COMPLETE GENOMICS INC
Form S-1
May 10, 2011
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As filed with the Securities and Exchange Commission on May 10, 2011

Registration No. 333-

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

COMPLETE GENOMICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	8731	20-3226545
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

2071 Stierlin Court, Mountain View, CA 94043

(650) 943-2800

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Clifford A. Reid, Ph.D.

Chairman, President and Chief Executive Officer

Complete Genomics, Inc.

2071 Stierlin Court

Mountain View, CA 94043

(650) 943-2800

(Name, address, including zip code, and telephone number, including area code, of agent for service)

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

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

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

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	**Amount to be Registered(1)**	**Proposed Maximum Aggregate Offering Price(1)**	**Proposed Maximum Aggregate Offering Price Per Unit(2)**	**Amount of Registration Fee(1)**
Common Stock, $0.001 par value	5,175,000	$ 74,338,875.00	$ 14.365	$ 8,630.74

(1) Includes 675,000 shares that the underwriters have the option to purchase to cover over-allotments.
(2) Estimated solely for the purpose of calculating the registration fee based on the average of the high and low prices for the registrant s common stock on The NASDAQ Global Market on May 6, 2011, pursuant to Rule 457(c) under the Securities Act of 1933, as amended.

The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion May 10, 2011

Preliminary Prospectus

4,500,000 Shares

Common Stock

We are offering all of the 4,500,000 shares of our common stock offered by this prospectus.

Our common stock is listed on The NASDAQ Global Market under the symbol GNOM. On May 6, 2011, the closing price of our common stock as reported on The NASDAQ Global Market was $14.78 per share.

Investing in our common stock involves a high degree of risk. Before buying any shares, you should carefully read the discussion of material risks of investing in our common stock in Risk Factors beginning on page 10 of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds, before expenses, to us	$	$

The underwriters have the option, exercisable on or before the thirtieth day after the date of this prospectus, to purchase up to an additional 675,000 shares of our common stock at the public offering price, less the underwriting discounts and commissions payable by us, to cover over-allotments, if any. If the underwriters exercise this option in full, the total underwriting discounts and commissions will be $, and our total proceeds, before expenses, will be $.

The underwriters are offering the common stock as set forth under Underwriting. Delivery of the shares will be made on or about , 2011.

Jefferies **UBS Investment Bank**

Baird **Cowen and Company**

The date of this prospectus is , 2011.

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You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized anyone to provide you with additional information or information different from that contained in this prospectus. We are offering to sell, and seeking offers to buy, shares of our common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of shares of our common stock.

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Our logo, Complete Genomics, Complete Genomics Analysis Platform, CGA Platform, CGATools, cPAL and DNB and other trademark service marks of Complete Genomics, Inc. appearing in this prospectus are the property of Complete Genomics, Inc. This prospectus contains additional trade names, trademarks and service marks of other companies. We do not intend our use or display of other companies trade names, trademarks or service marks to imply relationships with, or endorsement or sponsorship of us by, these other companies.

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Prospectus Summary

This summary highlights information contained elsewhere in this prospectus and does not contain all of the information you should consider in making your investment decision. You should read this summary together with the more detailed information, including our financial statements and the related notes, elsewhere in this prospectus. You should carefully consider, among other things, the matters discussed in Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations before making an investment decision. Unless otherwise indicated, Complete Genomics, Inc., Complete Genomics, the Company, we, us and our refer to Complete Genomics, Inc.

Our Company

We are a life sciences company that has developed and commercialized an innovative DNA sequencing platform, and our goal is to become the preferred solution for complete human genome sequencing and analysis. Our Complete Genomics Analysis Platform, or CGA Platform, combines our proprietary human genome sequencing technology with our advanced informatics and data management software and our innovative, end-to-end, outsourced service model to provide our customers with data that is immediately ready to be used for genome-based research. We believe that our solution provides academic and biopharmaceutical researchers with complete human genomic data and analysis at an unprecedented combination of quality, cost and scale without requiring them to invest in in-house sequencing instruments, high-performance computing resources and specialized personnel. By removing these constraints and broadly enabling researchers to conduct large-scale complete human genome studies, we believe that our solution has the potential to significantly advance medical research and expand understanding of the basis, treatment and prevention of complex diseases. Since launching our service in May 2010, we have sequenced over 1,400 complete human genomes, including over 600 in the first quarter of 2011, and, as of March 31, 2011, we had an order backlog of over 2,000 genomes.

We believe that our complete human genome sequencing technology, which is based on our proprietary DNA arrays and ligation-based read technology, is superior to existing commercially available complete human genome sequencing methods in terms of quality, cost and scale. In the DNA sequencing industry, complete human genome sequencing is generally deemed to be coverage of at least 90% of the nucleotides in the genome. Because we have optimized our technology platform and our operations for the unique requirements of high-throughput complete human genome sequencing, we are able to achieve accuracy levels of 99.999% at a total cost that is significantly less than the total cost of purchasing and using commercially available DNA sequencing instruments and the necessary information processing technology, and then performing all the required sequence data assembly and analysis. We believe that we will be able to further improve our accuracy levels and reduce the total cost of sequencing and analysis, enabling us to maintain significant competitive advantages over the next several years. Because our technology resides only in our centralized facilities, we can quickly and easily implement enhancements and provide their benefits to our entire customer base. Our goal is to be the first company to sequence and analyze high-quality complete human genomes, at scale, for a total cost of under $1,000 per genome.

While our competitors primarily sell DNA sequencing instruments and reagents that produce raw sequenced data, requiring their customers to invest significant additional resources to process that raw data into a form usable for research, we offer our customers an end-to-end, outsourced solution that delivers research-ready genomic data. As the cost of complete human genome sequencing declines, we believe the basis of competition in our industry will shift from the cost of sequencing to the value of the entire sequencing solution. We believe that our integrated, advanced informatics and data management services will emerge as a key competitive advantage as this shift occurs.

Our genome sequencing center, which began commercial operations in May 2010, combines a high-throughput sample preparation facility, a collection of our proprietary high-throughput sequencing instruments and a large- scale data center. Our customers ship us their samples via common carrier services such as Federal Express and

United Parcel Service. We then sequence and analyze these samples and provide our customers with finished, research-ready data, enabling them to focus exclusively on their single highest priority, discovery.

Our customers include some of the leading global academic and government research centers and biopharmaceutical companies. At present, our facility has the capacity to sequence and analyze over 400 complete human genomes per month. We expect this capacity to increase between two- and three-fold by the end of 2011 as we deploy additional sequencers and increase the throughput of our sequencing process through software refinements and component upgrades. In future years, we plan to construct additional genome centers in the United States and international strategic markets to accommodate an expected growing global demand for high-quality, low-cost complete human genome sequencing on a large scale.

Our Industry

Studying how genes differ between species and among individuals within a species, or genetic variations, helps scientists to determine their functions and roles in health and disease. Improving our understanding of the genome and its functions has driven and, we expect, will continue to drive advancements in medical research and diagnostics. Genetic analysis products comprise instruments and consumables, as well as associated hardware, software and services directly involved in the study of DNA and RNA. Scientia Advisors, a third-party research firm, estimated genomic revenue in 2009 to be approximately $5.8 billion and projects the market to grow to approximately $9.0 billion by 2014. Scientia Advisors further estimates that human genomics research will grow from $4.6 billion in 2009 to $7.3 billion in 2014.

The primary genetic analytical methods traditionally used by genetic researchers fall into three categories: DNA sequencing, genotyping and gene expression analysis. DNA sequencing is the process of determining the exact order, or sequence, of the individual nucleotides in a DNA strand so that this information can be correlated to the genetic activity influenced by that segment of DNA. Genotyping is the process of examining certain known mutations or variations in the DNA sequence of genes to determine whether the particular variant can be associated with a specific disease susceptibility or drug response. Gene expression analysis is the process of examining the molecules that are produced when a gene is activated, or expressed, to determine whether a particular gene is expressed in a specific biological tissue.

The Importance of Complete Human Genome Sequencing and the Limitations of Existing Technologies

One of the most difficult challenges facing the genetic research and analysis industry is the need to improve our understanding of how genes contribute to diseases that have a complex pattern of inheritance. For many diseases, multiple genes each make a subtle contribution to a person s predisposition or susceptibility to a disease or response to a drug treatment protocol. Accordingly, we believe that unraveling this complex network will be critical to understanding human health and disease. We believe that sequencing complete human genomes is the most comprehensive and accurate method by which to achieve these objectives and improve our understanding of human disease.

Innovations in DNA sequencing have led to the development of high-throughput sequencing technologies, commonly referred to as next-generation or second-generation sequencing, which produce thousands to millions of sequences at once. Although second-generation sequencing technologies have led to dramatic reductions in cost and improvements in quality and throughput for complete human genome sequencing, they were designed as general-purpose instruments for sequencing the DNA or RNA of plants, animals, bacteria and viruses. We believe the key limitations of the model of purchasing and using second-generation technologies for sequencing large numbers of complete human genomes include the following:

§ ***High Cost***. Laboratories using commercially available DNA sequencing instruments cannot sequence complete human genomes at a price low enough to make large-scale projects affordable to researchers.

§ ***Insufficient Scale and Speed***. Laboratories using commercially available DNA sequencing instruments typically require months to sequence all of the genomes for large projects.

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§ ***Difficulty of Data Management***. Many users of commercially available DNA sequencing instruments lack the costly computing resources, storage capacity, network bandwidth and specialized personnel to process and analyze the massive data sets generated by sequencing complete human genomes.

Our Solution

We have developed a novel approach focused on complete human genome sequencing. Our solution combines our proprietary sequencing technology, which achieves accuracy levels of 99.999%, with our advanced informatics and data management software and our innovative, end-to-end service model to deliver research-ready genomic data at a total cost that is significantly less than the total cost of purchasing and operating commercially available DNA sequencing instruments.

Proprietary Sequencing Technology

Our patterned DNA nanoball, or DNB, arrays, due to their small size and biochemical characteristics, enable us to pack DNA very efficiently on a silicon chip. In addition, we have developed a highly accurate combinatorial probe-anchor ligation, or cPAL, read technology, which enables us to read DNA fragments efficiently using small concentrations of low-cost reagents, while retaining extremely high single-read accuracy. We believe this unique combination of our proprietary DNB and cPAL technologies is superior in both quality and cost when compared to other commercially available approaches and provides us with significant competitive advantages. As reported in the January 2010 edition of *Science,* we sequenced a complete human genome at a consumables cost of approximately $1,800 and with a consensus error rate of approximately 1 error in 100,000 nucleotides. Our read accuracy was further validated by one of our customers, the Institute for Systems Biology, or ISB, as published in *Science Express* in March 2010. We have continued to reduce our costs of consumables, and, currently, our consumables costs are under $1,000 per genome.

Advanced Informatics and Data Management

Sequencing complete human genomes generates substantial amounts of data that must be managed, stored and analyzed. To address this potential need by our customers, we have built a genomics data processing facility with computing infrastructure for managing both small- and large-scale genomic sequencing projects. Our proprietary assembly software uses advanced data analysis algorithms and statistical modeling techniques to accurately reconstruct over 90% of the complete human genome from approximately two billion 70-base reads. After assembling the genomic data, we use our analysis software to identify and annotate key differences, or variants, in each genome.

By using our analytical tools and data management software, our customers can significantly reduce their investments in computing infrastructure. Our customers are provided with reliable access to assembled and annotated sequence data in multiple formats to ease data sharing and comparative analyses. In addition, our data storage options provide flexibility and allow customers to customize their data management strategy based on their particular business, operational and scientific requirements. We have developed a suite of open source analytical tools, called CGA Tools, designed to enable our customers to rapidly analyze the data we generate from their samples. We are also developing additional analytical tools, such as a tumor-normal comparison tool designed to allow cancer researchers to compare a cancer genome to the normal genome from which it was derived. As the reagent cost of sequencing declines, we believe that the cost and complexity of data analysis and management will emerge as the primary constraint for conducting complete human genome analysis.

Innovative, End-to-End Outsourced Solution

While our competitors primarily sell DNA sequencing instruments and reagents that produce raw sequenced data, our end-to-end, outsourced solution enables our customers to offload to us the complex processes of sample

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preparation, sequencing, computing and data storage and management. We believe our services will expand the potential addressable market by enabling a broad base of researchers who may lack sufficient capital and the specialized personnel necessary to build and operate a sequencing laboratory, or who have historically been constrained by the high total cost of sequencing, to conduct large-scale complete human genome studies.

Our end-to-end solution provides the following advantages to our customers:

§ ***High-Quality Data.*** Our technology delivers what we believe is the industry s highest quality complete human genome data.

§ ***Cost-Savings.*** Our customers can avoid purchasing expensive sequencing instruments and high-performance computing resources or hire the necessary specialized personnel to sequence and analyze large sets of complete human genome data.

§ ***Speed at Scale.*** Our customers can often complete their large-scale projects more quickly by using our services than by using commercially available sequencing instruments.

§ ***Ease of Use.*** We believe our customers can avoid the difficulty and time-consuming process of purchasing and operating their own sequencing instruments and can outsource the entire process to us, from sample preparation to delivery of research-ready data.

