Turning Point Brands, Inc.
Form 10-Q
May 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from_______________ to ________________

Commission file number: 001-37763

TURNING POINT BRANDS, INC.
(Exact name of registrant as specified in its charter)

Delaware	20-0709285
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
5201 Interchange Way, Louisville, KY	40229
(Address of principal executive offices)	(Zip Code)

(502) 778-4421
(Registrant's telephone number, including area code)

Former name, former address and former fiscal year, if changed since last report: not applicable

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

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

At May 3, 2018, there were 19,237,905 shares outstanding of the registrant's voting common stock, par value $0.01 per share.

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Cautionary Note Regarding Forward-Looking Statements

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. Forward-looking statements may generally be identified by the use of words such as "anticipate," "believe," "expect," "intend," "plan," and "will" or, in each case, their negative, or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. By their nature, forward-looking statements involve risks and uncertainties because they relate to events, and depend on circumstances, that may or may not occur in the future. As a result, actual events may differ materially from those expressed in, or suggested by, the forward-looking statements. Any forward-looking statement made by Turning Point Brands, Inc. (“TPB”), in this quarterly report on Form 10-Q speaks only as of the date hereof. New risks and uncertainties come up from time to time, and it is impossible for TPB to predict these events or how they may affect it. TPB has no obligation, and does not intend, to update any forward-looking statements after the date hereof, except as required by federal securities laws. Factors that could cause these differences include, but are not limited to:

- declining sales of tobacco products, and expected continuing decline of sales, in the tobacco industry overall;
- our dependence on a small number of third-party suppliers and producers;
- the possibility that we will be unable to identify or contract with new suppliers or producers in the event of a supply or product disruption;
- the possibility that our licenses to use certain brands or trademarks will be terminated, challenged or restricted;
- failure to maintain consumer brand recognition and loyalty of our customers;
- substantial and increasing U.S. regulation;
- regulation of our products by the FDA, which has broad regulatory powers;
- uncertainty related to the regulation and taxation of our NewGen products;
- possible significant increases in federal, state, and local municipal tobacco-related taxes;
- possible increasing international control and regulation;
- our reliance on relationships with several large retailers and national chains for distribution of our products;
- our amount of indebtedness;
- the terms of our credit facilities, which may restrict our current and future operations;
- intense competition and our ability to compete effectively;
- uncertainty and continued evolution of markets containing our NewGen products;
- significant product liability litigation;
- the scientific community’s lack of information regarding the long-term health effects of electronic cigarette, vaporizer, and e-liquid use;
- requirement to maintain compliance with Master Settlement Agreement escrow account requirements;
- competition from illicit sources;
- our reliance on information technology;
- security and privacy breaches;
- contamination of our tobacco supply or products;
- infringement on our intellectual property;
- third-party claims that we infringe on their intellectual property;
- failure to manage our growth;
- failure to successfully integrate our acquisitions or otherwise be unable to benefit from pursuing acquisitions;
- fluctuations in our results;
- exchange rate fluctuations;
- adverse U.S. and global economic conditions;
- sensitivity of end-customers to increased sales taxes and economic conditions;
- failure to comply with certain regulations;
- departure of key management personnel or our inability to attract and retain talent;
- imposition of significant tariffs on imports into the U.S.;
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- reduced disclosure requirements applicable to emerging growth companies may make our common stock less attractive to investors, potentially decreasing our stock price;
- failure to maintain our status as an emerging growth company before the five-year maximum time period a company may retain such status;
- our principal stockholders will be able to exert significant influence over matters submitted to our stockholders and may take certain actions to prevent takeovers;

- our certificate of incorporation and bylaws, as well as Delaware law and certain regulations, could discourage or prohibit acquisition bids or merger proposals which may adversely affect the market price of our common stock;
- our certificate of incorporation limits the ownership of our common stock by individuals and entities that are Restricted Investors. These restrictions may affect the liquidity of our common stock and may result in Restricted Investors being required to sell or redeem their shares at a loss or relinquish their voting, dividend, and distribution rights;
- future sales of our common stock in the public market could reduce our stock price, and any additional capital raised by us through the sale of equity or convertible securities may dilute your ownership in us;
- we may issue preferred stock whose terms could adversely affect the voting power or value of our common stock; and
- our status as a “controlled company” could make our common stock less attractive to some investors or otherwise harm our stock price.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

Turning Point Brands, Inc.
Consolidated Balance Sheets
(dollars in thousands except share data)

	(unaudited) March 31, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash	$ 3,792	$ 2,607
Accounts receivable, net of allowances of $46 in 2018 and $17 in 2017	2,283	3,248
Inventories	58,059	63,296
Other current assets	12,387	10,342
Total current assets	76,521	79,493
Property, plant, and equipment, net	8,662	8,859
Deferred income taxes	-	450
Deferred financing costs, net	1,025	630
Goodwill	134,620	134,620
Other intangible assets, net	26,260	26,436
Master Settlement Agreement (MSA) escrow deposits	30,316	30,826
Other assets	1,021	963
Total assets	$ 278,425	$ 282,277
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 6,641	$ 3,686
Accrued liabilities	13,586	18,694
Current portion of long-term debt	10,000	7,850
Revolving credit facility	-	8,000
Total current liabilities	30,227	38,230
Notes payable and long-term debt	188,165	186,190
Deferred income taxes	35	-
Postretirement benefits	3,968	3,962
Other long-term liabilities	1,138	571
Total liabilities	223,533	228,953
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; $0.01 par value; authorized shares 40,000,000; issued and outstanding shares -0-	-	-
Common stock, voting, $0.01 par value; authorized shares, 190,000,000; issued and outstanding shares - 19,222,617 at March 31, 2018, and 19,210,633 at December 31, 2017	192	192
Common stock, nonvoting, $0.01 par value; authorized shares, 10,000,000; issued and outstanding shares -0-	-	-
Additional paid-in capital	103,833	103,640

Accumulated other comprehensive loss	(3,829)	(2,973)
Accumulated deficit	(45,304)	(47,535)
Total stockholders' equity	54,892	53,324
Total liabilities and stockholders' equity	$ 278,425	$ 282,277

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

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Turning Point Brands, Inc.
Consolidated Statements of Income
(dollars in thousands except share data)
(unaudited)

	Three Months Ended March 31,	
	2018	2017
Net sales	$73,942	$66,788
Cost of sales	42,133	39,116
Gross profit	31,809	27,672
Selling, general, and administrative expenses	22,068	16,823
Operating income	9,741	10,849
Interest expense	3,654	4,933
Gain on investment	(95)	(114)
Loss on extinguishment of debt	2,384	6,116
Net periodic benefit expense (income), excluding service cost	(43)	92
Income (loss) before income taxes	3,841	(178)
Income tax expense (benefit)	809	(2,055)
Consolidated net income	$3,032	$1,877
Basic income per common share:		
Consolidated net income	$0.16	$0.10
Diluted income per common share:		
Consolidated net income	$0.15	$0.10
Weighted average common shares outstanding:		
Basic	19,221,892	18,734,393
Diluted	19,762,194	19,633,353

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

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Turning Point Brands, Inc.
Consolidated Statements of Comprehensive Income
(dollars in thousands)
(unaudited)

	Three Months Ended March 31,	
	2018	2017
Consolidated net income	$ 3,032	$ 1,877
Other comprehensive income (loss), net of tax		
Amortization of unrealized pension and postretirement losses, net of tax of $10 in 2018 and $0 in 2017	30	120
Unrealized gain (loss) on investments, net of tax of $135 in 2018 and $43 in 2017	(384)	71
Unrealized loss on interest rate swaps, net of tax of $185 in 2018	(526)	-
	(880)	191
Comprehensive income	$ 2,152	$ 2,068

The accompanying notes are an integral part of the consolidated financial statements

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Turning Point Brands, Inc.
Consolidated Statements of Cash Flows
(dollars in thousands)
(unaudited)

