INTERVOICE INC
Form 10-Q
July 06, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED May 31, 2007**

OR

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

Commission file number: 1-15045

INTERVOICE, INC.
(Exact name of registrant as specified in its charter)

TEXAS	**75-1927578**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
17811 WATERVIEW PARKWAY, DALLAS, TX	**75252**
(Address of principal executive offices)	**(Zip Code)**

972-454-8000
(Registrant s telephone number, including area code)

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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-Accelerated Filer o

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

The Registrant had 38,907,646 shares of common stock, no par value per share, outstanding as of June 25, 2007.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

INTERVOICE, INC.
CONSOLIDATED BALANCE SHEETS

	(In Thousands, Except Share and Per Share Data)	
	May 31, 2007 (Unaudited)	February 28, 2007
ASSETS		
Current Assets		
Cash and cash equivalents	$ 40,754	$ 28,215
Trade accounts receivable, net of allowance for doubtful accounts of $1,345 in fiscal 2008 and $1,476 in fiscal 2007	28,508	36,837
Inventory	16,892	13,751
Prepaid expenses and other current assets	3,662	3,909
Income taxes receivable	624	1,098
Deferred income taxes	4,480	3,880
	94,920	87,690
Property and Equipment, net of accumulated depreciation of $64,753 in fiscal 2008 and $62,419 in fiscal 2007	34,162	34,429
Other Assets		
Intangible assets, net of accumulated amortization of $20,789 in fiscal 2008 and $20,040 in fiscal 2007	8,924	9,505
Goodwill	32,193	32,193
Long term deferred income taxes	2,688	4,613
Other assets	142	135
	$ 173,029	$ 168,565
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 15,762	$ 12,881
Accrued expenses	13,176	15,571
Customer deposits	4,306	4,365
Deferred income	37,951	32,368
Deferred income taxes	322	196
	71,517	65,381
Stockholders Equity		

Preferred stock, $100 par value 2,000,000 shares authorized: none issued				
Common stock, no par value, at nominal assigned value 62,000,000 shares authorized: 38,866,893 issued and outstanding in fiscal 2008 and 38,727,628 issued and outstanding in fiscal 2007		19		19
Additional capital		103,217		101,608
Retained earnings (deficit)		(1,559)		1,861
Accumulated other comprehensive loss		(165)		(304)
		101,512		103,184
	$	173,029	$	168,565

See notes to consolidated financial statements.

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INTERVOICE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	(In Thousands, Except Per Share Data) Three Months Ended	
	May 31, 2007	May 31, 2006
Sales		
Solutions	$ 21,702	$ 19,469
Recurring services	26,029	26,199
	47,731	45,668
Cost of goods sold		
Solutions	15,182	12,304
Recurring services	7,291	7,474
	22,473	19,778
Gross margin		
Solutions	6,520	7,165
Recurring services	18,738	18,725
	25,258	25,890
Research and development expenses	5,317	5,782
Selling, general and administrative expenses	20,693	20,800
Amortization of acquisition related intangible assets	695	581
Income (loss) from operations	(1,447)	(1,273)
Interest income	590	499
Other income (expense)	(144)	207
Income (loss) before taxes	(1,001)	(567)
Income taxes (benefit)	(128)	(162)
Net income (loss)	$ (873)	$ (405)
Net income (loss) per share basic	$ (0.02)	$ (0.01)

Shares used in basic per share computation		38,807		38,504
Net income (loss) per share diluted	$	(0.02)	$	(0.01)
Shares used in diluted per share computation		38,807		38,504

See notes to consolidated financial statements.

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INTERVOICE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	(In Thousands) Three Months Ended	
	May 31, 2007	May 31, 2006
Operating activities		
Net income (loss)	$ (873)	$ (405)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	3,035	2,678
Non-cash compensation expense	1,008	1,381
Change in accounts receivable	8,337	59
Other changes in operating activities	2,573	314
Net cash provided by operating activities	14,080	4,027
Investing activities		
Purchases of property and equipment	(2,142)	(4,407)
Purchase of Edify Corporation		(836)
Net cash used in investing activities	(2,142)	(5,243)
Financing activities		
Exercise of stock options	601	149
Net cash provided by financing activities	601	149
Effect of exchange rates on cash		453
Increase (decrease) in cash and cash equivalents	12,539	(614)
Cash and cash equivalents, beginning of period	28,215	42,076
Cash and cash equivalents, end of period	$ 40,754	$ 41,462

See notes to consolidated financial statements.