§ ***Operational Flexibility.*** By outsourcing their large-scale complete human genome sequencing projects to us, our customers can free up the capacity of in-house instruments to run smaller or more targeted sequencing projects and applications.

§ ***Technological Flexibility.*** As DNA sequencing technology improves, our customers will have available to them the latest technology that we have implemented, and they avoid the risk of their expensive instruments becoming technologically obsolete.

§ ***Enables Customers to Focus on Discovery.*** Outsourcing offloads the operational burdens of managing large-scale genome sequencing projects and enables our customers to focus their resources on their strength in research, which can reduce the time to discovery.

We have more than 40 past and current customers, which include some of the leading global academic and government research centers and biopharmaceutical companies. In May 2010, we received an order from SAIC-Frederick, Inc., under a National Cancer Institute prime contract, to use our sequencing and bioinformatics end scientific services to sequence and analyze 50 tumor-normal pairs, or 100 complete human genomes. This contract contains a provision for SAIC-Frederick to engage us at its option to sequence more than 500 additional cancer cases, or more than a 1,000 complete human genomes, over an 18-month period. In addition, we sequenced complete genomes that enabled ISB to pinpoint the causal gene, and subsequently confirm that gene s role, in Miller Syndrome. This work has led to two follow-on projects with the ISB to sequence an additional 122 and 615 genomes, respectively. We also worked with Genentech, Inc. (a member of the Roche Group) on a non-small cell lung cancer study that was the first complete human genome sequence of a primary non-small cell lung tumor and matched normal tissue. The data we delivered allowed Genentech to measure the rate of smoking-induced mutations accumulated over time.

Applications for Our Sequencing Service

Potential applications for our complete human genome sequencing service include:

§ ***Cancer Research.*** We believe understanding genetic mutations in cancer patients will guide development of new cancer therapeutics and diagnostics and ultimately enable doctors to select the best course of therapy based on the specific mutations found in a tumor.

- ***Mendelian Disease Research.*** By sequencing the complete genomes of families affected with Mendelian diseases, which likely have a significant genetic component, we believe the genetic causes of these diseases can be discovered, which could lead to the development of novel diagnostics and therapeutics.

- ***Rare Variant Disease Research.*** Large-scale genomic studies of central nervous system disorders, cardiac disease and certain metabolic disorders may help to identify disrupted pathways and lead to the development of novel diagnostics and therapeutics.

- ***Clinical Trial Optimization.*** We believe that selecting or stratifying patients on the basis of their genetic profiles could enable the preferential admission of high responders into clinical trials, lowering costs and resulting in faster clinical trials and drug commercialization.

In addition to these research studies, we expect future clinical applications to include:

- ***Companion Diagnostics.*** We believe that therapeutics that are not first-line treatments for the general population may be elevated to first-line treatments or used in combination therapies for subsets of the population that share a common genetic profile. Complete human genome studies may unlock new market opportunities for these therapies or combination therapies.

- ***Cancer Pathology.*** We believe that analyzing complex cancer genomes that involve large and unpredictable structural changes will be most reliably and economically implemented using complete human genome sequencing.

- ***Universal Diagnostics.*** As medical records technology and public health policy advance, we believe that large numbers of people will have their complete human genomes sequenced and stored in their electronic medical records for use by their physicians in managing their health care decisions.

Competitive Strengths

We believe that our competitive strengths are as follows:

- ***Proprietary Human Genome Sequencing Technology.*** Our proprietary sequencing technology achieves accuracy levels of 99.999% at a total cost that is significantly less than the total cost of purchasing and operating commercially available DNA sequencing instruments and the necessary information processing technology, and then performing all the required sequence data assembly and analysis.

- ***Fully Integrated Advanced Informatics and Data Management Software.*** Our solution enables our customers to manage and gain useful information from the massive data sets generated in complete human genome sequencing.

- ***Highly Scalable and Capital-Efficient Business Model***. Consolidating volume across our entire customer base enables us to sequence large numbers of genomes while avoiding the cost and complexity of employing a large field installation and support organization. By implementing a high degree of automation, we have reduced the possibility of human errors that could adversely affect quality and increase costs.

- ***Unique Insight Into Customer Needs***. We interact directly with our customers on their discovery projects, which enables us to develop and enhance our analysis software to meet our customers specific needs while expanding our understanding of variation in the human genome.

- ***Fast and Efficient Deployment of Operational and Technological Enhancements***. Because our sequencing operations and data center are centralized, we can rapidly upgrade our technology and deliver the benefits to our customers. In addition, our access to genomic data allows our software engineers to continually refine and improve our software with each genome we sequence.

§ ***Expanded Market Opportunity***. We believe our outsourced model will expand the potential addressable market by providing academic and biopharmaceutical researchers who lack sufficient budgets or the specialized personnel necessary to build and operate a sequencing laboratory with access to high-quality, low-cost complete human genome data.

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Our Strategy

We intend to become the leading complete human genome sequencing and analysis company and the preferred platform for human genome discovery by:

- § continuing to deliver the highest quality genomic data and analysis at a low total cost;
- § maintaining and strengthening our technology;
- § capitalizing on our scalable model;
- § establishing ourselves as the leader in outsourced complete human genome sequencing;
- § expanding globally to increase capacity and reach new markets;
- § exploring strategic partnerships and collaborations; and
- § expanding applications for the use of our technology.

Risks Associated with our Business

Our business is subject to numerous risks, as discussed more fully in the section entitled Risk Factors immediately following this prospectus summary. These risks include the following, among others:

- § We are an early, commercial-stage company and have a limited operating history.
- § We may need substantial additional capital in the future in order to maintain and expand our business.
- § We have a history of losses, and we may not achieve or sustain profitability in the future, on a quarterly or annual basis.
- § Our only source of revenue is our human genome sequencing service, which is a new business model in an emerging industry, and failure to achieve market acceptance will harm our business.
- § Our order backlog may never be completed, and we may never earn revenue on backlogged contracts to sequence genomes; our ability to convert backlog orders into revenue is dependent in part on our receiving genomic samples from our customers, which can follow a signed order by weeks or months.
- §

The presence or absence in a specific quarter of one or more new large orders for hundreds of genomes may cause our results of operations and backlog to fluctuate significantly on a quarterly basis.

§ Our success depends on the growth of markets for analysis of genetic variation and biological function, and the shift of these markets to complete human genome sequencing.

§ We face significant competition from large, well-capitalized companies. The emergence of new competitive genome sequencing technologies may also harm our business.

§ We must significantly expand our capacity in order to reach profitability.

§ If our Mountain View genome sequencing facility becomes inoperable, we will be unable to perform our genome sequencing services, and our business will be harmed.

§ If third parties assert, as they currently are asserting, that we have infringed their patents or other proprietary rights or challenge the validity of our patents or other proprietary rights, we may become involved in costly and time-consuming disputes and litigation that could affect our ability to sell our services.

Corporate Information

We were incorporated in the state of Delaware on June 14, 2005. The address of our principal executive offices is 2071 Stierlin Court, Mountain View, California 94043, and our telephone number is (650) 943-2800. Our website address is www.completegenomics.com. We do not incorporate the information on, or that can be accessed through, our website into this prospectus, and you should not consider it part of this prospectus.

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The Offering

Common stock offered by Complete Genomics	4,500,000 shares (or 5,175,000 shares if the underwriters exercise their over-allotment option in full).
Common stock to be outstanding after this offering	30,488,934 shares (or 31,163,934 shares if the underwriters exercise their over-allotment option in full).
NASDAQ Global Market symbol	GNOM
Use of proceeds	We currently intend to use the net proceeds of this offering for capital expenditures to expand the sequencing and computing capacity in our Mountain View and Santa Clara leased facilities, to finance the further development of our sequencing technology and services, for sales and marketing activities and for working capital and other general corporate purposes. Please see Use of Proceeds.
Risk factors	See Risk Factors starting on page 10 of this prospectus for a discussion of factors you should carefully consider before deciding to invest in our common stock.

The number of shares of common stock to be outstanding after this offering is based on 25,988,934 shares outstanding as of March 31, 2011 and excludes:

§ 2,875,125 shares of common stock issuable upon exercise of options outstanding as of March 31, 2011 with a weighted-average exercise price of $2.40 per share;

§ 27,500 shares of common stock issuable upon vesting of restricted stock units outstanding as of March 31, 2011;

§ an aggregate of 5,207,396 shares of common stock reserved for future issuance under our 2010 Equity Incentive Award Plan and Employee Stock Purchase Plan, as well as any automatic increases in the number of shares of our common stock reserved for future issuance under these benefit plans; and

§ 2,165,323 shares of common stock subject to warrants outstanding as of March 31, 2011 with a weighted-average exercise price of $2.42 per share.

Except as otherwise indicated, all information in this prospectus reflects or assumes no exercise of the underwriters over-allotment option.

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Summary Financial Data

The following tables set forth a summary of our historical financial data as of, and for the periods ended on, the dates indicated. You should read these tables together with our financial statements and the related notes, Selected Financial Data and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this prospectus. The statement of operations data for the years ended December 31, 2008, 2009 and 2010 are derived from our audited financial statements included elsewhere in this prospectus. The statement of operations data for the three months ended March 31, 2010 and 2011, and the balance sheet data as of March 31, 2011 are derived from our unaudited financial statements included elsewhere in this prospectus. The unaudited financial statements have been prepared on a basis consistent with our audited financial statements and include, in the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of the financial information in those statements. Our historical results are not necessarily indicative of the results to be expected in any future period, and the results for the three months ended March 31, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011.

Years ended December 31,			Three months ended March 31,	
2008	2009	2010	2010	2011
(in thousands, except share and per share amounts)				
$	$ 623	$ 9,389	$ 336	$ 6,833
				6,582
	5,033	19,895	4,077	
23,633	22,424	21,691	6,169	6,808
3,179	4,953	9,345	3,099	2,780
1,045	1,798	6,111	1,226	2,700
27,857	34,208	57,042	14,571	18,870
(27,857)	(33,585)	(47,653)		

Comprehensive income	Common stock Shares	Common stock Amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income (loss)	Retained earnings
	50,450,675	$ 50	$ 105,687	$ (85,487)	$ 137	$ 92,716 $
$ 29,878	-	-	-	-	-	29,878
-	-	-	-	-	-	(17,497)
-	-	-	-	(45,107)	-	-
-	126,206	1	882	-	-	-
-	-	-	(1,126)	-	-	-
-	-	-	172	-	-	-
-		-	11,231	-	-	7
-	727,237	-	-	-	-	-
-	(35,037)	-	-	-	-	-
(1,036)	-	-	-	-	(1,036)	-
$ 28,842						
	51,269,081	$ 51	$ 116,846	$ (130,594)	$ (899)	$ 105,104 $

$ 10,660	-	-	-	-	-	10,660
-	-	-	-	-	-	(8,807)
-	-	-	-	(210)	-	-
-	56,928	-	255	-	-	-
-	-	-	401	-	-	-
-	-	-	5,519	-	-	12
-	39,140	-	449	-	-	-
-	(20,916)	-	-	-	-	-
681	-	-	-	-	681	-
$ 11,341						
	51,344,233	$ 51	$ 123,470	$ (130,804)	$ (218)	$ 106,969 $

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

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Blackbaud, Inc.

Notes to consolidated financial statements

(Unaudited)

1. Organization

Blackbaud, Inc. (the Company), a leading global provider of software and related services designed specifically for nonprofit organizations, provides products and services that enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage finances and optimize internal operations. As of June 30, 2009, the Company had approximately 22,000 active customers distributed across multiple verticals within the nonprofit market including education, foundations, health and human services, religion, arts and cultural, public and societal benefits, environment and animal welfare and international foreign affairs.

2. Summary of significant accounting policies

Unaudited interim financial statements

The Company prepared its interim consolidated financial statements as of June 30, 2009, and for the three and six months ended June 30, 2009 and 2008, pursuant to the rules and regulations of the SEC for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to state fairly the consolidated balance sheets, consolidated statements of operations, consolidated statements of cash flows and consolidated statements of stockholders equity and comprehensive income for the periods presented in accordance with accounting principles generally accepted in the United States (U.S. GAAP). The Company derived its consolidated balance sheet at December 31, 2008 from the audited consolidated financial statements at that date. Operating results for the three and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2009 or any other future period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been omitted in accordance with the rules and regulations for interim reporting of the SEC. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 and other forms filed with the SEC from time to time.

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The Company evaluates subsequent events through the date the financial statements were issued, which was August 7, 2009.

Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Areas of the financial statements where estimates may have the most significant effect include revenue recognition, the allowance for sales returns and doubtful accounts, valuation of long-lived and intangible assets and goodwill, stock-based compensation and provision for income taxes and valuation of deferred tax assets. Changes in the facts or circumstances underlying these estimates could result in material changes and actual results could differ from these estimates.

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Revenue recognition

The Company s revenue is primarily generated from the following sources: (1) selling perpetual licenses of its software products; (2) providing professional services including implementation, training, consulting, hosting and other services; (3) providing software maintenance and support services; and (4) charging for the use of its software products in a hosted environment.

License fees

The Company recognizes revenue from the sale of perpetual software license rights when all of the following conditions are met:

- persuasive evidence of an arrangement exists;
- the product has been delivered;
- the fee is fixed or determinable; and
- collection of the resulting receivable is probable.

