.8

*Licensed Technology.* The revenue decrease for the nine months ended March 31, 2006 was primarily attributable to decreases in software license revenue as a result of the conclusion of the BACSTEL-IP conversion in the UK and due to decreases in the foreign currency exchange rate in the UK. The decrease was offset in part by an increase in professional services revenues in both the US and UK.

*Outsourced Solutions.* The revenue increase for the nine months ended March 31, 2006 was primarily due to the revenue contribution from HMSL, which we acquired in April 2005, and increases in revenue from our Legal eXchange product in the US, including the revenue contribution from Visibillity, which we acquired in December 2005, and the revenue contribution from Transmit, which we acquired in January 2006.

**Revenues by category**

	Nine Months Ended March 31,				Increase (Decrease)	
	2006		2005		Between Periods	
	(in thousands)	As % of total Revenues	(in thousands)	As % of total Revenues	(in thousands)	%
Revenues:						
Software licenses	\$ 9,414	12.4	\$ 13,649	19.5	\$ (4,235)	(31.0)
Service and maintenance	54,883	72.5	44,724	63.7	10,159	22.7
Equipment and supplies	11,391	15.1	11,813	16.8	(422)	(3.6)
Total revenues	\$ 75,688	100.0	\$ 70,186	100.0	\$ 5,502	7.8

*Software Licenses.* The decrease in software license revenues was due principally to a decrease in software license revenues in the UK as the BACSTEL-IP initiative ended and due to a decrease in the foreign currency exchange rate in the UK.

*Service and Maintenance.* The increase in service and maintenance revenues occurred as a result of the revenue contribution from HMSL, which we acquired in April 2005, increases in Legal eXchange revenues and the revenue contribution from our acquisitions of Visibillity and Transmit in fiscal 2006.

*Equipment and Supplies.* The decrease in equipment and supplies revenues was primarily due to decreases in order flow in the UK, due in part to our continued de-emphasis of this revenue stream, offset in part by several large equipment orders with financial institution customers in the US.

**Cost of revenues by category**

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	Nine Months Ended March 31,				Increase (Decrease) Between Periods 2006 Compared to 2005	
	2006		2005		(in thousands)	%
	(in thousands)	As % of total Revenues	(in thousands)	As % of total Revenues		
Cost of revenues:						
Software licenses	\$ 1,072	1.4	\$ 1,868	2.7	\$ (796)	(42.6)
Service and maintenance	23,559	31.1	19,028	27.1	4,531	23.8
Stock compensation expense	368	0.5		0.0	368	
Equipment and supplies	9,105	12.0	8,970	12.8	135	1.5
Total cost of revenues	\$ 34,104	45.0	\$ 29,866	42.6	\$ 4,238	14.2
Gross profit	\$ 41,584	54.9	\$ 40,320	57.4	\$ 1,264	3.1

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*Software Licenses.* Software license costs consist of expenses incurred by us to manufacture, package and distribute our software products and related documentation and costs of licensing third party software that is incorporated into or sold with certain of our products. Software license costs decreased to 11% of software license revenues in the nine months ended March 31, 2006 compared to 14% in the nine months ended March 31, 2005. The decrease in software license costs in dollar terms was due to the overall decrease in software license revenues. The decrease in software license costs as a percentage of software license revenue was primarily due to the absence of a specific third party software cost that had been incorporated into, and sold with, one of our banking products in a large transaction in the UK in the nine months ended March 31, 2005.

*Service and Maintenance.* Service and maintenance costs include salaries and other related costs for our customer service, maintenance and help desk support staffs, as well as expenses associated with third party contractors used to complement our professional services team. Service and maintenance costs remained consistent at 43% of service and maintenance revenues in the nine months ended March 31, 2006 and 2005. The increase in service and maintenance costs in dollar terms was attributable to higher third party costs associated with BACSTEL-IP product implementations in the UK and increased operating costs associated with our acquisitions of HMSL, Visibillity and Transmit.