	Three Months Ended March 31, 2018	2017
Cash flows from operating activities:		
Consolidated net income	$ 3,032	$ 1,877
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on extinguishment of debt	2,384	6,116
Depreciation expense	560	354
Amortization of other intangible assets	176	175
Amortization of deferred financing costs	238	294
Amortization of original issue discount	-	66
Deferred income taxes	793	(2,564)
Stock compensation expense	197	45
Changes in operating assets and liabilities:		
Accounts receivable	965	(1,801)
Inventories	5,237	1,299
Other current assets	(2,051)	(1,420)
Other assets	(23)	26
Accounts payable	2,955	(1,597)
Accrued liabilities and other	(6,029)	(5,242)
Accrued postretirement liabilities	(14)	32
Net cash provided by (used in) operating activities	$ 8,420	$ (2,340)
Cash flows from investing activities:		
Capital expenditures	$ (363)	$ (368)
Restricted cash, MSA escrow deposits	(530)	1,192
Net cash provided by (used in) investing activities	$ (893)	$ 824

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Turning Point Brands, Inc.
Consolidated Statements of Cash Flows (Cont.)
(dollars in thousands)
(unaudited)

	Three Months Ended March 31, 2018	2017
Cash flows from financing activities:		
Proceeds from 2018 first lien term loan	$160,000	$-
Proceeds from 2018 second lien term loan	40,000	-
Payments of 2017 first lien term loans	(140,613)	-
Payments of 2017 second lien term loan	(55,000)	-
Proceeds from (payments of) 2017 revolving credit facility	(8,000)	29,550
Proceeds from 2017 first lien term loans	-	145,000
Proceeds from 2017 second lien term loan	-	55,000
Payments of first lien term loan	-	(147,312)
Payments of second lien term loan	-	(60,000)
Payments of revolving credit facility	-	(15,034)
	(3,279)	(4,792)

Payments of financing costs		
Exercise of options	20	679
Surrender of options	-	(1,000)
Net cash provided by (used in) financing activities	$(6,872)	$2,091
Net increase in cash:	$655	$575
Cash, beginning of period:		
Unrestricted	2,607	2,865
Restricted	4,709	3,889
Total cash at beginning of period	7,316	6,754
Cash, end of period:		
Unrestricted	3,792	2,248
Restricted	4,179	5,081
Total cash at end of period	$7,971	$7,329
Supplemental schedule of noncash financing activities:		
Accrued expenses incurred for financing costs	$	

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.

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, which generally ranges from one to three years, upon deployment and use of the service. Any related set-up fees are also recognized ratably over the customer relationship period, which the Company believes is the service period of the contract. The contract service period on average is two years.

The Company makes certain of its software products available for use in hosted application arrangements without licensing perpetual rights to the software (hosted applications). Revenue from hosted applications is recognized over the subscription service period, which generally ranges from one to three years, upon deployment and use of the hosted application. Any related upfront activation, set-up or implementation fees are also recognized ratably over

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(Unaudited)

the customer relationship period, which the Company believes is the service period of the contract. The contract service period on average is two years. Direct and incremental costs relating to activation, set-up and implementation for hosted applications are capitalized until the hosted application is deployed and in use, and then expensed over the remaining term of the arrangement.

For arrangements that have multiple elements and do not include software licenses, the Company allocates arrangement consideration at the inception of the arrangement to those elements that qualify as separate units of accounting. The arrangement consideration is allocated to the separate units of accounting based on relative selling price method in accordance with the selling price hierarchy, which includes: (i) vendor specific objective evidence (VSOE) if available; (ii) third party evidence (TPE) if VSOE is not available; and (iii) best estimate of selling price if neither VSOE nor TPE is available. In general, the Company uses VSOE to allocate the selling price to subscription and service deliverables.

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.

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.

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. Additionally, the Company sells fixed-rate programs, which permit 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 typically 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.

Deferred revenue

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

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Goodwill

The change in goodwill by reportable segment during the six months ended June 30, 2011 consisted of the following:

(in thousands)	ECBU	GMBU	IBU	Other	Total
Balance at December 31, 2010	$ 43,152	$ 26,472	$ 4,514	$ 2,109	$ 76,247
Additions related to business combinations	13,040	-	-	-	13,040
Disposition related to sale of assets	-	-	-	(61)	(61)
Effect of foreign currency translation	-	-	224	-	224
Balance at June 30, 2011	$ 56,192	$ 26,472	$ 4,738	$ 2,048	$ 89,450

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, 2011 and 2010.

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	2011	2010	2011	2010
Included in cost of revenue:				
Cost of license fees	$ 126	$ 115	$ 258	$ 209
Cost of subscriptions	816	760	1,617	1,520
Cost of services	391	341	778	677
Cost of maintenance	253	306	505	603
Cost of other revenue	19	18	38	37
Total included in cost of revenue	1,605	1,540	3,196	3,046
Included in operating expenses	245	196	479	392
Total	$ 1,850	$ 1,736	$ 3,675	$ 3,438

Recently adopted accounting pronouncements

Effective January 1, 2011, the Company adopted Accounting Standards Update (ASU) 2009-13, which amends the existing criteria for separating consideration in multiple-deliverable arrangements. Arrangements that include perpetual software licenses are excluded from the scope of this ASU. ASU 2009-13 establishes a hierarchy for determining the selling price of a deliverable and requires the use of best estimate of the selling price when VSOE or TPE of the selling price cannot be determined. As a result of the requirement to use the best estimate of the selling price when VSOE or TPE of the selling price cannot be determined, the residual method will no longer be permitted. ASU 2009-13 is applicable prospectively for revenue arrangements entered into or materially modified after the adoption date. The adoption of ASU 2009-13 did not have a material impact on the Company s consolidated financial statements.

Recently issued accounting pronouncements

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, which eliminates the option to present components of other comprehensive income, or OCI, as part of the statement of changes in stockholders equity, requires the presentation of each component of net income and each component of OCI either in a single continuous statement or in two separate but consecutive statements and also requires presentation of reclassification adjustments on the face of the financial statement. The Company is required to adopt ASU 2011-05 on January 1, 2012. Early adoption is permitted. The Company does not believe the adoption of ASU 2011-05 will have a material effect on its consolidated financial statements.

3. Business combinations

PIDI

On February 1, 2011, the Company acquired all of the outstanding stock of Public Interest Data, Inc. (PIDI), a privately held company based in Virginia, for $16.6 million in cash. The acquisition of PIDI provided the Company additional capabilities in the area of donor acquisition list analytics and should enhance the Company s database management services offerings. The additional capabilities include the established process for delivering list analytic and data management services as well as the associated experienced workforce and technology. The results of operations of PIDI are included in the consolidated financial

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(Unaudited)

statements of the Company from the date of acquisition. During the first six months of 2011, total revenue from PIDI was $3.6 million and cost of revenue was $2.2 million. Acquisition-related costs of $1.0 million, which primarily consisted of legal and financial advisory services, were expensed as incurred in general and administrative expense during the six months ended June 30, 2011.

In addition to the consideration paid at closing, the Company might be required to pay up to a maximum of $2.5 million in additional cash consideration if PIDI meets revenue targets over the two years subsequent to the acquisition. A liability of $1.4 million was initially recognized for the estimated contingent consideration that will be paid based on a probability-weighted discounted 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.

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

(in thousands)		
Cash and cash equivalents	$	91
Accounts receivable		686
Other assets, current and noncurrent		291
Property and equipment		459
Intangibles		7,390
Goodwill		13,040
Trade accounts payable		(478)
Accrued expenses and other liabilities		(1,814)
Deferred tax liabilities, current and noncurrent		(3,099)
	$	16,566

During the three months ended June 30, 2011, the Company finalized the allocation of purchase price which resulted in a reduction of $0.8 million in the estimated fair value of intangible assets and $0.3 million in the estimated fair value of the associated deferred tax liability.