The Company deems acceptance of an agreement to be evidence of an arrangement. Delivery occurs when the product is shipped or transmitted, and title and risk of loss have transferred to the customers. The Company s typical license agreement does not include customer acceptance provisions; however, if acceptance provisions are provided, delivery is deemed to occur upon acceptance. The Company considers the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within the Company s standard payment terms. Payment terms greater than 90 days are considered to be beyond the Company s customary payment terms. Collection is deemed probable if the Company expects that the customer will be able to pay amounts under the arrangement as they become due. If the Company determines that collection is not probable, it defers revenue recognition until collection.

The Company sells software licenses with maintenance, varying levels of professional services and, in certain instances, with hosting services. The Company allocates revenue to delivered components, normally the license component of the arrangement, using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to the Company. Fair value for maintenance services associated with software licenses is based upon renewal rates stated in the agreements with customers, which vary according to the level of support service provided under the maintenance program. Fair value of professional services and other products and services is based on sales of these products and services to other customers when sold on a stand-alone basis. When a software license is sold with software customization services, generally the services are to provide customer support for assistance in creating special reports and other enhancements that will assist with efforts to improve operational efficiency and/or to support business process improvements. These services are not essential to the functionality of the software. However, when software customization services are considered essential to the functionality of the software, the Company recognizes revenue for both the software license and the services on a percent-complete basis.

Services

The Company generally bills consulting, installation and implementation services based on hourly rates plus reimbursable travel-related expenses. Revenue is recognized for these services over the period the services are performed. For service engagements of less than $10,000, the Company frequently contracts for and bills based on a fixed fee plus reimbursable travel-related expenses. The Company recognizes this revenue

upon completion of the work performed.

The Company recognizes analytic services revenue from donor prospect research engagements, the sale of lists of potential donors, benchmarking studies and data modeling service engagements upon delivery.

The Company sells training at a fixed rate for each specific class, at a per attendee price or at a packaged price for several attendees, and revenue is recognized only upon the customer attending and completing training.

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Additionally, the Company sells a fixed-rate program, which permits customers to attend unlimited training over a specified contract period, typically one year, subject to certain restrictions, and revenue is recognized ratably over this contract period.

Maintenance

The Company recognizes revenue from maintenance services ratably over the contract term, which is principally one year. Maintenance contracts are at rates that vary according to the level of the maintenance program and are generally renewable annually. Maintenance contracts also include the right to unspecified product upgrades on an if-and-when available basis. Certain support services are sold in prepaid units of time and recognized as revenue upon their usage.

Subscriptions

The Company provides hosting services to customers who have purchased perpetual rights to certain of its software products (hosting services). Revenue from hosting services, as well as data enrichment services, data management services and online training programs is recognized ratably over the service period of the contract. Any related set-up fees are also recognized ratably over the service period of the contract.

The Company is increasingly making available certain of its software products for use in hosted application arrangements without licensing perpetual rights to the software (hosted applications). Revenue from hosted applications is recognized over the subscription agreement, which generally ranges from one to three years. For contractual arrangements covering the use of hosted applications the stand alone value of the delivered items or the fair value of undelivered items in the arrangement have not been established. Such items include upfront activation, implementation and hosting of the solution. For these arrangements the Company treats the transaction as a single element and the revenue is deferred until the hosted application is deployed and in use, at which time revenue is recognized over the remaining term of the arrangement. Direct and incremental costs relating to activation and implementation are capitalized until the hosted application is deployed and in use, and then expensed over the remaining term of the arrangement.

Revenue from transaction processing fees is recognized when received. Credit card fees directly associated with processing donations for customers are included in subscription revenue net of related transaction costs.

Deferred revenue

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

Goodwill

The change in goodwill during the six months ended June 30, 2009 consisted of the following:

(in thousands)	
Balance at December 31, 2008	$ 73,615
Additions related to business combinations	1,682
Adjustments related to business combinations	(543)
Effect of foreign currency translation	376

Balance at June 30, 2009	$	75,130

Additions and adjustments related to business combinations are described in Note 3 to the consolidated financial statements.

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(Unaudited)

Amortization expense

Amortization expense related to intangible assets acquired in business combinations is allocated to cost of revenue on the statements of operations based on the revenue stream to which the asset contributes. The following table summarizes amortization expense for the three and six months ended June 30, 2009 and 2008.

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	**2009**	**2008**	**2009**	**2008**
Included in cost of revenue:				
Cost of license fees	$ 90	$ 43	$ 171	$ 86
Cost of services	336	334	670	668
Cost of maintenance	325	98	650	196
Cost of subscriptions	806	409	1,625	818
Cost of other revenue	18	19	37	38
Total included in cost of revenue	1,575	903	3,153	1,806
Included in operating expenses	192	167	378	334
Total	$ 1,767	$ 1,070	$ 3,531	$ 2,140

Recently adopted accounting pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. On February 12, 2008, the FASB issued FASB Staff Position (FSP) SFAS No. 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2), which delayed the effective date of SFAS 157 for all non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years The Company adopted SFAS 157 with no material impact effective January 1, 2008 for financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Effective January 1, 2009, the Company adopted SFAS 157 for the remaining non-financial assets and liabilities, which primarily included goodwill and long-lived assets subject to impairment tests. The adoption of SFAS 157 on January 1, 2009 did not have a material impact on the Company s consolidated financial statements.

Effective January 1, 2009, the Company adopted SFAS No. 141 (revised 2007), Business Combinations (SFAS 141R). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R applies to business combinations for which the acquisition date is on or after January 1, 2009. The extent of the impact of SFAS 141R on future acquisitions is dependent upon the size and nature of the acquisitions. At the time of adoption on January 1, 2009, SFAS 141R did not have a material impact on the Company s consolidated financial statements. During the six months ended June 30, 2009, the Company expensed acquisition related costs of $0.2 million that prior to the adoption of SFAS 141R would have been included in the cost of the acquisition.

Effective January 1, 2009, the Company adopted FSP FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS 142-3). FSP FAS 142-3 removes the requirement of SFAS 142 for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. FSP FAS 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity consider its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. The adoption of FSP FAS 142-3 on January 1, 2009 did not have a material impact on the Company s consolidated financial statements.

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Effective January 1, 2009, the Company adopted FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1). FSP EITF 03-6-1 clarifies that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and should be included in the calculation of basic earnings per share pursuant to the two-class method. The adoption of FSP EITF 03-6-1 on January 1, 2009 did not have a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued FSP FAS 141R-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies, which provides additional guidance regarding the initial recognition and measurement model under SFAS 141R for assets and liabilities arising from contingencies. The FSP establishes a model for preacquisition contingencies similar to the model used under SFAS 141. Under the FSP, an acquirer is required to recognize, at fair value, an asset acquired or liability assumed in a business combination that arises from a contingency if the acquisition-date fair value can be determined during the measurement period. If the acquisition-date fair value cannot be determined, the acquirer applies the recognition criteria of SFAS 5 to determine when the contingency should be recognized. This FSP applies to business combinations for which the acquisition date is on or after January 1, 2009. At the time of adoption, the application of this FSP did not have a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued FSP No. SFAS 107-1 and APB No. 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1), which requires quarterly disclosure of information about the fair value of financial instruments within the scope of FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments. FSP FAS 107-1 and APB 28-1 has an effective date requiring adoption by the second quarter of 2009. At the time of adoption, the application of FSP FAS 107-1 and APB 28-1 did not have a material impact on the Company s consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (SFAS 165), which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 became effective in the second quarter of 2009. The adoption of SFAS 165 on April 1, 2009 did not have a material impact on the Company s consolidated financial statements.

Recently issued accounting pronouncements

In June 2009, the FASB issued SFAS No. 168, The *FASB Accounting Standards Codification*™ and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162 (SFAS 168), which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with generally accepted accounting principles. The Codification is not intended to change U.S. GAAP, but will significantly change the way in which the accounting literature is organized and the way U.S. GAAP is referenced by companies in their financial statements and accounting policies. SFAS 168 will become effective in the third quarter of 2009. The Company does not expect the adoption of SFAS 168 to have a material impact on its consolidated financial statements.

3. Business combinations

RLC

On April 29, 2009, the Company acquired all of the outstanding stock of RLC Customer Centric Technology B.V. (RLC), a privately held limited liability company based in the Netherlands, for 1.8 million in cash, or the equivalent of $2.4 million based on the foreign exchange rate at the time of the acquisition. The Company will also pay a maximum of 400,000, or the equivalent of $0.5 million based on the foreign exchange rate at the time of the acquisition, in earn-out payments if RLC meets revenue and EBITDA margin targets, as defined in the agreement, over the two years subsequent to the acquisition. RLC is the leading provider of software and services to nonprofits in the Netherlands. The acquisition of RLC provides the Company with a foundation to expand into the Netherlands and other Western European markets. The results of operations of RLC are included in the

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consolidated financial statements of the Company from the date of acquisition. During the three and six months ended June 30, 2009, total revenue and cost of revenue from the RLC operations were $0.4 million and $0.2 million, respectively.

The Company recorded a preliminary purchase price allocation based on the estimated fair value of the assets acquired and liabilities assumed. The following table summarizes the allocation of the purchase price:

(in thousands)	
Cash and cash equivalents	$ 110
Accounts receivable	374
Other assets, current and noncurrent	165
Property and equipment	188
Intangibles	840
Goodwill	1,682
Trade accounts payable	(118)
Accrued expenses and other current liabilities	(179)
Deferred tax liability, current and noncurrent	(286)
Deferred revenue, current and noncurrent	(200)
Contingent consideration liability	(208)
	$ 2,368

The purchase price allocation is preliminary because the Company is still in the process of valuing certain contingent liabilities. The Company expects to complete the purchase price allocation when additional information becomes available, which it expects will be within one year of the acquisition date. None of the goodwill arising in the acquisition is deductible for income tax purposes. The Company is currently in the process of completing its determination of the assignment of the goodwill to reportable segments. The acquisition resulted in the identification of $0.8 million of intangible assets, all of which are subject to amortization on a straight-line basis. A liability of $0.2 million was recognized for the contingent consideration based on a probability-weighted discount cash flow valuation technique. Any change in the fair value, or any change upon final settlement, of the contingent consideration liability will be recognized in income from operations.

Kintera

On July 8, 2008, the Company acquired Kintera, a publicly traded company based in San Diego, California. Kintera is a leader in providing web-based, software-as-a-service solutions to the nonprofit market. The acquisition of Kintera added experience in on-demand solutions and expanded the Company s online offerings. The Company acquired all of the outstanding capital stock of Kintera through a tender offer and subsequent short-form merger, paying $1.12 per share for a total of $45,660,000. The Company financed this acquisition with cash on hand and borrowings under the Company s revolving credit facility. The total purchase price of $50.2 million includes $2.4 million in payments to Kintera management under change of control provisions, $1.9 million of direct acquisition-related costs and $0.2 million related to Kintera employee stock options assumed. The results of operations of Kintera are included in the consolidated financial statements of the Company from the date of acquisition.

In connection with the acquisition, the Company entered into employment agreements with certain members of Kintera s management team that include bonuses which could total as much as $449,000, payable in shares of the Company s common stock in February 2009 based on continued employment. In February 2009, the Company issued 39,140 shares of common stock at a fair market value of $11.47 per share in connection

with these employment agreements. In addition, the Company entered into an employment agreement with the former CEO of Kintera that includes a targeted bonus of $330,000, payable in shares of the Company s common stock in July 2009 conditioned upon his continued employment and achievement of certain performance targets. In August 2009, the Company issued 10,898 shares of common stock at a fair market value of $19.73 per share for a total of $215,000 in connection with this bonus arrangement. As of June 30, 2009, the Company had accrued $330,000 of stock based compensation cost in connection with this bonus arrangement.

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During the six months ended June 30, 2009, the Company completed its purchase price allocation for Kintera, which resulted in a net decrease to goodwill of $0.5 million. The adjustments to the purchase price allocation primarily related to (i) approximately $0.5 million of an increase in deferred tax assets, net of valuation allowance, related to the state net operating loss carryforwards that were determined to be realizable in the future and changes in state rates at the time of the acquisition, (ii) approximately $0.8 million of reduction in current taxes payable and $0.6 million increase in deferred tax assets, net of valuation allowance, for certain tax items that were deemed to be more-likely-than-not to be realized in the future, and (iii) an increase in contingent tax liabilities, royalties and other preacquisition accruals of $1.4 million.

Pro forma information

The following unaudited pro forma information presents the consolidated results of operations of the Company as if the acquisition of Kintera had taken place at the beginning of 2008. The pro forma information includes the historical operating results of Kintera and adjustments for the business combination effect of the amortization charges from acquired intangible assets, interest expense, interest income and related tax effects. The pro forma information does not necessarily reflect the actual results that would have occurred nor is it necessarily indicative of future results of operations.

