EVOLVING SYSTEMS INC
Form 10-K
March 13, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x	**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934** **For the fiscal year ended December 31, 2007**
	OR
o	**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934** **For the transition period from to**

Commission File Number: 0-24081

EVOLVING SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**84-1010843**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
9777 Pyramid Court, Suite 100, Englewood, Colorado	**80112**
(Address of principal executive offices)	(Zip Code)

(303) 802-1000

(Registrant s telephone number, including area code)

Securities registered under Section 12(b) of the Act:

Common Stock, Par Value $0.001 Per Share	**The Nasdaq Capital Market**
(Title of Class)	(Name of exchange on which registered)

Securities registered under Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

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

The approximate aggregate market value of the Common Stock held by non-affiliates of the registrant, based upon the last sale price of the Common Stock reported on the Nasdaq Capital Market, was approximately $37.5 million as of June 30, 2007.

The number of shares of Common Stock outstanding was 19,310,944 as of March 5, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III (Items 10, 11, 12, 13 and 14) is incorporated by reference to portions of the registrant s definitive proxy statement for the 2008 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the 2007 year.

EVOLVING SYSTEMS, INC.

Annual Report on Form 10-K

For the year ended December 31, 2007

Table of Contents

FORWARD-LOOKING STATEMENTS

Except for the historical information contained in this document, this report contains forward-looking statements including estimates, projections, statements relating to our business plans, objectives and expected operating results and assumptions. These forward-looking statements generally are identified by the words believes, goals, projects, expects, anticipates, estimates, intends, strategy, plan and similar expressions. Forward-looking statements are based on current expectations and assumptions and are subject to risks and uncertainties which may cause our actual results to differ materially from those discussed here. Factors that could cause or contribute to such differences include, but are not limited to those discussed in this section, in the sections entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

ITEM 1. BUSINESS

INTRODUCTION

Evolving Systems, Inc. is a leading provider of software solutions and services to the wireless, wireline and IP carrier market. We maintain long-standing relationships with many of the largest wireline, wireless and IP communications carriers worldwide. Our customers rely on us to develop, deploy, enhance, maintain and integrate complex, highly reliable software solutions for a range of Operations Support Systems (OSS). Included among our more than 50 global customers is the largest wireline carrier, the largest wireless carrier and the largest cable company in North America, as well as two of the world s largest wireless carriers headquartered outside of North America. We offer software products and solutions in three core areas:

- service activation solutions used to activate complex bundles of voice, video and data services for traditional and next generation wireless and wireline networks;
- numbering solutions products used by carriers to manage their telephone number inventory and number assignment processes and products that comply with government-mandated requirements regarding local number portability in North America; and
- mediation solutions supporting data collection for both service assurance and billing applications.

Historically, our products have been used to support traditional wireless and wireline network telephony capabilities; however, as a result of our on-going investment in and improvement of our products, we now offer products to carriers to support both their convergent offerings over Internet Protocol (IP) and advanced broadband networks.

We report the operations of our business as two operating segments based on revenue type: license fees/services revenue and customer support revenue. We further report geographic information based upon revenues and long-lived assets in the United States, United Kingdom and all other foreign countries. Further information regarding our operating segments and geographical information is contained in Note 11 to our Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

COMPANY BACKGROUND

Founded in 1985, we initially focused on providing custom software development and professional services to a limited number of large telecommunications companies in the United States. In 1996, concurrent with the passage of the Telecommunications Act of 1996 (the Telecom Act), we made a strategic decision to add software products to our established professional services offerings. The outcome of that decision was the creation of a comprehensive product portfolio, of which we are best known for our Local Number Portability and Number Management solutions.

In 2003 and 2004, we significantly expanded our portfolio of products as a result of three acquisitions that were made over the periods of November 2003 through November 2004. The first acquisition was CMS Communications, Inc. (CMS) in November 2003, where we acquired a network mediation and service assurance solution. In October 2004, we acquired Telecom Software Enterprises, LLC (TSE) adding Local Number Portability (LNP) and Wireless Number Portability (WNP) number ordering and provisioning monitoring and testing products. Finally, in November 2004, we acquired Tertio Telecoms Ltd. (Evolving Systems U.K.), a supplier of OSS software solutions for service activation and mediation to communication carriers throughout Europe, the Middle East, Africa and Asia. With this acquisition we expanded our markets beyond North America and added an activation solution, *Tertio* , and a mediation solution, *Evident* , to our product portfolio. The consequence of these acquisitions is a significantly expanded product and service capability to address a larger portion of our customers OSS application needs with a balanced mix of products and product enhancements, as well as services.

In 2005, with our growing product portfolio and geographic reach, we enhanced our sales model to include both direct and indirect channels. We formed new relationships with network equipment providers and system integrators to extend our reach to new geographical regions as well as help us further penetrate our existing territories. In 2006 and 2007, we added more regional partners to help with both local selling and deployments in emerging markets.

RECENT DEVELOPMENTS

Dynamic SIM Allocation

In 2007, we announced our *Dynamic SIM Allocation* solution that offers carriers a new way to provision wireless services by dynamically activating a wireless device when it is first used. In countries around the world, the wireless Subscriber Identity Module (SIM) card is central to the provision of wireless access and services. Typically, SIM cards are either pre-provisioned before they are distributed to the retail environment or are provisioned at the point-of-sale. Pre-provisioning SIM cards means that phone numbers are allocated a long time before the SIM card is available for sale, leading to poor utilization of numbers, increased network costs, and a poor user experience since users cannot choose their phone number. Provisioning SIM cards at the point-of-sale overcomes some of these issues but at a high cost, as retail and back-office infrastructure needs to be in place and consequently distribution is constrained. Our *Dynamic SIM Allocation* solution offers carriers the user experience and resource efficiency benefits of provisioning at the point-of-sale without demanding the retail and back-office infrastructure usually required. The solution offers a number of benefits including:

For wireless carriers that have a high proportion of SIM cards that are never activated, the solution improves the utilization of mobile phone numbers, reducing the cost of acquiring and owning number ranges while making sure new numbers are always available to meet demand.

Prepaid subscribers have traditionally been unable to choose their mobile phone number easily and from a wide range of available numbers. With this solution, prepaid subscribers can choose their number using just their mobile phone, and carriers can monetize their valuable stock of vanity or golden numbers.

Wireless carriers that have regional number allocation can overcome SIM card supply chain inflexibility to reduce SIM card logistical and capacity costs.

INDUSTRY DYNAMICS

Historically, telecommunications carriers have operated in a highly regulated environment. Deregulation in many countries has stimulated competition which has led to an increase in the number of telecommunications carriers that operate in a given market. This increase in competition coupled with the emergence of new telecommunications technologies, such as fiber optics, packet-data networks, digital and wireless telephony as well as Internet-based services, has created an industry that is in the midst of significant change. Traditional wireline customers are migrating with an increasing frequency to broadband and wireless services, requiring network operators to make large capital expenditures in the areas of broadband and wireless infrastructure, as well as new product offerings to differentiate themselves. In response to these market changes, we have broadened our product portfolio through internal R&D, customer-funded initiatives and the acquisition of key new products and technologies. The competitive landscape is continually changing as the communications industry consolidates in almost every geographic market.

OPERATIONS SUPPORT SYSTEMS (OSS)

OSS encompasses a broad array of software and systems that perform critical functions for telecommunications carriers, such as service fulfillment, service assurance, and billing. Service fulfillment encompasses ordering, provisioning and activation as well as inventory systems. Ordering systems collect customer information, retrieve current service information, capture and validate new service requests, verify the availability of selected services and transmit completed orders to one or more provisioning OSS. Inventory systems maintain both physical and logical views of all the telecommunications assets required to turn up a service. Carriers use provisioning and activation systems to turn up network service and turn services off and on for new customers, as well as change or add services for existing customers. Service assurance systems allow carriers to perform the testing, monitoring and reporting necessary to maintain appropriate network availability and feed operational data to other business systems. Service assurance systems also allow carriers to track and report on service conditions or outages in order to dispatch the carrier s large work force for necessary repairs. Carriers use billing systems to collate, manage and report usage information for partner and customer billing. OSS systems typically operate in a 24x7 environment to support the real-time communication networks that are the backbone of the carriers service offerings.

Traditionally, as carriers have added new services, such as wireless or Internet-based services, they have either developed their own in-house OSS systems or added new OSS systems from product vendors. These additional OSS systems can be difficult to integrate into the carriers operations. In addition, these various OSS systems often utilize incompatible elements, making interoperability among the systems difficult. These OSS systems are further constrained by the many incremental changes that have been made in order to accommodate new computing and network technologies and new value-added services, such as call waiting, call forwarding and voice mail, broadband data and video. In addition, carriers have had to adapt their OSS to comply with government or regulatory mandates that in some cases change how systems and processes are required to work. Despite these difficulties, the carriers have been unable to completely replace existing OSS systems due to the large investment and vast amounts of historical data contained in these systems. As a result, carriers continue to make incremental modifications to these OSS systems, thereby further increasing their complexity and making it more difficult for the systems to interoperate successfully. However, a trend over the past decade has been the replacement of a portion of the carrier s legacy OSS environment with OSS software packages designed to meet growing complex processes in the areas of service fulfillment, service assurance and billing.

PRODUCT PORTFOLIO

Service Activation

Our service activation solution, *Tertio* , is employed by carriers to activate a new subscriber or to add a new service to an existing subscriber. Our Tertio product provides a flexible operating environment and can be used by carriers to manage their voice, data, and content service needs for both their traditional and broadband IP networks. Our solution is deployed as the service activation engine for over 50 networks around the world including two of the world s largest wireless carriers.

Tertio is an integrated solution comprised of the following components:

- Tertio Service Composer a modeling tool that simplifies the creation of new services;
- Tertio Content Connector a tool used for activation of next-generation services;
- Tertio Activation Designer a tool that is designed to speed network feature activation;
- Tertio Service Activation the platform that provides scalability and performance, flexibility and a graphical interface; and

- Tertio Service Verification a module that allows carriers to verify that the services implemented in the network match those that were in the original service order. By providing this capability, carriers can continually check the accuracy of their order/activation processes.

- Tertio Process Management a module that allows carriers to manage long running transactions. Long running transactions can often occur when a carrier is implementing a converged activation solution that encompasses the activation of both a wireless and fixed line (or IP) component.

Our Tertio solution addresses the entire service lifecycle, enabling service providers to better plan, manage and execute the introduction of new services. Tertio allows carriers to introduce new network technologies and eases the burden of integration with existing devices and systems.

Numbering Solutions

Evolving Systems Numbering Solutions product line includes our Local Number Portability (LNP) and Wireless Number Portability (WNP) products as well as our *NumeriTrack®* number management solution.