The estimated fair value of accounts receivable approximates contractual value. The goodwill recognized is attributable primarily to the assembled workforce of PIDI and the opportunities for expected synergies. None of the goodwill arising in the acquisition is deductible for income tax purposes. All of the goodwill is assigned to the ECBU reporting segment. The acquisition resulted in the identification of the following intangible assets:

		Intangible assets acquired (in thousands)	**Weighted average amortization period (in years)**
Customer relationships	$	5,150	15

Marketing assets	140	2
Acquired software	1,550	8
Non-compete agreements	550	4
	$ 7,390	

The fair value of the intangible assets was based on the income approach, which included both the relief of royalty and multi-period excess earnings methods. Customer relationships are amortized on an accelerated basis. Marketing assets, acquired software and non-compete agreements are amortized on a straight-line basis.

Pro forma results of operations for PIDI have not been presented because the results of PIDI are not material to the Company s consolidated financial results.

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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. Diluted earnings per share is computed 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, settlement of stock appreciation rights and vesting of restricted stock awards and units.

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)	**2011**	**2010**	**2011**	**2010**
Numerator:				
Net income, as reported	$ 8,928	$ 6,790	$ 16,512	12,742
Denominator:				
Weighted average common shares	43,447,007	43,260,625	43,399,874	43,347,630
Add effect of dilutive securities:				
Employee stock options and restricted stock	651,039	766,682	604,838	778,629
Weighted average common shares assuming dilution	44,098,046	44,027,307	44,004,712	44,126,259
Earnings per share:				
Basic	$ 0.21	$ 0.16	$ 0.38	$ 0.29
Diluted	$ 0.20	$ 0.15	$ 0.38	$ 0.29

The following shares and potential shares underlying stock-based awards were not included in diluted earnings per share because their inclusion would have been anti-dilutive:

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Shares excluded from calculations of diluted EPS	83,975	144,514	380,914	151,899

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(Unaudited)

5. Comprehensive income

Total comprehensive income for the three and six months ended June 30, 2011 and 2010 is as follows:

(in thousands)	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Net income	$ 8,928	$ 6,790	$ 16,512	$ 12,742
Foreign currency translation adjustment, net of tax	(53)	(10)	(4)	(284)
Comprehensive income	$ 8,875	$ 6,780	$ 16,508	$ 12,458

The amount of tax allocated to the translation adjustment recorded in accumulated other comprehensive income (loss) was not material for the three and six months ended June 30, 2011 and the three months ended June 30, 2010. For the six months ended June 30, 2010, a tax benefit of $0.2 million was allocated to the translation adjustment recorded in accumulated other comprehensive income (loss).

6. Prepaid expenses and other current assets

Prepaid expenses and other current assets consisted of the following as of June 30, 2011 and December 31, 2010:

(in thousands)	June 30, 2011	December 31, 2010
Deferred sales commissions	$ 13,571	$ 11,666
Prepaid software maintenance and royalties	7,485	4,352
Deferred professional services costs	2,865	3,447
Taxes, prepaid and receivable	356	10,826
Other	5,493	3,556
Total prepaid expenses and other current assets	$ 29,770	$ 33,847

7. Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following as of June 30, 2011 and December 31, 2010:

(in thousands)	June 30, 2011	December 31, 2010
Accrued bonuses	$ 7,317	$ 8,952
Accrued commissions and salaries	5,307	5,922
Customer credit balances	3,222	3,379

Taxes payable	4,369	3,683
Accrued royalties	1,626	1,273
Other	5,990	5,113
Total accrued expenses and other current liabilities	$ 27,831	$ 28,322

8. Debt

Revolving credit facility

In June 2011, the Company entered into a new five-year $125.0 million revolving credit facility, which has three options to increase the amount available under the facility up to an additional $75.0 million, subject to certain terms

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Notes to consolidated financial statements

(Unaudited)

and conditions. The revolving credit facility is guaranteed by the Company s material subsidiaries, as defined, and is collateralized with the stock of the Company s subsidiaries, as defined. At June 30, 2011, there were no outstanding borrowings under the credit facility. There was also no outstanding balance on the previous credit facility at the time of termination.

Amounts borrowed under the revolving credit facility bear interest, at the Company s option, at a variable rate based on (a) the highest of (i) the prime rate (ii) federal funds rate plus 0.5% or (iii) one month LIBOR plus 1%, in addition to a margin of 0.375% to 1.0% (Base Rate Loans) or (b) LIBOR plus a margin of 1.375% to 2.0% (LIBOR Loans). The exact amount of any margin depends on the nature of the loan and the Company s leverage ratio at the time of the borrowing. The Company also pays a quarterly commitment fee on the unused portion of the revolving credit facility equal to 0.25%, 0.275%, 0.3% or 0.35% per annum, depending on the Company s leverage ratio. At June 30, 2011, the commitment fee was 0.25%.

Under the credit facility the Company has the ability to choose either Base Rate Loans or LIBOR Loans. Base rate borrowings mature in June 2016. LIBOR Loans can be one, two, three or six month maturities (or, if agreed to by all applicable lenders, nine or twelve months), 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.

Deferred financing costs

In connection with the Company s new credit facility, the Company paid $0.8 million of financing costs, which will be amortized over the term of the new facility. As of June 30, 2011 and December 31, 2010, deferred financing costs totaling $0.8 million and $0.1 million, respectively, are included in other assets on the consolidated balance sheet.

9. Commitments and contingencies

Leases

The Company leases its headquarters facility. 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 each of the three and six-month periods ended June 30, 2011 and 2010 rent expense was reduced by $67,000 and $134,000, respectively, related to this lease provision. 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 then remaining life of the lease from October 2008. The timing of the reimbursements for the actual leasehold improvements may vary from the amount reflected in the table below.

Additionally, the Company has subleased a portion of its facilities under various agreements extending through 2012. Under these agreements, rent expense was reduced by $0.1 million and $0.2 million in each of the three and six-month periods ended June 30, 2011 and 2010, respectively. The operating lease commitments in the table below have been reduced by minimum aggregate sublease commitments of $0.2 million and $0.3 million for 2011 and 2012, respectively. No minimum aggregate sublease commitments exist after 2012. 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 $0.4 million for the three months ended June 30, 2011 and 2010, respectively, and $1.2 million and $1.1 million for the six months ended June 30, 2011 and 2010, 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 that are not significant.

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(Unaudited)

As of June 30, 2011, the future minimum lease commitments related to operating lease agreements, net of related sublease commitments and lease incentives, were as follows:

Year ending December 31, **(in thousands)**	
2011 remaining	$ 3,448
2012	6,179
2013	5,293
2014	5,016
2015	4,838
Thereafter	37,366
Total minimum lease payments	$ 62,140

Other commitments

The Company utilizes third-party relationships in conjunction with its products, with contractual arrangements varying in length from one to three years. In certain cases, these arrangements require a minimum annual purchase commitment. As of June 30, 2011, the remaining aggregate minimum purchase commitment under these arrangements is approximately $4.4 million through 2013. The Company incurred expense under these arrangements of $1.2 million and $0.9 million for the three months ended June 30, 2011 and 2010, respectively, and $2.3 million and $1.7 million for the six months ended June 30, 2011 and 2010, 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 consolidated financial position, results of operations or cash flows.

10. Income taxes

The Company calculated the provision for income taxes for the three and six months ended June 30, 2011 using the 2011 projected annual effective tax rate of 36.5%, which excludes period-specific items. The Company s effective tax rate, including the effects of period-specific events, was as follows:

	Three months ended June 30,		**Six months ended June 30,**	
	2011	**2010**	**2011**	**2010**
Effective tax rate	36.1%	37.8%	32.2%	38.0%

Period-specific items recorded in the three and six months ended June 30, 2011 included a decrease of $1.0 million in the valuation allowance for certain state net operating loss carryforwards, which reduced income tax expense. There were no material period-specific items recorded in the three and six months ended June 30, 2010.

