BLACKBAUD INC
Form S-1/A
March 03, 2005

As filed with the Securities and Exchange Commission on March 3, 2005

Registration Statement No. 333-122122

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 2
TO

FORM S-1

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

Blackbaud, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**7372**	**11-2617163**
(State or other jurisdiction of incorporation or organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification No.)*

2000 Daniel Island Drive
Charleston, South Carolina 29492
Telephone: (843) 216-6200
(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Robert J. Sywolski
Chief Executive Officer
Blackbaud, Inc.
2000 Daniel Island Drive
Charleston, South Carolina 29492
Telephone: (843) 216-6200
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Donald R. Reynolds, Esq.
Kevin A. Prakke, Esq.
Wyrick Robbins Yates & Ponton LLP
4101 Lake Boone Trail, Suite 300
Raleigh, North Carolina 27607
Telephone: (919) 781-4000
Facsimile: (919) 781-4865

Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this registration statement.

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

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

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

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

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

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

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

Subject to completion, dated March 3, 2005

Prospectus

10,000,000 shares

BLACKBAUD, INC.

Common stock

This prospectus relates to the offer and sale from time to time of up to an aggregate of 10,000,000 shares of our common stock for the account of the selling stockholders named in this prospectus. The selling stockholders may sell the common stock from time to time in public transactions or in privately negotiated transactions, without limitation, through any means described in the section hereof entitled Plan of Distribution , at market prices prevailing at the time of sale or at negotiated prices. The timing and amount of any sale are within the sole discretion of the selling stockholders.

Our common stock is listed on the Nasdaq National Market under the symbol BLKB . On March 2, 2005, the last reported sale price of our common stock on the Nasdaq National Market was $11.18 per share.

You should read this prospectus and any prospectus supplement carefully before you invest. See Where You Can Find More Information for more information.

See Risk factors beginning on page 7 to read about factors you should consider before buying shares of our common stock.

Neither the SEC nor any state securities commission has approved or disapproved of these securities or passed on the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

, 2005

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About this prospectus

This prospectus is part of a Registration Statement (the Registration Statement) utilizing the shelf registration process that we filed with the Securities and Exchange Commission (the SEC), which registers the distribution of the securities offered under this prospectus. The Registration Statement, including the attached exhibits and schedules, contains additional relevant information about our company and the securities. The Registration Statement can be read at the SEC s web site (www.sec.gov) or at the offices mentioned under the heading Where you can find more information.

Under this Registration Statement, the selling stockholders may, from time to time, sell up to 10,000,000 shares of Common Stock, including shares obtained through the exercise of warrants.

This prospectus provides you with a general description of the securities the selling stockholders may offer. Each time securities are sold, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and any prospectus supplement, together with additional information described in this prospectus under the heading Where you can find more information.

You should rely only on the information provided in this prospectus and in any prospectus supplement. We have not authorized anyone to provide you with different information. We may only use this prospectus to sell securities if it is accompanied by a prospectus supplement. We are only offering the securities in states where offers are permitted. You should not assume that the information in this prospectus or any prospectus supplement is accurate at any date other than the date indicated on the cover page of these documents.

Unless the context otherwise requires, we , us , our , and similar terms refer to Blackbaud, Inc. and its subsidiaries.

Prospectus summary

This summary highlights selected information contained elsewhere in this prospectus. This summary does not contain all the information you should consider before investing in shares of our common stock. You should read this entire prospectus carefully, including Risk factors beginning on page 7 and our consolidated financial statements and the related notes thereto, before making an investment decision.

Blackbaud, Inc.

We are the leading global provider of software and related services designed specifically for nonprofit organizations. Our products and services enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage their finances and optimize internal operations. We have focused solely on the nonprofit market since our incorporation in 1982 and have developed our suite of products and services based upon our extensive knowledge of the operating challenges facing nonprofit organizations. In 2004, we had over 12,700 customers, over 12,300 of which pay us annual maintenance and support fees. Our customers operate in multiple verticals within the nonprofit market including religion, education, foundations, health and human services, arts and cultural, public and societal benefits, environment and animal welfare, and international and foreign affairs.

Industry

Nonprofit organizations are a large part of the U.S. economy, employing one out of every ten Americans. There were greater than 1.5 million registered U.S. nonprofit organizations in 2003 according to data from the Internal Revenue Service. In addition, there are greater than 1.5 million nonprofit organizations outside the United States. Donations to nonprofit organizations in the United States were $241 billion in 2003, having increased almost every year since 1962, with a compound annual growth rate over that period of 7.8%, according to Giving USA. In addition, these organizations received fees of approximately $600 billion in the twelve months prior to December 2003 for services they provided.