LNP and WNP

Our Number Portability software solution enables carriers to comply with U.S. and Canadian mandates for regulations implementing LNP and WNP. Number porting allows customers the ability to retain, or port , their phone numbers when changing from one service provider to another. Our LNP software which includes the functionality to support ordering, provisioning, reporting, testing and exchanging information between carriers is widely used by wireline, wireless and cable service providers in North America. In addition, we developed the initial custom software used by all eight regional Number Portability Administration Centers (NPACs) in North

America to control the porting process. This software receives ported telephone number information from carriers as changes occur and distributes the data to all subscribing carriers in the region. Our software was provided under contract to NeuStar, Inc., formerly a division of Lockheed Martin IMS. Over time, we have expanded our number portability product features and developed other number portability related OSS software products for the wireline, wireless and cable markets. Our full LNP and WNP product line comprises the following collection of products:

- *OrderPath*® order entry;
- *NumberManager*® network provisioning;
- *LNP DataServer* data warehousing;
- *VeriPort* NPAC testing;
- *VeriComm* Inter-carrier Communications Processor testing; and
- *Verify* product suite for monitoring carriers application communications for optimum service assurance,

Number Management

We developed our *NumeriTrack*® solution in response to the FCC mandated number conservation and number pooling regulations for both wireline and wireless carriers. These regulations, implemented in 2003, resulted from the FCC s concern that the U.S. was running out of 10-digit telephone numbers. As a result, the FCC designed regulations to extend the life of the 10-digit numbering plan well into the 21st century by changing the way phone numbers are allocated to carriers and specifying rules regarding the assignment and classification of those numbers. The regulations also require regular utilization reporting by carriers and articulation of circumstances under which previously underutilized telephone numbers must be returned to the pool to be reallocated to other carriers. Our *NumeriTrack*® solution, which has been licensed to seven carriers, facilitates compliance with the FCC mandates for both wireline and wireless carriers (and cable carriers providing telephony services). Our solution provides inventory management of phone numbers and other assets such as SIM cards and supports inventory assignments and integration with carriers existing back-office systems. The *NumeriTrack*® solution also contains features for the inventory of, and assignment logic for, numbers associated with IP addresses and is used by a large carrier in the U.S. for deployment of a Voice over Internet Protocol (VoIP) service offering. As is the case with our LNP and WNP solutions, the implementation of our *NumeriTrack*® solution has far-reaching implications for integration with carriers existing OSS environments and business processes. During 2006 and 2007, we modified our *NumeriTrack*® International application to address markets outside of North America.

Our investments in our International *NumeriTrack*® solution allow us to sell and deploy this solution in markets outside of the United States with a version of the product that we call International *NumeriTrack*®. The resource management and assignment capabilities of International *NumeriTrack*® enables carriers around the globe to acquire and track phone numbers and other logical and physical assets for their products on both traditional and next generation wireline and wireless networks. The system will efficiently manage those assets through the lifecycle of the service, allowing carriers to spend less in acquiring new resources such as IP addresses, phone numbers and SIM cards, for various products and regions.

Mediation

Our mediation portfolio consists of network data mediation products and billing mediation. Our billing mediation product, *Evident* , was acquired as part of the Evolving Systems U.K. acquisition. Our network mediation products are Traffic Data Management System (TDMS) and *Mediation Central* .

Billing Mediation

Billing mediation is the process of collecting network usage data and verifying that usage data is accurate, and is a required pre-condition for generating accurate bills for a carrier s customers. Billing mediation s importance lies in its ability to provide a systematic point of reliability and assurance between network consumption and the billing system input. Our Evident product supports convergent voice, data, and content services. Evident enables the accurate management of data, allowing reconciliation of data inputs and outputs. In addition, Evident provides support for compliance with relevant regulatory, accounting and data integrity requirements. This product also provides service usage data for business intelligence, revenue assurance, and next-generation billing solutions. Our Evident solution can be used by wireline, broadband and wireless carriers and provides carrier-grade support in terms of reliability, performance, and scalability.

As carriers bring new services to market they often need a new mediation process to support those new services. Our Evident solution has been designed with the flexibility to support new service concepts and designs.

Network Assurance and Data Collection Solutions

A common challenge for telecommunications carriers is to create an integration layer between network element (NE) devices and the OSS applications that provision, monitor and control these devices. Deploying new devices needed for extending service offerings into the network can therefore be difficult, time consuming and expensive. Our mediation solutions provide a common framework for simplifying the collection and distribution of critical network data. Our network mediation product, Mediation Central, supports a broad array of technologies that carriers typically deploy in their network. Mediation Central provides support for wireline, broadband, transport and wireless networks. Our Mediation Central product supports both centralized and distributed configurations allowing, for example, carriers to deploy a single solution for all their data collection and distribution needs. Our TDMS product is a legacy product that helps traditional wireline carriers collect usage data from their circuit switch networks.

PROFESSIONAL AND INTEGRATION SERVICES

Our Professional and Integration Services team provides expert consulting services and advice for the design, customization, integration and deployment for our Service Activation, Numbering Solutions, and Mediation product portfolios. The Professional and Integration Services team works closely with the Product Engineering and Development teams to ensure we are up to date with the latest product developments. These services cover all aspects of the project lifecycle including system architecture and design, component design, development and customization, system integration and testing, deployment and production support, program and project level management, domain and product expertise. Our teams work closely with customers and integration partners and have established close, long-term relationships with operators in the Americas, Europe, the Middle East, Africa and Asia Pacific regions.

RESEARCH AND DEVELOPMENT

We expend amounts on research and development (R&D), particularly for new products and/or for enhancements of existing products. As discussed in Note 1 in the notes to our Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K, R&D is expensed as incurred. For the years ended December 31, 2007, 2006 and 2005, we expensed $2.4 million, $3.1 million and $1.9 million, respectively, in R&D costs. The majority of all new R&D investments in 2007 have gone into enhancing our Tertio activation solutions and internationalizing our *NumeriTrack*® inventory and assignment solution.

We focus our product development efforts on identifying specific industry and customer business needs as well as market requirements and then developing solutions that leverage our existing product capabilities. Based upon the identified customer business needs, our research and development efforts comprise a combination of design and development of new products or features to enhance our existing products, and design and development of new product functionality as identified in our product roadmaps. We build investment plans for our three principal product areas and we make other investments in tools and product extensions to accelerate the development, implementation and integration process for customer solutions.

BUSINESS STRUCTURE AND STRATEGY FOR GROWTH

We have developed a combination product/solutions business model that leverages our products and strong telecommunications domain expertise with a worldwide work force. This business model combines our U.S. and United Kingdom presence with the cost effective offshore development capabilities provided by our Indian subsidiary.

Our strategy for growth revolves around Tertio, our wireless service activation product, our international version of our *NumeriTrack*® product, and our recently released Dynamic SIM Allocation product. We continue to make investments in these products and will focus on both traditional and emerging markets as we build plans to add significant new functionality to these products. These plans include enhancing and extending the functionality of these platforms to provide a more complete and robust solution set for the activation and number/SIM management for all markets. These investments target growth in the market around wireless and wireline convergence of services on IP networks.

SALES AND MARKETING

The primary objective of our sales and marketing efforts is to identify markets for our products, create appropriate sales collateral and direct our sales force to those carriers likely to need our products and services. Our sales force builds relationships with target carriers and educates both existing and potential carriers about the depth and breadth of our capabilities, experience, product portfolio and the business case for an implementation of our solutions. Our sales and marketing efforts also include a high-level of interaction with existing customers and prospects, participation in relevant industry bodies and trade shows, a website presence, presentations at industry conferences and forums, new releases to the industry and other marketing initiatives. Many of our sales activities are a result of responding to requests for proposals and competitive tenders. The majority of our sales efforts are conducted by direct sales teams. We are increasingly engaging in sales activities with channel and business partners or system integrators such as Alcatel, Siemens and Accenture who have been selected by our customers for larger solution implementations where our products represent a portion of the overall solution. We plan to continue this approach of working with global and local partners and system integrators.

COMPETITION

The market for telecommunications OSS products is intensely competitive and is subject to rapid technological change, changing industry standards, regulatory developments and consolidation. We face increasing demand for improved product performance, reduced prices and rapid integration capabilities, and pricing pressures. Our existing and potential competitors include many large domestic and international companies that often have substantially greater financial, technological, marketing, distribution and other resources, larger installed customer bases and longer-standing relationships with telecommunications customers than we do. The market for telecommunications OSS software and services is extremely large. That notwithstanding, we currently hold only a small portion of total market share. Our increased focus on numbering solutions and activation solutions has resulted in our achieving a measurable and reasonable market share in those two areas.

Our principal competitors in activation are Comptel Corporation (Comptel), Oracle/Metasolv, Intec Telecom Systems PLC (Intec) and Synchronoss Technologies, Inc. Our principal competitors in the numbering solutions market include Telcordia Technologies, Inc., Neustar, Inc. and Syniverse Technologies. In mediation, we compete with many different companies including Intec, Amdocs and Comptel.

We believe that our ability to compete successfully depends on a wide range of factors. We compete by offering quality solutions at a competitive price that are tailored specifically to the customer. Furthermore, once our customer has implemented one of our core software products, we are in a preferable position as the incumbent vendor. Many of our customer relationships span five years or more with some extending beyond ten years. We believe these long-term relationships give us a competitive advantage and represent a barrier to entry for our competitors.

SIGNIFICANT CUSTOMERS

In 2007, approximately 35% of our consolidated revenues came from two unrelated customers in the telecommunications industry, each of which accounted for more than 10% of our consolidated revenues. Of these customers, one is located in the U.S. and the other is located in the U.K.   The loss of either of these customers would have a material adverse effect on our business as a whole.

INTELLECTUAL PROPERTY

We rely on a combination of copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. We presently have U.S. and Canadian patents on elements of our principal LNP OSS products, *NumberManager*® and *OrderPath*® and have a U.S. patent pending on elements of our Dynamic SIM Allocation product.

BACKLOG

We define backlog as firm non-cancelable sales orders that are anticipated to be delivered and recognized in revenue over the next twelve months. As of December 31, 2007 and 2006, our backlog was approximately $19.7 million and $13.8 million, respectively. Our backlog at December 31, 2007 is comprised of license fees and services of $6.5 million and customer support of $13.2 million compared to license fees and services of $4.8 million and customer support of $9.0 million at December 31, 2006.

EMPLOYEES

As of December 31, 2007, we employed 226 people including 57 in the United States, 69 in the United Kingdom and 100 in Bangalore, India. Of our worldwide staff, 82% are involved in product delivery, development, support and professional services, 10% in sales and marketing, and 8% in general administration.

ACCELERATED FILER STATUS

Companies considered accelerated or large accelerated filers under Securities Exchange Act Rule 12b-2, are required to comply with the internal control reporting and disclosure requirements of Section 404 of the Sarbanes-Oxley Act of 2002. An accelerated or large accelerated filer is defined as a company that meets the following conditions:

- Has a common equity public float of $75 million or more as of the last business day of its most recently completed second fiscal quarter;

- Has been subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least 12 calendar months;

- Previously filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and

- Is not eligible to use smaller public company disclosure standards for its annual and quarterly reports.

As of the last business day of our most recently completed second fiscal quarter, June 30, 2007, our common equity public float was less than $75 million. Therefore, we are not an accelerated or large accelerated filer, as defined in Securities Exchange Act Rule 12b-2. Under current SEC rules, we are required in this Annual Report on Form 10-K to provide a report by management assessing the effectiveness of our internal control over financial reporting as of December 31, 2007 and will be required to provide an auditor s report on internal control over financial reporting in our Annual Report on Form 10-K for the year ended December 31, 2008. The SEC has proposed delaying the auditor s attestation for an additional year, which if adopted, will delay our requirement to provide an auditor s report on internal control over financial reporting until our Annual Report on Form 10-K for the year ended December 31, 2009.

AVAILABLE INFORMATION

You can find out more information about us at our Internet website located at www.evolving.com. The information on our website is not incorporated into this Annual Report on Form 10-K. Our Annual Reports on Form 10-K, our Quarterly Reports on Form 10-Q, and our Current Reports on Form 8-K and any amendments to those reports are available free of charge on our Internet website as soon as reasonably practicable after we electronically file such material with the SEC. Additionally, these reports are available at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 or on the SEC s website at www.sec.gov. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330.

ITEM 1A. RISK FACTORS

Risks Related to Our Business

Because our quarterly and annual operating results are difficult to predict and may fluctuate, the market price for our stock may be volatile.