The Company has deferred tax assets for, among other items, 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 realizing such carryforwards and credits in the future. Additionally, the Company has a valuation allowance for certain state deferred tax assets acquired from Kintera.

The Company recorded net excess tax benefits on stock option exercises and restricted stock vesting of $0.2 million and $1.0 million in stockholders equity during the six months ended June 30, 2011 and 2010, respectively.

Blackbaud, Inc.

Notes to consolidated financial statements

(Unaudited)

The total amount of unrecognized tax benefit that, if recognized, would favorably affect the effective tax rate, was $1.5 million at June 30, 2011. The Company recognizes accrued interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense. The total amount of accrued interest and penalties was not material to the consolidated balance sheet as of June 30, 2011 or December 31, 2010, or to the consolidated statement of operations for the three and six months ended June 30, 2011 or 2010.

The Company has taken positions in certain taxing jurisdictions related to state nexus issues for which it is reasonably possible that the total amounts of unrecognized tax benefits might decrease within the next twelve months. This possible decrease could result from the finalization of state income tax reviews and the expiration of statutes of limitations. The reasonably possible decrease was not material at June 30, 2011.

It continues to be the Company s intention to indefinitely reinvest undistributed foreign earnings. Accordingly, no deferred tax liability has been recorded in connection with the undistributed foreign earnings. It is not practicable for the Company to determine the amount of the unrecognized deferred tax liability for temporary differences related to investments in foreign subsidiaries.

11. Stock-based compensation

During the six months ended June 30, 2011, the Company issued 22,235 shares of restricted stock and 30,325 stock appreciation rights with an aggregate grant date fair value of $0.6 million and $0.3 million, respectively. The Company also issued performance-based restricted stock units to certain executive officers with an aggregate grant date value range of zero to $1.3 million depending on the achievement of the various performance targets. Under the performance-based restricted stock unit agreements, if the minimum performance targets are not met, the restricted stock units will not vest and no shares of the Company s common stock will be granted. Compensation cost for the performance-based awards will be recognized to the extent the performance targets are achieved using the graded-vesting method over the requisite service period of three years. No stock options were issued in the six months ended June 30, 2011.

Stock-based compensation expense is allocated to expense categories on the consolidated statements of operations based on where the associated employee s compensation is recorded. The following table summarizes stock-based compensation expense for the three and six months ended June 30, 2011 and 2010.

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	**2011**	**2010**	**2011**	**2010**
Included in cost of revenue:				
Cost of subscriptions	$ 225	$ 75	$ 327	$ 167
Cost of services	447	414	904	850
Cost of maintenance	138	178	380	355
Total included in cost of revenue	810	667	1,611	1,372
Included in operating expenses:				
Sales and marketing	272	344	629	705
Research and development	671	704	1,514	1,415
General and administrative	1,777	1,193	3,572	2,568

Total included in operating expenses	2,720	2,241	5,715	4,688
Total	$ 3,530	$ 2,908	$ 7,326	$ 6,060

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(Unaudited)

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, 2011.

Declaration Date	Dividend per Share	Record Date	Payable Date
February 2011	$ 0.12	February 28	March 15
May 2011	$ 0.12	May 27	June 15

In August 2011, the Company s Board of Directors declared a third quarter dividend of $0.12 per share payable on September 15, 2011 to stockholders of record on August 26, 2011.

13. Segment information

The Company is organized into three operating units that are aligned to key customer groups. Following is a description of each operating unit:

The ECBU is focused on marketing, sales, delivery and support to large and/or strategic, specifically identified named prospects and customers in North America. In addition, ECBU is focused on marketing, sales and delivery of analytic services to all prospects and customers worldwide.

The GMBU is focused on marketing, sales, delivery and support to all emerging and mid-sized prospects and customers in North America that are not specifically identified as ECBU prospects and customers.

The IBU is focused on marketing, sales, delivery and support to all prospects and customers outside of North America.

The Company has determined that the three operating units represent the Company s reportable segments. The Company s chief operating decision maker is its chief executive officer, or CEO. The CEO reviews financial information presented on an operating segment basis for the purposes of making certain operating decisions and assessing financial performance. The CEO uses internal financial reports that provide segment revenues and operating income, excluding stock-based compensation expense, amortization expense, depreciation expense, research and development expense and certain corporate sales, marketing, general and administrative expenses. The CEO believes that the exclusion of these costs allows for a better understanding of the operating performance of the operating units and management of other operating expenses and cash needs. The CEO does not review any segment balance sheet information.

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(Unaudited)

(in thousands)	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Revenue by segment:				
ECBU	$ 39,866	$ 31,124	$ 76,865	$ 60,358
GMBU	43,446	40,962	84,463	79,587
IBU	8,284	6,871	15,500	13,596
Other[1]	1,806	1,714	3,848	3,369
Total revenue	$ 93,402	$ 80,671	$ 180,676	$ 156,910
Segment operating income[2]:				
ECBU	16,405	13,692	31,405	26,205
GMBU	26,142	23,794	49,163	46,373
IBU	1,221	1,739	2,670	3,179
Other[1]	1,453	(2,327)	3,005	(1,184)
	45,221	36,898	86,243	74,573
Less:				
Corporate unallocated costs[3]	26,067	21,099	51,180	44,252
Stock-based compensation costs	3,530	2,908	7,326	6,060
Amortization expense	1,850	1,736	3,675	3,438
Interest expense, net	15	56	6	82
Other (income) expense, net	(216)	185	(285)	182
Income before provision for income taxes	$ 13,975	$ 10,914	$ 24,341	$ 20,559

(1) Other includes revenue and the related costs from the sale of products and services not directly attributable to an operating segment.

(2) Segment operating income includes direct, controllable costs related to the sale of products and services by the reportable segment, except for IBU, which includes operating costs from our foreign locations such as sales, marketing, general, administrative, depreciation, facilities and IT support costs.

(3) Corporate costs include research and development, data center operating costs, depreciation expense, and certain corporate sales, marketing, general and administrative expenses.

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, 2011, we had approximately 24,000 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. Consulting, training and implementation services are generally not essential to the functionality of our software products and are sold separately. 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 2011 and the first six months of 2011 increased 16% and 15% compared to the same periods in 2010, respectively. When removing the impact of foreign currency translation and revenue from acquired companies, revenue increased by approximately 12% for both the second quarter of 2011 and the first six months of 2011 when compared to the same periods in 2010. These increases resulted from continued growth in our subscription revenue, principally attributable to increased demand for our hosting services, online fundraising and data management offerings and the shift in our business towards hosted solutions. Also contributing to the growth in revenue is an increase in our services revenue, which is primarily due to an increase in volume of consulting and training services provided. We continue to experience declines in revenue associated with our core perpetual license offerings as a result of the continuing decreases in sales of our perpetual license offerings to the mid-market customer base, which is principally the result of customers opting to purchase our solutions under alternative packaging with more flexible subscription-based pricing. We believe this trend will continue in the future.

Income from operations for the second quarter of 2011 and the first six months of 2011 increased by $2.6 million and $3.2 million, respectively, when compared to the same periods in 2010. The increase in income from operations is primarily attributable to growth in revenue, partially offset by (1) acquisition-related costs, (2) an increase in stock-based compensation expense and (3) an increase in sales and marketing and general and administrative expenses. The increase in these expenses is principally attributable to merit-based salary increases, an increase in commission expense associated with higher commissionable revenue and an increase in marketing costs associated with the launch of our new corporate branding and newly packaged offerings.

We ended the second quarter of 2011 with cash and cash equivalents totaling $33.4 million and no outstanding borrowings on our credit facility. During the first six months of 2011, we generated $37.8 million in cash flow from operations, of which we used $16.5 million to acquire a business, $10.7 million to pay dividends and $7.7 to purchase software and computer equipment.