*Equipment and Supplies.* Equipment and supplies costs include the costs associated with equipment and supplies that we resell, as well as freight, shipping and postage costs associated with the delivery of our products. Equipment and supplies costs increased to 80% of equipment and supplies revenues in the nine months ended March 31, 2006 compared to 76% of equipment and supplies revenues in the nine months ended March 31, 2005. The increase in equipment and supplies costs as a percentage of equipment and supplies revenues was attributable to several lower margin equipment transactions in the US and an increase in third party costs in the UK.

**Operating Expenses**

	Nine Months Ended March 31,				Increase (Decrease)	
	2006	2005	2006	2005	Between Periods 2006	Compared to 2005
	As % of	As % of				
	total	total				
	(in thousands)	(in thousands)	(in thousands)	(in thousands)	(in thousands)	%
Operating expenses:						
Sales and marketing	\$ 16,775	22.2	\$ 17,806	25.4	\$ (1,031)	(5.8)
Stock compensation expense	1,854	2.4	0.0	0.0	1,854	
Product development and engineering	8,303	10.9	7,170	10.2	1,133	15.8
Stock compensation expense	653	0.9	14	0.0	639	4,564.3
General and administrative	10,957	14.5	9,349	13.3	1,608	17.2
Stock compensation expense	2,407	3.2	0.0	0.0	2,407	
Amortization of intangible assets	3,018	4.0	2,349	3.4	669	28.5
<b>Total operating expenses</b>	<b>43,967</b>	<b>58.1</b>	<b>36,688</b>	<b>52.3</b>	<b>\$ 7,279</b>	<b>19.8</b>

*Sales and Marketing.* Sales and marketing expenses consist primarily of salaries and other related costs for sales and marketing personnel, sales commissions, travel, public relations and marketing materials and trade show participation. The decrease in sales and marketing expenses was attributable to decreased commissions and other employee compensation costs and a decrease in the foreign currency exchange rate in the UK, offset by increases in expenses associated with the operations of HMSL, Visibillity and Transmit.

*Product Development and Engineering.* Product development and engineering expenses consist primarily of personnel costs to support product development, which continues to be focused on enhancements and revisions to our products based on customer feedback and general marketplace demands. Product development and engineering expenses increased in the US as a result of contract employee costs associated with development efforts on certain of our banking products. This increase was offset in part by a decrease in employee related expenses in Australia due to a decrease in headcount.

*General and Administrative.* General and administrative expenses consist primarily of salaries and other related costs for operations and finance employees and legal and accounting services. The increase in general and administrative expenses was attributable to the operations of HMSL, Visibillity and Transmit, and an increase in employee and contract labor costs in the US and the UK.





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*Stock Compensation Expense.* During the nine months ended March 31, 2006, we recorded approximately \$5.3 million of expense associated with share-based payments in connection with our adoption of SFAS 123R on July 1, 2005. The expense associated with these awards is recorded as expense within the same functional expense category as cash compensation for the respective employee is recorded. For the nine months ended March 31, 2006, stock compensation expense was allocated as follows:

	<b>In Thousands</b>
Cost of revenues: service and maintenance	\$ 368
Sales and marketing	1,854
Product development and engineering	653
General and administrative	2,407
	<b>\$ 5,282</b>

*Amortization of Intangible Assets.* Amortization expense increased for the nine months ended March 31, 2006 compared to the nine months ended March 31, 2005. The increase in amortization expense was due to the amortization of intangible assets arising from our acquisitions of HMSL, Visibillity, Transmit and a patent.

*Provision for Income Taxes.* Our provision for income taxes was \$859,000 for the nine months ended March 31, 2006 compared to \$349,000 for the nine months ended March 31, 2005. The increase in income tax expense was due principally to an increase in the income tax expense associated with our UK and Australia operations. A large portion of the increase in the UK tax expense results from certain expenses that are not deductible for UK tax purposes. We have several tax planning initiatives in process that we hope will ultimately result in reduced tax expense associated with our UK operations. However, there can be no assurance that these initiatives will ultimately be successful in reducing tax expense in subsequent periods.