Our operating results have fluctuated significantly in the past and may continue to fluctuate significantly in the future. Fluctuations in operating results may result in volatility of the price of our common stock. These quarterly and annual fluctuations may result from a number of factors, including:

- the size of new contracts and when we are able to recognize the related revenue;
- our rate of progress under our contracts;
- consolidation in the communications market;
- the timing of customer and market acceptance of our products and service offerings;
- our ability to effectively manage offshore software development and control costs and turnover in India;
- budgeting cycles of our customers;
- changes in the terms and rates related to the renewal of support agreements;
- actual or anticipated changes in U.S. or foreign laws and regulations related to the telecommunications market;
- judicial or administrative actions about these laws or regulations;
- product lifecycles;
- the mix of products and services sold;
- changes in demand for our products and services;
- the timing of third-party contractors delivery of software and hardware;
- level and timing of expenses for product development and sales, general and administrative expenses;

- competition by existing and emerging competitors in the communications software markets;
- our success in developing and selling new products, controlling costs, attracting and retaining qualified personnel and expanding our sales and customer focused programs;
- software defects and other product quality problems;
- changes in our strategy;
- foreign exchange fluctuations; and
- general economic conditions.

Personnel costs are a significant component of our budgeted expense levels and, therefore, our expenses are, to a degree, variable based upon our expectations regarding future revenue. Our revenue is difficult to forecast because the market for our products and services is rapidly changing, and our sales cycle and the size and timing of significant contracts vary substantially among customers. Accordingly, we may be unable to adjust spending in a timely manner to compensate for any unexpected shortfall in revenue. Any significant shortfall from anticipated levels of demand for our products and services could adversely affect our business, financial condition, results of operations and cash flows.

Based on these factors, we believe our future quarterly and annual operating results may vary significantly from quarter to quarter and year to year. As a result, quarter-to-quarter and year-to-year comparisons of operating results are not necessarily meaningful nor do they indicate what our future performance will be. Furthermore, we believe that in future reporting periods if our operating results fall below the expectations of public market analysts or investors, it is possible that the market price of our common stock could go down.

Our results of operations could be negatively impacted if we are unable to manage our liquidity.

Our cash forecast indicates that we will have sufficient liquidity to cover anticipated operating costs as well as debt service payments for at least the next twelve months, but this could be negatively impacted to the extent we are unable to invoice and collect from our customers in a timely manner, or an unexpected adverse event, or combination of events occurs. Therefore, if the timing of cash generated from operations is insufficient to satisfy our liquidity requirements, we may require access to additional funds to support our business objectives through another debt restructuring, a credit facility or possibly the issuance of additional equity. Additional financing may not be available at all or, if available, may not be obtainable on terms that are favorable to us and not dilutive.

The indebtedness incurred in connection with the Evolving Systems U.K. acquisition may limit our ability to grow and could adversely affect our financial condition.

In February 2008, we restructured the remaining debt associated with our 2004 acquisition of Evolving Systems U.K. We replaced our existing senior term note and senior revolving facility with a new $4.0 million senior term loan, a $1.0 million U.S. revolving credit facility and a $5.0 million U.K. revolving credit facility. We used proceeds from the $4.0 million senior term loan to pay down our existing senior term note balance of approximately $3.8 million. As part of this restructuring, we used $1.0 million in existing cash to pay down approximately $0.2 million and $0.8 million in principal and interest, respectively, on our subordinated notes. No borrowings have been made under either the U.S. or U.K. revolving credit facilities. See Note 13, Subsequent Events, for further details related to changes in our Long-Term Debt.

The indebtedness incurred with respect to the acquisition of Evolving Systems U.K. is material in relation to prior levels of indebtedness. We may not have sufficient funds available to meet our operating needs or to pay the interest due on our secured debt. This debt secured by a general lien on all of our assets. If we are unable to pay the debt as it becomes due, the holders of the debt could foreclose on all of our assets. The increased level of our indebtedness, among other things, could:

- make it difficult for us to obtain any necessary future financing for working capital, capital expenditures, debt service requirements or other purposes;
- limit our flexibility in planning for, or reacting to changes in, our business; and
- make us more vulnerable in the event of a downturn in our business.

If we incur new indebtedness in the future, the related risks that we now face could intensify. Whether we are able to make required payments on our outstanding indebtedness and to satisfy any other future debt obligations will depend on our future operating performance and our ability to obtain additional debt or equity financing.

Certain provisions of the senior debt and subordinated notes payable issued in conjunction with the restructuring of our debt resulting from our acquisition of Evolving Systems U.K. call for the acceleration of payments if certain covenants are breached or cash balance thresholds are achieved.

The outstanding senior debt, as well as the subordinated notes, contain certain affirmative and negative covenants that, if breached, could result in such notes becoming immediately due and payable. The covenants include our agreement to do the following:

- maintain a specified ratio of debt to EBITDA, minimum EBITDA for the trailing twelve months, minimum liquidity, and ratio of fixed charges to EBITDA;
- comply with applicable laws and licensing requirements;
- file and pay all applicable taxes as they become due; and
- operate in the ordinary course of business.

The covenants also include our agreement not to do any of the following (except as specifically authorized):

- liquidate, dissolve or wind-up operations;
- cause or permit a change in control;
- pay any dividends or make prepayments on any indebtedness;
- acquire, merge or consolidate with any other businesses or entities or make investments in third parties;
- sell or transfer a substantial portion of our assets;
- incur additional indebtedness or permit any liens on our assets;
- make loans or enter into letters for credit or guarantees;
- enter into affiliate transactions;
- make negative pledges;
- change our methods of accounting and record keeping away from generally accepted accounting principles;
- change the nature of our business materially;
- make capital expenditures beyond established thresholds; or
- take certain other operational actions.

The covenants may limit our flexibility in planning for, or reacting to changes in, our business. Failure to comply with the covenants, if not waived, could result in the acceleration of the debt. If we are required to pay the debt on an accelerated basis, it would have a significant adverse impact on our liquidity and financial condition and could cause us to incur additional indebtedness.

Additionally, the unsecured notes issued to the Evolving Systems U.K. sellers require us to offer the note holders a prepayment on such notes at the end of any fiscal quarter if we achieve certain minimum cash thresholds. Such a requirement will restrict our liquidity and cash management flexibility. Until the notes are repaid, our ability to engage in transactions or to enter into agreements requiring significant cash investments may be adversely affected.

If we are unable to properly supervise our software development subsidiary in India, or if political or other uncertainties interfere, we may be unable to satisfactorily perform our customer contracts and our business could be materially harmed.

In February 2004, we formed Evolving Systems India, a wholly owned subsidiary of Evolving Systems, Inc. It is difficult managing development staff over multiple time zones. We are currently experiencing a high level of turnover with our Indian development staff as a result of strong competition for technology-based personnel in India. In addition, salary levels in India are steadily increasing, reducing the competitive advantages associated with offshore labor. If we are unable to effectively manage the Evolving India development staff and/or we continue to experience high levels of staff turnover, we may fail to provide quality software in a timely fashion, which could negatively affect our ability to satisfy our customer contracts. Furthermore, political changes and uncertainties in India could negatively impact the business climate there. As a result, we may be unable to satisfactorily perform our customer contracts and our business, financial condition and results of operations could be materially harmed.

We operate a global business that exposes us to additional currency, economic, regulatory and tax risks.

A significant part of our revenue comes from international sales. Our international operations are subject to the risk factors inherent in the conduct of international business, including:

- unexpected changes in regulatory requirements;
- tariffs and other barriers;
- political and economic instability;
- limited intellectual property protection;
- difficulties in staffing and managing foreign operations; and
- potentially adverse tax consequences in connection with repatriating funds.

We may not be able to sustain or increase our international revenue or repatriate cash without incurring substantial risks involving floating currency exchange rates and income tax expenses. Any of the foregoing factors may have a material adverse impact on our international operations and, therefore, our business, financial condition and results of operations.

Changes or challenges to the regulations of the communication industry could hurt the market for our products and services.

The market for our traditional North American OSS products was created and has primarily been driven by the adoption of regulations under the Telecom Act requiring Regional Bell Operating Companies (RBOCs) to implement LNP as a condition to being permitted to provide long distance services. Therefore, any changes to these regulations, or the adoption of new regulations by federal or state regulatory authorities under the Telecom Act, or any legal challenges to the Telecom Act, could hurt the market for our products and services. For example, when the FCC delayed implementation of the Telecom Act with respect to wireless carriers until November 2003, these delays impacted our revenue from our WNP products and services. Likewise, in mid-2001 when Verizon Wireless petitioned the FCC requesting forbearance from this requirement, we saw our wireless customers delay making decisions to purchase WNP products. WNP went into effect in November 2003. Any invalidation, repeal or modification in the requirements imposed by the Telecom Act or the FCC, could materially harm our business, financial condition and results of operations. In addition, customers may require, or we may find it necessary or advisable, to modify our products or services to address actual or anticipated changes in regulations affecting our customers. This could also materially harm our business, financial condition, results of operations, and cash flows. Additionally, with our acquisition of Evolving Systems U.K., we are now subject to numerous regulatory requirements of foreign jurisdictions. Any compliance failures or changes in such regulations could also materially harm our business, financial condition, results of operations and cash flows.

Consolidation in the communications industry may impact our financial performance.

The communications industry has experienced and continues to experience significant consolidation, both in the United States and internationally. These consolidations are causing our existing and potential customers to re-evaluate their OSS solutions and their capital expenditures. These consolidations have caused us to lose customers and may result in fewer potential customers requiring OSS solutions in the future. In addition, combining companies may choose a competitive OSS solution used by one of the combining companies. As our customers become larger, they generally have stronger purchasing power, which can result in reduced prices for our products, lower margins on our products and longer sales cycles. Because of the uncertainty resulting from these consolidations and the variations in our quarterly operating results, it is extremely difficult for us to forecast our quarterly and annual revenue and we have discontinued providing revenue guidance. All of these factors can have a negative impact on our financial performance, particularly in any fiscal quarter. This negative impact, in turn, could result in noncompliance with certain financial covenants governing our senior secured notes. If we were unsuccessful in amending the agreements or obtaining a waiver from our senior lender in future reporting periods, these violations could result in such notes becoming immediately due and payable. We can give no assurance that we would be successful in amending the agreements or obtaining a waiver of any covenant violation.

We depend on a limited number of significant customers for a substantial portion of our revenues, and the loss of one or more of these customers could adversely affect our business.

In the past, and currently, we earn a significant portion of our revenue from a small number of customers in the communications industry. This has been mitigated somewhat by the expansion of our customer base in recent years, but, as noted above, consolidation in the industry continues. The loss of any significant customer, delays in delivery or acceptance of any of our products by a customer, delays in the performance of services for a customer, or delays in collection of customer receivables could harm our business and operating results.

Our products are complex and have a lengthy implementation process; unanticipated difficulties or delays in the customer acceptance process could result in higher costs and delayed payments.

Implementing our solutions can be a relatively complex and lengthy process since we typically customize these solutions for each customer s unique environment. Often our customers may also require rapid deployment of our software solutions, resulting in pressure on us to meet demanding delivery and implementation schedules. Delays in implementation may result in customer dissatisfaction and/or damage our reputation which could materially harm our business.

The majority of our existing contracts provide for acceptance testing by the customer, which can be a lengthy process. Unanticipated difficulties or delays in the customer acceptance process could result in higher costs, delayed payments, and deferral of revenue recognition. In addition, if our software contains defects or we otherwise fail to satisfy acceptance criteria within prescribed times, the customer may be entitled to cancel its contract and receive a refund of all or a portion of amounts paid or other amounts as damages, which could exceed related contract revenue and which could result in a future charge to earnings. Any failure or delay in achieving final acceptance of our software and services could harm our business, financial condition, results of operations and cash flows.

Sales of our products typically require significant review and internal approval processes by our customers over an extended period of time. Interruptions in such process due to economic downturns, consolidations or otherwise could result in the loss of our sale or deferral of revenues into later periods and adversely affect our financial performance.

Large communications solutions used for enterprise-wide, mission-critical purposes, involve significant capital expenditures and lengthy implementation plans. Prospective customers typically commit significant resources to the technical evaluation of our products and services and require us to spend substantial time, effort and money providing education regarding our solutions. This evaluation process often results in an extensive and lengthy sales cycle, typically ranging between three and twelve months, making it difficult for us to forecast the timing and magnitude of our contracts. For example, customers budgetary constraints and internal acceptance reviews may cause potential customers to delay or forego a purchase. The delay or failure to complete one or more large contracts could materially harm our business, financial condition, results of operations and cash flows and cause our operating results to vary significantly from quarter to quarter and year to year.