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INTERVOICE, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(Unaudited)
(In Thousands, Except Share Data)

	Common Stock		Additional	Retained Earnings	Accumulated Other Comprehensive	
	Shares	Amount	Capital	(Deficit)	Loss	Total
Balance at February 28, 2007	38,727,628	$ 19	$ 101,608	$ 1,861	$ (304)	$ 103,184
Net income (loss)				(873)		(873)
Foreign currency translation adjustment					139	139
Comprehensive income						(734)
Cumulative effect of adopting FIN48				(2,547)		(2,547)
Exercise of stock options	139,265		601			601
Non-cash compensation			1,008			1,008
Balance at May 31, 2007	38,866,893	$ 19	$ 103,217	$ (1,559)	$ (165)	$ 101,512

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
THREE MONTHS ENDED MAY 31, 2007

Note A Basis of Presentation

We have prepared the accompanying consolidated financial statements in accordance with generally accepted accounting principles for interim financial information. The consolidated balance sheet at February 28, 2007 has been derived from audited financial statements at that date. We believe we have included all adjustments necessary for a fair presentation of the unaudited May 31, 2007 and 2006 consolidated financial statements. Such adjustments are of a normal recurring nature. These financial statements should be read in conjunction with our audited financial statements and related notes for the three years ended February 28, 2007 included in our Annual Report on Form 10-K. Our Annual Report is available on our website at www.intervoice.com. Our operating results for the three-month period ended May 31, 2007 are not necessarily indicative of the results that may be expected for our fiscal year ending February 29, 2008, as our results may be affected by a number of factors including the timing and ultimate receipt of orders from significant customers which continue to constitute a large portion of our sales, the sales channel mix of products and services sold, and changes in general economic conditions, any of which could have an adverse effect on our operations.

Our consolidated financial statements include the accounts of Intervoice, Inc. and our subsidiaries, all of which are directly or indirectly 100% owned by Intervoice, Inc. All significant intercompany transactions and accounts have been eliminated in consolidation. Financial statements of our foreign subsidiaries have been translated into U.S. dollars at current and average exchange rates. Resulting translation adjustments are recorded in stockholders equity as a part of accumulated other comprehensive loss. Any foreign currency transaction gains and losses are included in the accompanying consolidated statements of operations. Our total comprehensive loss for the first quarter of fiscal 2008 was $0.7 million and our total comprehensive income for the first quarter of fiscal 2007 was $0.5 million. Total comprehensive income/loss is comprised of net income/loss and foreign currency translation adjustments.

Note B Inventory

Our inventory consists of the following (in thousands):

	May 31, 2007	February 28, 2007
Purchased parts	$ 4,424	$ 4,475
Work in progress	12,468	9,276
	$ 16,892	$ 13,751

Note C Property & Equipment

Our property and equipment consisted of the following (in thousands):

	May 31, 2007	February 28, 2007
Land and buildings	$ 17,411	$ 17,385
Computer equipment and software	53,925	52,364
Furniture and fixtures	3,438	3,344
Managed services equipment	16,998	16,481
Maintenance services equipment	7,143	7,274
	98,915	96,848
Less allowance for accumulated depreciation	64,753	62,419
Property and equipment, net	$ 34,162	$ 34,429

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Note D Stock-based Compensation

Our stock-based employee compensation plans are fully described in Note J in our 2007 Annual Report on Form 10-K. The following is the effect of adopting SFAS 123R as of March 1, 2006 (in thousands):