**Liquidity and Capital Resources**

The metrics we use in assessing the strength of our liquidity are summarized in the table below:

	<b>Nine Months Ended</b>	
	<b>March 31, 2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
Cash provided by operating activities	\$ 8,773	\$ 10,889
	<b>March 31, 2006</b>	<b>June 30, 2005</b>
	<b>(in thousands)</b>	
Cash, cash equivalents and marketable securities	\$ 77,250	\$ 35,916
Working capital	68,551	27,552

We have financed our operations primarily from cash provided by operating activities and the sale of our common stock. In July 2005, we completed a follow-on offering of our common stock resulting in net proceeds to us of approximately \$47 million. This significantly increased our cash, cash equivalents and marketable securities holdings and significantly improved our overall liquidity position.

We have generated positive operating cash flows in the first nine months of the current fiscal year and in each of our last four completed fiscal years. We believe that the cash generated from our operations and the cash, cash equivalents and marketable securities on hand, particularly given that we have no long-term debt obligations, will be sufficient to meet our working capital and capital expenditure requirements for the foreseeable future. We also may receive additional investments from, and make investments in, customers or other companies. However, any such transactions would require the approval of our board of directors, and in some cases, stockholders and potentially bank or regulatory approval. We also may undertake additional business or asset acquisitions.

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In January 2006, we paid approximately \$18.2 million from our cash balances in connection with our acquisitions of Visibillity, Tranmit and a patent. We do not believe that these disbursements adversely affect our overall liquidity position, and we continue to believe that our existing cash and investment balances, as well as cash generated from operations, will be sufficient to meet our operating requirements for the foreseeable future.

**Table of Contents***Operating Activities*

	<b>Nine Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
Net income (loss)	\$ (957)	\$ 3,684
Non-cash adjustments	10,340	4,243
Changes in working capital	(610)	2,962
Net cash provided by operating activities	\$ 8,773	\$ 10,889

Net cash provided by operating activities for the nine months ended March 31, 2006 was primarily due to our net loss, affected by favorable non-cash adjustments. Net cash provided by operating activities for the nine months ended March 31, 2005 was primarily due to our net income, affected by favorable non-cash adjustments. Non-cash adjustments are transactions that result in the recognition of financial statement income or expense but not a corresponding cash receipt or disbursement, such as stock compensation expense, amortization of intangible assets, acquisition related technology write-offs, the impact of deferred income taxes, depreciation and amortization of property and equipment and provision for allowances of accounts receivable.

*Investing Activities*

	<b>Nine Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
Purchases of short-term investments, net	\$ (26,012)	\$ (10,245)
Purchases of property and equipment, net	(1,791)	(1,515)
Acquisition of businesses and assets, net of cash acquired	(18,186)	
Net cash used in investing activities	\$ (45,989)	\$ (11,760)

In the nine months ended March 31, 2006 and 2005, cash was primarily used to acquire high quality marketable securities and to fund our acquisitions of Visibility, Tranmit and a patent. The significant increase in purchases of marketable securities in the nine months ended March 31, 2006 was due to our investment of proceeds received from our follow-on offering of common stock completed in July 2005. We expect to incur quarterly capital expenditures during the remainder of fiscal 2006 consistent with the average level of capital expenditures incurred in the first nine months.

*Financing Activities*

	<b>Nine Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
Net proceeds from sale of common stock	46,769	
Proceeds from employee stock purchase plan, exercise of stock options and warrants	5,952	3,901
Payment of bank financing fees	(33)	

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Net cash provided by financing activities	\$ 52,688	\$ 3,901
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Net cash provided by financing activities for the nine months ended March 31, 2006 was primarily the result of \$46.8 million in net proceeds received from the follow-on offering of our common stock in July 2005 and proceeds of \$6.0 million from the exercise of stock options and purchases under our employee stock purchase plan. Net cash provided by financing activities for the nine months ended March 31, 2005 was the result of proceeds received from the exercise of stock options, contributions to our employee stock purchase plan and the exercise of stock warrants.

### *Commitments*

In December 2004, Bottomline Europe entered into a contract with a vendor to provide software installation services to certain Bottomline Europe customers. Under the terms of the arrangement, Bottomline Europe agreed to a minimum purchase commitment of £450,000 (approximately \$774,000) from this vendor. The services procured by Bottomline Europe were used to supplement our existing professional services team with respect to UK product installations. As of December 31, 2005, Bottomline Europe had expended the full amount of this commitment.