Nonprofit organizations often utilize methods of fundraising that are costly and inefficient, largely because of the difficulties in effectively collecting, sharing and using information. Fundraising and administration costs are significant, with the fundraising component alone amounting to more than $0.24 for each dollar donated based on our market research. Furthermore, nonprofit organizations face distinct operational challenges, such as soliciting contributions from numerous contributors and complying with unique accounting, tax and reporting issues. Because of these fundraising costs and operational challenges, we believe nonprofit organizations can benefit from software applications and services specifically designed to serve their particular needs.

Our products and services

Our suite of products and services includes:

The Raiser s Edge®, a complete fundraising software solution that helps nonprofit organizations improve relationships with their donors and constituents to more effectively raise money;

The Financial Edge , a complete financial management solution that addresses the specific fund accounting needs of nonprofit organizations;

The Education Edge, a student information management software suite designed primarily for K-12 independent schools;

The Patron Edge, a comprehensive ticketing management solution that streamlines ticketing, marketing, staffing and other administrative tasks;

The Information Edge, a comprehensive business intelligence application that extracts, aggregates and analyzes data to improve strategic decision making;

ProspectPoint and **WealthPoint**, services that use custom statistical models developed by us to more effectively analyze customer databases to better target and build more productive relationships with their key constituents; and

NetCommunity and NetSolutions, internet applications that enable our customers to establish online communities and conduct online fundraising.

We have web-enabled most of our applications to allow our customers to access them over the Internet. We also offer a variety of Internet applications and consulting services that allow nonprofit organizations to leverage the Internet for online fundraising and other important operations. In addition, we provide a broad range of services, including implementation, business process improvement, training and education services, and maintenance and technical support to enable our customers to more effectively run their organizations.

Our strategy

Our objective is to maintain and leverage our position as the leading provider of software and related services designed specifically for nonprofit organizations. Key elements of our strategy to achieve this objective are to:

- grow our customer base;
- maintain and expand existing customer relationships;
- introduce additional products and services;
- leverage the Internet as a means of additional growth;
- expand international presence; and
- pursue strategic acquisitions and alliances.

Sales and marketing

We primarily sell our products and services to nonprofit organizations through our direct sales force. Our customers enter into license agreements and pay us an upfront license fee and annual maintenance and support fees for our software. We also receive fees, on a subscription and fixed price basis, for our hosted services and access to our data enrichment and analytical services. We sell the majority of our consulting and technical services on a time and materials basis.

Over the past three years we have added an average of 1,400 new customers per year. Our customers are located in 47 countries, primarily the United States, the United Kingdom and Canada. Ongoing customer relationships that illustrate our broad customer base include the American Red Cross, the Chesapeake Bay Foundation, the Crohn s & Colitis Foundation of

America, the Detroit Zoological Society, the Mayo Foundation, the New York Philharmonic, Seton Hall University and the United Way of America.

Recent developments

Financial results for the quarter and year ended December 31, 2004

On February 1, 2005, we announced financial results for our quarter and year ended December 31, 2004.

For the quarter ended December 31, 2004, we reported total revenue of $35.7 million, an increase of 17% compared with the fourth quarter of 2003. License revenue increased 15% to $6.8 million, services revenue increased 21% to $9.9 million, and maintenance and subscriptions revenue increased 17% to $17.6 million, over the comparable period.

Our loss from operations and net loss for the fourth quarter 2004 was $(9.2) million and $(4.3) million, respectively, including stock-based compensation expense of $19.1 million. Our income from operations and a net loss for the fourth quarter of 2003 was $914,000 and $(129,000), respectively, including stock-based compensation expense and amortization of intangibles arising from business combinations of $7.6 million.

Diluted loss per share was $(0.10) for the quarter ended December 31, 2004, compared with $(0.00) in the same period last year.

Cash from operations for the fourth quarter of 2004 was $10.2 million, and cash from operations for the full year 2004 was $43.5 million, up 19% on a year-over-year basis. We had cash and cash equivalents of $42.1 million at December 31, 2004.

All of the foregoing preliminary results are subject to revision based upon completion of our year end 2004 financial statements and the related audit for such financial statements by our independent registered public accounting firm in connection with the filing of our Form 10-K for the year ended December 31, 2004. The foregoing preliminary results may be changed based upon completion of these financial statements and this audit. These changes, if any, might be material. We therefore urge you not to put undue reliance on these preliminary results.