Mergers and acquisitions of large communications companies, as well as the formation of new alliances, have resulted in a constantly changing marketplace for our products and services. Purchasing delays and pricing pressures associated with these changes are common. In addition, many of the companies in the communications industry have kept capital expenditures at historically low levels in response to changes in the communications marketplace; some companies have declared bankruptcy, cancelled contracts, delayed payments to their suppliers or delayed additional purchases. The delay or failure to complete one or more large contracts, or the loss of a significant customer, could materially harm our business, financial condition, results of operations, or cash flows, and cause our operating results to vary significantly from quarter to quarter and year to year.

Many of our products and services are sold on a fixed-price basis. If we incur budget overruns, our margins and results of operations may be materially harmed.

Currently, a large portion of our revenue is from contracts that are on a fixed-price basis. We anticipate that customers will continue to request we provide software and integration services as a total solution on a fixed-price basis. These contracts specify certain obligations and deliverables we must meet regardless of the actual costs we incur. Projects done on a fixed-price basis are subject to budget overruns. On occasion, we have experienced budget overruns, resulting in lower than anticipated margins. We may incur similar budget overruns in the future, including overruns that result in losses on these contracts. If we incur budget overruns, our margins may be harmed, thereby affecting our overall profitability.

Percentage-of-completion accounting used for most of our projects can result in overstated or understated profits or losses.

The revenue for most of our contracts is accounted for on the percentage-of-completion method of accounting. This method of accounting requires us to calculate revenues and profits to be recognized in each reporting period for each project based on our predictions of future outcomes, including our estimates of the total cost to complete the project, project schedule and completion date, the percentage of the project that is completed and the amounts of any probable unapproved change orders. Our failure to accurately estimate these often subjective factors could result in reduced profits or losses for certain contracts.

The industry in which we compete is subject to rapid technological change. If we fail to develop or introduce new, reliable and competitive products in a timely fashion, our business may suffer.

The market for our products and services is subject to rapid technological changes, evolving industry standards, changes in carrier requirements and preferences and frequent new product introductions and enhancements. The introduction of products that incorporate new technologies and the emergence of new industry standards can make existing products obsolete and unmarketable. In addition, internationalizing products that we have developed for our U.S. customer carriers is a complex process. To compete successfully, we must continue to design, develop and sell enhancements to existing products and new products that provide higher levels of performance and reliability in a timely manner, take advantage of technological advancements and changes in industry standards and respond to new customer requirements. As a result of the complexities inherent in software development, major new product enhancements and new products can require long development and testing periods before they are commercially released and delays in planned delivery dates may occur. We may not be able to successfully identify new product opportunities or achieve market acceptance of new products brought to market. In addition, products developed by others may cause our products to become obsolete or noncompetitive. If we fail to anticipate or respond adequately to changes in technology and customer preferences, or if our products do not perform satisfactorily, or if we have delays in product development, we may lose customers and our sales may deteriorate.

The market for our number portability products is mature in the U.S. and we may not be able to successfully develop new products to remain competitive.

The market for our number portability products is mature in the U.S. and we may not be able to successfully identify new product opportunities in the U.S. or abroad or achieve market acceptance of new products brought to the market. Many of the wireless carriers in the U.S. selected solutions from our competitors and it is unclear how many new opportunities there will be with these carriers. If we are unable to identify new product opportunities in the U.S. or areas outside of the U.S., sales and profit growth would be adversely affected.

The steps that we have taken to reduce costs may have a negative impact on our ability to grow and generate future revenue.

We have taken steps to reduce our expenses, such as reductions in staff and general cost control measures. If, as a result of such cost reductions, we have not adequately responded to balance expenses against revenue, or if our fixed costs cannot be reduced enough, our financial condition could be materially harmed. Likewise, cutbacks in staff may have an adverse impact on our ability to generate future revenue, because we may not have sufficient staffing to meet any unexpected increases in customer demand for our products.

The communications industry is highly competitive and if our products do not satisfy customer demand for performance or price, our customers could purchase products and services from our competitors.

Our primary markets are intensely competitive and we face continuous demand for improved product performance, new product features and reduced prices, as well as intense pressure to accelerate the release of new products and product enhancements. Our existing and potential competitors include many large domestic and international companies, including some competitors that have substantially greater financial, manufacturing, technological, marketing, distribution and other resources, larger installed customer bases and longer-standing relationships with customers than we do. Our principal competitors in the numbering solutions market include Telcordia Technologies, Syniverse Technologies and Neustar. Our principal competitors in activation are Oracle (as a result of its acquisition of Metasolv), Comptel, Intec and Synchronoss Technologies. In mediation, we compete with many different companies with no single dominant competitor. Customers also may offer competitive products or services in the future since customers who have purchased solutions from us are not precluded from competing with us. Many telecommunications companies have large internal development organizations, which develop software solutions and provide services similar to the products and services we provide. We also expect competition may increase in the future from application service providers, existing competitors and from other companies that may enter our existing or future markets with solutions which may be less costly, provide higher performance or additional features or be introduced earlier than our solutions.

We believe that our ability to compete successfully depends on numerous factors. For example, the following factors affect our ability to compete successfully:

- how well we respond to our customers needs;
- the quality and reliability of our products and services and our competitors products and services;
- the price for our products and services, as well as the price for our competitors products and services;
- how well we manage our projects;
- our technical subject matter expertise;
- the quality of our customer service and support;
- the emergence of new industry standards;
- the development of technical innovations;
- our ability to attract and retain qualified personnel;
- regulatory changes; and
- general market and economic conditions.

Some of these factors are within our control, and others are not. A variety of potential actions by our competitors, including a reduction of product prices or increased promotion, announcement or accelerated introduction of new or enhanced products, or cooperative relationships among competitors and their strategic partners, could negatively impact the sales of our products and we may have to reduce the prices we charge for our products. Revenue and operating margins may consequently decline. We may not be able to compete successfully with existing or new competitors or to properly identify and address the demands of new markets. This is particularly true in new markets where standards are not yet established. Our failure to adapt to emerging market demands, respond to regulatory and technological changes or compete successfully with existing and new competitors would materially harm our business, financial condition, results of operations and cash flows.

Our business depends largely on our ability to attract and retain talented employees.

Our ability to manage future expansion, if any, effectively will require us to attract, train, motivate and manage new employees successfully, to integrate new management and employees into our overall operations and to continue to improve our operations, financial and management systems. We may not be able to retain personnel or to hire additional personnel on a timely basis, if at all. Because of the complexity of our software solutions, a significant time lag exists between the hiring date of technical and sales personnel and the time when they become fully productive. We have at times experienced high employee turnover and difficulty in recruiting and retaining technical personnel. Our failure to retain personnel or to hire qualified personnel on a timely basis could adversely affect our business by impacting our ability to develop new products, to complete our projects and secure new contracts.

Our products are complex and may have errors that are not detected until deployment, and litigation related to warranty and product liability claims could be expensive and could negatively affect our reputation and profitability.

Our agreements with our customers typically contain provisions designed to limit our exposure to potential liability for damages arising out of the use of or defects in our products. These limitations, however, tend to vary from customer to customer and it is possible that these limitations of liability provisions may not be effective. We currently have errors and omissions insurance, which, subject to customary exclusions, covers claims resulting from failure of our software products or services to perform the function or to serve the purpose intended. To the extent that any successful product liability claim is not covered by this insurance, we may be required to pay for a claim. This could be expensive, particularly since our software products may be used in critical business applications. Defending such a suit, regardless of its merits, could be expensive and require the time and attention of key management personnel, either of which could materially harm our business, financial condition and results of operations. In addition, our business reputation could be harmed by product liability claims, regardless of their merit or the eventual outcome of these claims.

Our measures to protect our proprietary technology and other intellectual property rights may not be adequate and if we fail to protect those rights, our business would be harmed.

Our success and ability to compete are dependent to a significant degree on our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. We have a U.S. patent pending on elements of our Dynamic SIM Allocation product and we have U.S. and Canadian patents on elements of our LNP products, ***NumberManager***® and ***OrderPath***®, and U.S. patents on elements of some of our other products. In addition, we have registered or filed for registration of certain of our trademarks. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our products or technology without authorization or to develop similar technology independently through reverse engineering or other means. In addition, the laws of some foreign countries may not adequately protect our proprietary rights. Our means of protecting our proprietary rights in the U.S. or abroad may not be adequate or others may independently develop technologies that are similar or superior to our technology, duplicate our technology or design around any of our patents.

In the event that we are infringing upon the proprietary rights of others or violating licenses, we may become subject to infringement claims that may prevent us from selling certain products and we may incur significant expenses in resolving these claims.

It is also possible that our business activities may infringe upon the proprietary rights of others, or that other parties may assert infringement claims against us. If we become liable to any third party for infringing its intellectual property rights, we could be required to pay substantial damage awards and to develop non-infringing technology, obtain licenses, or to cease selling the applications that contain the infringing intellectual property. Litigation is subject to inherent uncertainties, and any outcome unfavorable to us could materially harm our business. Furthermore, we could incur substantial costs in defending against any intellectual property litigation, and these costs could increase significantly if any dispute were to go to trial. Our defense of any litigation, regardless of the merits of the complaint, likely would be time-consuming, costly, and a distraction to our management personnel. Adverse publicity related to any intellectual property litigation also could harm the sale of our products and damage our competitive position.

Certain software developed or used by Evolving Systems, as well as certain software acquired in our acquisitions of CMS, TSE or Evolving Systems U.K., may include or be derived from software that is made available under an open source software license.

- Such open source software may be made available under a license such as the GNU General Public License (GPL) or GNU Lesser General Public License (LGPL) which imposes certain obligations on us in the event we were to distribute derivative works based on the open source software. These obligations may require us to make source code for these derivative works available to the public or license the derivative works under a particular type of open source software license, rather than the license terms we customarily use to protect our software.

- There is little or no legal precedent for interpreting the terms of certain of these open source licenses, including the terms addressing the extent to which a derivative work based on open source software may be subject to these licenses. We believe we have complied with our obligations under the various applicable open source licenses. However, if the owner of any open source software were to successfully establish that we had not complied with the terms of an open source license for a particular derivative work based on that open source software, we may be forced to release the source code for that derivative work to the public or cease distribution of that work.

- We generally prohibit the combination of our proprietary software with open source software. Despite these restrictions, parties may combine our proprietary software with open source software without our authorization, in which case such parties could be forced to release to the public the source code of our proprietary software.

Disruptions from terrorist activities or military actions may have an adverse effect on our business.

The continued threat of terrorism within the U.S. and throughout the world and acts of war may cause significant disruption to commerce throughout the world. Our business and results of operations could be materially and adversely affected to the extent that such disruptions result in delays or cancellations of customer orders, delays in collecting cash, a general decrease in corporate spending on information technology, or our inability to effectively market, manufacture or ship our products. We are unable to predict whether war and the threat of terrorism or the responses thereto will result in any long-term commercial disruptions or if such activities or responses will have any long-term material adverse effect on our business, results of operations, financial condition or cash flows.

We face special risks associated with doing business in highly corrupt environments.

Our international business operations include projects in developing countries and countries torn by conflict. To the extent we operate outside the U.S., we are subject to the Foreign Corrupt Practices Act (FCPA), which generally prohibits U.S. companies and their intermediaries from paying or offering anything of value to foreign government officials for the purpose of obtaining or keeping business, or otherwise receiving discretionary favorable treatment of any kind. In particular, we may be held liable for actions taken by our local partners and agents, even though such parties are not always subject to our control. Any determination that we have violated the FCPA (whether directly or through acts of others, intentionally or through inadvertence) could result in sanctions that could have a material adverse effect on our business. While we have procedures and controls in place to monitor compliance, situations outside of our control may arise that could potentially put us in violation of the FCPA inadvertently and thus negatively impact our business.