While we have experienced growth in revenue as our market has stabilized, we continue to believe the pace and impact of economic recovery on the nonprofit market remains uncertain. We expect that our existing and prospective customers will remain cautious in their expenditure decisions for the remainder of 2011. Notwithstanding these conditions, we remain focused on execution, investing in our key growth initiatives,

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Blackbaud, Inc.

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

strengthening our leadership position and carefully managing our costs and expenses to achieve our targeted level of profitability.

Results of operations

Comparison of the three and six months ended June 30, 2011 and 2010

We completed the acquisition of Public Interest Data, Inc., or PIDI, on February 1, 2011. We have included PIDI s results of operations in our consolidated results of operations from the date of acquisition, which impacts the comparability of our results of operations. We have noted in the discussion below, to the extent meaningful, the impact on the comparability of our consolidated results of operations due to the inclusion of PIDI. During the first six months of 2011, PIDI s total revenue was $3.6 million, cost of revenue was $2.2 million and operating expenses was $0.1 million.

Revenue

The table below compares revenue from our statements of operations for the three and six months ended June 30, 2011 with the same period in 2010.

	Three months ended June 30,				Six months ended June 30,			
(in millions)	**2011**	**2010**	**Change**	**% Change**	**2011**	**2010**	**Change**	**% Change**
License fees	$ 5.1	$ 7.0	$ (1.9)	(27)%	$ 9.7	$ 12.1	$ (2.4)	(20)%
Subscriptions	25.9	20.4	5.5	27%	51.4	39.6	11.8	30%
Services	28.0	20.9	7.1	34%	52.0	41.0	11.0	27%
Maintenance	32.6	30.9	1.7	6%	64.4	61.5	2.9	5%
Other	1.8	1.5	0.3	20%	3.2	2.7	0.5	19%
Total revenue	$ 93.4	$ 80.7	$ 12.7	16%	$ 180.7	$ 156.9	$ 23.8	15%

Total revenue increased 16% and 15% in the second quarter of 2011 and in the first six months of 2011 when compared to the same periods in 2010. When removing the impact of revenue from PIDI, revenue increased by 13% for both the second quarter of 2011 and the first six months of 2011 when compared to the same periods in 2010. The increase in revenue is primarily attributable to growth in our subscriptions and services revenue. The increase in subscriptions revenue is primarily due to an increase in demand for our hosting services, online fundraising and data management offerings. The growth in revenue from our subscription offerings is also a result of the ongoing evolution of our product offerings from traditional perpetual license-based arrangements with upfront payments to subscription-based offerings with more flexible pricing and payments. Services revenue grew principally due to an increase in the volume of consulting services associated with implementation engagements of Blackbaud Enterprise CRM. The increase in maintenance revenue is primarily attributable to new maintenance contracts associated with new license agreements and increases in contracts with existing customers when compared to the same periods in 2010. The decrease in license fees is principally attributable to the continued shift in our customers buying preference away from traditional perpetual license-based arrangements with upfront payments to offerings with subscription-based payment arrangements.

Operating results

The operating results analyzed below are presented on a non-GAAP basis: the results exclude the impact of stock-based compensation expense, amortization of intangibles arising from business combinations, gain on the sale of assets and acquisition-related expenses incurred in connection with our 2011 acquisition of PIDI because, in managing our operations, we believe that the exclusion of these costs allows us to better understand and manage our operating expenses and cash needs. These excluded costs are analyzed separately following the discussion of operating expenses.

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Blackbaud, Inc.

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

License fees

(in millions)	Three months ended June 30, 2011	2010	Change	% Change	Six months ended June 30, 2011	2010	Change	% Change
License fee revenue	$ 5.1	$ 7.0	$ (1.9)	(27)%	$ 9.7	$ 12.1	$ (2.4)	(20)%
Controllable cost of license fees	0.9	0.9	-	0%	1.5	1.4	0.1	7%
License fee gross profit	$ 4.2	$ 6.1	$ (1.9)	(31)%	$ 8.2	$ 10.7	$ (2.5)	(23)%
License fee gross margin	82%	87%			85%	88%		

Revenue from license fees is derived from the sale of our software products under a perpetual license agreement. We continue to experience a shift in our customers buying preference away from solutions offered under perpetual license arrangements with upfront payments to offerings with subscription-based payment arrangements. Additionally, we continue to experience longer sales cycle times, delays and postponements of purchasing decisions and overall caution exercised by existing and prospective customers as a result of continued challenges posed by the economic environment. During the second quarter of 2011, revenue from license fees to existing customers remained unchanged and sales to new customers decreased by $1.9 million when compared to the same period in 2010. During the first six months of 2011, revenue from license fees to existing customers slightly increased and sales to new customers decreased by $2.4 million when compared to the same period in 2010.

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 of 2011 compared to the same period in 2010 remained unchanged. The increase in cost of license fees in the first six months of 2011 compared to the same period in 2010 is primarily attributable to higher reseller commissions. Reseller commissions have increased due to the increase in use of resellers during the first six months of 2011 when compared to the same period in 2010.

The decrease in license fee gross margin in the second quarter of 2011 and the first six months of 2011 when compared to the same periods in 2010 is the result of an increase in the mix of license revenue for which we paid variable reseller commissions during 2011.

Subscriptions

(in millions)	Three months ended June 30, 2011	2010	Change	% Change	Six months ended June 30, 2011	2010	Change	% Change
Subscriptions revenue	$ 25.9	$ 20.4	$ 5.5	27%	$ 51.4	$ 39.6	$ 11.8	30%
Controllable cost of subscriptions	9.4	6.8	2.6	38%	17.7	13.1	4.6	35%
Subscriptions gross profit	$ 16.5	$ 13.6	$ 2.9	21%	$ 33.7	$ 26.5	$ 7.2	27%
Subscriptions gross margin	64%	67%			66%	67%		

Revenue from subscriptions is principally comprised of revenue from providing access to hosted applications and hosting services, access to certain data services and our online subscription training offerings, and variable transaction fees associated with the use of our products to fundraise online. We continue to experience growth in our hosted applications business and are increasingly experiencing a shift in our customers buying preference away from traditional perpetual licenses arrangements with upfront payment terms towards subscription based-offerings with more flexible pricing and payments. Additionally, revenue from our hosting services continues to increase as demand for these services continues to grow from both our existing and new perpetual license customers.

Included in subscriptions revenue for the second quarter of 2011 is $1.6 million of revenue attributable to the inclusion of PIDI. Excluding the revenue from PIDI, the increase in subscriptions revenue of $3.9 million, or 19%, is principally attributable to the increase in demand for hosting services, online fundraising and data management offerings.

Included in subscriptions revenue for the first six months of 2011 is $2.7 million of revenue attributable to the inclusion of PIDI and an out-of-period adjustment of $1.7 million, which increased subscriptions revenue in the first quarter 2011, related to our accounting for subscription-based offerings that were earned in prior periods. Excluding the revenue from PIDI and the out-of-period adjustment, the increase in subscriptions revenue of $7.4 million, or 19%, is principally attributable to the increase in demand for hosting services, online fundraising and data management offerings.

Controllable cost of subscriptions is primarily comprised of human resource costs, third-party royalty and data expenses, hosting expenses, an allocation of depreciation, facilities and IT support costs and other costs incurred in

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Blackbaud, Inc.

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

providing support and services to our customers. The increase in cost of subscriptions in the second quarter of 2011 and in the first six months of 2011 compared to the same periods in 2010 is principally attributable to an increase in headcount and investments we are making in our infrastructure to support the growth in our subscription offerings. Human resource costs increased $1.9 million and $3.3 million in the second quarter of 2011 and the first six months of 2011, respectively, compared to the same periods in 2010 as a result of the increase in headcount. Additional headcount due to the inclusion of PIDI represented approximately $0.8 million and $1.4 million of the increase in human resource costs for the second quarter of 2011 and the first six months of 2011, respectively. The remaining increase in headcount is due to additional resources needed to support the continued growth in this area. The remaining increase in cost of subscriptions is due to an increase in data center operating costs.