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### ***Off-Balance Sheet Arrangements***

During the three and nine months ended March 31, 2006, we did not engage in material off-balance sheet activities, including the use of structured finance, special purpose or variable interest entities, material trading activities in non-exchange traded commodity contracts or transactions with persons or entities that benefit from their non-independent relationship with us.

### **CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS**

*Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below before making an investment decision involving our common stock. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties may also impair our business operations. If any of the following risks actually occur, our business, financial condition or results of operations would likely suffer. In that case, the trading price of our common stock could fall, and you may lose all or part of the money you paid to buy our common stock.*

### **Our common stock has experienced and may continue to undergo extreme market price and volume fluctuations**

Stock markets in general, and The NASDAQ Stock Market in particular, have experienced extreme price and volume fluctuations, particularly in recent years. Broad market fluctuations of this type may adversely affect the market price of our common stock. The stock prices for many companies in the technology sector have experienced wide fluctuations that often have been unrelated to their operating performance. The market price of our common stock has experienced and may continue to undergo extreme fluctuations due to a variety of factors, including:

changes in or our failure to meet analysts' or investors' estimates or expectations;

general and industry-specific business, economic and market conditions;

actual or anticipated fluctuations in operating results, including those arising as a result of any impairment of goodwill or other intangible assets related to past or future acquisitions;

the impact on operating results of the significant expense associated with share based payments (stock compensation expense) under SFAS 123R which we adopted on July 1, 2005;

public announcements concerning us, including announcements of litigation, our competitors or our industry;

introductions of new products or services or announcements of significant contracts by us or our competitors;

acquisitions, strategic partnerships, joint ventures, or capital commitments by us or our competitors;

adverse developments in patent or other proprietary rights; and

announcements of technological innovations by our competitors.

**Our future financial results could depend on our success in moving components of our business to a subscription-based revenue model**

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A substantial portion of our historic revenues and profitability are generated from software license revenues. We are currently transforming some, and may in the future transform other, portions of our business to a subscription-based revenue model which we believe has certain advantages over a perpetual license model, including better predictability of revenue. Our recent acquisitions of Visibillity and Transmit are aligned toward, and will be operated principally under, a subscription-based revenue model. Additionally, over time, more of our licensed software products that were historically sold only on a perpetual license basis could be offered for sale on a subscription basis.

A subscription-based revenue model results in substantially less up-front revenue than a perpetual license model. Additionally, there can be no assurance that our customers, or the markets in which we compete, will respond favorably to

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our approach. To the extent that our software license revenues were to decline significantly in any period, or if we did not receive general marketplace acceptance of a subscription-based approach, our financial results could be materially and adversely affected.

### **The demand for our BACSTEL-IP product in the UK, which during 2005 generated significant software license revenue growth, has declined as the technology adoption date has passed**

In 2005, we experienced strong market demand in the UK for our software products that address the new standard for electronic payments in the UK called BACSTEL-IP. Under the existing regulatory requirements, UK businesses had until the end of December 2005 to be in compliance with this standard.

We have introduced new products to the UK market which are intended to capitalize on the customer relationships we established during the BACSTEL-IP initiative. In addition, we offer the BACSTEL-IP solution on a subscription basis to a portion of our customers, which we expect will generate ongoing recurring revenues. The payment market in Europe is continuing to evolve with new payment regulations and payment types, both currently proposed and expected in the future, for which we have introduced and anticipate continuing to introduce new products. However, the combination of new product sales, recurring subscription revenues, sales of new products targeting new payment regulations and standards or growth in our other revenue streams may not be sufficient to offset the revenue from our BACSTEL-IP software products, in which case our operating results and stock price could be materially and adversely affected.