The trading price of our stock has been subject to wide fluctuations and may continue to experience volatility in the future.

The trading price of our common stock has been subject to wide fluctuations in response to quarterly variations in operating results, announcements of technological innovations or new products by us or our competitors, merger and acquisition activity, changes in financial estimates by securities analysts, the operating and stock price performance of other companies that investors may deem comparable to us, general stock market and economic considerations and other events or factors. This may continue in the future.

In addition, the stock market has experienced volatility that has particularly affected the market prices of stock of many technology companies and often has been unrelated to the operating performance of these companies. These broad market fluctuations may negatively impact the trading price of our common stock. As a result of the foregoing factors, our common stock may not trade at or higher than its current price.

Sales of large blocks of our stock may result in the reduction in the market price of our stock and make it more difficult to raise funds in the future.

If our stockholders sell substantial amounts of our common stock in the public market, the market price of our common stock could fall. The perception among investors that such sales will occur could also produce this effect. These factors also could make it more difficult to raise funds through future offerings of common stock.

We are subject to certain rules and regulations of federal, state and financial market exchange entities, the compliance with which requires substantial amounts of management time and company resources. Any material weaknesses in our financial reporting or internal controls could adversely affect our business and the price of our common stock.

Because our common stock is publicly traded, we are subject to certain rules and regulations of federal, state and financial market exchange entities charged with the protection of investors and the oversight of companies whose securities are publicly traded. These entities, including the Public Company Accounting Oversight Board, the SEC and Nasdaq, have recently issued new requirements and regulations and are currently developing additional regulations and requirements in response to recent laws enacted by Congress, most notably the Sarbanes-Oxley Act of 2002. Our compliance with certain of these rules, such as Section 404 of the Sarbanes-Oxley Act, is likely to require the commitment of significant managerial resources. In addition, establishment of effective internal controls is further complicated because we are now a global company with multiple locations and IT systems.

We continue to review our material internal control systems, processes and procedures for compliance with the requirements of Section 404. Such a review may result in the identification of material weaknesses in our internal controls. Disclosures of material weaknesses in our SEC reports could cause investors to lose confidence in our financial reporting and may negatively affect the price of our stock. Moreover, effective internal controls are necessary to produce reliable financial reports and to prevent fraud. If we have material weaknesses in our internal control over financial reporting it may negatively impact our business, results of operations and reputation.

We have never paid dividends and do not anticipate paying cash dividends on our common stock in the foreseeable future.

We have never paid cash dividends on our common stock. We currently intend to retain all future earnings, if any, for use in the operation of our business. In addition, our senior debt and subordinated notes prohibit us from declaring dividends to our common stockholders during the term of the notes. Accordingly, we do not anticipate paying cash dividends on our common stock in the foreseeable future.

Certain provisions of our charter documents, employment arrangements and Delaware law may discourage, delay or prevent an acquisition of us, even if an acquisition would be beneficial to our stockholders, and may prevent attempts by our stockholders to replace or remove our current management.

Provisions of our amended and restated certificate of incorporation and bylaws, as well as provisions of Delaware law, could make it more difficult for a third party to acquire us, even if doing so would benefit our stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors. Because our board of directors is responsible for appointing the members of our management team, these provisions could in turn affect any attempt by our stockholders to replace current members of our management team. These provisions include:

- authorizing our board of directors to issue up to 2,000,000 shares of preferred stock and to determine the price, rights, preferences and privileges of those shares without any further vote or action by our stockholders;

- our board of directors designated 250,000 shares of Series A Junior Participating Preferred Stock that contain poison pill provisions;

- we have a staggered board with each member of the Board of Directors serving for three years; in any given year, only a portion of our Board of Directors have terms that expire;

- our stockholders cannot take action by written consent; and

- we have advance notice requirements for nominations for election to the Board of Directors or for proposing matters that can be acted upon at stockholder meetings.

In addition, we are subject to the anti-takeover provisions of Section 203 of Delaware General Corporation Law, which prohibit us from engaging in a business combination with an interested stockholder for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in the prescribed manner. The application of Section 203 and certain provisions of our restated certificate of incorporation, including a classified board of directors, may have the effect of delaying or preventing changes in control of our management, which could adversely affect the market price of our common stock by discouraging or preventing takeover attempts that might result in the payment of a premium price to our stockholders. Notwithstanding the foregoing, the three year moratorium imposed on business combinations by Section 203 will not apply to the Singer Group because, prior to the date on which the Singer Group became an interested stockholder, our board of directors approved the transaction which resulted in the Singer Group becoming an interested stockholder. However, in connection with its purchase of the Company s common stock resulting in the Singer Group becoming beneficial owners of more than 15% of the Company s stock, Karen Singer, as Trustee of the Singer Children s Management Trust, entered into a standstill agreement agreeing not to pursue, for 18 months, certain activities the purpose or effect of which may be to change or influence the control of the Company.

Our executive officers have entered into management change in control agreements with us. Each agreement generally provides for acceleration on vesting of options, 50% upon a change in control (as defined in such agreements) if the executive remains employed with the new entity, or 100% in the event such executive s employment is terminated. The acceleration of vesting of options upon a change in control may be viewed as an anti-takeover measure and may have the effect of discouraging a merger proposal, tender offer or other attempt to gain control of us.

Our Amended and Restated Stock Option Plan provides for acceleration of vesting under certain circumstances. Upon certain changes in control of us, vesting on some options awarded to directors may be accelerated. In addition, the successor corporation may assume outstanding stock awards or substitute equivalent stock awards. If the successor corporation refuses to do so, such stock awards will become fully vested and exercisable for a period of 15 days after notice from us but the option will terminate if not exercised during that period. As noted above, the acceleration on vesting of options upon a change in control may be viewed as an anti-takeover measure.

General risk statement

Based on all of the foregoing, we believe it is possible for future revenue, expenses and operating results to vary significantly from quarter to quarter and year to year. As a result, quarter-to-quarter and year-to-year comparisons of operating results are not necessarily meaningful or indicative of future performance. Furthermore, we believe that it is possible that in any given quarter or fiscal year our operating results could differ from the expectations of public market analysts or investors. In such event or in the event that adverse conditions prevail, or are perceived to prevail, with respect to our business or generally, the market price of our common stock would likely decline.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease office space at various locations which are shown below.

Location	Square Footage	Lease Expiration
Englewood, Colorado (Headquarters)	24,305	10/31/12
Bath, England	5,100	9/26/10
London, England	7,765	3/24/10
Windsor, England	118	6/30/08
Bangalore, India	1,411	1/7/08
Bangalore, India	4,404	1/7/08
Bangalore, India	776	1/7/08
Bangalore, India	776	1/7/08
Bangalore, India	1,410	2/29/08
Bangalore, India	776	2/29/08
Bangalore, India	1,575	1/14/08
Munich, Germany	732	Month-to-month
Kuala Lumpur, Malaysia	1,042	7/14/09

ITEM 3. LEGAL PROCEEDINGS

During the fourth quarter of 2006, a previous software vendor filed a complaint in the Superior Court of New Jersey against us asserting we breached certain provisions of a license agreement. While the outcome of this matter is uncertain, we believe we have paid all fees due under our license agreement and will vigorously defend this claim.

We are involved in various other legal matters arising in the normal course of business. We do not believe that any such matters are probable of loss that would have a material impact on our results of operations and financial position.

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

None.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock began trading publicly through the Nasdaq National Market under the symbol EVOL on May 12, 1998. Prior to that date, there was no public market for our common stock. We transferred from the Nasdaq National Market to the Nasdaq SmallCap Market (now known as the Nasdaq Capital Market) on August 28, 2002. The closing price of our common stock as reported on the Nasdaq Capital Market as of March 5, 2008 was $2.35 per share. The following table sets forth for the periods indicated the high and low closing sale quotations and may not be based on actual transactions for our common stock as reported on the Nasdaq Capital Market. The prices reported do not include retail mark-ups, markdowns or commissions.

	For the Years Ended December 31,			
	2007		2006	
	High	Low	High	Low
First Quarter	$ 2.10	$ 1.20	$ 2.96	$ 1.96
Second Quarter	$ 2.44	$ 1.70	$ 2.06	$ 1.25
Third Quarter	$ 2.29	$ 1.66	$ 1.44	$ 0.92
Fourth Quarter	$ 3.07	$ 1.70	$ 1.38	$ 1.00

As of March 5, 2008, there were approximately 168 holders of record of our common stock.

We have not declared or paid a cash dividend on our common stock. In addition, the notes issued in connection with the Evolving Systems U.K. acquisition prohibit us from declaring dividends to our common stockholders during the term of the notes. We currently intend to retain future earnings, if any, to finance the growth and development of our business and, therefore, do not anticipate paying cash dividends in the foreseeable future.

The graph below matches Evolving Systems, Inc. s cumulative 5-year total shareholder return on common stock with the cumulative total returns of the NASDAQ Composite index, the RDG Software Composite index and the DJ Wilshire MicroCap Software Index. The graph tracks the performance of a $100 investment in our common stock and in each of the indices (with the reinvestment of all dividends) from December 31, 2002 to December 31, 2007.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data set forth below for each of the years in the five-year period ended December 31, 2007, has been derived from our consolidated financial statements. The following selected financial data should be read in conjunction with Item 7 - Management s Discussion and Analysis of Financial Condition and Results of Operations , the consolidated financial statements and the notes thereto and other financial information included elsewhere in this Annual Report on Form 10-K. Results for 2004 include amounts related to the acquisition of Evolving Systems U.K. from the purchase date of November 2, 2004 to December 31, 2004 and amounts related to the acquisition of TSE from the purchase date of October 15, 2004 to December 31, 2004. Results for 2003 include amounts related to the acquisition of CMS from the purchase date of November 3, 2003 to December 31, 2003.

	For the Years Ended December 31, (in thousands, except per share amounts)				
	2007	2006	2005	2004	2003
Revenue	$ 35,953	$ 33,833	$ 39,452	$ 26,342	$ 27,973
Costs of Revenue and Operating Expenses:					
Cost of revenue, excluding depreciation and amortization	14,260	13,036	16,070	12,936	11,346
Sales and marketing	8,557	8,962	9,643	4,412	2,940
General and administrative	5,862	5,138	6,818	5,085	3,494
Product development (1)	2,376	3,072	1,921	1,066	2,043
Depreciation	899	1,169	1,443	1,152	1,182
Amortization (2)	1,565	2,511	5,215	1,667	130
Impairment of goodwill and intangible assets (3)		16,516			
Restructuring and other expense (4)	(4)	(21)	(49)	(15)	(9)
Income (loss) from operations	2,438	(16,550)	(1,609)	39	6,847
Interest and other, net	(1,284)	(1,837)	(1,692)	87	191
Income tax expense (benefit)	556	(1,604)	(396)	(298)	167
Net income (loss)	598	(16,783)	(2,905)	424	6,871
Deemed dividend for beneficial conversion feature of Series B convertible redeemable preferred stock (4)				3,306	
Net income (loss) available to common and preferred stockholders	$ 598	$ (16,783)	$ (2,905)	$ (2,882)	$ 6,871
Basic income (loss) available to common and preferred stockholders per common share	$ 0.03	$ (0.88)	$ (0.16)	$ (0.18)	$ 0.48
Diluted income (loss) available to common and preferred stockholders per common share	$ 0.03	$ (0.88)	$ (0.16)	$ (0.18)	$ 0.43
Weighted average basic shares outstanding	19,198	19,100	18,695	16,307	14,205
Weighted average diluted shares outstanding	19,576	19,100	18,695	16,307	16,139
Working capital (deficiency) (5)	$ 1,395	$ 803	$ 447	$ (3,343)	$ 13,836
Total assets (6)	53,727	51,338	67,398	86,601	41,701
Long-term debt, net of current portion	8,686	11,370	14,373	11,959	183
Series B convertible redeemable preferred stock (8)	5,587	11,281	11,281	11,281	
Stockholders equity (7) (8)	$ 17,928	$ 10,158	$ 22,124	$ 29,314	$ 26,473

(1) In 2004 and 2003, we expensed $90,000 and $233,000, respectively, of in-process research and development associated with the acquisitions of Evolving Systems U.K. and CMS.