Dividend policy

On February 1, 2005, we announced that our board of directors has adopted a dividend policy that reflects an intention to distribute to our stockholders a portion of the cash generated by our business that exceeds our operating needs and capital expenditures as regular quarterly dividends. In accordance with this dividend policy, we will pay an initial dividend of $0.05 per share on February 28, 2005 to stockholders of record on February 14, 2005, and currently intend to continue to pay quarterly dividends at an annual rate of $0.20 per share for the fiscal year ending December 31, 2005. Dividends will be paid only if and to the extent they are declared by our board of directors and are permitted by applicable law and by the terms of our credit facility. Based on current outstanding share numbers, dividends at this rate would total approximately $2.1 million in cash per quarter and $8.6 million in the aggregate for the year ending December 31, 2005. Dividend payments are not guaranteed and our board of directors may decide, in its absolute discretion, at any time and for any reason, not to declare or pay further dividends. Dividends on our common stock are not cumulative. See Dividend policy and restrictions .

Stock repurchase program

On February 1, 2005, we also announced that our board of directors has approved a stock repurchase program to purchase of up to $35.0 million of our outstanding shares of common stock in open market or privately negotiated transactions from time to time. Any open market purchases under the repurchase program will be made in compliance with Rule 10b-18 of the Securities Exchange Act of 1934 and all other applicable securities regulations. We may choose to not purchase any shares of our common stock and our board of directors may decide, in its absolute discretion, at any time and for any reason, to terminate the stock repurchase program.

The stock repurchase program and divided policy are intended to achieve multiple objectives, including providing value to continuing stockholders, providing an opportunity for our stockholders who wish to receive cash for their shares, establishing a capital structure that we believe is appropriate for our current business and maintaining financial flexibility and a strong balance sheet. We intend to fund the dividends and stock purchases from a combination of our existing cash balances, which totaled approximately $42.1 million as of December 31, 2004, and anticipated future earnings.

Company information

We originally incorporated in New York in 1982 and moved our operations to Charleston, South Carolina in 1989. We reincorporated in South Carolina in December 1991, engaged in a recapitalization in October 1999 and reincorporated under the laws of the State of Delaware on July 16, 2004. Our principal executive offices are located at 2000 Daniel Island Drive, Charleston, South Carolina 29492, and our telephone number at that location is (843) 216-6200. Our web site address is *www.blackbaud.com*. The information contained on our web site is not a part of, and should not be construed as being incorporated by reference into, this prospectus.

Summary consolidated financial data

The following data, insofar as it relates to each of the years 1998 -2003, has been derived from annual financial statements, including the consolidated balance sheets at December 31, 2003 and 2002 and the related consolidated statements of operations, cash flows and shareholders equity (deficit) and comprehensive income for the three years ended December 31, 2003 and notes thereto appearing elsewhere herein. The consolidated financial statements for the year ended December 31, 1998 were audited by other auditors. The consolidated financial statements for the year ended December 31, 1999 were audited by Arthur Andersen LLP, which has ceased operations. The data for the nine months ended September 30, 2004 and 2003 has been derived from unaudited financial statements also appearing herein and which, in the opinion of management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the unaudited interim periods. This summary consolidated financial data should be read together with Selected consolidated financial data , Management s discussion and analysis of financial condition and results of operations and our consolidated financial statements and related notes contained elsewhere in this prospectus. See Capitalization .

	Year ended December 31,						Nine months ended September 30,	
(in thousands, except per share data)	**1998[2][3]**	**1999[2][3]**	**2000[3]**	**2001**	**2002**	**2003**	**2003**	**2004**
Consolidated statements of operations data:								
Revenue								
License fees	$29,408	$37,938	$ 24,471	$19,300	$ 20,572	$ 21,339	$15,427	$ 18,614
Services	10,716	17,309	14,266	18,797	26,739	34,042	25,888	32,678
Maintenance and subscriptions	22,446	29,680	39,042	47,022	52,788	58,360	43,271	48,886
Other revenue	3,062	7,550	5,838	4,915	5,130	4,352	2,906	2,849
Total revenue	65,632	92,477	83,617	90,034	105,229	118,093	87,492	103,027
Cost of revenue								
Cost of license fees	709	989	1,284	1,726	2,547	2,819	2,110	2,733
Cost of services[1]	4,339	5,534	7,028	10,253	14,234	21,006	15,347	15,988
Cost of maintenance and subscriptions[1]	11,443	15,246	15,120	11,733	10,588	11,837	9,031	7,864
Cost of other revenue	1,559	2,160	1,972	2,750	3,611	3,712	2,556	2,577
Total cost of revenue	18,050	23,929	25,404	26,462	30,980	39,374	29,044	29,162
Gross profit	47,582	68,548	58,213	63,572	74,249	78,719	58,448	73,865
Sales and marketing	11,337	13,719	12,326	15,173	19,173	21,883	15,991	20,646
Research and development	9,604	13,923	13,912	14,755	14,385	15,516	11,506	13,245
General and administrative	8,938	12,833	10,390	9,031	10,631	11,085	8,042	9,093
Amortization	2,574	2,510	2,200	2,239	1,045	848	800	32
Cost of initial public offering								2,455
Stock option compensation						23,691	17,326	55
Total operating expenses	32,453	42,985	38,828	41,198	45,234	73,023	53,665	45,526
Income from operations	15,129	25,563	19,385	22,374	29,015	5,696	4,783	28,339
Interest income	1,032	716	241	96	138	97	70	133
Interest expense	(638)	(2,752)	(11,265)	(7,963)	(4,410)	(2,559)	(2,216)	(268)
Other income (expense), net	6,310	(79)	(185)	(113)	63	235	(100)	342
Income before provision for income taxes	21,833	23,448	8,176	14,394	24,806	3,469	2,537	28,546
Income tax provision (benefit)	158	(1,456)	3,080	5,488	9,166	3,947	2,886	11,619
Net income (loss)	$21,675	$24,904	$ 5,096	$ 8,906	$ 15,640	$ (478)	$ (349)	$ 16,927