### **As a result of our acquisitions, we could be subject to significant future write-offs with respect to intangible assets, which may adversely affect our future operating results**

We review our intangible assets, including goodwill, periodically for impairment. At March 31, 2006, the carrying value of our goodwill and our other intangible assets was \$40.0 million and \$20.8 million, respectively. While we reviewed our goodwill and intangible assets during our fourth quarter of fiscal year 2005 and concluded that there was no impairment, we could be subject to future impairment charges with respect to these intangible assets, or intangible assets arising as a result of additional acquisitions in future periods. Such charges, to the extent occurring, would likely have a material adverse effect on our operating results.

### **Our fixed costs may lead to operating results below analyst or investor expectations if our revenues are below anticipated levels, which could adversely affect the market price of our common stock**

A significant percentage of our expenses, particularly personnel and facilities costs, are relatively fixed and based in part on anticipated revenue levels. In recent years we have experienced slowing growth rates with certain of our licensed software products, and we are currently experiencing a decrease in software license revenues as a result of the BACSTEL-IP initiative having ended in the UK. A decline in revenues without a corresponding and timely slowdown in expense growth could negatively affect our business. Significant revenue shortfalls in any quarter may cause significant declines in operating results since we may be unable to reduce spending in a timely manner.

Quarterly operating results that are below the expectations of public market analysts could adversely affect the market price of our common stock. Factors that could cause fluctuations in our operating results include the following:

economic conditions, which may affect our customers and potential customers budgets for information technology expenditures;

the timing of orders and longer sales cycles;

the timing of product implementations, which are highly dependent on customers resources and discretion;

the incurrence of costs relating to the integration of software products and operations in connection with acquisitions of technologies or businesses; and



the timing and market acceptance of new products or product enhancements by either us or our competitors.  
Because of these factors, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful.

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### **Our mix of products and services could have a significant effect on our financial condition, results of operations and the market price of our common stock**

The gross margins for our products and services vary considerably. Our software revenues generally yield significantly higher gross margins than do our service, maintenance, and equipment and supplies revenue streams. In recent fiscal years we experienced a decrease in our software license fees, particularly in the US, and we are currently experiencing a decrease in software license revenues as the BACSTEL-IP initiative in the UK has ended. If software license fees continue to decline, or if the mix of our products and services in any given period does not match our expectations, our results of operations and the market price of our common stock could be significantly affected.

### **We face risks associated with our international operations that could harm our financial condition and results of operations**

A significant percentage of our revenues have been generated by our international operations, and our future growth rates and success are in part dependent on our continued growth and success in international markets. We have operations in the US, UK and Australia. As is the case with most international operations, the success and profitability of these operations are subject to numerous risks and uncertainties that include, in addition to the risks our business as a whole faces, the following:

difficulties and costs of staffing and managing foreign operations;

differing regulatory and industry standards and certification requirements;

the complexities of foreign tax jurisdictions;

reduced protection for intellectual property rights in some countries;

currency exchange rate fluctuations; and

import or export licensing requirements.

### **A significant percentage of our revenues to date have come from our payment management offerings and our performance will depend on continued market acceptance of these solutions**

A significant percentage of our revenues to date have come from the license and maintenance of our payment management offerings and sales of associated products and services. Any significant reduction in demand for our payment management offerings could have a material adverse effect on our business, operating results and financial condition. Our future performance could depend on the following factors:

continued market acceptance of our payment management offerings as a payment management solution;

prospective customers' dependence upon enterprises seeking to enhance their payment functions to integrate electronic payment capabilities;

our ability to introduce enhancements to meet the market's evolving needs for secure payments and cash management solutions; and

continued acceptance of desktop and enterprise software, and laser check printing solutions.

**Our future financial results will depend on our ability to manage growth effectively**

In the past, rapid growth has strained our managerial and other resources. If rapid growth resumes, our ability to manage that growth will depend in part on our ability to continue to enhance our operating, financial and management information systems. We cannot assure you that our personnel, systems and controls will be adequate to support future growth. If we are unable to manage growth effectively, the quality of our services, our ability to retain key personnel and our business, operating results and financial condition could be materially adversely affected.

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### **Our future financial results will be affected by the acceptance of electronic invoice presentment product offerings in an emerging market**

Our electronic invoice presentment business model is in the early stages of market adoption, even though the product has been generally available from us and our competitors for some time. Customers and potential customers may not be ready to adopt our electronic invoice presentment business model, or may be slower to adopt the model than we, or the public market analysts, anticipate. If this emerging market does not adopt our business model or the market does not respond as quickly as we expect, our future results could be materially and adversely affected.