(2) With the acquisition of Evolving Systems U.K. and TSE, intangible asset amortization has become a significant expense and is now being shown separately on the statements of operations. Amortization expense for the year ended December 31, 2003 of $130,000 has been reclassified to conform to the current period s presentation.

(3) In 2006, we recognized an impairment of $16.5 million on goodwill and amortizable intangible assets related to our L&S operating segment.

(4) In November 2004, we issued 966,666 shares of Series B Preferred Stock as part of our acquisition of Evolving Systems U.K. Based upon the various features of the Series B Preferred Stock, the fair value of this security was estimated to approximate the stated redemption price. Since the conversion price of the Series B Preferred Stock was fixed in the purchase agreement to equal $3.50 per common share, a beneficial conversion feature existed on the acquisition date equal to the difference between the value of our common stock on the acquisition date, or $4.64, and the conversion price stated in the purchase agreement. The beneficial conversion feature was recognized as a reduction in net income available to common stockholders of $3.3 million on the acquisition date since the Series B Preferred Stock was immediately convertible to common stock.

(5) The decrease in working capital during 2004 was a result of our acquisition of two companies, TSE and Evolving Systems U.K., during the fourth quarter of 2004. In those transactions we paid cash of $1.5 million and $11.0 million for TSE and Evolving Systems U.K., respectively. The TSE transaction also included a short-term note payable of approximately $889,000. The acquisition of Evolving Systems U.K. also included the issuance of seller-financed notes of approximately $15.9 million, including a short-term note of $4.0 million and a long-term note of approximately $11.9 million. The purchase price related to these two acquisitions, including estimated transaction costs of $2.0 million, reduced our working capital by approximately $19.4 million.

(6) The decrease in total assets from 2004 to 2005 and 2005 to 2006 is primarily due to impairment of intangible assets, amortization of intangible assets, goodwill impairment, adjustments to goodwill related to the acquisitions of TSE and Evolving Systems U.K., foreign currency translation adjustments and use of cash to pay short-term obligations owed as a result of the acquisitions of TSE and Evolving Systems U.K.

(7) The decrease in equity from 2005 to 2006 is primarily a result of the impairment of goodwill and intangible assets recorded during 2006.

(8) The decrease in Series B convertible redeemable preferred stock and the increase in stockholders equity from 2006 to 2007 is primarily the result of holders of 487,916 shares of Series B Preferred Stock, with an aggregate carrying value of $5.7 million, converting their shares of preferred stock into 1,463,748 shares of our common stock in accordance with the conversion provisions of the Series B Preferred Stock, during 2007. See also Note 13, Subsequent Events, for changes to our stockholders equity.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current expectations, estimates, and projections about Evolving Systems industry, management s beliefs, and certain assumptions made by management. Forward-looking statements include our expectations regarding product, services, and customer support revenue; our expectations associated with Evolving India and Evolving Systems U.K., and short- and long-term cash needs. In some cases, words such as anticipates , expects , intends , plans , believes , estimates , variations of these words, and similar expressions are intended to identify forward-looking statements. The following discussion should be read in conjunction with, and is qualified in its entirety by, the consolidated financial statements and the notes thereto included elsewhere in this Annual Report on Form 10-K. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth in this section and in Item 1A - Risk Factors.

OVERVIEW

We are a provider of software solutions and services to the wireless, wireline and IP carrier market. We maintain long-standing relationships with many of the largest wireline, wireless and IP communications carriers worldwide. Our customers rely on us to develop, deploy, enhance, maintain and integrate complex, highly reliable software solutions for a range of Operations Support Systems (OSS). Our activation solution is the leading packaged solution for activation in the wireless industry.

We recognize revenue in accordance with the prescribed accounting standards for software revenue recognition under generally accepted accounting principles. As a result, our license fees and services revenues fluctuate from period to period as a result of the timing of revenue recognition on existing projects.

2007 HIGHLIGHTS

Consolidated revenues increased to $36.0 million from $33.8 million, for the years ended December 31, 2007 and 2006, respectively, representing a 6% increase. This growth is primarily the result of expansion into new international markets for both activation and numbering solutions (NumeriTrack®) and follow on sales from our existing activation account base. Our investment in the emerging growth markets netted us ten new customer accounts during 2007, up from three in 2006. In addition, we sold our NumeriTrack® product outside of the United States three times during 2007, rewarding us for investments made in 2006 for this product.

Our Dynamic SIM Allocation solution was introduced in 2007. This solution utilizes our *Tertio* and NumeriTrack® technology to offer carriers a new way to provision wireless services by dynamically activating a wireless device when it is first switched on. In countries around the world, the wireless Subscriber Identity Module (SIM) card is central to the provision of wireless access and services. Our Dynamic SIM Allocation solution simplifies SIM management and inventory for wireless carriers allowing carriers to provide enhanced customer features.

As a result of the improvement in revenue, we reported net income for the year ended December 31, 2007 for the first time since the year ended December 31, 2003. Our backlog increased to $19.7 million as of December 31, 2007, from $13.8 million as of December 31, 2006. This ending backlog of $19.7 million represents our highest ending backlog for any year following our 2003 and 2004 acquisitions of Tertio Telecoms Ltd., Telecom Software Enterprises, LLC and CMS Communications, Inc.

We also had several significant improvements to our balance sheet during 2007. Benefiting from our increased cash flows from operations during 2007, we grew cash 43% while at the same time reducing our total debt. Working capital grew to $1.4 million at December 31, 2007 from $0.8 million at December 31, 2006. During 2007, holders of 487,916 shares of Series B Preferred Stock, or approximately 50% of the outstanding preferred stock as of December 31, 2006, with an aggregate carrying value of $5.7 million, converted their shares of preferred stock into 1,463,748 shares of our common stock in accordance with the conversion provisions of the Series B Preferred Stock. This conversion plus the net income earned during 2007 contributed to the increased total stockholders   equity of approximately $7.8 million or 76% from the beginning of the year total stockholders   equity balance. Additionally, subsequent to December 31, 2007, holders of 461,758 shares of Series B Preferred Stock, with an aggregate carrying value of $5.4 million, converted their shares of preferred stock into 1,385,274 shares of common stock in accordance with the provisions of the Series B Preferred Stock.

RESULTS OF OPERATIONS

The following table presents our consolidated statements of operations in comparative format.

	For the Year Ended December 31, 2007	For the Year Ended December 31, 2006	Change	For the Year Ended December 31, 2006	For the Year Ended December 31, 2005	Change
Revenue:						
License fees and services	$ 17,895	$ 15,883	$ 2,012	$ 15,883	$ 19,779	$ (3,896)
Customer support	18,058	17,950	108	17,950	19,673	(1,723)
Total revenue	35,953	33,833	2,120	33,833	39,452	(5,619)
Costs of revenue and operating expenses:						
Costs of license fees and related services, excluding depreciation and amortization	8,023	7,342	681	7,342	9,491	(2,149)
Costs of customer support, excluding depreciation and amortization	6,237	5,694	543	5,694	6,579	(885)
Sales and marketing	8,557	8,962	(405)	8,962	9,643	(681)
General and administrative	5,862	5,138	724	5,138	6,818	(1,680)
Product development	2,376	3,072	(696)	3,072	1,921	1,151
Depreciation	899	1,169	(270)	1,169	1,443	(274)
Amortization	1,565	2,511	(946)	2,511	5,215	(2,704)
Impairment of goodwill and intangible assets		16,516	(16,516)	16,516		16,516
Restructuring and other expense (recovery)	(4)	(21)	17	(21)	(49)	28
Total costs of revenue and operating expenses	33,515	50,383	(16,868)	50,383	41,061	9,322
Income (loss) from operations	2,438	(16,550)	18,988	(16,550)	(1,609)	(14,941)
Interest income	304	160	144	160	116	44
Interest expense	(1,747)	(1,992)	245	(1,992)	(1,636)	(356)
Gain on extinguishment of debt	42		42			
Gain (loss) on foreign exchange transactions	117	(5)	122	(5)	(172)	167
Income (loss) before income taxes	1,154	(18,387)	19,541	(18,387)	(3,301)	(15,086)
Income tax expense (benefit)	556	(1,604)	2,160	(1,604)	(396)	(1,208)
Net income (loss)	$ 598	$ (16,783)	$ 17,381	$ (16,783)	$ (2,905)	$ (13,878)

Revenue

Revenue is comprised of license fees and services and customer support. License fees and services revenue represent the fees we receive from the licensing of our software products and those services directly related to the delivery of the licensed product as well as integration services and time and materials work. Customer support revenue includes annual support fees, recurring maintenance fees, minor product upgrades and warranty fees. Warranty fees are typically bundled with a license sale and the related revenue, based on vendor specific objective evidence (VSOE), is deferred and recognized ratably over the warranty period. The following table presents our revenue by product line (in thousands).

	For the Years Ended December 31, 2007	2006	2005
Activation	$ 19,533	$ 16,717	$ 18,868
Numbering solutions	11,919	12,006	15,336
Mediation	4,501	5,110	5,248
	$ 35,953	$ 33,833	$ 39,452

License Fees and Services

License fees and services revenue increased 13%, or $2.0 million, to $17.9 million for the year ended December 31, 2007 compared to $15.9 million for the year ended December 31, 2006. The increase was a result of an increase of $2.3 million in revenue from our activation products and an increase of $0.5 million in revenue from our numbering solutions products, partially offset by a $0.8 million decrease in revenue from our mediation products. This growth is due to our expansion into new international markets for both activation and numbering solutions (NumeriTrack®) and follow on sales from our existing activation account base, partially offset by lower revenue from our existing mediation account base.

License fees and services revenue decreased 20%, or $3.9 million, to $15.9 million for the year ended December 31, 2006 compared to $19.8 million for the year ended December 31, 2005. The decline was a result of a decrease of $1.8 million in revenue from our activation products and a decrease of $2.1 million in revenue from our numbering solutions products. The decline in activation products revenue was due to fewer license sales resulting from industry consolidation, competitive pressures and longer customer purchasing cycles. The decline in numbering solutions license fees and services revenue was due to the maturity of the narrowband numbering solutions market in the U.S.

Customer Support

Customer support revenues increased 1%, or $0.1 million, to $18.1 million for the year ended December 31, 2007 from $18.0 million for the year ended December 31, 2006. The increase in customer support revenue was a result of an increase of $0.5 million in revenue from our activation products and an increase of $0.2 million in revenue from our mediation products, partially offset by $0.6 million in revenues from our numbering solutions products. The increase in activation customer support revenue was a result of our increased installed base. The decrease in numbering solutions customer support revenue was due to one of our products reaching its end of life.

Customer support revenues decreased 9%, or $1.7 million, to $18.0 million for the year ended December 31, 2006 from $19.7 million for the year ended December 31, 2005. The decrease in customer support revenue included a decrease of $0.3 million in our activation products, a decrease of $1.2 million from our numbering solutions products and a decrease of $0.2 million in our mediation products. The decrease in activation revenue is a result of pricing pressures on support contract renewals. The decrease in the numbering solutions revenue was due to industry consolidation and smaller overall license sales, which is reflective of the maturity of the narrowband numbering solutions market in the U.S. The decline in mediation revenue is consistent with our focus on our activation and numbering solutions products.