Earnings (loss) per share								
Basic	$	$	$ 0.13	$ 0.21	$ 0.37	$ (0.01)	$ (0.01)	$ 0.40
Diluted	$	$	$ 0.13	$ 0.21	$ 0.37	$ (0.01)	$ (0.01)	$ 0.36
Common shares and equivalents outstanding								
Basic weighted average shares	N/A	N/A	40,277	41,492	42,360	42,396	42,391	42,480
Diluted weighted average shares	N/A	N/A	40,277	41,492	42,360	42,396	42,391	46,467
Summary of stock option compensation:								
Cost of services	$	$	$	$	$	$ 3,342	$ 2,291	$ (644)
Cost of maintenance and subscriptions						505	344	(106)
Total cost of revenue						3,847	2,635	(750)
Sales and marketing						1,817	1,201	(194)
Research and development						2,341	1,639	(517)
General and administrative						19,533	14,486	766
Total operating expenses						23,691	17,326	55
Total stock option compensation	$	$	$	$	$	$ 27,538	$ 19,961	$ (695)

(1) Includes stock option compensation as set forth in Summary of stock option compensation.

(2) Earnings per share not computed for this year because we were an S corporation until our recapitalization in October 1999 and therefore the information would not be meaningful.

(3) Certain amounts in the 1998, 1999 and 2000 financial statements have been reclassified to conform to the 2003 financial statement presentation. These reclassifications have no effect on previously reported net income (loss), shareholders equity or net income (loss) per share.

September 30, 2004 (unaudited) (in thousands)	Actual
Consolidated balance sheet data:	
Cash and cash equivalents	$ 33,382
Deferred tax asset, including current portion	81,210
Working capital	(11,879)
Total assets	143,172
Deferred revenue	51,727
Total liabilities	66,853
Common stock	43
Additional paid-in capital	38,056
Total stockholders equity	$ 76,319

Risk factors

An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors and the other information in this prospectus, including our consolidated financial statements and the related notes thereto, before investing in our common stock. Our business, operating results and financial condition could be seriously harmed by any of the following risks. The trading price of our common stock could decline due to any of these risks, in which case you could lose all or part of your investment.

Risks related to our business

The market for software and services for nonprofit organizations might not grow, and nonprofit organizations might not continue to adopt our products and services.

Many nonprofit organizations have not traditionally used integrated and comprehensive software and services for their nonprofit-specific needs. We cannot be certain that the market for such products and services will continue to develop and grow or that nonprofit organizations will elect to adopt our products and services rather than continue to use traditional, less automated methods, attempt to develop software internally, rely upon legacy software systems, or use generalized software solutions not specifically designed for the nonprofit market. Nonprofit organizations that have already invested substantial resources in other fundraising methods or other non-integrated software solutions might be reluctant to adopt our products and services to supplement or replace their existing systems or methods. In addition, the implementation of one or more of our core software products can involve significant time and capital commitments by our customers, which they may be unwilling or unable to make. If demand for and market acceptance of our products and services does not increase, we might not grow our business as we expect.

We might not generate increased business from our current customers, which could limit our revenue in the future.

Our business model is highly dependent on the success of our efforts to increase sales to our existing customers. Many of our customers initially make a purchase of only one or a limited number of our products or only for a single department within their organization. These customers might choose not to expand their use of or make additional purchases of our products and services. If we fail to generate additional business from our current customers, our revenue could grow at a slower rate or even decrease. In addition, as we deploy new applications and features for our existing products or introduce new products and services, our current customers could choose not to purchase these new offerings.