	Three months ended	Six months ended
(in thousands, except per share amounts)	**June 30, 2008**	**June 30, 2008**
Revenue	$ 82,489	$ 160,836
Net income	7,610	11,718
Earnings per share, basic	$ 0.18	$ 0.27
Earnings per share, diluted	0.18	0.27

eTapestry

In connection with the acquisition of eTapestry in August 2007, the Company entered into employment agreements with certain members of eTapestry s management team. Under these arrangements, an additional amount of up to $1.0 million remains contingently payable based upon performance of the acquired business for the twelve-month period ending September 30, 2009. Based on actual and expected performance, the Company had accrued, as of June 30, 2009, a liability of $0.8 million under these arrangements.

4. Earnings per share

The Company computes basic earnings per share by dividing net income available to common stockholders by the weighted average number of common shares outstanding. The Company computes diluted earnings per share by dividing net income available to common stockholders by the weighted average number of common shares and dilutive potential common shares then outstanding. Diluted earnings per share reflect the assumed conversion of all dilutive securities, using the treasury stock method. Dilutive potential common shares consist of shares issuable upon the exercise of stock options, shares of non-vested restricted stock and settlement of stock appreciation rights. Additionally, dilutive potential common shares includes shares issuable for certain contingent liabilities that will be paid in shares of common stock based on the number of shares that would be issuable if June 30, 2009 was the end of the contingency period.

Diluted earnings per share for the three and six months ended June 30, 2009 does not include the effect of 1,137,335 and 1,126,270, respectively, potential common shares equivalents, as they are anti-dilutive. There were no anti-dilutive potential common shares outstanding for the three and six months ended June 30, 2008.

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

	Three months ended June 30,		Six months ended June 30,	
(in thousands, except share and per share amounts)	**2009**	**2008**	**2009**	**2008**
Numerator:				
Net income, as reported	$ 6,588	$ 8,987	$ 10,660	$ 16,030
Denominator:				
Weighted average common shares	42,577,549	42,776,609	42,531,323	43,336,989
Add effect of dilutive securities:				
Liabilities to be paid in shares of common stock	85,531	-	85,531	-
Employee stock options and restricted stock	670,791	681,101	524,800	727,447
Weighted average common shares assuming dilution	43,333,871	43,457,710	43,141,654	44,064,436
Earnings per share:				
Basic	$ 0.15	$ 0.21	$ 0.25	$ 0.37
Diluted	$ 0.15	$ 0.21	$ 0.25	$ 0.36

5. Comprehensive income

Total comprehensive income for the three and six months ended June 30, 2009 and 2008 is as follows:

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	**2009**	**2008**	**2009**	**2008**
Net income	$ 6,588	$ 8,987	$ 10,660	$ 16,030
Foreign currency translation adjustment, net of tax	351	(54)	681	(46)
Comprehensive income	$ 6,939	$ 8,933	$ 11,341	$ 15,984

The amount of tax allocated to the translation adjustment recorded in accumulated other comprehensive income was an expense of $0.2 million and a benefit of $35,000 for the three months ended June 30, 2009 and 2008, respectively. For the six months ended June 30, 2009 and 2008, a tax benefit of $0.4 million and $29,000, respectively, was allocated to the translation adjustment recorded in accumulated other comprehensive income.

6. Prepaid expenses and other current assets

Prepaid expenses and other current assets consisted of the following as of June 30, 2009 and December 31, 2008:

(in thousands)	June 30, 2009	December 31, 2008
Taxes, prepaid and receivable	$ 4,155	$ 6,385
Prepaid software maintenance and royalties	5,153	3,904
Deferred sales commissions	4,598	3,047
Other	2,933	3,945
Total prepaid expenses and other current assets	$ 16,839	$ 17,281

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7. Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following as of June 30, 2009 and December 31, 2008:

(in thousands)	June 30, 2009	December 31, 2008
Accrued bonuses	$ 7,134	$ 6,905
Accrued commissions and salaries	3,826	3,703
Customer credit balances	2,708	3,028
Taxes payable	3,686	2,033
Accrued health care costs	1,473	758
Accrued accounting and legal fees	967	1,283
Other	3,454	4,048
Total accrued expenses and other current liabilities	$ 23,248	$ 21,758

8. Debt

The Company has a five-year $75.0 million revolving credit facility, which expires July 2012. Under the terms of the credit agreement, the Company may elect not more than twice over the term of the agreement to increase the amount available under the facility for an aggregate amount of up to $50.0 million, subject to certain terms and conditions. In June 2008, the Company exercised one of its options and increased the credit facility by $15.0 million to an aggregate available amount of $90.0 million. The revolving credit facility is guaranteed by the material domestic subsidiaries and is collateralized with the stock of all of the Company s subsidiaries.

Amounts borrowed under the revolving credit facility bear interest, at the Company s option, at a variable rate based (a) on the higher of the prime rate plus a margin of up to 0.5% or federal funds rate plus a margin of 0.5% to 1.0% (Base Rate Loans) or (b) LIBOR plus a margin of 1.0% to 1.5% (LIBOR Loans). The exact amount of any margin depends on the nature of the loan and the leverage ratio at the time of the borrowing. At June 30, 2009, the weighted average interest rate on the credit facility was 1.32%. The Company also pays a quarterly commitment fee on the unused portion of the revolving credit facility equal to 0.2%, 0.25% or 0.3% per annum, depending on the Company s leverage ratio.

Under the credit facility the Company has the ability to choose either Base Rate Loans or LIBOR Loans. Base rate borrowings mature in July 2012. LIBOR Loans can have one, two, three or six month maturities, and the Company has the ability to extend the maturity of these loans by rolling them at their maturity into new loans with the same or longer maturities. The Company evaluates the classification of its debt based on the maturity of individual borrowings and any roll-over of borrowings subsequent to the balance sheet date, but prior to issuance of the financial statements. During the six months ended June 30, 2009, the Company repaid $18.5 million of borrowings under the credit facility. At June 30, 2009, outstanding borrowings under the credit facility were $40.5 million, all of which were in the form of short-term LIBOR Loans, and accordingly classified as current liabilities. The fair value of the outstanding borrowings under the credit facility approximates the carrying value due to the short-term nature of the borrowings.

Note payable

As a result of the acquisition of Kintera, the Company assumed a note payable which was executed on December 1, 2007 in the amount of $3.2 million for the purchase of computer equipment. The note is collateralized by the underlying computer equipment, bears interest at a rate of 11.34% and has a maturity date of November 30, 2010. The Company recorded the note at its fair value as of the acquisition date, which resulted in an increase of $0.1 million in the carrying value. As of June 30, 2009, the note payable balance was $1.8 million, of which $1.1 million was classified as current.

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Using a discounted cash flow technique that incorporates a market interest rate with adjustments for duration and risk profile, the Company has determined the fair value of this note payable to be $1.9 million at June 30, 2009.

9. Commitments and contingencies

Leases

The Company leases its headquarters facility from Duck Pond Creek, LLC. Two current executive officers of the Company each have a 4% ownership interest in Duck Pond Creek, LLC. The lease agreement has a term of 15 years with two five-year renewal options by the Company. The annual base rent of the lease is $3.6 million payable in equal monthly installments. The base rent escalates annually at a rate equal to the change in the consumer price index, as defined in the agreement, but not to exceed 5.5% in any year. In addition, under the terms of the lease, the lessor will reimburse the Company an aggregate amount of $4.0 million for leasehold improvements, which will be recorded as a reduction to rent expense ratably over the term of the lease. During the three and six months ended June 30, 2009 rent expense was reduced by $66,700 and $133,400, respectively, related to this lease provision. There were no such amounts recorded during the three and six months ended June 30, 2008 since this lease provision became effective under renegotiated lease terms in October 2008. The $4.0 million leasehold improvement allowance has been included in the table below of operating lease commitments as a reduction in the Company s lease commitments ratably over the life of the lease. The timing of the reimbursements for the actual leasehold improvements are expected to vary from the amount reflected in the table below.

Additionally, the Company has subleased a portion of its headquarters facility under various agreements extending through 2010. Under these agreements, rent expense was reduced by $47,000 and $65,000 for the three months ended June 30, 2009 and 2008, respectively, and by $92,000 and $131,000 for the six month ended June 30, 2009 and 2008, respectively. The operating lease commitments in the table below have been reduced by minimum aggregate sublease commitments of $94,000 and $62,000 during the remainder of 2009 and 2010, respectively. No minimum aggregate sublease commitments exist after 2010. The Company has also received, and expects to receive through 2012, quarterly South Carolina state incentive payments as a result of locating its headquarters facility in Berkeley County, South Carolina. These amounts are recorded as a reduction of rent expense and were $0.5 million and $0.7 million for the three months ended June 30, 2009 and 2008, respectively, and were $0.9 million and $1.1 million for the six months ended June 30, 2009 and 2008, respectively.

Additionally, the Company leases various office space and equipment under operating leases. The Company also has various non-cancelable capital leases for computer equipment and furniture.

As of June 30, 2009, the future minimum lease commitments related to lease agreements, net of related sublease commitments and lease incentives, were as follows:

Year ending December 31, **(in thousands)**	**Operating leases**	**Capital leases**
2009 remaining	$ 3,858	$ 184
2010	6,197	174
2011	5,729	40
2012	5,152	2
2013	4,269	-
2014 and thereafter	41,142	-
Total minimum lease payments	$ 66,347	400

Less: portion representing interest	29
Present value of net minimum lease payments	371
Less: current portion	290
Noncurrent portion	$ 81

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Other commitments

The Company has a commitment through 2009 for naming rights on a stadium in Charleston, South Carolina. The remaining commitment under this agreement is $100,000. The Company incurred expense under this agreement of $50,000 for the three months ended June 30, 2009 and 2008, respectively, and $100,000 for the six months ended June 30, 2009 and 2008, respectively.

The Company utilizes third-party relationships in conjunction with its products. The contractual arrangements vary in length from one to three years. In certain cases, these arrangements require a minimum annual purchase commitment. The aggregate minimum purchase commitment under these arrangements is approximately $1.6 million through 2012. The Company incurred expense under these arrangements of $0.9 million and $0.6 million for the three months ended June 30, 2009 and 2008, respectively, and $1.9 million and $1.3 million for the six months ended June 30, 2009 and 2008, respectively.

Legal contingencies

The Company is subject to legal proceedings and claims that have arisen in the ordinary course of business. The Company records an accrual for a contingency when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The Company does not believe the amount of potential liability with respect to these actions will have a material adverse effect upon the Company s financial position, results of operations or cash flows.

10. Income taxes

The Company calculated the provision for income taxes for the six months ended June 30, 2009 using the 2009 projected annual effective tax rate of 38.2%, which excludes period-specific items. The Company s effective tax rate for each of the three months ended June 30, 2009 and 2008, including the effects of period-specific events, was 38.1%, respectively. The Company s effective tax rate for the six months ended June 30, 2009 and 2008, including the effects of period-specific events, was 40.4% and 37.8%, respectively. Period specific items recorded in the three and six months ended June 30, 2009 include an increase of $0.8 million in the valuation allowance for certain state tax credits and net operating loss carryforwards and a correction of an immaterial prior period error of $0.4 million, which reduced income tax expense.

The Company has deferred tax assets for, among other matters, federal net operating loss carryforwards, state net operating loss carryforwards and state tax credits. A portion of the state net operating loss carryforwards and state tax credits have a valuation reserve due to the uncertainty of the future ability to use such carryforwards and credits. Additionally, the Company has a valuation allowance for certain state deferred tax assets acquired from Kintera. During the six months ended June 30, 2009, the Company recorded purchase accounting adjustments related to the deferred tax assets acquired from Kintera and the related valuation allowance, which were reflected in goodwill.

The Company recorded excess tax benefits on stock option exercises and restricted stock vesting of $0.4 million and $0.7 million in stockholders equity during the six months ended June 30, 2009 and 2008, respectively.

The total unrecognized tax benefit that, if recognized, would impact our effective tax rate was $0.2 million as of June 30, 2009 and December 31, 2008. The total amount of interest and penalties included in the consolidated balance sheets as of June 30, 2009 and December 31, 2008 was $0.2 million.

The Company has taken positions in certain taxing jurisdictions for which it is reasonably possible that the total amounts of unrecognized tax benefits may significantly decrease within the next twelve months. The possible decrease could result from the finalization of state income tax reviews and the expiration of statutes of limitations. These positions relate to state nexus issues.

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Blackbaud, Inc.

Notes to consolidated financial statements

(Unaudited)

11. Stock-based compensation

During the six months ended June 30, 2009, the Company issued 39,140 shares of restricted stock. The aggregate grant date fair value of awards issued during the period was $449,000. No stock options or stock appreciation rights were issued in the six months ended June 30, 2009.

The Company allocates stock-based compensation expense to expense categories on the consolidated statements of operations. The following table summarizes stock-based compensation expense for the three and six months ended June 30, 2009 and 2008.

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	2009	2008	2009	2008
Included in cost of revenue:				
Cost of services	$ 360	$ 302	$ 737	$ 652
Cost of maintenance	157	119	314	231
Cost of subscriptions	114	58	233	85
Total included in cost of revenue	631	479	1,284	968
Included in operating expenses:				
Sales and marketing	331	295	671	581
Research and development	686	508	1,397	1,028
General and administrative	1,377	1,037	2,893	2,101
Total included in operating expenses	2,394	1,840	4,961	3,710
Total	$ 3,025	$ 2,319	$ 6,245	$ 4,678

12. Stockholders equity

Dividends

The following table provides information with respect to quarterly dividends paid on common stock during the six months ended June 30, 2009.