The decrease in subscriptions gross margin in the second quarter of 2011 and the first six months of 2011 compared to the same periods in 2010 is due to an increase in the investments we are making in the infrastructure to support the growth in our subscriptions offerings.

Services

	Three months ended June 30,				Six months ended June 30,			
(in millions)	**2011**	**2010**	**Change**	**% Change**	**2011**	**2010**	**Change**	**% Change**
Services revenue	$ 28.0	$ 20.9	$ 7.1	34%	$ 52.0	$ 41.0	$ 11.0	27%
Controllable cost of services	19.4	15.1	4.3	28%	37.5	30.2	7.3	24%
Services gross profit	$ 8.6	$ 5.8	$ 2.8	48%	$ 14.5	$ 10.8	$ 3.7	34%
Services gross margin	31%	28%			28%	26%		

Services revenue consists of consulting, installation, implementation, education and analytic services. Consulting, installation and implementation services involve converting data from a customer s existing system, assistance in file set up and system configuration, and/or process re-engineering. Education services involve customer training activities. 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 organizations to more effectively target their fundraising activities. We recognize services revenue attributable to consulting services for implementation of our hosted applications and subscription offerings ratably over the related term of the hosting or subscription arrangement. We also recognize the direct and incremental costs associated with consulting services revenue ratably over the service period. However, we continue to expense indirect costs in the period the cost is incurred.

Included in services revenue for the second quarter of 2011 is $0.5 million of revenue attributable to the inclusion of PIDI. Excluding the revenue from PIDI, the increase in services revenue of $6.6 million, or 32%, is attributable to increases in consulting services revenue of $5.2 million, analytic services revenue of $0.8 million and education services revenue of $0.6 million. The increase in consulting services revenue is principally attributable to an increase in the volume of consulting, installation and implementation services associated with our Blackbaud Enterprise CRM product offering. The rates we charge for our education and analytic services offerings have remained relatively constant year over year and, as such, the increase in revenue is principally the result of an increase in the volume of services provided.

Included in services revenue for the first six months of 2011 is $0.9 million of revenue attributable to the inclusion of PIDI. Excluding the revenue from PIDI, the increase in services revenue of $10.1 million, or 25%, is attributable to increases in consulting services revenue of $8.7 million, analytic services revenue of

$1.0 million and education services revenue of $1.2 million, partially offset by an out-of-period adjustment recorded in the first quarter of 2011 of $0.8 million which reduced consulting services revenue. The increase in consulting services revenue is principally attributable to an increase in the volume of consulting, installation and implementation services associated with our Blackbaud Enterprise CRM product offering, which was partially offset by a reduction in the effective rates we charge as a result of a higher level of discounts offered on our consulting services during 2010. The rates we charge for our education and analytic services offerings have remained relatively constant year over year and, as such, the increase in revenue is principally the result of an increase in the volume of services provided.

Controllable cost of services is principally comprised of human resource costs, third-party contractor expenses, classroom rentals, other costs incurred in providing consulting, installation and implementation services and customer training, data expense incurred to perform analytic services and an allocation of depreciation, facilities and IT support costs. The increase in cost of services in the second quarter of 2011 and first six months of 2011 when compared to the same periods in 2010 is primarily attributable to an increase in human resource and third-party

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

contractor costs, which was driven by the need for additional resource capacity to meet the increasing demand for consulting services. Additionally, we continue to experience a shift in the mix of consultants to meet the needs of our enterprise customers, which require a higher level of skilled resources that carry a higher cost.

The services gross margin increased in the second quarter of 2011 and the first six months of 2011 compared to the same periods in 2010 primarily as a result of an increase in demand for consulting services associated with our Blackbaud Enterprise CRM offering and a shift in the mix of consulting engagements to higher margin projects.

Maintenance

	Three months ended June 30,				Six months ended June 30,			
(in millions)	2011	2010	Change	% Change	2011	2010	Change	% Change
Maintenance revenue	$ 32.6	$ 30.9	$ 1.7	6%	$ 64.4	$ 61.5	$ 2.9	5%
Controllable cost of maintenance	5.6	5.4	0.2	4%	11.4	10.7	0.7	7%
Maintenance gross profit	$ 27.0	$ 25.5	$ 1.5	6%	$ 53.0	$ 50.8	$ 2.2	4%
Maintenance gross margin	83%	83%			82%	83%		

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. The increase in maintenance revenue of $1.7 million in the second quarter of 2011 compared to the same period in 2010 is principally comprised of $2.5 million of maintenance with new customers associated with new license agreements and increases in contracts with existing customers and $0.9 million from maintenance contract inflationary rate adjustments, offset by $1.7 million from maintenance contracts that were not renewed.

The increase in maintenance revenue of $2.9 million in the first six months of 2011 compared to the same period in 2010 is principally comprised of $4.0 million of maintenance with new customers associated with new license agreements and increases in contracts with existing customers and $1.9 million from maintenance contract inflationary rate adjustments, offset by $3.0 million from maintenance contracts that were not renewed.

Controllable cost of maintenance is primarily comprised of human resource costs, third-party contractor expenses, third-party royalty costs, an allocation of depreciation, facilities and IT support costs and other costs incurred in providing support and services to our customers. The increase in cost of maintenance in the second quarter of 2011 and the first six months of 2011 compared to the same periods in 2010 is principally attributable to an increase in human resource costs. Human resource costs increased due to merit-based salary increases, an increase in headcount and a change in the mix of support resources. Headcount increased due to an increase in volume of our new maintenance contracts and increases in our existing maintenance customer contracts. Additionally, we continue to experience a shift in the mix of support resources to the meet the needs of our enterprise customers, which require a higher level of skilled resources that carry a higher cost.

The decrease in maintenance gross margin in the first six months of 2011 compared to the same period in 2010 is due to the shift in the mix of support resources to more highly skilled resources.

Other revenue

(in millions)	Three months ended June 30, 2011	2010	Change	% Change	Six months ended June 30, 2011	2010	Change	% Change
Other revenue	$ 1.8	$ 1.5	$ 0.3	20%	$ 3.2	$ 2.7	$ 0.5	19%
Controllable cost of other revenue	1.4	1.3	0.1	8%	2.5	2.5	-	0%
Other gross profit	$ 0.4	$ 0.2	$ 0.2	100%	$ 0.7	$ 0.2	$ 0.5	250%
Other gross margin	22%	13%			22%	7%		

Other revenue includes the sale of business forms that are used in conjunction with our software products, reimbursement of travel-related expenses, primarily incurred during the performance of services at customer locations, fees from user conferences and third party software referral fees. Other revenue increased in the second quarter of 2011 and the first six months of 2011 when compared to the same periods in 2010 primarily due to an increase in revenue from third party software referral fees.

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Blackbaud, Inc.

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

Controllable cost of other revenue includes human resource costs, costs of business forms, costs of user conferences, reimbursable expenses relating to the performance of services at customer locations and an allocation of depreciation, facilities and IT support costs. The increase in other gross margin is due to the increase in revenue from third party software referral fees.