If our customers do not renew their annual maintenance and support agreements for our products or if they do not renew them on terms that are favorable to us, our business might suffer.

Most of our maintenance agreements are for a term of one year. As the end of the annual period approaches, we pursue the renewal of the agreement with the customer. Historically, maintenance renewals have represented a significant portion of our total revenue, including approximately 49% of our total revenue in 2003 and 47% of our total revenue for the fiscal nine months ended September 30, 2004. Because of this characteristic of our business, if our customers choose not to renew their maintenance and support agreements with us on beneficial terms, our business, operating results and financial condition could be harmed.

A substantial majority of our revenue is derived from The Raiser s Edge and a decline in sales or renewals of this product and related services could harm our business.

We derive a substantial majority of our revenue from the sale of The Raiser s Edge and related services, and revenue from this product and related services is expected to continue to account for a substantial majority of our total revenue for the foreseeable future. For example, revenue from the sale of The Raiser s Edge and related services represented approximately 72% of our total revenue in 2003 and 70% of our total revenue for the nine months ended September 30, 2004. Because we generally sell licenses to our products on a perpetual basis and deliver new versions and enhancements to customers who purchase annual maintenance and support, our future license, services and maintenance revenue are substantially dependent on sales to new customers. In addition, we frequently sell The Raiser s Edge to new customers and then attempt to generate incremental revenue from the sale of additional products and services. If demand for The Raiser s Edge declines significantly, our business would suffer.

Our quarterly financial results fluctuate and might be difficult to forecast and, if our future results are below either any guidance we might issue or the expectations of public market analysts and investors, the price of our common stock might decline.

Our quarterly revenue and results of operations are difficult to forecast. We have experienced, and expect to continue to experience, fluctuations in revenue and operating results from quarter to quarter. As a result, we believe that quarter-to-quarter comparisons of our revenue and operating results are not necessarily meaningful and that such comparisons might not be accurate indicators of future performance. The reasons for these fluctuations include but are not limited to:

- the size and timing of sales of our software, including the relatively long sales cycles associated with many of our large software sales;
- budget and spending decisions by our customers;
- market acceptance of new products we release, such as our recently-introduced business intelligence tools;
- the amount and timing of operating costs related to the expansion of our business, operations and infrastructure;
- changes in our pricing policies or our competitors pricing policies;
- seasonality in our revenue;
- general economic conditions; and
- costs related to acquisitions of technologies or businesses.

Our operating expenses, which include sales and marketing, research and development and general and administrative expenses, are based on our expectations of future revenue and are, to a large extent, fixed in the short term. If revenue falls below our expectations in a quarter and we are not able to quickly reduce our operating expenses in response, our operating results for that quarter could be adversely affected. It is possible that in some future quarter our operating results may be below either any guidance we might issue or the expectations of public market analysts and investors and, as a result, the price of our common stock might fall.

We encounter long sales and implementation cycles, particularly for our largest customers, which could have an adverse effect on the size, timing and predictability of our revenue and sales.

Potential customers, particularly our larger enterprise-wide clients, generally commit significant resources to an evaluation of available software and require us to expend substantial time, effort and money educating them as to the value of our software and services. Sales of our core software products to these larger customers often require an extensive education and marketing effort.

We could expend significant funds and management resources during the sales cycle and ultimately fail to close the sale. Our core software product sales cycle averages approximately two months for sales to existing customers and from six to nine months for sales to new customers and large enterprise-wide sales. Our implementation cycle for large enterprise-wide sales can extend for a year or more, which can negatively impact the timing and predictability of our revenue. Our sales cycle for all of our products and services is subject to significant risks and delays over which we have little or no control, including:

- our customers budgetary constraints;
- the timing of our clients budget cycles and approval processes;
- our clients willingness to replace their current methods or software solutions;
- our need to educate potential customers about the uses and benefits of our products and services; and
- the timing and expiration of our clients current license agreements or outsourcing agreements for similar services.

If we are unsuccessful in closing sales after expending significant funds and management resources or if we experience delays as discussed above, it could have a material adverse effect on the size, timing and predictability of our revenue.

We have recorded a significant deferred tax asset, and we might never realize the full value of our deferred tax asset, which would result in a charge against our earnings.