	Three Months Ended May 31, 2007	Three Months Ended May 31, 2006
Cost of Goods Sold	$ 201	$ 263
R&D	130	150
SG&A	677	926
Total	$ 1,008	$ 1,339
Related deferred income tax benefit	342	389
Decrease in net income	$ 666	$ 950
Decrease in earning per share basic	$ 0.02	$ 0.02

Note E Special Charges

Fiscal 2008

During the first quarter of fiscal 2008, we incurred approximately $1.8 million associated with severance and organizational changes affecting approximately 45 positions. In addition, we reversed a facilities related charge of approximately $0.3 million. The following table summarizes the effect on reported operating results by financial statement category of this restructuring charge activity for fiscal 2008 (in thousands):

	Cost of Goods Sold	Research and Development	Selling, General and Administrative	Total
Severance payments and related benefits	$ 396	$ 451	$ 957	$ 1,804

Of the severance and related benefits, $1.7 million remained accrued at May 31, 2007.

Fiscal 2007

Accrued expenses at February 28, 2007 included amounts associated with three severance and organizational changes affecting approximately 55 positions as well as special charges incurred in connection with the elimination of redundant office leases. Activity during the first quarter of fiscal 2008 related to such accruals was as follows (in thousands):

	Accrued Balance February 28, 2007	Payments	Accrued Balance May 31, 2007
Severance payments and related benefits	$ 886	$ (469)	$ 417
Facility costs	134		134
Total	$ 1,020	$ (469)	$ 551

Note F Income Taxes

For the three months ended May 31, 2007 our quarterly effective tax rate of 13% varies from the U.S. federal statutory rate primarily due to certain non-deductible expenditures, an increase in the valuation allowance associated with our U.K. deferred tax assets and the effect of non-U.S. income tax rates. Our U.K. deferred tax assets remain fully reserved accordingly, we did not recognize the tax benefit associated with our first quarter U.K. loss.

For the three months ended May 31, 2006, our quarterly effective tax rate differed from the U.S. federal statutory rate primarily due to expected benefits to be realized from the use of state net operating losses and certain foreign deferred tax assets for which we had not previously realized a benefit due to our uncertainty related to the utilization of those tax assets, and the effect of non-U.S. income tax rates.

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In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in enterprises financial statements in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109). The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Also, the interpretation provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, and we adopted the interpretation in the first quarter of fiscal 2008.

As a result of our adoption of FIN 48, we recognized a cumulative effect adjustment of $2.5 million, increasing our liability for unrecognized tax benefits and related penalties and interest by $0.3 million, decreasing our non-current deferred tax assets by $2.2 million, and reducing the March 1, 2007 balance of retained earnings by $2.5 million. As of the date of adoption, our unrecognized tax benefits totaled $3.6 million, of which $0.7 million, if recognized, would affect our effective tax rate. We do not anticipate a significant change to the total amount of unrecognized tax benefits over the next twelve months.

We conduct business globally and, as a result, we, or one or more of our subsidiaries, files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. In the normal course of business, we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the U.K., Germany, Canada and the United States. Although we believe our tax estimates and our tax positions are reasonable, the final outcome of tax audits could be materially different, both favorable and unfavorable. With few exceptions, we are no longer subject to U.S. federal income tax examinations for years before fiscal 2005, and state and local income tax examinations for years before fiscal 2004. With respect to our U.S. federal, state and local net operating loss (NOL) carryforwards, we have years open under statutes of limitations back to fiscal year 2002, where tax authorities may not adjust income tax liabilities for these years, but can reduce NOL carryforwards and other tax attribute carryforwards to future open tax years.

We recognize potential interest and penalties related to unrecognized tax benefits as interest expense and penalties expense, respectively. As of May 31, 2007, we have accrued less than $0.1 million for the potential payment of interest and penalties related to uncertain tax positions.