Declaration Date	Dividend per Share	Record Date	Payable Date
February 2009	$0.10	February 27	March 13
April 2009	$0.10	May 28	June 15

In July 2009, the Company s Board of Directors declared a third quarter dividend of $0.10 per share payable on September 15, 2009 to stockholders of record on August 28, 2009.

Stock surrenders

During the six months ended June 30, 2009, restricted stock holders surrendered 18,235 shares of common stock, totaling $0.2 million, to satisfy their tax obligations due upon vesting.

13. Segment information

The Company has determined that it has six reportable segments based on the way that management organizes the operating segments within the Company for making operational decisions and assessments of financial performance. Internal financial reports disaggregate certain operating information into six reportable segments. The Company s chief operating decision maker is its chief executive officer, or CEO. The CEO uses the information presented in these reports to make certain operating decisions. The CEO does not review any report presenting segment balance sheet information.

The segment revenues and direct controllable costs, which include salaries, related benefits, third-party contractors, data expense and classroom rentals, for the three and six months ended June 30, 2009 and 2008 were as follows:

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Blackbaud, Inc.

Notes to consolidated financial statements

(Unaudited)

(in thousands)	License fees	Consulting and education services(1)	Analytic services(2)	Maintenance	Subscriptions	Other	Total
Three months ended June 30, 2009							
Revenue	$5,799	$17,420	$5,045	$28,821	$17,773	$1,557	$76,415
Direct controllable costs	891	10,597	2,526	3,969	5,529	1,511	25,023
Segment income	4,908	6,823	2,519	24,852	12,244	46	51,392
Corporate costs not allocated(3)							5,473
Operating expenses							35,078
Interest expense, net							233
Other income, net							(31)
Income before provision for income taxes							$10,639
Three months ended June 30, 2008							
Revenue	$9,603	$20,217	$5,119	$26,371	$9,010	$2,182	$72,502
Direct controllable costs	764	10,529	2,136	3,582	2,961	2,001	21,973
Segment income	8,839	9,688	2,983	22,789	6,049	181	50,529
Corporate costs not allocated(3)							4,181
Operating expenses							31,754
Interest expense, net							114
Other income, net							(49)
Income before provision for income taxes							$14,529

(in thousands)	License fees	Consulting and education services(1)	Analytic services(2)	Maintenance	Subscriptions	Other	Total
Six months ended June 30, 2009							
Revenue	$13,204	$33,481	$10,113	$56,832	$34,496	$3,030	$151,156
Direct controllable costs	1,714	21,831	5,065	7,750	10,739	2,766	49,865
Segment income	11,490	11,650	5,048	49,082	23,757	264	101,291
Corporate costs not allocated(3)							10,909
Operating expenses							71,779
Interest expense, net							596
Other expense, net							130
Income before provision for income taxes							$17,877
Six months ended June 30, 2008							
Revenue	$19,238	$39,492	$9,420	$51,801	$17,795	$4,192	$141,938
Direct controllable costs	1,563	21,562	4,378	7,265	5,801	3,826	44,395
Segment income	17,675	17,930	5,042	44,536	11,994	366	97,543

Corporate costs not allocated[3]	8,502
Operating expenses	63,193
Interest expense, net	19
Other expense, net	40
Income before provision for income taxes	$25,789

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

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

(3) Various corporate costs such as depreciation, facilities and IT support costs, stock-based compensation and amortization of intangibles arising from business combinations are not allocated to the segment income as management believes that the exclusion of these costs allows the Company to better understand and manage other operating expenses and cash needs.

Blackbaud, Inc.

Item 2. Management s discussion and analysis of financial condition and results of operations

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

Executive summary

We are the leading global provider of software and related services designed specifically for nonprofit organizations. Our products and services enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage finances and optimize internal operations. We have focused solely on the nonprofit market since our incorporation in 1982 and have developed our suite of products and services based upon our extensive knowledge of the operating challenges facing nonprofit organizations. As of June 30, 2009, we had approximately 22,000 active customers. Our customers operate in multiple verticals within the nonprofit market, including education, foundations, health and human services, religion, arts and cultural, public and societal benefits, environment and animal welfare and international foreign affairs.

We derive revenue from selling perpetual licenses or charging for the use of our software products in a hosted environment and providing a broad offering of services, including consulting, training, installation and implementation, as well as ongoing customer support and maintenance. Furthermore, we derive revenue from providing hosting services, performing donor prospect research engagements, selling lists of potential donors, and providing benchmarking studies and data modeling services.

Overall, revenue for the second quarter of 2009 and the first six months of 2009 increased 5% and 7% compared to the same periods in 2008, respectively. The inclusion of Kintera, which we acquired in July 2008, resulted in an increase in revenue of $8.4 million and $16.1 million for the second quarter of 2009 and the first six months of 2009, respectively. Excluding the impact of the inclusion of Kintera, revenue decreased by 6% and 5% when comparing the second quarter of 2009 and the first six months of 2009 to the same periods in 2008, respectively. Further, when removing the impact of foreign currency translation, revenue decreased by 4% and 2% when comparing the second quarter of 2009 and the first six months of 2009 to the same periods in 2008, respectively.

Through the first six months of 2009, our selling environment has remained challenging as difficult and uncertain economic conditions continued to put pressure on the spending of many organizations in the nonprofit industry. Revenues associated with our perpetual license offerings and related services decreased compared with the same period in 2008 as a result of these economic conditions and reduced market demand for these offerings. However, during the second quarter of 2009 and the first six months of 2009 compared to the same periods in 2008, our recurring revenue, which is comprised of maintenance services and subscription offerings, continued to experience growth. Revenue from maintenance services and subscription offerings, which represents approximately 60% of our revenue on a combined basis, grew 31%. Approximately 20 percentage points of the 31% revenue growth is attributable to the inclusion of Kintera, for the quarter and six months ended June 30, 2009 compared with the same periods in 2008. Our business has increasingly evolved towards product sales on a subscription offering basis over the past several years and we believe this trend will continue in the future.

In the first six months of 2009, we have focused on closely managing our operating expenses and achieving our targeted level of profitability. Income from operations for the second quarter and the first six months of 2009 decreased by approximately $3.8 million and $7.2 million compared to the same periods in 2008, respectively. The decrease in income from operations is primarily attributable to an increase in stock-based compensation expense, amortization expense associated with intangible assets from our recent acquisitions, research and development expense to support our continuing product investment, and higher operating costs as a result of our acquisition of Kintera.

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Blackbaud, Inc.

Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

We ended the second quarter of 2009 with cash and cash equivalents totaling $18.6 million and outstanding borrowings on our credit facility of $40.5 million. During the first six months of 2009, we generated $34.5 million in cash flow from operations out of which we paid $8.8 million in dividends and repaid $18.5 million on our credit facility. Additionally, cash flow from operations allowed us to increase our cash and cash equivalents by $2.2 million.

We expect to continue to face a challenging economic environment through the remainder of 2009 as we expect that our existing and prospective customers will continue to exercise caution in expenditure decisions. However, we plan to continue to focus on expanding market share, selectively investing in our growth initiatives and strengthening our leadership position. In this environment, we will continue to focus on controlling and, as necessary, reducing the costs and expenses of our operations to achieve our targeted level of profitability.

Results of operations

Comparison of the three and six months ended June 30, 2009 and 2008

During 2008 and 2009 we acquired the following companies at the indicated dates:

Kintera, Inc. (Kintera)	July 8, 2008
RLC Customer Centric Technology B.V. (RLC)	April 29, 2009

The results of operations of Kintera and RLC are included in our consolidated results of operations from the date of their respective acquisition as noted above, which impacts the comparability of our results of operations when comparing 2009 to 2008. We have noted in the discussion below, to the extent meaningful, the impact of the inclusion of Kintera and/or RLC on our results of operations.

Revenue

The table below compares revenue from our statements of operations for the three and six months ended June 30, 2009 with the same periods in 2008.

	Three months ended June 30,				Six months ended June 30,			
(in millions)	**2009**	**2008**	**Change**	**% Change**	**2009**	**2008**	**Change**	**% Change**
License fees	$ 5.8	$ 9.6	$ (3.8)	(40)%	$ 13.2	$ 19.2	$ (6.0)	(31)%
Services	22.5	25.3	(2.8)	(11)%	43.6	48.9	(5.3)	(11)%
Maintenance	28.8	26.4	2.4	9 %	56.8	51.8	5.0	10 %
Subscriptions	17.8	9.0	8.8	98 %	34.5	17.8	16.7	94 %
Other	1.5	2.2	(0.7)	(32)%	3.1	4.2	(1.1)	(26)%
Total revenue	$ 76.4	$ 72.5	$ 3.9	5 %	$ 151.2	$ 141.9	$ 9.3	7 %

Total revenue increased $3.9 million, or 5%, in the second quarter of 2009 compared to the same period in 2008. Excluding the increase in revenue attributable to the inclusion of Kintera of $8.4 million, revenue decreased by $4.5 million, or 6%. The organic decrease in revenue, in the second quarter of 2009 is primarily due to decreases in license fees and services revenue, partially offset by an increase in revenue from our subscription offerings. We also experienced growth in revenue from new maintenance contracts associated with new license agreements and

existing client increases.

Total revenue increased $9.3 million, or 7%, in the first six months of 2009 compared to the same period in 2008. Excluding the increase in revenue attributable to the inclusion of Kintera of $16.1 million, revenue decreased by $6.8 million, or 5%. The organic decrease in revenue is primarily due to decreases in license fees and services revenue, partially offset by an increase in subscription revenue. The increase in subscription revenue is principally due to an increase in demand for our hosting services and online data services.

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Blackbaud, Inc.

Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

During the second quarter and the first six months of 2009, revenue attributable to the inclusion of RLC was $0.4 million.

Segment results

We analyze our business according to our six operating segments as identified in Note 13, which are license fees, consulting and education services, analytic services, maintenance, subscriptions and other. The analyses provided below are presented on a non-GAAP basis before the inclusion of various allocable corporate costs such as depreciation, facilities and IT support costs, stock-based compensation and amortization of intangibles arising from business combinations because, in managing our operations, we believe that the exclusion of these costs allows us to better understand and manage other operating expenses and cash needs. These excluded costs are analyzed separately following the segment results analysis.

License fees

	Three months ended June 30,				Six months ended June 30,			
(in millions)	**2009**	**2008**	**Change**	**% Change**	**2009**	**2008**	**Change**	**% Change**
License fee revenue	$ 5.8	$ 9.6	$ (3.8)	(40)%	$ 13.2	$ 19.2	$ (6.0)	(31)%
Direct controllable cost of license fees	0.9	0.8	0.1	13%	1.7	1.5	0.2	13%
Segment income	$ 4.9	$ 8.8	$ (3.9)	(44)%	$ 11.5	$ 17.7	$ (6.2)	(35)%
Segment margin %	84%	92%			87%	92%		

Revenue from license fees is derived from the sale of our software products under a perpetual license agreement. The decrease in license fee revenue in the second quarter and the first six months of 2009, compared to the same periods in 2008, is principally attributable to longer sales cycle times, delays and postponement of purchasing decisions and overall caution exercised by existing and prospective customers as a result of continued challenges posed by the overall economic environment.

During the second quarter of 2009, license fee revenue decreased by $3.8 million when compared to the same period in 2008. Revenue from both license fees to new customers and sales to existing clients decreased by $1.9 million each.

During the first six months of 2009, license fee revenue decreased by $6.0 million when compared to the same period in 2008. Revenue from license fees to new customers decreased $1.3 million and sales to existing clients decreased by $4.7 million. Additionally, during the first six months of 2009, revenue related to our eCRM offering grew by $1.8 million which was offset by decreases in our core perpetual license product offerings of $7.5 million and other products of $0.3 million.

Direct controllable cost of license fees is principally comprised of third-party software royalties and variable reseller commissions. Cost of license fees in the second quarter and the first six months of 2009 compared to the same periods in 2008 increased primarily due to increases in our third-party software costs.

The decrease in segment margin in the second quarter and first six months of 2009 compared to the same periods in 2008 is the result of a decrease in sales of software while our third-party software costs increased slightly.

Consulting and education services

Three months ended June 30,	Six months ended June 30,

(in millions)	2009	2008	Change	% Change	2009	2008	Change	% Change
Consulting and education services revenue	$ 17.4	$ 20.2	$ (2.8)	(14)%	$ 33.5	$ 39.5	$ (6.0)	(15)%
Direct controllable cost of consulting and education services	10.6	10.5	0.1	1 %	21.8	21.6	0.2	1%
Segment income	$ 6.8	$ 9.7	$ (2.9)	(30)%	$ 11.7	$ 17.9	$ (6.2)	(35)%
Segment margin %	39 %	48 %			35 %	45 %		

Consulting and education services revenue consists of consulting, installation, implementation and education services. Consulting, installation and implementation services involve converting data from a customer s existing system, assisting in file set up and system configuration, and/or process re-engineering. Education services involve customer training activities.

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Blackbaud, Inc.

Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

During the second quarter 2009, consulting and education services revenue decreased $2.8 million as compared to the same period in 2008. Included in consulting and education services revenue in the second quarter of 2009 is $0.4 million of revenue attributable to the inclusion of Kintera. Additionally, $0.1 million of revenue attributable to RLC is included in the consulting and education services revenue for the second quarter of 2009. Excluding the impact of Kintera and RLC, consulting and education services revenue decreased $3.3 million in second quarter 2009 as compared to the same period in 2008. The decrease in revenue is principally the result of decreased volume of consulting, installation and implementation services delivered for our core software products and decreased demand for training services as existing and prospective customers continue to experience budgetary constraints associated with the challenges posed by the overall economic environment. To a lesser extent, the decrease in revenue is attributable to a reduction in the rates we charge as a result of a higher level of discounts offered on our service offerings during the second quarter of 2009 compared to the same period in 2008. During the second quarter these decreases of $5.3 million were partially offset by an increase of $2.0 million in consulting services associated with our new eCRM product offering and our internet-based products.

During the first six months of 2009, consulting and education services revenue decreased $6.0 million as compared to the same period in 2008. Included in consulting and education services revenue in the first six months of 2009 is $0.6 million of revenue attributable to the inclusion of Kintera. Additionally, $0.1 million of revenue attributable to RLC is included in the consulting and education services revenue for the first six months of 2009. Excluding the impact of the inclusion of Kintera and RLC, consulting and education services revenue decreased $6.7 million in the first six months of 2009 as compared to the same period in 2008. The decrease in revenue is principally the result of decreased volume of consulting, installation and implementation services delivered for our core software products and decreased demand for training services as existing and prospective customers continue to experience budgetary constraints associated with the challenges posed by the overall economic environment. To a lesser extent, the decrease in revenue is attributable to a reduction in the rates we charge as a result of a higher level of discounts offered on our service offerings during the first six months of 2009 compared to the same period in 2008. During the first six months of 2009, these decreases of $10.6 million were partially offset by an increase of $3.9 million in consulting services associated with our new eCRM product offering and our internet-based products.

Cost of consulting and education services is principally comprised of human resource costs, third-party contractor expenses, classroom rentals and other costs incurred in providing consulting, installation and implementation services and customer training.

During the second quarter 2009, cost of consulting and education services increased by $0.1 million. Additional headcount and other costs attributable to the inclusion of Kintera represented $0.9 million of the increase in cost of consulting and education services. In addition, costs attributable to RLC were $0.1 million for the second quarter of 2009. Excluding the impact of the inclusion of Kintera and RLC, cost of consulting and education services decreased by $0.9 million in the second quarter of 2009 compared to the same period in 2008. Human resource costs decreased by $0.2 million due to a reduction in headcount, and travel-related expenses, recruiting and other costs decreased $0.7 million.

During the first six months of 2009, cost of consulting and education services increased by $0.2 million. Additional headcount and other costs attributable to the inclusion of Kintera represented $1.8 million of the increase in cost of consulting and education services. In addition, costs attributable to RLC were $0.1 million for the first six months of 2009. During the first six months of 2009, excluding the impact of the inclusion of Kintera and RLC, cost of consulting and education services decreased by $1.7 million compared to the same period in 2008. Human resource costs decreased by $0.7 million due to a reduction in headcount, and travel-related expenses, recruiting and other costs decreased $1.0 million.

The segment margin decrease in the second quarter and first six months of 2009 compared to the same periods in 2008 is principally due to the decrease in demand for consulting and education services while the cost of consulting and education services remained relatively flat.

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Blackbaud, Inc.

Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

Analytic services

(in millions)	Three months ended June 30, 2009	2008	Change	% Change	Six months ended June 30, 2009	2008	Change	% Change
Analytic services revenue	$ 5.1	$ 5.1	$ -	0%	$ 10.1	$ 9.4	$ 0.7	7%
Direct controllable cost of analytic services	2.5	2.1	0.4	19%	5.1	4.4	0.7	16%
Segment income	$ 2.6	$ 3.0	$ (0.4)	(13)%	$ 5.0	$ 5.0	$ -	0%
Segment margin %	51%	59%			50%	53%		

Analytic services are comprised of donor prospect research, selling lists of potential donors, benchmarking studies and data modeling services. These services involve the assessment of current and prospective donor information of the customer and are performed using our proprietary analytical tools. The end product enables the customer to more effectively target its fundraising activities.

During the second quarter 2009, analytic services revenue remained unchanged when compared to the same period in 2008. Included in analytic services revenue in the second quarter of 2009 is $0.3 million of revenue attributable to the inclusion of Kintera. Excluding the impact of the inclusion of Kintera, analytic services revenue decreased $0.3 million in the second quarter of 2009 as compared to the same period in 2008. The rates charged for our analytic services have remained relatively constant year over year and, as such, the remaining decrease in analytic services revenue is principally the result of the decreased volume of services provided.

During the first six months of 2009, analytic services revenue increased by $0.7 million when compared to the same period in 2008. Included in analytic services revenue in the first six months of 2009 is $0.8 million of revenue attributable to the inclusion of Kintera. Excluding the impact of the inclusion of Kintera, analytic services revenue decreased $0.1 million in the first six months of 2009 as compared to the same period in 2008. The rates charged for our analytic services have remained relatively constant year over year and, as such, the remaining decrease in analytic services revenue is principally the result of the decreased volume of services provided.

Cost of analytic services is primarily comprised of human resource costs and data expense incurred to perform analytic services. The increase in cost of analytic services for the second quarter of 2009 and the first six months of 2009 compared to the same periods in 2008 is primarily attributable to human resource costs associated with additional headcount and other costs attributable to the inclusion of Kintera.

The decrease in analytic services margin in the second quarter and first six months of 2009 compared to the same periods in 2008 is primarily due to a decrease in demand for our analytic services while the cost of analytic services slightly increased.

Maintenance

(in millions)	Three months ended June 30, 2009	2008	Change	% Change	Six months ended June 30, 2009	2008	Change	% Change
Maintenance revenue	$ 28.8	$ 26.4	$ 2.4	9%	$ 56.8	$ 51.8	$ 5.0	10%
Direct controllable cost of maintenance	4.0	3.6	0.4	11%	7.7	7.3	0.4	5%
Segment income	$ 24.8	$ 22.8	$ 2.0	9%	$ 49.1	$ 44.5	$ 4.6	10%

Segment margin %	86%	86%	86%	86%

Revenue from maintenance is comprised of annual fees derived from maintenance contracts associated with new software licenses and annual renewals of existing maintenance contracts. These contracts provide customers with updates, enhancements and upgrades to our software products and online, telephone and email support.

During the second quarter 2009, maintenance revenue increased $2.4 million when compared to the same period in 2008. Included in maintenance revenue in the second quarter of 2009 is $1.4 million of revenue attributable to the inclusion of Kintera. Additionally, $0.1 million of revenue attributable to RLC is included in maintenance revenue for the second quarter of 2009. Excluding the impact of the inclusion of Kintera and RLC, maintenance revenue increased $0.9 million in the second quarter of 2009 as compared to the same period in 2008. The increase of $0.9 million is comprised of $1.4 million from new maintenance contracts with new customers associated with new license agreements and increases in contracts with existing customers and $1.0 million from maintenance contract inflationary rate adjustments, offset by $1.5 million of maintenance contracts that were not renewed.

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Blackbaud, Inc.

Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

During the first six months of 2009, maintenance revenue increased $5.0 million when compared to the same period in 2008. Included in maintenance revenue in the first six months of 2009 is $2.8 million of revenue attributable to the inclusion of Kintera. Additionally, $0.1 million of revenue attributable to RLC is included in maintenance revenue for the first six months of 2009. Excluding the impact of the inclusion of Kintera and RLC, maintenance revenue increased $2.1 million in the first six months of 2009 as compared to the same period in 2008. The increase of $2.1 million is comprised of $3.0 million of new maintenance with new customers associated with new license agreements and increases in contracts with existing customers and $1.8 million from maintenance contract inflationary rate adjustments, offset by $2.7 million of maintenance contracts that were not renewed.

Direct controllable cost of maintenance is primarily comprised of human resource costs, third-party contractor expenses, third-party royalty costs and other costs incurred in providing support and related services to our customers. The increase in cost of maintenance in the second quarter and first six months of 2009 compared to the same periods in 2008 is principally the result of an increase in human resources costs attributable to additional headcount associated with Kintera.

The maintenance segment margin remained unchanged during the second quarter and first six months of 2009 compared to the same periods in 2008.

Subscriptions

(in millions)	Three months ended June 30, 2009	2008	Change	% Change	Six months ended June 30, 2009	2008	Change	% Change
Subscriptions revenue	$ 17.8	$ 9.0	$ 8.8	98%	$ 34.5	$ 17.8	$ 16.7	94%
Direct controllable cost of subscriptions	5.5	3.0	2.5	83%	10.7	5.8	4.9	84%
Segment income	$ 12.3	$ 6.0	$ 6.3	105%	$ 23.8	$ 12.0	$ 11.8	98%
Segment margin %	69%	67%			69%	67%		

Revenue from subscriptions is principally comprised of revenue from providing hosting services and access to hosted applications, access to certain data services and our online subscription training offerings.

Subscriptions revenue increased $8.8 million during the second quarter 2009 as compared to the same period in 2008. Included in subscriptions revenue in the second quarter of 2009 is $6.2 million of revenue attributable to the inclusion of Kintera s revenue from hosted applications. Excluding the impact of Kintera, subscription revenue increased $2.6 million in the second quarter 2009 as compared to the same period in 2008. The increase of $2.6 million is attributable to organic growth from increased demand for hosting services and other online data services.

Subscriptions revenue increased $16.7 million during the first six months of 2009 as compared to the same period in 2008. Included in subscriptions revenue in the first six months of 2009 is $11.7 million of revenue attributable to the inclusion of Kintera s revenue from hosted applications. Excluding the impact of Kintera, subscription revenue increased $5.0 million in the first six months of 2009 as compared to the same period in 2008. The increase of $5.0 million is attributable to organic growth from increased demand for hosting services and other online data services.

Direct controllable cost of subscriptions is primarily comprised of human resource costs, third-party royalty and data expenses, hosting expenses, and other costs incurred in providing support and services to our customers.

During the second quarter 2009, cost of subscriptions increased by $2.5 million when compared to the same period in 2008. Additional headcount and increases in data expense, hosting and other costs attributable to the inclusion of Kintera represented $2.0 million of the increase in costs of subscriptions. Excluding the impact of the inclusion of Kintera, cost of subscriptions increased by $0.5 million in the second quarter

of 2009 compared to the same period in 2008. The increase of $0.5 million in cost of subscriptions is principally due to an increase in data expense, hosting and other costs.

During the first six months of 2009, cost of subscriptions increased by $4.9 million when compared to the same period in 2008. Additional headcount and increases in data expense, hosting and other costs attributable to the inclusion of Kintera represented $4.0 million of the increase in costs of subscriptions. Excluding the impact of the inclusion of Kintera, cost of subscriptions increased by $0.9 million in the first six months of 2009 compared to the same period in 2008. The increase of $0.9 million in cost of subscriptions is principally due to an increase in data expense, hosting and human resource costs.

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Blackbaud, Inc.

Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

The increase in subscriptions segment margin during the second quarter and the first six months of 2009 compared to the same periods in 2008 is predominantly due to an increase in demand for our internet products and our continued focus on closely managing our operating costs.

Other revenue

(in millions)	Three months ended June 30, 2009	2008	Change	% Change	Six months ended June 30, 2009	2008	Change	% Change
Other revenue	$ 1.5	$ 2.2	$ (0.7)	(32)%	$ 3.1	$ 4.2	$ (1.1)	(26)%
Direct controllable cost of other revenue	1.5	2.0	(0.5)	(25)%	2.9	3.8	(0.9)	(24)%
Segment income	$ -	$ 0.2	$ (0.2)	(100)%	$ 0.2	$ 0.4	$ (0.2)	(50)%
Segment margin %	0%	9%			6%	10%		

Other revenue includes the sale of business forms that are used in conjunction with our software products; reimbursement of travel and related expenses, primarily incurred during the performance of services at customer locations; fees from user conferences; and sale of hardware in conjunction with The Patron Edge. Other revenue decreased in the second quarter and the first six months of 2009 primarily due to a decrease in reimbursable travel-related costs from our services businesses and a decrease in fees from user conferences.

Direct controllable cost of other revenue includes human resource costs, costs of business forms, costs of user conferences and reimbursable expense relating to the performance of services at customer locations. The decrease in the second quarter and the first six months of 2009 compared to the same periods in 2008 is due to a decrease in reimbursable expenses related to providing services at customer locations and a decrease in the costs of user conferences.

U.S. GAAP gross profit

Segment income does not include an allocation of corporate costs, stock-based compensation expense and amortization expense. The following schedule reconciles total segment income to gross profit as stated on the statements of operations.