In connection with the initial acquisition of our common stock by our current stockholders in 1999, we recorded approximately $107 million as a deferred tax asset. Our deferred tax asset was approximately $81 million as of September 30, 2004, or approximately 57% of our total assets as of that date. Realization of our deferred tax asset is dependent upon our generating sufficient taxable income in future years to realize the tax benefit from that asset. In accordance with Financial Accounting Standards Board Statement of Financial Accounting Standards No. 109, deferred tax assets are reviewed at least annually for impairment. Impairment would result if, based on the available evidence, it is more likely than not that some portion of the deferred tax asset will not be realized. This impairment could be caused by, among other things, deterioration in performance, loss of key contracts, adverse market conditions, adverse changes in applicable laws or regulations, including changes that restrict the activities of or affect the products sold by our business and a variety of other factors. If an impairment were to occur in a future period, it would be recognized as an expense in our results of operations during the period of impairment. Depending on future circumstances, it is possible that we might never realize the full value of our deferred tax asset. Any future determination of impairment of a significant portion of our deferred tax asset would have an adverse effect on our financial condition and results of operations. See our discussion of

Deferred taxes in Management s discussion and analysis of financial condition and results of operations Critical accounting policies and estimates .

Nonprofit organizations might not use the Internet to facilitate their fundraising and organizational efforts in a manner sufficient to allow us to make a profit or even recapture our investment in this area. In addition, even if they increasingly use the Internet for these purposes, if we fail to capitalize on this opportunity, we could lose market share.

The market for online fundraising solutions for nonprofit organizations is new and emerging. Nonprofit organizations have not traditionally used the Internet or web-enabled software solutions for fundraising. We cannot be certain that the market will continue to develop and grow or that nonprofit organizations will elect to use any of our web-enabled products rather than continue to use traditional offline methods, attempt to develop software solutions internally or use standardized software solutions not designed for the specific needs of nonprofits. Nonprofit organizations that have already invested substantial resources in other fundraising methods may be reluctant to use the Internet to supplement their existing systems or methods. In addition, increasing concerns about fraud, privacy, reliability and other problems might cause nonprofit organizations not to adopt the Internet as a method for fundraising. If demand for and market acceptance of Internet-based products for nonprofits does not occur, we might not recapture our investment in this area or grow our business as we expect. On the other hand, even if nonprofits increasingly use the Internet for their fundraising and organizational efforts, if we fail to develop and offer products that meet customer needs in this area, we could lose market share.

Our failure to compete successfully could cause our revenue or market share to decline.

Our market is fragmented, competitive and rapidly evolving, and there are limited barriers to entry for some aspects of this market. We mainly face competition from four sources:

- software developers offering integrated specialized products designed to address specific needs of nonprofit organizations;
- providers of traditional, less automated fundraising services, such as services that support traditional direct mail campaigns, special events fundraising, telemarketing and personal solicitations;
- custom-developed products created either internally or outsourced to custom service providers; and
- software developers offering general products not designed to address specific needs of nonprofit organizations.

The companies we compete with, and other potential competitors, may have greater financial, technical and marketing resources and generate greater revenue and better name recognition than we do. If one or more of our competitors or potential competitors were to merge or partner with one of our competitors, the change in the competitive landscape could adversely affect our ability to compete effectively. For example, a large diversified software enterprise, such as Microsoft, Oracle or PeopleSoft, could decide to enter the market directly, including through acquisitions.

Additionally, Sage and Intuit have recently made acquisitions and product development efforts in the nonprofit market. Our competitors might also establish or strengthen cooperative relationships with our current or future resellers and third-party consulting firms or other parties with whom we have relationships, thereby limiting our ability to promote our products and limiting the number of channel partners available to help market our products. These competitive pressures could cause our revenue and market share to decline. For more information on our competitors, see Business Competition .

We might not be able to manage our future growth efficiently or profitably.

We have experienced significant growth since our inception, and we anticipate that continued expansion will be required to address potential market opportunities. For example, we will need to expand the size of our sales and marketing, product development and general and administrative staff and operations, as well as our financial and accounting controls. There can be no assurance that our infrastructure will be sufficiently scalable to manage our projected growth. For example, our anticipated growth will result in a significant increase in demands on our maintenance and support services professionals to continue to provide the high level of quality service that our customers have come to expect. If we are unable to sufficiently address these additional demands on our resources, our profitability and growth might suffer. Also, if we continue to expand our operations, management might not be effective in expanding our physical facilities and our systems, procedures or controls might not be adequate to support such expansion. Our inability to manage our growth could harm our business.

Because competition for highly qualified personnel is intense, we might not be able to attract and retain the employees we need to support our planned growth.