The following schedule reconciles non-GAAP gross profit discussed above to gross profit as presented on the statement of operations:

	Three months ended June 30,				Six months ended June 30,			
(in millions)	2011	2010	Change	% Change	2011	2010	Change	% Change
License fees	$ 4.2	$ 6.1	$ (1.9)	(31)%	$ 8.2	$ 10.7	$ (2.5)	(23)%
Subscriptions	16.5	13.6	2.9	21%	33.7	26.5	7.2	27%
Services	8.6	5.8	2.8	48%	14.5	10.8	3.7	34%
Maintenance	27.0	25.5	1.5	6%	53.0	50.8	2.2	4%
Other	0.4	0.2	0.2	100%	0.7	0.2	0.5	250%
Total non-GAAP gross profit	$ 56.7	$ 51.2	$ 5.5	11%	$ 110.1	$ 99.0	$ 11.1	11%
Less corporate costs not allocated:								
Stock-based compensation expense	0.8	0.7	0.1	14%	1.6	1.4	0.2	14%
Amortization of intangible assets acquired in business combinations	1.6	1.5	0.1	7%	3.2	3.0	0.2	7%
Gross profit as stated in statements of operations	$ 54.3	$ 49.0	$ 5.3	11%	$ 105.3	$ 94.6	$ 10.7	11%
Gross margin %	58%	61%			58%	60%		

Operating expenses

Sales and marketing

	Three months ended June 30,				Six months ended June 30,			
(in millions)	2011	2010	Change	% Change	2011	2010	Change	% Change
Sales and marketing expense excluding stock-based compensation	$ 18.8	$ 18.7	$ 0.1	1%	$ 37.8	$ 34.7	$ 3.1	9%
Add: Stock-based compensation expense	0.3	0.3	-	0%	0.6	0.7	(0.1)	(14)%
Sales and marketing expense	$ 19.1	$ 19.0	$ 0.1	1%	$ 38.4	$ 35.4	$ 3.0	8%
% of revenue (excluding stock-based compensation)	20%	23%			21%	22%		

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. Sales and marketing expense in the second quarter of 2011 compared to the same period in 2010 increased by $0.1 million. During second quarter 2010, we recorded an out-of-period adjustment of $0.8 million related to our accounting for deferred sales commissions. Excluding the out-of-period adjustment, sales and marketing expense increased $0.9 million, largely due to an increase in human resource costs as a result of additional headcount.

Excluding the out-of-period adjustment discussed above, sales and marketing expense in the first six months of 2011 compared to the same period in 2010 increased by $3.9 million, principally due to an increase of $1.6 million in commission expense and $1.7 million in human resource costs. The increase in commission expense is principally attributable to higher commission rates and an increase in commissionable sales and revenue in 2011. Human resources costs increased due to additional headcount. Additionally, marketing programs related costs increased by $0.6 million. The increase in marketing programs related costs is principally attributable to the launch of our new corporate branding and an increase in marketing costs associated with our newly packaged offerings.

The decrease in sales and marketing expense as a percentage of revenue in the second quarter of 2011 and first six months of 2011 when compared to the same periods in 2010 is principally due to the out-of-period adjustment recorded in 2010.

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Blackbaud, Inc.

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

Research and development

(in millions)	Three months ended June 30, 2011	2010	Change	% Change	Six months ended June 30, 2011	2010	Change	% Change
Research and development expense excluding stock-based compensation	$ 11.4	$ 11.0	$ 0.4	4%	$ 22.5	$ 21.2	$ 1.3	6%
Add: Stock-based compensation	0.6	0.7	(0.1)	(14)%	1.5	1.4	0.1	7%
Research and development expense	$ 12.0	$ 11.7	$ 0.3	3%	$ 24.0	$ 22.6	$ 1.4	6%
% of revenue (excluding stock-based compensation)	12%	14%			12%	14%		

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. During the second quarter of 2011 and the first six months of 2011, the increase in research and development costs is principally attributable to an increase in human resource costs resulting from the ongoing investment we are making in our products.

General and administrative

(in millions)	Three months ended June 30, 2011	2010	Change	% Change	Six months ended June 30, 2011	2010	Change	% Change
General and administrative expense excluding stock-based compensation, acquisition-related costs and gain on sale of assets	$ 7.4	$ 5.7	$ 1.7	30%	$ 14.3	$ 12.7	$ 1.6	13%
Add: Acquisition-related costs	-	-	-	- %	1.0	-	1.0	- %
Add: Gain on sale of assets	-	-	-	- %	(0.5)	-	(0.5)	- %
Add: Stock-based compensation	1.8	1.2	0.6	50%	3.6	2.6	1.0	38%
General and administrative expense	$ 9.2	$ 6.9	$ 2.3	33%	$ 18.4	$ 15.3	$ 3.1	20%
% of revenue (excluding stock-based compensation)	8%	7%			8%	8%		

General and administrative expense consists primarily of human resource costs for general corporate functions, including senior management, 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 2011 and the first six months of 2011 compared to the same periods in 2010, the increase in general and administrative expense and the increase in general and administrative costs as a percentage of revenue was principally attributable to an increase in human resource costs due to merit-based salary increases, higher health benefit costs and an increase in bonus expense.

Stock-based compensation

We recognize compensation expense related to stock-based awards granted to employees. We measure stock-based compensation cost at the grant date based on the fair value of the award and recognize it 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, 2011 and 2010 include the amounts of stock-based compensation illustrated below:

	Three months ended June 30,				Six months ended June 30,			
(in millions)	**2011**	**2010**	**Change**	**% Change**	**2011**	**2010**	**Change**	**% Change**
Included in cost of revenue:								
Cost of subscriptions	$ 0.2	$ 0.1	$ 0.1	100%	$ 0.3	$ 0.2	$ 0.1	50%
Cost of services	0.5	0.4	0.1	25%	0.9	0.8	0.1	13%
Cost of maintenance	0.1	0.2	(0.1)	(50)%	0.4	0.4	-	- %
Total included in cost of revenue	0.8	0.7	0.1	14%	1.6	1.4	0.2	14%
Included in operating expenses:								
Sales and marketing	0.3	0.3	-	0%	0.6	0.7	(0.1)	(14)%
Research and development	0.6	0.7	(0.1)	(14)%	1.5	1.4	0.1	7%
General and administrative	1.8	1.2	0.6	50%	3.6	2.6	1.0	38%
Total included in operating expenses	2.7	2.2	0.5	23%	5.7	4.7	1.0	21%
Total	$ 3.5	$ 2.9	$ 0.6	21%	$ 7.3	$ 6.1	$ 1.2	20%

Stock-based compensation is comprised of expense from restricted stock, performance-based restricted stock units and stock appreciation rights. The table below summarizes the stock-based compensation by award type for the three and six months ended June 30, 2011 and 2010.

	Three months ended June 30,				Six months ended June 30,			
(in millions)	**2011**	**2010**	**Change**	**% Change**	**2011**	**2010**	**Change**	**% Change**
Stock-based compensation from:								
Restricted stock	$ 2.4	$ 2.1	$ 0.3	14%	$ 4.8	$ 4.4	$ 0.4	9%
Performance-based restricted stock units	0.1	-	0.1	- %	0.4	-	0.4	- %
Stock appreciation rights	1.0	0.8	0.2	25%	2.1	1.7	0.4	24%
Total stock-based compensation	$ 3.5	$ 2.9	$ 0.6	21%	$ 7.3	$ 6.1	$ 1.2	20%

Stock-based compensation expense increased in the second quarter of 2011 and the first six months of 2011 compared to the same periods in 2010 due to additional grants in the second half of 2010, 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 $27.4 million as of June 30, 2011. This amount will be recognized as expense over a weighted average period of 1.7 years.