### **We face significant competition in our targeted markets, including competition from companies with significantly greater resources**

In recent years we have encountered increasing competition in our targeted markets. We compete with a wide range of companies, ranging from small start-up enterprises with limited resources, which compete principally on the basis of technology features or specific customer relationships, to large companies, which can leverage significant customer bases and financial resources. Given the size and nature of our targeted markets, the implementation of our growth strategy and our success in competing for market share generally may be dependent on our ability to grow our sales and marketing capabilities and maintain a critical level of financial resources.

### **Integration of acquisitions could interrupt our business and our financial condition could be harmed**

We have made several recent acquisitions of companies, including our acquisition of HMSL during fiscal 2005 and our fiscal 2006 acquisitions of Visibility and Transmit. We may in the future continue to acquire, or make investments in, other businesses, products or technologies. Any acquisition or strategic investment we have made in the past or may make in the future may entail numerous risks, including the following:

difficulties integrating acquired operations, personnel, technologies or products;

inadequacy of existing operating, financial and management information systems to support the combined organization or new operations;

write-offs related to impairment of goodwill and other intangible assets;

entrance into markets in which we have no or limited prior experience or knowledge;

diversion of management's focus from our core business concerns;

dilution to existing stockholders and earnings per share;

incurrence of substantial debt; and

exposure to litigation from third parties, including claims related to intellectual property or other assets acquired or liabilities assumed. Any such difficulties encountered as a result of any merger, acquisition or strategic investment could have a material adverse effect on our business, operating results and financial condition.

### **The slowdown in the economy experienced in recent fiscal years affected the market for information technology solutions, including our products and services. If this slowdown were to reoccur our future financial results could be materially adversely affected**

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As a result of past unfavorable economic conditions and reduced capital spending by our customers and potential customers, demand for certain of our licensed software products and services was adversely affected. In recent years, this resulted in decreased revenues, particularly software license revenues, and a decline in our historic growth rate. In the most recent slowdown, the US marketplace was particularly affected but there can be no assurance that any future trend would not extend to the UK marketplace where we also have significant operations. Our future results could be materially and adversely affected if such a slowdown were to reoccur. During recent fiscal years, in response to such events, we implemented several cost reduction initiatives in an attempt to improve our profitability. To the extent required in any future period as a response to market conditions, cost reductions may prove to be inadequate and we may experience a material adverse impact on our business, operating results, and financial condition.

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### **We depend on key employees who are skilled in e-commerce, payment, cash and document management and invoice presentment methodology and Internet and other technologies**

Our success depends upon the efforts and abilities of our executive officers and key technical employees who are skilled in e-commerce, payment methodology and regulation, and Internet, database and network technologies. The loss of one or more of these individuals could have a material adverse effect on our business. We currently do not maintain key man life insurance policies on any of our employees. While some of our executive officers have employment or retention agreements with us, the loss of the services of any of our executive officers or other key employees could have a material adverse effect on our business, operating results and financial condition.

### **We must attract and retain highly skilled personnel with knowledge in e-commerce, payment, cash and document management and invoice presentment methodology and Internet and other technologies**

We believe that our success is in part dependent upon our ability to attract, hire, train and retain highly skilled technical, sales and marketing, and support personnel, particularly with expertise in e-commerce, payment, cash management and invoice methodology and Internet and other technologies. Competition for qualified personnel is intense. As a result, we may experience increased compensation costs that may not be offset through either improved productivity or higher sales prices. There can be no assurance that we will be successful in attracting, recruiting or retaining existing personnel. Based on our experience, it takes an average of nine months for a salesperson to become fully productive. We cannot assure you that we will be successful in increasing the productivity of our sales personnel, and the failure to do so could have a material adverse effect on our business, operating results and financial condition.