To execute our continuing growth plans, we need to increase the size and maintain the quality of our sales force, software development staff and our professional services organization. To meet our objectives successfully, we must attract and retain highly qualified personnel with specialized skill sets focused on the nonprofit industry. Competition for qualified personnel can be intense, and we might not be successful in attracting and retaining them. The pool of qualified personnel with experience working with or selling to nonprofit organizations is limited overall and specifically in Charleston, South Carolina, where our principal office is located. Our ability to maintain and expand our sales, product development and professional services teams will depend on our ability to recruit, train and retain top quality people with advanced skills who understand sales to, and the specific needs of, nonprofit organizations. For these reasons, we have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications for our business. In addition, it takes time for our new sales and services personnel to become productive, particularly with respect to obtaining and supporting major customer accounts. In particular, we plan to continue to increase the number of services personnel to attempt to meet the needs of our customers and potential new customers. In addition to hiring services personnel to meet our needs, we might also engage additional third-party consultants as contractors, which could have a negative impact on our earnings. If we are unable to hire or retain qualified personnel, or if newly hired personnel fail to develop the necessary skills or reach productivity slower than anticipated, it would be more difficult for us to sell our products and services, and we could experience a shortfall in revenue or earnings, and not achieve our planned growth.

Our services revenue produces substantially lower gross margins than our license revenue, and an increase in services revenue relative to license revenue would harm our overall gross margins.

Our services revenue, which includes fees for consulting, implementation, training, data and technical services and analytics, was approximately 32% of our revenue for the nine months ended September 30, 2004, 29% of our revenue for 2003 and approximately 25% of our revenue for 2002. Our services revenue has substantially lower gross margins than our product license revenue. An increase in the percentage of total revenue represented by services revenue would adversely affect our overall gross margins.

Certain of our services are contracted under fixed fee arrangements, which we base on estimates. If our estimated fees are less than our actual costs, our operating results would be adversely affected.

Services revenue as a percentage of total revenue has varied significantly from quarter to quarter due to fluctuations in licensing revenue, economic changes, changes in the average selling prices for our products and services, our customers acceptance of our products and our sales force execution. In addition, the volume and profitability of services can depend in large part upon:

competitive pricing pressure on the rates that we can charge for our services;

the complexity of the customers information technology environment and the existence of multiple non-integrated legacy databases;

the resources directed by customers to their implementation projects; and

the extent to which outside consulting organizations provide services directly to customers.

Any erosion of our margins for our services revenue or any adverse changes in the mix of our license versus service revenue would adversely affect our operating results.

Failure to adapt to technological change and to achieve broad adoption and acceptance of our new products and services could adversely affect our earnings.

If we fail to keep pace with technological change in our industry, such failure would have an adverse effect on our revenue and earnings. We operate in a highly competitive industry characterized by evolving technologies and industry standards, changes in customer requirements and frequent new product introductions and enhancements. During the past several years, many new technological advancements and competing products have entered the marketplace. Our ability to compete effectively and our growth prospects depend upon many factors, including the success of our existing software products and services to address the changing needs of our customers, the timely introduction and success of future software products and services and releases and the ability of our products to perform well with existing and future technologies, including databases, applications, operating systems and other platforms. We have made significant investments in research and development and our growth plans are premised in part on generating substantial revenue from new product introductions. New product introductions involve significant risks. For example, delays in new product introductions, or less-than-anticipated market acceptance of our new products are possible and would have an adverse effect on our revenue and earnings. We cannot be certain that our new products or future enhancements to existing products will meet customer performance needs or expectations when shipped or that they will be free of significant software defects or bugs. If they do not meet customer needs or expectations, for whatever reason, upgrading or enhancing these products could be costly and time consuming. In addition, the selling price of software products tends to decline significantly over the life of the product. If we are unable to offset any reductions in the selling prices of our products by introducing new products at higher prices or by reducing our costs, our revenue, gross margin and operating results would be adversely affected.

If our products fail to perform properly due to undetected errors or similar problems, our business could suffer.

Complex software such as ours often contains undetected errors or bugs. Such errors are frequently found after introduction of new software or enhancements to existing software. We continually introduce new products and new versions of our products. If we detect any errors before we ship a product, we might have to delay product shipment for an extended period of time while we address the problem. We might not discover software errors that affect our new or current products or enhancements until after they are deployed, and we may need to provide enhancements to correct such errors. Therefore, it is possible that, despite testing by us, errors may occur in our software. These errors could result in:

- harm to our reputation;
- lost sales;
- delays in commercial release;
- product liability claims;
- delays in or loss of market acceptance of our products;
- license terminations or renegotiations; and
- unexpected expenses and diversion of resources to remedy errors.

Furthermore, our customers may use our software together with products from other companies. As a result, when problems occur, it might be difficult to identify the source of the problem. Even when our software does not cause these problems, the existence of these errors might cause us to incur significant costs, divert the attention of our technical personnel from our product development efforts, impact our reputation and cause significant customer relations problems.