Amortization

We allocated amortization expense to cost of revenue based on the nature of the respective identifiable intangible asset and whether the asset is directly associated with a specific component of revenue. Amortization expense included in our consolidated statements of operations for the three and six months ended June 30, 2011 and 2010 is illustrated below:

	Three months ended June 30,				Six months ended June 30,			
(in millions)	2011	2010	Change	% Change	2011	2010	Change	% Change
Included in cost of revenue:								
Cost of license fees	$ 0.1	$ 0.1	$ -	0%	$ 0.3	$ 0.2	$ 0.1	50%
Cost of subscriptions	0.8	0.8	-	0%	1.6	1.5	0.1	7 %
Cost of services	0.4	0.3	0.1	33%	0.8	0.7	0.1	14%
Cost of maintenance	0.3	0.3	-	0%	0.5	0.6	(0.1)	(17)%
Cost of other revenue	-	-	-	-%	-	-	-	- %
Total included in cost of revenue	1.6	1.5	0.1	7%	3.2	3.0	0.2	7 %
Included in operating expenses	0.2	0.2	-	0%	0.5	0.4	0.1	25%
Total	$ 1.8	$ 1.7	$ 0.1	6%	$ 3.7	$ 3.4	$ 0.3	$ 9%

Acquisition-related costs

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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 2011, we expensed $1.0 million of acquisition-related costs, in connection with the acquisition of PIDI, which were recorded in general and administrative expense. There were no similar expenses in the first six months of 2010.

Gain on sale of assets

During the first six months of 2011, we recognized a gain of $0.5 million from the sale of intangible assets, which was recorded as a reduction of general and administrative expense. There was no similar transaction in the first six months of 2010.

Income tax provision

The estimated annual effective tax rate for 2011 is 36.5%, which excludes period-specific items. Following is our effective tax rate, including the effects of period-specific items, for the three and six months ended June 30:

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Effective tax rate	36.1%	37.8%	32.2%	38.0%

Period-specific items recorded in the six months ended June 30, 2011 included a decrease of $1.0 million in the valuation allowance for certain state net operating loss carryforwards, which reduced income tax expense. There were no material period-specific items recorded in the three months ended June 30, 2011 or the three and six months ended June 30, 2010.

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 amount of unrecognized tax benefit that, if recognized, would favorably affect our effective rate as of June 30, 2011 was $1.5 million. We have taken positions in certain taxing jurisdictions related to state nexus issues for which it is reasonably possible that the total amount of unrecognized tax benefits may 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. The reasonably possible decrease was not material at June 30, 2011.

Liquidity and capital resources

At June 30, 2011, cash and cash equivalents totaled $33.4 million, compared to $28.0 million at December 31, 2010. The $5.4 million increase in cash and cash equivalents during the first six months of 2011 is principally the result of cash generated from operations of $37.8 million, of which $16.5 million was used to acquire a business, $10.7 million to pay dividends and $7.7 to purchase software and computer equipment.

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 and pay dividends. 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.

We have drawn on our credit facility from time to time to help us meet short-term financial needs, such as business acquisitions and purchase of common stock under our repurchase program. In June 2011, we entered into a new five-year $125.0 million credit facility which replaced our previous $90.0 million credit facility that was to mature in July 2012. Under the new credit facility we have three options to increase the aggregate amount available by up to $75.0 million. At June 30, 2011, we had no outstanding borrowings under our credit facility. We believe our cash on hand, cash generated from operations and our credit facility provides us with sufficient flexibility to meet our financial needs.

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Blackbaud, Inc.

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

Operating cash flow

Net cash provided by operating activities of $37.8 million increased by $13.2 million during the first six months of 2011 when compared to the same period in 2010. 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 expense; and (iii) changes in our working capital.

Working capital changes as they impact the statement of cash flows are composed of changes in accounts receivable, prepaid expenses and other assets, accounts payable, accrued expenses, accrued liabilities and deferred revenue. Cash flow from operations associated with working capital increased $5.1 million in the first six months of 2011 when compared to the same period in 2010. This net increase is principally due to:

- an increase of $1.9 million in cash associated with a decrease in accounts receivable, primarily from an increase in the collection of accounts receivable as a result the timing of billings in late 2010 as compared to late 2009, and a slight improvement in collections; and

- a refund of income tax payments of $6.0 million; partially offset by

- a decrease of $1.1 million in cash associated with a decrease in deferred revenue, primarily resulting from a decrease in consulting services billings for which revenue could not be recognized; and

- a decrease of $1.7 million in cash associated with an increase in payments for deferred commissions and other prepaid items as a result of fluctuations in timing of vendor payments.

The provision for doubtful accounts and sales returns increased $1.7 million during the six months ended June 30, 2011 when compared to the same period in 2010. The increase is principally due to an increase in credits associated with maintenance, subscription and consulting services that is commensurate with the growth in sales. Additionally, during the first six months of 2010, we decreased our allowance for doubtful accounts and sales returns by $0.5 million as a result of favorable returns and collections experience, which contributed to the year-over-year increase.

Investing cash flow

Net cash used in the first six months of 2011 for investing activities was $23.5 million compared to $9.3 million in the same period in 2010. The increase is principally due to the purchase of PIDI in the first quarter of 2011. As of June 30, 2011, we spent $7.7 million on software and computer equipment associated with the infrastructure that supports our subscription-based offerings. We expect to continue making similar investments in our infrastructure and expect our full year 2011 capital expenditures to be in the range of $15.0 million to $20.0 million.

Financing cash flow

Net cash used in financing activities for the first six months of 2011 was $9.3 million compared to $24.5 million in the same period in 2010. The decrease in cash used in financing activities is primarily due to a decrease in the purchase of treasury stock under our repurchase program. We did not repurchase any treasury shares during the six months ended June 30, 2011, and as of June 30, 2011, $50.0 million remained available under our share repurchase program.

Commitments and contingencies

As of June 30, 2011, we had future minimum lease commitments of $62.1 million. There were no material changes outside the ordinary course of business in our contractual obligations since December 31, 2010.

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 remaining minimum purchase commitments under these arrangements at June 30, 2011 were $4.4 million through 2013. We incurred expense under these arrangements of $1.2 million and $0.9 million for the three months ended June 30, 2011 and 2010, respectively, and $2.3 million and $1.7 million for the six months ended June 30, 2011 and 2010, respectively.

In February 2011, our Board of Directors approved our annual dividend rate of $0.48 per share for 2011. Dividends at the annual rate would aggregate to $21.1 million assuming 44.0 million shares of common stock are outstanding. Our ability to continue to declare and pay dividends quarterly this year and beyond might be restricted by, among other things, the terms of our credit facility, general economic conditions and our ability to generate operating cash flow.

Blackbaud, Inc.

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

Off-balance sheet arrangements

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

Foreign currency exchange rates

Approximately 14% of our total net revenue for the six months ended June 30, 2011 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 $0.5 million at June 30, 2011 and at December 31, 2010.

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., Australian and Netherlands subsidiaries are generally denominated in pounds sterling, Australian dollars and Euros, respectively. Historically, as the U.S. dollar weakened, foreign currency translation resulted in an increase in our revenues and expenses denominated in non-U.S. currencies. During second quarter 2011, foreign translation resulted in an increase in our revenues and expenses denominated in non-U.S. currencies. Though we do not believe our exposure to currency exchange rates have had a material impact on our consolidated 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, which 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; management of integration of recently acquired companies and other risks associated with acquisitions; the ability to attract and retain key personnel, including a new CFO; risk associated with successful implementation of multiple integrated software products; 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 SEC filings.

Item 3. Quantitative and qualitative disclosures about market risk

Due to the nature of our short-term investments and the lack of material debt, we have concluded at June 30, 2011 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

Blackbaud, Inc.

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

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, 2011 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, 2011				$50,000
April 1, 2011 through April 30, 2011	1,478	$26.59	-	$50,000
May 1, 2011 through May 31, 2011	9,237	$29.18	-	$50,000
June 1, 2011 through June 30, 2011	-	$ -	-	$50,000
Total	10,715	$28.82	-	$50,000

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

Item 6. Exhibits

Exhibits:

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.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.

101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

* *Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability of that Section, and shall not be part of any registration statement or other document filed under the Securities Act of the Exchange Act, except as shall be expressly set forth by specific reference in such filing.*

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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 9, 2011	By: /s/ Marc E. Chardon Marc E. Chardon President and Chief Executive Officer
Date: August 9, 2011	By: /s/ Timothy V. Williams Timothy V. Williams Senior Vice President and Chief Financial Officer