(in millions)	Three months ended June 30, 2009	2008	Change	% Change	Six months ended June 30, 2009	2008	Change	% Change
License fees	$ 4.9	$ 8.8	$ (3.9)	(44)%	$ 11.5	$ 17.7	$ (6.2)	(35)%
Consulting and education services	6.8	9.7	(2.9)	(30)%	11.7	17.9	(6.2)	(35)%
Analytic services	2.6	3.0	(0.4)	(13)%	5.0	5.0	-	0%
Maintenance	24.8	22.8	2.0	9%	49.1	44.5	4.6	10%
Subscriptions	12.3	6.0	6.3	105%	23.8	12.0	11.8	98%
Other	-	0.2	(0.2)	(100)%	0.2	0.4	(0.2)	(50)%
Total segment income	$ 51.4	$ 50.5	$ 0.9	2%	$ 101.3	$ 97.5	$ 3.8	4%
Less corporate costs not allocated to segment expenses:								
Stock-based compensation expense	0.6	0.5	0.1	20%	1.2	1.0	0.2	20%

Amortization of intangible assets acquired in business combinations	1.6	0.9	0.7	78%	3.1	1.8	1.3	72%
Corporate overhead costs	3.3	2.8	0.5	18%	6.6	5.7	0.9	16%
Gross profit as stated in statements of operations	$ 45.9	$ 46.3	$ (0.4)	(1)%	$ 90.4	$ 89.0	$ 1.4	2%
Gross margin %	60%	64%			60%	63%		

Stock-based compensation expense and amortization expense are analyzed separately following the operating expenses section.

Allocated corporate overhead costs are comprised of depreciation, facilities and IT support costs. The increase in corporate overhead costs allocated to cost of revenue during the second quarter of 2009 and the first six months of 2009 is primarily attributable to the increase in facilities costs associated with the inclusion of Kintera.

Operating expenses

The operating expenses analyzed below are presented on a non-GAAP basis; that is, they exclude stock-based compensation expense. We believe that the exclusion of these costs allows us to better understand and manage other operating expenses and cash needs. Stock-based compensation expense is analyzed, in total, in the section following the operating expense analysis.

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Sales and marketing

(in millions)	Three months ended June 30, 2009	2008	Change	% Change	Six months ended June 30, 2009	2008	Change	% Change
Sales and marketing expense excluding stock-based compensation	$ 14.8	$ 15.4	$ (0.6)	(4)%	$ 30.5	$ 30.3	$ 0.2	1%
Add: Stock-based compensation	0.3	0.3	-	0%	0.7	0.6	0.1	17%
Sales and marketing expense	$ 15.1	$ 15.7	$ (0.6)	(4)%	$ 31.2	$ 30.9	$ 0.3	1%
% of revenue (excluding stock-based compensation)	19%	21%			20%	21%		

Sales and marketing expense includes salaries and related human resource costs, travel-related expenses, sales commissions, advertising and marketing materials, public relations and an allocation of depreciation, facilities and IT support costs.

During the second quarter of 2009, sales and marketing expense decreased $0.6 million when compared to the same period in 2008. Included in sales and marketing expense in the second quarter of 2009 is $1.3 million of human resource and other costs attributable to the inclusion of Kintera. Excluding the sales and marketing expense attributable to Kintera, sales and marketing expense decreased $1.9 million. The remaining decrease of $1.9 million is primarily attributable to decreases in human resource costs of $0.5 million, commission expense of $0.5 million and $0.9 million of travel-related expenses and other sales and marketing related costs.

During the first six months of 2009, sales and marketing expense increased $0.2 million when compared to the same period in 2008. Included in sales and marketing expense in the first six months of 2009 is $2.8 million of human resource and other costs attributable to the inclusion of Kintera. Excluding the sales and marketing expense attributable to Kintera, sales and marketing expense decreased $2.6 million. The remaining decrease of $2.6 million is primarily attributable to decreased human resource costs of $0.3 million, commission expense of $1.0 million and a reduction in travel-related expenses and other sales and marketing related costs of $1.3 million.

Human resource, travel-related and other costs decreased in both periods as a result of our focus on closely managing our operating expenses during the first six months of 2009. Commission expense in both periods decreased due to lower commissionable sales.

As a percentage of revenue, sales and marketing expense in the second quarter and the first six months of 2009 decreased compared to the same periods in 2008, principally due to a decrease in commission expense associated with the decline in license fees and services revenue and a decrease in travel-related expenses.

Research and development

(in millions)	Three months ended June 30, 2009	2008	Change	% Change	Six months ended June 30, 2009	2008	Change	% Change
Research and development expense excluding stock-based compensation	$ 10.6	$ 8.1	$ 2.5	31%	$ 21.4	$ 16.4	$ 5.0	30%
Add: Stock-based compensation	0.7	0.5	0.2	40%	1.4	1.0	0.4	40%

Research and development expense	$	11.3	$	8.6	$	2.7	31%	$	22.8	$	17.4	$	5.4	31%
% of revenue (excluding stock-based compensation)		14%		11%					14%		12%			

Research and development expenses include human resource costs, third-party contractor expenses, software development tools and other expenses related to developing new products, upgrading and enhancing existing products and an allocation of depreciation, facilities and IT support costs. Research and development costs increased during the second quarter and the first six months of 2009 principally due to an increase in headcount associated with our increased investment in our products.

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Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

During the second quarter of 2009, research and development costs increased $2.5 million when compared to the same period in 2008. The increase in research and development costs attributable to human resource costs was $2.2 million, of which $1.6 million is due to the inclusion of Kintera. The remaining increase of $0.3 million is attributable to higher allocated costs.

During the first six months of 2009, research and development costs increased $5.0 million when compared to the same period in 2008. The increase in research and development costs attributable to an increase in human resource costs was $4.5 million, of which $3.2 million is due to the inclusion of Kintera. Further increases of $0.6 million are attributable to higher allocated costs, partially offset by decreased recruiting costs of $0.1 million.

Research and development expense as a percentage of revenue increased in the second quarter 2009 and the first six months of 2009 compared to the same periods in 2008 primarily due to an increased investment in our product initiatives.

General and administrative

(in millions)	Three months ended June 30, 2009	Three months ended June 30, 2008	Change	% Change	Six months ended June 30, 2009	Six months ended June 30, 2008	Change	% Change
General and administrative expense excluding stock-based compensation	$ 7.1	$ 6.3	$ 0.8	13%	$ 14.6	$ 12.4	$ 2.2	18%
Add: Stock-based compensation	1.4	1.0	0.4	40%	2.9	2.1	0.8	38%
General and administrative expense	$ 8.5	$ 7.3	$ 1.2	16%	$ 17.5	$ 14.5	$ 3.0	21%
% of revenue (excluding stock-based compensation)	9%	9%			10%	9%		

General and administrative expense consists primarily of human resource costs for general corporate functions, including finance, accounting, legal, human resources, corporate development, third-party professional fees, insurance, an allocation of depreciation, facilities and IT support costs, and other administrative expenses.

During the second quarter of 2009 and the first six months of 2009 compared to the same periods in 2008, the increase in general and administrative expense was primarily due to an increase in human resource costs attributed to the inclusion of Kintera. Excluding the costs attributable to Kintera, general and administrative expense decreased by $0.1 million for the second quarter 2009 and remained unchanged for the first six months of 2009 compared to the same periods in 2008.

As a percentage of revenue, general and administrative costs increased by one percentage point in the first six months of 2009 compared to the same period in 2008 due to the increased headcount associated with the acquisition of Kintera.

Stock-based compensation

Beginning on January 1, 2006, we adopted SFAS No. 123(R), using the modified prospective transition method. SFAS No. 123(R) requires us to recognize compensation expense related to stock-based awards granted to employees. Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is the vesting period.

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Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

Our consolidated statements of operations for the three and six months ended June 30, 2009 and 2008 include the amounts of stock-based compensation illustrated below:

	Three months ended June 30,				Six months ended June 30,			
(in millions)	**2009**	**2008**	**Change**	**% Change**	**2009**	**2008**	**Change**	**% Change**
Included in cost of revenue:								
Cost of services	$ 0.4	$ 0.3	$ 0.1	33 %	$ 0.7	$ 0.7	$ -	- %
Cost of maintenance	0.1	0.1	-	- %	0.3	0.2	0.1	50 %
Cost of subscriptions	0.1	0.1	-	- %	0.2	0.1	0.1	100 %
Total included in cost of revenue	0.6	0.5	0.1	20 %	1.2	1.0	0.2	20 %
Included in operating expenses:								
Sales and marketing	0.3	0.3	-	- %	0.7	0.6	0.1	17 %
Research and development	0.7	0.5	0.2	40 %	1.4	1.0	0.4	40 %
General and administrative	1.4	1.0	0.4	40 %	2.9	2.1	0.8	38 %
Total included in operating expenses	2.4	1.8	0.6	33 %	5.0	3.7	1.3	35 %
Total	$ 3.0	$ 2.3	$ 0.7	30 %	$ 6.2	$ 4.7	$ 1.5	32 %

Stock-based compensation is comprised of expense from common stock awards, stock options, restricted stock awards and stock appreciation rights. The table below summarizes the stock-based compensation by award type for the three and six months ended June 30, 2009 and 2008.

	Three months ended June 30,				Six months ended June 30,			
(in millions)	**2009**	**2008**	**Change**	**% Change**	**2009**	**2008**	**Change**	**% Change**
Stock-based compensation from:								
Common stock	$ 0.2	$ -	$ 0.2	- %	$ 0.7	$ -	$ 0.7	- %
Stock options	0.1	0.3	(0.2)	(67) %	0.1	0.7	(0.6)	(86) %
Restricted stock awards	2.1	1.5	0.6	40 %	4.2	3.1	1.1	35 %
Stock appreciation rights	0.6	0.5	0.1	20 %	1.2	0.9	0.3	33 %
Total stock-based compensation	$ 3.0	$ 2.3	$ 0.7	30 %	$ 6.2	$ 4.7	$ 1.5	32 %

During the second quarter and the first six months of 2009, we expensed $0.2 million and $0.7 million, respectively, related to compensation and incentive arrangements payable in common stock associated with business acquisitions completed in 2007 and 2008. The decrease in compensation expense from stock options for the second quarter and the first six months of 2009 compared to the same periods in 2008 is the result of using the accelerated method for recognizing stock-based compensation expense associated with stock options, which results in the recognition of more expense in the earlier periods of vesting when compared with the straight-line method. We have not granted stock options

since 2005 and all historical awards will be fully vested by the end of 2009.

Stock-based compensation expense from restricted stock awards and stock appreciation rights increased in the second quarter and the first six months of 2009 compared to the same periods in 2008 due to the issuance of additional grants in the second half of 2008, partially offset by the vesting of grants issued in prior years.

The total amount of compensation costs related to non-vested awards not yet recognized was $21.8 million as of June 30, 2009. This amount will be recognized as expense over a weighted average period of 1.7 years.

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Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

Amortization

We allocated amortization expense to cost of revenue according to the nature of the respective identifiable intangible asset and to the extent it is directly associated with revenue. Amortization expense included in our consolidated statements of operations for the three and six months ended June 30, 2009 and 2008 is illustrated below:

	Three months ended June 30,				Six months ended June 30,			
(in millions)	**2009**	**2008**	**Change**	**% Change**	**2009**	**2008**	**Change**	**% Change**
Included in cost of revenue:								
Cost of license fees	$ 0.1	$ 0.1	$ -	- %	$ 0.2	$ 0.1	$ 0.1	100 %
Cost of services	0.4	0.3	0.1	33 %	0.7	0.7	-	- %
Cost of maintenance	0.3	0.1	0.2	200 %	0.6	0.2	0.4	200 %
Cost of subscriptions	0.8	0.4	0.4	100 %	1.6	0.8	0.8	100 %
Cost of other revenue	-	-	-	- %	-	-	-	- %
Total included in cost of revenue	1.6	0.9	0.7	78 %	3.1	1.8	1.3	72 %
Included in operating expenses	0.2	0.2	-	- %	0.4	0.3	0.1	33 %
Total	$ 1.8	$ 1.1	$ 0.7	$ 64 %	$ 3.5	$ 2.1	$ 1.4	$ 67 %

The increase in amortization expense for the second quarter and the first six months of 2009 compared to the same periods in 2008 is directly attributable to the acquisition of Kintera in July 2008, which resulted in the recognition of $17.0 million in identifiable intangible assets.

Interest expense

Interest expense was $0.3 million in the second quarter of 2009 compared with $0.1 million in the same period in 2008. Interest expense was $0.7 million in the first six months of 2009 compared with $0.2 million in the same period in 2008. These increases are directly related to the greater amount and duration of borrowing outstanding under our credit facility during the first half of 2009 compared to 2008.

Income tax provision

We record income tax expense in our consolidated financial statements based on an estimated annual effective income tax rate, prior to any quarter-specific items. The 2009 estimated annual effective tax rate of 38.2%, which excludes period-specific items, was applied as the effective rate for the six months ended June 30, 2009. Our actual effective rate for the each of the quarters ended June 30, 2009 and 2008 was 38.1%. Our actual effective rates for each of the six months ended June 30, 2009 and 2008 were 40.4% and 37.8%, respectively. The higher effective rate in the first six months of 2009 was attributable to a decrease in the amount of benefit we were able to recognize for certain state income tax credits, partially offset by a correction of an immaterial prior period error which reduced income tax expense by $0.4 million.