### **An increasing number of large and more complex customer contracts, or contracts that involve the delivery of services over contractually committed periods, may delay the timing of our revenue recognition and affect our operating results, financial condition and the market price of our stock**

Due to an increasing number of large and more complex customer contracts, we have experienced, and will likely continue to experience, delays in the timing of our revenue recognition. These large and complex customer contracts generally require significant implementation work, product customization and modification resulting in the recognition of revenue over the period of project completion, which normally spans several quarters. Additionally, certain of our products and services are sold on a hosted basis, which can involve contractually defined service periods. In such cases, revenue is typically recorded over the expected life of the arrangement, rather than at the outset of the arrangement, thus lengthening the period of revenue recognition. Delays in revenue recognition on these contracts could affect our operating results, financial condition and the market price of our common stock.

### **Increased competition may result in price reductions and decreased demand for our product solutions**

The markets in which we compete are intensely competitive and characterized by rapid technological change. Some competitors in our targeted markets have longer operating histories, significantly greater financial, technical, and marketing resources, greater brand recognition and a larger installed customer base than we do. We expect to face additional competition as other established and emerging companies enter the markets we address. In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships to expand their product offerings and to offer more comprehensive solutions. This growing competition may result in price reductions of our products and services, reduced revenues and gross margins and loss of market share, any one of which could have a material adverse effect on our business, operating results and financial condition.

### **Our success depends on our ability to develop new and enhanced software, services and strategic partner relationships**

The markets in which we compete are subject to rapid technological change and our success is dependent on our ability to develop new and enhanced software, services and strategic partner relationships that meet evolving market needs. Trends that could have a critical impact on us include:

other evolving industry standards, mandates and laws, such as those mandated by the National Automated Clearing House Association and the Association for Payment Clearing Services;

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rapidly changing technology, which could cause our software to become suddenly outdated or could require us to make our products compatible with new database or network systems;

developments and changes relating to the Internet that we must address as we maintain existing products and introduce any new products; and

the loss of any of our key strategic partners who serve as a valuable network from which we can leverage industry expertise and respond to changing marketplace demands.

There can be no assurance that technological advances will not cause our technology to become obsolete or uneconomical. If we are unable to develop and introduce new products, or enhancements to existing products, in a timely and successful manner, our business, operating results and financial condition could be materially adversely affected. Similarly, if we were to lose support from any of our key strategic partner relationships, our results could be negatively affected.

### **Our products could be subject to future legal or regulatory actions, which could have a material adverse effect on our operating results**

Our software products and hosted services offerings facilitate the transmission of business documents and information including, in some cases, confidential financial data related to payments, invoices and cash management. Our web-based software products, and certain of our hosted services offerings, transmit this data electronically. While we believe that all of our product and service offerings comply with current regulatory and security requirements, there can be no assurance that future legal or regulatory actions will not impact our product and service offerings. To the extent that regulatory or legal developments mandate a change in any of our products or services, or alter the demand for or the competitive environment of our products and services, we might not be able to respond to such requirements in a timely or successful manner. If this were to occur, our business, operating results and financial condition could be materially adversely affected.

### **Any unanticipated performance problems or bugs in our product offerings could have a material adverse effect on our future financial results**

If the products that we offer do not continue to achieve market acceptance, our future financial results will be adversely affected. Since many of our software solutions are still in early stages of adoption and since most of our software products are continually being enhanced or further developed in response to general marketplace demands, any unanticipated performance problems or bugs that we have not been able to detect could result in additional development costs, diversion of technical and other resources from our other development efforts, negative publicity regarding us and our products, harm to our customer relationships and exposure to potential liability claims. In addition, if our products do not enjoy wide commercial success, our long-term business strategy will be adversely affected, which could have a material adverse effect on our business, operating results and financial condition.

### **We could incur substantial costs resulting from warranty claims or product liability claims**

Our software license agreements typically contain provisions that afford customers a degree of warranty protection in the event that our software fails to conform to its written specifications. These agreements typically contain provisions intended to limit the nature and extent of our risk of warranty and product liability claims. There is a risk, however, that a court might interpret these terms in a limited way or could hold part or all of these terms to be unenforceable. Furthermore, some of our licenses with our customers are governed by non-U.S. law, and there is a risk that foreign law might provide us less or different protection. While we maintain general liability insurance, including coverage for errors and omissions, we cannot be sure that our existing coverage will continue to be available on reasonable terms or will be available in amounts sufficient to cover one or more large claims. Although we have not experienced any material warranty or product liability claims to date, a warranty or product liability claim, whether or not meritorious, could result in substantial costs and a diversion of management's attention and our resources, which could have an adverse effect on our business, operating results and financial condition.