Costs of Revenue, excluding depreciation and amortization

Costs of revenue consist primarily of personnel costs, facilities costs, the costs of third-party software and all other direct costs associated with these personnel. Costs of revenue, excluding depreciation and amortization were $14.3 million, $13.0 million and $16.1 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Costs of License Fees and Services, excluding depreciation and amortization

Costs of revenue for license fees and services increased 9%, or $0.7 million, to $8.0 million for the year ended December 31, 2007 from $7.3 million for the year ended December 31, 2006. The increase in costs is attributed to increased labor necessary to support the increase in license fees and services revenue. As a percentage of license fees and services revenue, costs of license fees and services, excluding depreciation and amortization, decreased to 45% for the year ended December 31, 2007 from 46% for the year ended December 31, 2006. This decrease was due to reduced partner commissions for the year ended December 31, 2007.

Costs of revenue for license fees and services decreased 23%, or $2.1 million, to $7.3 million for the year ended December 31, 2006 from $9.5 million for the year ended December 31, 2005. The decrease was due to decreased revenue as well as cost savings from our 2005 cost saving initiatives. As a percentage of license fees and services revenue, costs of license fees and services, excluding depreciation and amortization, decreased to 46% for the year ended December 31, 2006 from 48% for the year ended December 31, 2005. This decrease was due to cost savings as well as savings from the increased utilization of our offshore development subsidiary in Bangalore, India.

Costs of Customer Support, excluding depreciation and amortization

Costs of revenue for customer support increased 10%, or $0.5 million, to $6.2 million for the year ended December 31, 2007 from $5.7 million for the year ended December 31, 2006. As a percentage of customer support revenue, costs of customer support revenue, excluding depreciation and amortization, increased to 35% for the year ended December 31, 2007 from 32% for the year ended December 31, 2006. These increases are due to higher support costs for our LNP products as a result of the increased porting volumes and supporting additional platforms.

Costs of revenue for customer support decreased 13%, or $0.9 million, to $5.7 million for the year ended December 31, 2006 from $6.6 million for the year ended December 31, 2005. The decrease was due to reduced revenue as well as cost savings. As a percentage of customer support revenue, costs of customer support revenue, excluding depreciation and amortization, decreased to 32% for the year ended December 31, 2006 from 33% for the year ended December 31, 2005. This decrease was primarily due to cost reductions as well as savings from the increased utilization of our offshore development subsidiary in Bangalore, India.

Sales and Marketing

Sales and marketing expenses primarily consist of compensation costs including bonuses and commissions, other employee related costs, travel expenses, advertising and occupancy expenses. Sales and marketing expenses decreased 5%, or $0.4 million, to $8.6 million for the year ended December 31, 2007 from $9.0 million for the year ended December 31, 2006. As a percentage of total revenue, sales and marketing expenses for the year ended December 31, 2007 decreased to 24% from 26% for the year ended December 31, 2006. These decreases are the result of decreased headcount.

Sales and marketing expenses decreased 7%, or $0.7 million, to $9.0 million for the year ended December 31, 2006 from $9.6 million for the year ended December 31, 2005. Cost saving measures targeted at reducing the number of U.S. sales personnel were somewhat offset by sales and marketing investments made in Asia and Central and Latin America as well as stock-based compensation expenses recorded during the year ended December 31, 2006. As a percentage of total revenue, sales and marketing expenses for the year ended December 31, 2006 increased to 26% from 24% for the year ended December 31, 2005. This increase was a result of decreased revenue without proportional decreases in sales and marketing expenses during the year ended December 31, 2006 as compared to the same period in 2005.

General and Administrative

General and administrative expenses consist principally of employee related costs, professional fees and occupancy costs for the following departments: facilities, finance, legal, human resources and executive management. General and administrative expenses increased 14%, or $0.8 million, to $5.9 million for the year ended December 31, 2007 from $5.1 million for the year ended December 31, 2006. As a percentage of total revenue, general and administrative expenses for the year ended December 31, 2007 and 2006, increased to 16% from 15%, respectively. These increases are the result of higher professional and legal fees, as well as higher incentive compensation earned due to the improved results from operations.

General and administrative expenses decreased 25%, or $1.7 million, to $5.1 million for the year ended December 31, 2006 from $6.8 million for the year ended December 31, 2005. As a percentage of total revenue, general and administrative expenses for the year ended December 31, 2006 and 2005, decreased to 15% from 17%, respectively. These decreases were primarily a result of cost saving measures and reductions in professional and legal fees which were offset by stock-based compensation costs recorded during the year ended December 31, 2006. As part of the reduction in professional fees, we did not incur any professional fees during 2006 for compliance efforts related to the Sarbanes-Oxley Act.

Product Development

Product development expenses consist primarily of employee-related costs for product development. Product development expenses decreased 23%, or $0.7 million, to $2.4 million for the year ended December 31, 2007 from $3.1 million for the year ended December 31, 2006. As a percentage of total revenue, product development expenses decreased to 7% in 2007 from 9% in 2006. These decreases were due to the completion of certain LNP product release enhancements as well as the completion of the internationalization of our NumeriTrack® product, which were under production during 2006.

Product development expenses increased 60%, or $1.2 million, to $3.1 million for the year ended December 31, 2006 from $1.9 million for the year ended December 31, 2005. As a percentage of total revenue, product development expenses increased to 9% in 2006 from 5% in 2005. These increases were due to costs incurred to internationalize our NumeriTrack® product as well as costs attributable to product enhancements during 2006.

Depreciation

Depreciation expense consists of depreciation of long-lived property and equipment. Depreciation expenses decreased 23%, or $0.3 million, to $0.9 million for the year ended December 31, 2007 from $1.2 million for the year ended December 31, 2006. This decrease is a result of certain assets becoming fully depreciated.

Depreciation expenses decreased 19%, or $0.3 million, to $1.2 million for the year ended December 31, 2006 from $1.4 million for the year ended December 31, 2005. This decrease is a result of certain assets becoming fully depreciated.

Amortization

Amortization expense consists of amortization of identifiable intangibles related to our acquisitions of CMS, TSE and Evolving Systems U.K. Amortization expenses decreased 38%, or $0.9 million, to $1.6 million for the year ended December 31, 2007 from $2.5 million for the year ended December 31, 2006. This decrease was attributable to certain intangible assets becoming fully amortized as well as the impairment of certain intangible assets during 2006.

Amortization expenses decreased 52%, or $2.7 million, to $2.5 million for the year ended December 31, 2006 from $5.2 million for the year ended December 31, 2005. This decrease was attributable to certain intangible assets becoming fully amortized as well as the impairment of certain intangible assets during 2006.

Impairment of Goodwill and Intangible Assets

During 2007, we conducted our annual goodwill impairment test and it was determined that goodwill was not impaired.

During 2006, we recorded a goodwill impairment of $10.9 million related to impairment of our License Fees and Services operating segment. Continued pricing pressures and consolidation in the telecommunications industry negatively impacted our achievement of forecasted revenues associated with the acquisitions of CMS in November 2003, TSE in October 2004 and Evolving Systems U.K. in November 2004. The market price of our common stock declined. Based upon these events, we determined that a triggering event had occurred and we conducted a goodwill impairment analysis as of June 30, 2006. This goodwill impairment analysis resulted in the $10.9 million goodwill impairment charge. We estimated the fair value of each reporting unit using the expected present value of future cash flows and other market factors.

As a result of the events that led to a triggering event related to the goodwill impairment, we first reviewed intangible assets in accordance with Statement of Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets . An evaluation of product strategy and development plans resulted in the determination that the undiscounted cash flows associated with these assets would not be sufficient to recover the carrying amounts of these assets. This review indicated that $5.6 million of intangible assets related to our License Fees and Services and Customer Support operating segments were impaired. The impaired intangible assets were purchased software, purchased licenses and customer relationships which were acquired through our acquisitions of Evolving Systems U.K., CMS and TSE. As a result of the impairment of intangible assets, our future amortization expense will be lower than originally projected by the amount of the $5.6 million impairment charge.

Interest Income

Interest income includes interest income earned on cash and cash equivalents. Interest income for the year ended December 31, 2007 increased $144,000 as compared to the year ended December 31, 2006 as a result of higher cash and cash equivalents balances.

Interest income for the year ended December 31, 2006 increased $44,000 as compared to the year ended December 31, 2005 as a result of higher cash and cash equivalents balances.

Interest Expense

Interest expense includes interest expense on our long-term debt and capital lease obligations as well as amortization of debt issuance costs. Interest expense for the year ended December 31, 2007 decreased $0.3 million to $1.7 million as compared to $2.0 million for the year ended December 31, 2006. This decrease was a result of lower outstanding debt balances as well as lower variable interest rates on our senior debt obligations.

Interest expense for the year ended December 31, 2006 increased $0.4 million to $2.0 million as compared to $1.6 million for the year ended December 31, 2005. This increase was a result of higher variable interest rates on our senior debt obligations and increased amortization of debt issuance costs.

Gain (Loss) on Foreign Exchange Transactions

Gain (loss) on foreign exchange transactions consists primarily of realized foreign currency transaction gains and losses. Foreign currency transaction gains and losses result from transactions denominated in a currency other than the functional currency of the respective subsidiary. Foreign currency transaction gain (loss) increased $122,000 to a foreign currency gain of $117,000 for the year ended December 31, 2007 compared to a $5,000 foreign currency loss for the year ended December 31, 2006. These gains were primarily generated by Evolving Systems U.K. transactions denominated in currencies other than its functional currency.

Foreign currency transaction loss decreased $0.2 million to $5,000 for the year ended December 31, 2006 compared to $0.2 million the year ended December 31, 2005. These losses were primarily generated by Evolving Systems U.K. transactions denominated in currencies other than its functional currency.

Income Tax Expense (Benefit)

We recorded net income tax expense (benefit) of $0.6 million, $(1.6) million and $(0.4) million during the years ended December 31, 2007, 2006 and 2005, respectively. The U.S. has net operating loss carryforwards of $50.5 million which are used to offset any U.S. tax liability. Our tax expense or benefit primarily relates to our U.K-based subsidiary.

The net income tax expense for the year ended December 31, 2007 of $0.6 million consisted of current tax expense of $0.9 million, partially offset by a deferred tax benefit of $0.3 million.

The net income tax benefit for the year ended December 31, 2006 of $1.6 million related primarily to our U.K.-based operations and consisted of current income tax expense of $0.3 million and a deferred tax benefit of $1.9 million. During 2006, we recorded a $224,000 current tax benefit for research and development expenses related to a change in estimate based on our as-filed 2005 tax return for Evolving Systems U.K. The deferred tax benefit of $1.9 million relates primarily to amortization expense on intangible assets.

The net income tax benefit for the year ended December 31, 2005 of $0.4 million related primarily to our U.K.-based operations and consisted of current income tax expense of $0.8 million and a deferred tax benefit of $1.2 million.

In conjunction with the acquisition of Evolving Systems U.K., certain identifiable intangible assets were recorded. Since the amortization of these identifiable intangibles is not deductible for income tax purposes, a long-term deferred tax liability of $4.6 million was established at the acquisition date for the expected difference between what would be expensed for financial reporting purposes and what would be deductible for income tax purposes. As of December 31, 2007 and 2006, this deferred tax liability was $1.2 million and $1.5 million, respectively. The deferred tax liability relates to Evolving Systems U.K. and has no impact on our ability to recover the U.S. based deferred tax assets. This deferred tax liability will be recognized as the identifiable intangibles are amortized.

A full valuation allowance was recorded against our U.S. net deferred tax assets as of December 31, 2007 and 2006 as we determined that it was more likely than not that we will not realize our U.S. deferred tax assets. Such assets primarily consist of certain net operating loss carryforwards. Our assessment of the realizability of our domestic deferred tax assets was made using all available evidence. In particular, we considered both historical results and projections of profitability for only the reasonably foreseeable future periods and any tax planning strategies.