Note G Earnings Per Share

	Three Months Ended May 31,	
(in thousands, except per share data)	2007	2006
Numerator:		
Net income (loss)	$ (873)	$ (405)
Denominator:		
Denominator for basic earnings per share	38,807	38,504
Dilutive potential common shares:		
Employee stock options		
Denominator for diluted earnings per share	38,807	38,504
Net income per share:		

Basic	$	(0.02)	$	(0.01)
Diluted	$	(0.02)	$	(0.01)

Options to purchase 7,532,240 and 4,611,008 shares of common stock at an average exercise price of $8.19 and $10.04 per share were outstanding at May 31, 2007 and 2006, respectively, but were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive given our loss for the quarters.

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Note H Operating Segment Information and Major Customers

We operate as a single, integrated business unit. Our chief operating decision maker assesses performance and allocates resources on an enterprise wide basis. Our product line includes voice portal solutions, messaging solutions, payment solutions, maintenance and related services, and hosted solutions provided for customers on an outsourced or hosted solutions provider basis. We believe that product line distinction provides the most meaningful breakdown of quarterly and annual sales activity. Our net sales by product line for the three months ended May 31, 2007 and 2006 were as follows (in thousands):

	Three Months Ended May 31,	
	2007	2006
Voice portal solution sales	$ 13,249	$ 13,744
Messaging solution sales	6,526	3,718
Payment solution sales	1,927	2,007
Total solution sales	21,702	19,469
Maintenance and related services revenues	21,275	20,185
Hosted solutions revenues	4,754	6,014
Total recurring services revenues	26,029	26,199
Total sales	$ 47,731	$ 45,668

Geographic Operations

We assign revenues to geographic areas based on the locations of our customers. Our net sales by geographic area for the three-month periods ended May 31, 2007 and 2006 were as follows (in thousands):

	Three Months Ended May 31,	
	2007	2006
North America	$ 31,164	$ 27,041
Europe	8,251	8,736
Middle East and Africa	4,931	3,077
Central and South America	1,036	4,726
Pacific Rim	2,349	2,088
Total	$ 47,731	$ 45,668

Concentration of Revenue

No customer accounted for 10% or more of our revenue for the quarter ended May 31, 2007. One customer, O2, accounted for approximately 10% of our revenue for the quarter ended May 31, 2006.

Note I Contingencies

Intellectual Property Matters

We generally provide our customers a qualified indemnity against the infringement of third party intellectual property rights. From time to time, various owners of patents and copyrighted works send us or our customers letters alleging that our products do or might infringe upon the owner s intellectual property rights, and/or suggesting that we or our customers should negotiate a license or cross-license agreement with the owner. Our policy is to never knowingly infringe upon any third party s intellectual property rights. Accordingly, we forward any such allegation or licensing request to our outside legal counsel for their review, analysis and, where appropriate, opinion. We generally attempt to resolve any such matter by informing the owner of our position concerning non-infringement or invalidity, and/or, if appropriate, negotiating a license or cross-license agreement. Even though we attempt to resolve these matters without litigation, it is always possible that the owner of a patent or copyrighted work will sue us. Other than the current litigation with a patent holder discussed in Pending Litigation in this Note I, no such litigation is currently pending against us. We currently have a portfolio of 86 United States patents, and we have applied for and will continue to apply for and receive

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a number of additional patents to protect our technological innovations. We believe our patent portfolio could allow us to assert counterclaims for infringement against certain owners of intellectual property rights if those owners were to sue us for infringement.

From time to time Ronald A. Katz Technology Licensing L.P. (RAKTL) has sent letters to certain of our customers suggesting that the customer should negotiate a license agreement to cover the practice of certain patents owned by RAKTL. In the letters, RAKTL has alleged that certain of its patents pertain to certain enhanced services offered by network providers, including prepaid card and wireless services and postpaid card services. RAKTL has further alleged that certain of its patents pertain to certain call processing applications, including applications for call centers that route calls using a called party s DNIS identification number. As a result of the correspondence, many of Intervoice s customers have had discussions, or are in discussions, with RAKTL.