### **We could be adversely affected if we are unable to protect our proprietary technology and could be subject to litigation regarding our intellectual property rights, causing serious harm to our business**

We rely upon a combination of patent, copyright and trademark laws and non-disclosure and other intellectual property contractual arrangements to protect our proprietary rights. However, we cannot assure you that our patents, pending applications for patents that may issue in the future, or other intellectual property will be of sufficient scope and strength to





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provide meaningful protection of our technology or any commercial advantage to us, or that the patents will not be challenged, invalidated or circumvented. We enter into agreements with our employees and customers that seek to limit and protect the distribution of proprietary information. Despite our efforts to safeguard and maintain our proprietary rights, there can be no assurance that such rights will remain protected or that we will be able to detect unauthorized use and take appropriate steps to enforce our intellectual property rights.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. We may be a party to litigation in the future to protect our intellectual property rights or as a result of an alleged infringement of the intellectual property rights of others. For example, in October 2005 we were served as a defendant in a lawsuit alleging infringement by our Legal eXchange product. Any such claims, whether or not meritorious, could require us to spend significant sums in litigation, pay damages, delay product implementations, develop non-infringing intellectual property or acquire licenses to intellectual property that is the subject of the infringement claim. These claims could have a material adverse effect on our business, operating results and financial condition.

### **We may incur significant costs from class action litigation as a result of expected volatility in our common stock**

In the past, companies that have experienced market price volatility of their stock have been the targets of securities class action litigation. In August 2001, we were named as a party in one of the so-called "laddering" securities class action suits relating to the underwriting of our initial public offering. We could incur substantial costs and experience a diversion of our management's attention and resources in connection with such litigation, which could have a material adverse effect on our business, financial condition and results of operations.

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

We are exposed to a variety of risks, including foreign currency exchange rate fluctuations and changes in the market value of our investments in marketable securities primarily due to changes in the interest rates. We have not entered into any foreign currency hedging transactions or other instruments to minimize our exposure to foreign currency exchange rate fluctuations nor do we presently plan to in the future. Also, we have not entered into any interest rate swap agreements, or other instruments to minimize our exposure to interest rate fluctuations. Our follow-on offering of common stock completed in July 2005 has resulted in a significant increase to our cash, cash equivalents and marketable securities balances. As a result of this increase there could be a material change to our exposure to market risk from that which was disclosed in our Annual Report on Form 10-K as filed with the SEC on September 12, 2005. Based on our average cash and investment balances for the nine months ended March 31, 2006, a 100 basis point increase or decrease in interest rates would result in an increase or decrease of approximately \$824,000 in interest income during the fiscal year.

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

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2006. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of March 31, 2006, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended March 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

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

In July 2002, our board of directors announced that it had authorized a repurchase program, for the repurchase of up to \$3.0 million of our common stock. At March 31, 2006, we had repurchased 242,650 shares at an average repurchase price of \$5.79 per share. The approximate remaining dollar value of shares available for repurchase under this program is \$1.6 million.

During the three months ended March 31, 2006, we did not repurchase any shares under this program.

**Item 6. Exhibits**

See the Exhibit Index on page 34 for a list of exhibits filed as part of this Quarterly Report on Form 10-Q, which Exhibit Index is incorporated herein by reference.

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**SIGNATURE**

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.

**Bottomline Technologies (de), Inc.**

Date: May 9, 2006

By:

/s/ KEVIN M. DONOVAN  
**Kevin M. Donovan**

**Chief Financial Officer and Treasurer**

**(Principal Financial and Accounting Officer)**

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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer
32.1	Section 1350 Certification of Principal Executive Officer
32.2	Section 1350 Certification of Principal Financial Officer