Our deferred tax assets and liabilities are recorded at an amount based upon a U.S. federal income tax rate of 35.0% and appropriate statutory tax rates of various foreign, state and local jurisdictions in which we operate. If our tax rates change in the future, we will adjust our deferred tax assets and liabilities to an amount reflecting those income tax rates. Any change will affect the provision for income taxes during the period in which the determination is made.

The total unrecognized tax benefit that, if recognized, would have impacted our effective rate as of June 30, 2009 and December 31, 2008 was $0.2 million. As of June 30, 2009 and December 31, 2008, the total amount of accrued interest and penalties included in the consolidated balance sheets was $0.2 million.

We have taken positions in certain taxing jurisdictions for which it is reasonably possible that the total amounts of unrecognized tax benefits may significantly change in the next twelve months. The possible decrease could result from the finalization of state income tax reviews and the expiration of statutes of limitations.

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Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

Liquidity and capital resources

At June 30, 2009, cash and cash equivalents totaled $18.6 million, compared to $16.4 million at December 31, 2008. The $2.2 million increase in cash and cash equivalents during the first six months of 2009 is principally the result of generating $34.5 million of cash from operations offset by $18.5 million in debt repayments on our credit facility, $8.8 million in dividends paid to stockholders and $2.3 million used to acquire RLC.

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

At June 30, 2009, outstanding borrowings under our credit facility were $40.5 million. We have drawn on our credit facilities from time to time to help us meet short-term financial needs, such as business acquisitions and share repurchases. Under our credit facility, we may elect not more than twice over the five-year term of the agreement to increase the aggregate amount available up to $50.0 million. We exercised one of these options for an additional $15.0 million in June 2008, which increased our aggregate amount available to $90.0 million. We believe our credit facility provides us with the financial flexibility that we need because of its size and terms. During the first six months of 2009, we were focused on generating cash flow from operations to allow us to maintain our cash and cash equivalents balance to a desired level of liquidity and repay borrowings. We plan to continue to focus on generating cash flow from operations during the remainder of 2009, which should enable us to maintain our desired level of liquidity to preserve financial flexibility, while also reducing our debt balance.

Operating cash flow

Net cash provided by operating activities for the first six months of 2009 of $34.5 million increased $13.1 million when compared to the same period in 2008. Throughout both periods, our cash flows from operations were derived principally from: (i) our earnings from on-going operations prior to non-cash expenses such as depreciation, amortization and stock-based compensation and adjustments to our provision for sales returns and allowances; (ii) the tax benefit associated with our deferred tax asset, which reduces our cash outlay for income tax; and (iii) changes in our working capital.

Working capital changes that impact the statement of cash flows are in accounts receivable, other current assets, accounts payable, accrued expenses, accrued liabilities and deferred revenue. Net collections of accounts receivable and the change in deferred revenue represented a net increase of $5.2 million in the first six months of 2009 and a net decrease of $7.7 million in the first six months of 2008 in cash associated with working capital changes. The increase in cash associated with these working capital changes is principally due to a difference in the timing of maintenance billings when comparing 2009 to 2008. In the second quarter 2008, a substantial portion of customer billings were delayed in timing due to our conversion to a new accounting system in April 2008. Changes in our balances of accounts payable, accrued expenses, accrued liabilities and other current assets represented a net increase of $0.5 million in the first six months of 2009 and a net decrease of $1.3 million in the first six months of 2008 in cash associated with working capital changes. The primary driver of the decrease in the net cash outflow associated with these accounts is fluctuations in the timing of vendor and income taxes payments.

Investing cash flow

Net cash used in investing activities in the first six months of 2009 was $4.9 million compared to $5.9 million in the same period in 2008. The decrease in cash used for investing activities was principally due to a decrease in payments related to business acquisitions and property and equipment. We invested $2.3 million in the acquisition of RLC during the first six months of 2009. In the first six months of 2008, $2.9 million of cash was used for payment of contingent purchase price obligations under arrangements associated with historical acquisitions, including the Target Companies and Campagne. In addition, we invested $2.7 million in property and equipment in the first six months of 2009 compared to $3.0 million in the same period in 2008.

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Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

Financing cash flow

Net cash used in financing activities for the first six months of 2009 was $27.3 million compared to $20.3 million in the same period in 2008. The increase in cash used in financing activities for the first six months of 2009 is primarily due to the repayment of borrowings under our credit facility. In the first six months of 2008, we borrowed funds which were principally used to repurchase our stock. These amounts partially offset each other when determining the cash used in or generated from financing activities.

Commitments and contingencies

As of June 30, 2009, we had $42.3 million of outstanding debt and future minimum lease commitments of $71.5 million as follows (amounts in millions):

					Payments due by period
		Less than 1			More than 5
	Total	year	1-3 years	3-5 years	years
Operating leases	$ 71.1	$ 4.2	$ 13.0	$ 10.2	$ 43.7
Capital leases	0.4	0.2	0.2	-	-
Debt and interest	42.8	42.0	0.8	-	-
Total	$ 114.3	$ 46.4	$ 14.0	$ 10.2	$ 43.7

Our commitments related to operating leases as shown above have not been reduced by the future minimum lease commitments under sublease agreements that expire in 2010. The outstanding debt of $40.5 million under our credit facility is reflected in the table above as a commitment for less than one year based on the maturities of the underlying individual borrowings. However, we have the ability to extend the maturities of these borrowings by rolling them into new borrowings with the same or longer maturities through the expiration of the credit facility in July 2012.

Included in the table above is interest expense of $0.5 million. The actual interest expense recognized in our consolidated statements of operations will depend on the amount of debt, interest rate and length of time the debt is outstanding, which could be different from our assumptions used in the table above.

As of June 30, 2009, we had accrued an estimate of $0.2 million related to contingent consideration in connection with the acquisition of RLC. Please refer to Note 3 in our notes to the consolidated financial statements for further information. We are unable to determine the actual amount, if any, for which this liability will be settled, and accordingly, we have not included this amount in the table above.

As of June 30, 2009, we had accrued $0.3 million of state taxes and $0.2 million of interest and penalties related to uncertain tax positions taken in current and prior years. Please refer to Note 10 in our notes to the consolidated financial statements for further information. We are unable to determine the period in which these liabilities will be settled, and accordingly, we have not included these amounts in the table above.

We utilize third-party relationships in conjunction with our products. The contractual arrangements vary in length from one to three years. In certain cases, these arrangements require a minimum annual purchase commitment. The total minimum purchase commitments under these arrangements at June 30, 2009 are $1.6 million through 2012. We incurred expense under these arrangements of $0.9 million and $0.6 million for the three months ended June 30, 2009 and 2008, respectively, and $1.9 million and $1.3 million for the six months ended June 30, 2009 and 2008, respectively.

In February 2009, our Board of Directors approved our annual dividend of $0.40 per share for 2009. Dividends at the annual rate would aggregate to $17.6 million, assuming 44 million shares of common stock are outstanding. Our ability to continue to declare and pay dividends may be restricted by, among other things, the terms of our credit facility, general economic conditions and our ability to generate operating cash flow.

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Item 2. Management s discussion and analysis of financial condition and results of operations (continued)

Off-balance sheet arrangements

We do not believe we currently have any off-balance sheet arrangements, financings or other relationships with unconsolidated entities or other persons.

Foreign currency exchange rates

Approximately 12% of our total net revenue for the six-month period ended June 30, 2009 was derived from operations outside the United States. We do not have significant operations in countries in which the economy is considered to be highly inflationary. Our consolidated financial statements are denominated in U.S. dollars and, accordingly, changes in the exchange rate between foreign currencies and the U.S. dollar will affect the translation of our subsidiaries financial results into U.S. dollars for purposes of reporting our consolidated financial results. The accumulated currency translation adjustment, recorded as a separate component of stockholders equity, was $0.2 million and $0.9 million at June 30, 2009 and at December 31, 2008, respectively.

The vast majority of our contracts are entered into by our U.S., Canadian or U.K. entities. The contracts entered into by the U.S. entity are almost always denominated in U.S. dollars, contracts entered into by our Canadian subsidiary are generally denominated in Canadian dollars, and contracts entered into by our U.K. subsidiary, Australian subsidiary and Netherlands subsidiary are generally denominated in pounds sterling, Australian dollar and euro, respectively. Historically, as the U.S. dollar weakened, foreign currency translation resulted in an increase in our reported revenues and expenses denominated in non-U.S. currencies. Recently, the U.S. dollar has strengthened against many non-U.S. currencies, including the British pound and Canadian dollar. As a result, the foreign currency translation has since resulted in a decrease in our reported revenues and expenses denominated in non-U.S. currencies. Though we do not believe our increased exposure to currency exchange rates have had a material impact on our results of operations or financial position, we intend to continue to monitor such exposure and take action as appropriate.

Cautionary statement

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

Statements contained in this Form 10-Q that are not historical facts are or might constitute forward-looking statements under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Although we believe the expectations reflected in such forward-looking statements are based on reasonable assumptions, we can give no assurance that our expectations will be attained. Forward-looking statements involve known and unknown risks that could cause actual results to differ materially from expected results. Factors that could cause actual results to differ materially from our expectations expressed in the report include general economic risk; lengthy sales and implementation cycles, particularly in larger organizations; uncertainty regarding increased business and renewals from existing customers; continued success in sales growth; risk associated with successful implementation of multiple integrated software products; management of integration of recently acquired companies and other risks associated with acquisitions; the ability to attract and retain key personnel; risks related to our dividend policy and stock repurchase program, including potential limitations on our ability to grow and the possibility that we might discontinue payment of dividends; risks relating to restrictions imposed by the credit facility; risks associated with management of growth; technological changes that make our products and services less competitive; and the other risk factors set forth from time to time in our other SEC filings. For more detail, see Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008.

Item 3. Quantitative and qualitative disclosures about market risk

We have market rate sensitivity for interest rates and foreign currency exchange rates. Our variable rate debt is our primary financial instrument with market risk exposure for changing interest rates. We manage interest rate risk

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through a combination of short-term and long-term borrowings and a mix between borrowings indexed at prime, federal funds and LIBOR rates. Due to the nature of our short-term investments and debt, we have concluded that we face no material market risk exposure. Therefore, no quantitative tabular disclosures are required. For a discussion of our exposure to foreign currency exchange rate fluctuations, see the Foreign currency exchange rates section of Management s discussion and analysis of financial condition and results of operations in this report.

Item 4. Controls and procedures

Evaluation of disclosure controls and procedures

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

Changes in internal control over financial reporting

As previously reported and as further discussed in our Annual Report on Form 10-K dated December 31, 2008, we acquired Kintera on July 8, 2008. Management is in the process of assessing and integrating internal control over financial reporting for the acquisition. No change in internal control over financial reporting occurred during the most recent fiscal quarter with respect to our operations, which has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Blackbaud, Inc.

PART II. OTHER INFORMATION

Item 2. Unregistered sales of equity securities and use of proceeds

The following table provides information about shares of common stock repurchased during the three months ended June 30, 2009 under our stock repurchase program, as well as common stock withheld by us to satisfy tax obligations of employees due upon vesting of restricted stock.

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plan or programs (in thousands)
Beginning balance, April 1, 2009				$30,770
April 1, 2009 through April 30, 2009	-	-	-	$30,770
May 1, 2009 through May 31, 2009	636	$14.98	-	$30,770
June 1, 2009 through June 30, 2009	133	$15.39	-	$30,770
Total	769	$15.05	-	$30,770

(1) During the period, there were no shares repurchased. The shares represent shares withheld by us to satisfy the tax obligations of employees due upon vesting of restricted stock.

Item 4. Submission of matters to a vote of security holders

Our stockholders voted on three items at the 2009 Annual Meeting of Stockholders held on June 16, 2009:

1. The election of two Class B directors for a three-year term expiring in 2012;
2. The approval of our Amended and Restated Certificate of Incorporation; and
3. The approval of the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2009.

The nominees for directors were elected based upon the following votes:

Nominee	Votes for	Votes withheld
George H. Ellis	41,089,612	151,375
Andrew M. Leitch	41,089,059	151,928

Marc E. Chardon and John P. McConnell continued their terms as Class C directors, with terms expiring in 2010, and Timothy Chou, Marco W. Hellman and Carolyn Miles continued their terms as Class A directors, with terms expiring in 2011.

Our Amended and Restated Certificate of Incorporation was approved as follows:

Votes for	Votes against	Abstentions	Broker non-votes
29,608,944	8,706,133	912,384	2,013,526

Blackbaud, Inc.

PART II. OTHER INFORMATION

The appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm was approved as follows:

Votes for	Votes against	Abstentions
41,133,402	71,613	35,971

Item 6. Exhibits

Exhibits:

10.42*	Share Purchase Agreement between RLC Group B.V., as the Seller, and Blackbaud, Inc., as the Purchaser.
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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* The registrant has requested confidential treatment with respect to portions of this exhibit. Those portions have been omitted from the exhibit and filed separately with the U.S. Securities and Exchange Commission.

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Blackbaud, Inc.

SIGNATURES

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

	BLACKBAUD, INC.
Date: August 7, 2009	By: /s/ Marc E. Chardon Marc E. Chardon President and Chief Executive Officer
Date: August 7, 2009	By: /s/ Timothy V. Williams Timothy V. Williams Senior Vice President and Chief Financial Officer