We offer certain products that can be programmed and configured to provide enhanced services to network providers and call processing applications for call centers. Our contracts with customers usually include a qualified obligation to indemnify and defend customers against claims that products as delivered by Intervoice infringe a third party s patent. None of our customers has notified us that RAKTL has claimed that any specific product provided by us infringes any claims of any RAKTL patent. Accordingly, we have not been required to defend any customers against a claim of infringement under a RAKTL patent. We have, however, received letters from customers notifying us of the efforts by RAKTL to license its patent portfolio and reminding us of our potential obligations under the indemnification provisions of our agreements in the event that a claim is asserted.

Some of our customers have licensed certain rights under the RAKTL patent portfolio. Two such customers who had previously attempted to tender the defense of their products to us informed us that they had entered into agreements to license certain rights under the RAKTL patents and demanded we indemnify them for unspecified amounts, including attorney s fees, paid in connection with the license agreements. We notified these customers that we believe we do not have any indemnity obligation in connection with the license agreements. We have received no further response from either customer.

A number of customers, including customers of ours and our Edify Corporation subsidiary (Edify) have been sued as defendants in several lawsuits brought by RAKTL in the United States District Court for the Eastern District of Texas and the United States District Court for the District of Delaware. Several of these defendants who are also customers have notified us or Edify of the lawsuits pursuant to the indemnity paragraphs of their respective sales agreements and have indicated to us that the lawsuits could potentially impact the defense and indemnity paragraphs of their respective sales agreements. Neither we nor Edify believe that we have a current obligation to defend or indemnify these customers in connection with the current allegations made in the RAKTL lawsuits and when contacted we have requested that the customers provide additional information concerning the assertions made by RAKTL.

In response to the correspondence from, and litigation initiated by, RAKTL, a few of our customers and customers of Edify have attempted to tender to us the defense of our products under contractual indemnity provisions. We have informed these customers that, while we fully intend to honor any contractual indemnity provisions, we do not believe we currently have any obligation to provide such a defense because RAKTL does not appear to have made a claim, either in the correspondence or litigation, that any Intervoice product infringes a RAKTL patent. Some of these customers have disagreed with us and stated that they believe that the statements and allegations contained within correspondence and/or litigation pleadings filed by RAKTL can be construed as a claim against Intervoice products.

Even though no claims have been made by RAKTL that a specific product offered by Intervoice infringes any claim under the RAKTL patent portfolio, we have received opinions from our outside patent counsel that certain products and applications we offer do not infringe certain claims of the RAKTL patents. We have also received opinions from our outside counsel that certain claims under the RAKTL patent portfolio are invalid or unenforceable. Furthermore, based on the reviews by outside counsel, we are not aware of any valid and enforceable claims under the RAKTL portfolio that are infringed by our products. If we do become involved in litigation in connection with the RAKTL patent portfolio, under a contractual indemnity or any other legal theory, we intend to vigorously contest the claims and to assert appropriate defenses.

We have received letters from Webley Systems (Webley), a division of Parus Holdings, Inc. (Parus), and its counsel alleging that certain Webley patents cover one or more of our products and services. In the letters, Parus offers a license to the Webley patents. As a result of the correspondence, we conducted

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discussions with Parus. We have not had any recent discussions with Parus. Based on reviews by our outside counsel, we are not aware of any valid and enforceable claims under the Webley patents that are infringed by our products or services.

Pending Litigation

David Barrie, et al., on Behalf of Themselves and All Others Similarly Situated v. InterVoice-Brite, Inc., et al., No. 3-01CV1071-D, pending in the United States District Court, Northern District of Texas, Dallas Division:

Several related class action lawsuits were filed in the United States District Court for the Northern District of Texas on behalf of purchasers of common stock of Intervoice during the period from October 12, 1999 through June 6, 2000 (the Class Period). Plaintiffs have filed claims, which were consolidated into one proceeding, under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the Exchange Act) and Securities and Exchange Commission (SEC) Rule 10b-5 against us as well as certain named current and former officers and directors of Intervoice on behalf of the alleged class members. In the complaint, Plaintiffs claim that we and the named current and former officers and directors issued false and misleading statements during the Class Period concerning the financial condition of Intervoice, the results of the merger with Brite and the alleged future business projections of Intervoice. Plaintiffs have asserted that these alleged statements resulted in artificially