Effective January 1, 2007, the company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. There was not a material impact on the company s consolidated financial position and results of operations as a result of the adoption of the provisions of FIN 48.

On January 1, 2007, we recorded a FIN 48 transition adjustment consisting of a $0.4 million decrease in our deferred tax assets related to Research and Development Tax Credits that was offset by a corresponding decrease in our valuation allowance. As of December 31, 2007, we had no liability for unrecognized tax benefits. We do not believe there will be any material changes our unrecognized tax positions over the next twelve months.

FINANCIAL CONDITION

Our working capital position of $1.4 million at December 31, 2007 reflects an increase of $0.6 million from our working capital position of $0.8 million at December 31, 2006. Our working capital position increased at December 31, 2007 despite $2.1 million in principal payments on our senior note payable and a $0.5 million increase in the current portion of long-term debt, in accordance with the repayment schedule associated with our senior note payable.

LIQUIDITY AND CAPITAL RESOURCES

We have historically financed operations through a combination of cash flow from operations and equity transactions. At December 31, 2007, our principal source of liquidity was $7.3 million in cash and cash equivalents and $2.5 million of unused availability under a revolving credit facility. The revolving credit facility is available through November 2010.

Net cash provided by operating activities for the years ended December 31, 2007, 2006 and 2005 was $4.8 million, $3.4 million and $0.4 million, respectively. The primary contribution to the improvement in cash provided by operating activities for the year ended December 31, 2007 is the result of net income of $0.6 million plus non-cash operating adjustments of $3.0 million compared to a net loss of $16.8 million plus non-cash operating adjustments of $19.4 million for the year ended December 31, 2006. Additionally, changes in operating assets and liabilities reflected an increase of $0.5 million in cash from operating activities in 2007 from 2006. For the year ended December 31, 2006, net loss of $16.8 million plus non-cash operating adjustments of $19.4 million compared to a net loss of $2.9 million plus non-cash operating adjustments of $7.0 million for the year ended December 31, 2005 resulted in a decrease in cash from operating activities. However, changes in operating assets and liabilities reflected a net increase in cash from operating activities in an increase of $4.4 million in 2006 from 2005. These fluctuations were primarily attributable to the timing of billings and collections for existing projects which vary based upon the specific billing schedules in each contract and affect the reported amounts of contract receivables, unbilled work-in-process and unearned revenue.

Net cash used by investing activities was $0.4 million, $0.6 million and $1.3 million for the years ended December 31, 2007, 2006 and 2005, respectively. During 2007, we purchased $0.5 million in property and equipment to support operations, partially offset by reductions in restricted cash of $0.2 million. During 2006, we purchased $0.5 million in property and equipment to support operations and paid additional cash consideration to the TSE sellers of approximately $0.2 million. During 2005, we purchased $0.8 million in property and equipment to support operations, paid additional cash consideration to the TSE sellers of approximately $0.8 million, including $0.3 million which was accrued as of December 31, 2004, received $0.1 million in settlement of pre-acquisition contingencies from the Evolving U.K. acquisition, which were partially offset by a reduction in restricted cash of $0.1 million.

Net cash used in financing activities was $2.1 million, $1.9 million and $6.0 million for the years ended December 31, 2007, 2006 and 2005, respectively. The net cash used in financing activities during 2007 is the result of $2.1 million in principal payments on our senior debt facility. The net cash used during 2006 of $1.9 million included $2.0 million in principal payments on our senior debt facility. During 2005, we paid $16 million toward reduction of our obligations incurred in connection with the TSE and Evolving Systems U.K. acquisitions which included a debt restructuring prepayment of $8.5 million to the Evolving Systems U.K. sellers. This prepayment was funded through proceeds obtained from an $8.5 million senior note payable that matures in November 2010. We restructured the remaining $4.9 million in debt obligations to the Evolving Systems U.K. sellers. The addition of the senior note payable and restructuring of the Evolving Systems U.K. seller debt reduced our scheduled principal payments through December 31, 2007, from approximately $12.0 million to $3.0 million. In addition, we obtained a $4.5 million senior revolving credit facility in November 2005 which required a minimum draw down of $2.0 million.

Our capital expenditures over the last three years averaged $0.6 million annually. A financial covenant on our senior note payable prohibits capital expenditures in excess of $1.4 million annually. Over the next twelve months, we expect our capital expenditure requirements will approximate $1.0 million which will be used to support operations.

We believe that our current cash and cash equivalents, together with anticipated cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months. In making this assessment, we considered the following:

- Our cash and cash equivalents balance at December 31, 2007 of $7.3 million;

- The availability under our revolving credit facility of $2.5 million at December 31, 2007;

- Our demonstrated ability to generate positive operating cash flows;

- Our backlog of approximately $19.7 million, including $6.5 million in license fees and services and $13.2 million in customer support at December 31, 2007;

- Our planned capital expenditures; and

- Regardless of the long-term debt restructuring, our cash forecast indicates that we will have sufficient liquidity to cover anticipated operating costs as well as debt service payments.

On February 22, 2008, we replaced our existing senior term note and senior revolving facility with a new $4.0 million senior term loan, a $1.0 million U.S. revolving credit facility (U.S. Revolving Facility) and a $5.0 million U.K. revolving credit facility (U.K. Revolving Facility). Upon execution of these new debt agreements, the entire $1.0 million and $5.0 million was available for borrowing under the U.S. Revolving Facility and the U.K. Revolving Facility, respectively. The new debt agreements improve our liquidity position by decreasing our average interest rates as well as providing additional borrowing capacity. See Note 13, Subsequent Events, for further details on changes to our long-term debt.

We are exposed to foreign currency rate risks which impact the carrying amount of our foreign subsidiaries and our consolidated equity, as well as our consolidated cash position due to translation adjustments. For the year ended December 31, 2007, the effect of exchange rate changes resulted in a $0.1 million reduction to consolidated cash. For the year ended December 31, 2006, the effect of exchange rate changes resulted in a $0.4 million increase to consolidated cash. During the year ended December 31, 2005, the effect of exchange rate changes resulted in a $0.6 million reduction to consolidated cash. We do not currently hedge our foreign currency exposure, but we intend to monitor the rate changes and may hedge our exposures if we see significant negative trends in exchange rates.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have a material current effect or that are reasonably likely to have a material future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Contractual Obligations and Commercial Commitments

The following summarizes our significant contractual obligations as of December 31, 2007, which are comprised of a capital lease, operating leases and principal and interest payments on our long-term debt, assuming no prepayments are made (in thousands).

	Payments due by period				
	Total	**2008**	**2009-2010**	**2011-2012**	**2013 and thereafter**
Long-term debt (1)	$ 11,186	$ 2,500	$ 3,919	$ 4,767	$

Interest on debt (2)		5,673		472		407		4,794	
Capital lease		130		30		60		40	
Operating leases		3,638		984		1,718		936	
Total commitments	$	20,627	$	3,986	$	6,104	$	10,537	$

(1) See Note 13, Subsequent Events, for changes to our long-term debt.

(2) Interest on debt represents cash interest payment obligations assuming all indebtedness at December 31, 2007 will be paid in accordance with its contractual terms and maturity and assumes interest rates on variable interest debt as of December 31, 2007 will remain unchanged in future periods.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are disclosed in Note 1 of our Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K. The following discussion addresses our most critical accounting policies, which are those that are both important to the portrayal of our financial condition and results of operations and that require significant judgment or use of complex estimates.

Revenue Recognition

We derive revenue from two primary sources: license fees/services and customer support. We recognize revenue in accordance with Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended and interpreted by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. In addition we have applied Staff Accounting Bulletin

(SAB) No. 104, Revenue Recognition, which provides further interpretive guidance for public companies on the recognition, presentation and disclosure of revenue in financial statements.

The majority of our license fees and services revenue is generated from fixed-price contracts which provide for licenses to our software products and services. Generally, when the services are determined to be essential to the functionality of the delivered software, we recognize revenue using the percentage-of-completion method of accounting, in accordance with SOP 97-2 and SOP 81-1, Accounting for Long-Term Construction Type Contracts. The percentage of completion for each contract is estimated based on the ratio of direct labor hours incurred to total estimated direct labor hours. Since estimated direct labor hours and project costs, and changes thereto, can have a significant impact on revenue recognition, these estimates are critical and are reviewed by management regularly. Amounts billed in advance of services being performed are recorded as unearned revenue. Unbilled work-in-progress represents revenue earned but not yet billable under the terms of the fixed-price contracts. All such amounts are expected to be billed and collected within 12 months.

We may encounter budget and schedule overruns on fixed price contracts caused by increased labor, overhead or material costs. Adjustments to cost estimates are made in the periods in which the facts requiring such revisions become known. Estimated losses, if any, are recorded in the period in which current estimates of total contract revenue and contract costs indicate a loss.

In arrangements where the services are not essential to the functionality of the delivered software, we recognize license revenue when a license agreement has been signed, delivery has occurred, the fee is fixed or determinable and collectibility is reasonably assured. Where applicable, fees from multiple element arrangements are unbundled and recorded as revenue as the elements are delivered to the extent that vendor specific objective evidence (VSOE) of fair value of the undelivered elements exist. If VSOE for the undelivered elements does not exist, fees from such arrangements are deferred until the earlier of the date that VSOE does exist on the undelivered elements or all of the elements have been delivered.

Services revenue provided under fixed-price contracts is generally recognized using the percentage of completion method described above. Revenue from professional services provided pursuant to time-and-materials contracts and training services are recognized as the services are performed, as that is when our obligation to our customers under such arrangements is fulfilled.

Customer support and maintenance revenue is generally recognized ratably over the service contract period. When maintenance or training services are bundled with the original license fee arrangement, their fair value, based upon VSOE, is deferred and recognized during the periods such services are provided.

Allowance for Doubtful Accounts

We make judgments related to our ability to collect outstanding accounts receivable. We provide allowances for receivables when their collection becomes doubtful by recording an expense. Generally, we determine the allowance based on our assessment of the realization of receivables using historical information and current economic trends, including assessing the probability of collection from customers. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments owed to us, an increase in the allowance for doubtful accounts would be required. We evaluate the adequacy of the allowance regularly and make adjustments accordingly. Adjustments to the allowance for doubtful accounts could materially affect our results of operations.

Income Taxes

We account for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. Significant judgment is required in determining our provision for income taxes. We assess the likelihood that our deferred tax asset will be recovered from future taxable income, and to the extent we believe that recovery is not likely, we establish a valuation allowance. We consider future taxable income projections, historical results and ongoing tax planning strategies in assessing the recoverability of deferred tax assets. However, adjustments could be required in the future if we determine that the amount to be realized is less or greater than the amount that we recorded. Such adjustments, if any, could have a material impact on our results of our operations.

Effective January 1, 2007, the company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. There was not a material impact on the company s consolidated financial position and results of operations as a result of the adoption of the provisions of FIN 48.

On January 1, 2007, we recorded a FIN 48 transition adjustment consisting of a $0.4 million decrease in our deferred tax assets related to Research and Development Tax Credits that was offset by a corresponding decrease in our valuation allowance. As of December 31, 2007, we had no liability for unrecognized tax benefits. We do not believe there will be any material changes our unrecognized tax positions over the next twelve months.

Goodwill

Goodwill is the excess of acquisition cost of an acquired entity over the fair value of the identifiable net assets acquired. Goodwill is not amortized, but tested for impairment annually or whenever indicators of impairment exist. These indicators may include a significant change in the business climate, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business or other factors. For purposes of the goodwill evaluation, we compare the fair value of each of our reporting units to its respective carrying amount. If the carrying value of a reporting unit were to exceed its fair value, we would then compare the fair value of the reporting unit s goodwill to its carrying amount, and any excess of the carrying amount over the fair value would be charged to operations as an impairment loss. During the year ended December 31, 2006, we recorded an impairment of goodwill. See Note 2 to the Consolidated Financial Statements for further details.

Intangible Assets

We allocate the co