Our failure to integrate third-party technologies could harm our business.

We intend to continue licensing technologies from third parties, including applications used in our research and development activities and technologies which are integrated into our products. These technologies might not continue to be available to us on commercially reasonable terms or at all. Our inability to obtain any of these licenses could delay product development until equivalent technology can be identified, licensed and integrated. This inability in turn would harm our business and operating results. Our use of third-party technologies exposes us to increased risks, including, but not limited to, risks associated with the integration of new technology into our products, the diversion of our resources from development of our own proprietary technology and our inability to generate revenue from licensed technology sufficient to offset associated acquisition and maintenance costs.

If the security of our software, in particular our hosted Internet solutions products, is breached, our business and reputation could suffer.

Fundamental to the use of our products is the secure collection, storage and transmission of confidential donor and end user information. Third parties may attempt to breach our security or that of our customers and their databases. We might be liable to our customers for any breach in such security, and any breach could harm our customers, our business and our reputation. Any imposition of liability, particularly liability that is not covered by insurance or is in excess of insurance coverage, could harm our reputation and our business and operating results. Also, computers, including those that utilize our software, are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. We might be required to expend significant capital and other resources to protect further against security breaches or to rectify problems caused by any security breach.

If we are unable to detect and prevent unauthorized use of credit cards and bank account numbers and safeguard confidential donor data, we could be subject to financial liability, our reputation could be harmed and customers may be reluctant to use our products and services.

We rely on third-party and internally-developed encryption and authentication technology to provide secure transmission of confidential information over the Internet, including customer credit card and bank account numbers, and protect confidential donor data. Advances in computer capabilities, new discoveries in the field of cryptography or other events or developments could result in a compromise or breach of the technology we use to protect sensitive transaction data. If any such compromise of our security, or the security of our customers, were to occur, it could result in misappropriation of proprietary information or interruptions in operations and have an adverse impact on our reputation or the reputation of our customers. If we are unable to detect and prevent unauthorized use of credit cards and bank account numbers or protect confidential donor data, our business could suffer.

We currently do not have any issued patents, but we rely upon trademark, copyright, patent and trade secret laws to protect our proprietary rights, which might not provide us with adequate protection.

Our success and ability to compete depend to a significant degree upon the protection of our software and other proprietary technology rights. We might not be successful in protecting our proprietary technology, and our proprietary rights might not provide us with a meaningful competitive advantage. To protect our proprietary technology, we rely on a combination of patent, trademark, copyright and trade secret laws, as well as nondisclosure agreements, each of which affords only limited protection. We currently do not have patents issued for any of our proprietary technology and we only recently filed patent applications relating to a number of our products. Moreover, we have no patent protection for The Raiser s Edge, which is one of our core products. Any inability to protect our intellectual property rights could seriously harm our business, operating results and financial condition. It is possible that:

- our pending patent applications may not result in the issuance of patents;

- any patents issued to us may not be timely or broad enough to protect our proprietary rights;

- any issued patent could be successfully challenged by one or more third parties, which could result in our loss of the right to prevent others from exploiting the inventions claimed in those patents; and

- current and future competitors may independently develop similar technologies, duplicate our products or design around any of our patents.

In addition, the laws of some foreign countries do not protect our proprietary rights in our products to the same extent as do the laws of the United States. Despite the measures taken by us, it may be possible for a third party to copy or otherwise obtain and use our proprietary technology and information without authorization. Policing unauthorized use of our products is difficult, and litigation could become necessary in the future to enforce our intellectual property rights. Any litigation could be time consuming and expensive to prosecute or resolve, result in substantial diversion of management attention and resources, and materially harm our business, financial condition and results of operations.

If we do not successfully address the risks inherent in the expansion of our international operations, our business could suffer.

We currently have operations in the United Kingdom, Canada and Australia, and we intend to expand further into international markets. We have limited experience in international operations and may not be able to compete effectively in international markets. In 2003, our international offices generated revenues of approximately $10.7 million, an increase of 78% over international revenue of $6.0 million for 2002. In the nine months ended September 30, 2004, our international revenue was $16.0 million. Expansion of our international operations will require a significant amount of attention from our management and substantial financial resources and may require us to add qualified management in these markets. Our direct sales model requires us to attract, retain and manage qualified sales personnel capable of selling into markets outside the United States. In some cases, our costs of sales might increase if our customers require us to sell through local distributors. If we are unable to grow our international operations in a cost effective and timely manner, our business and operating results could be harmed. Doing business internationally involves additional risks that could harm our operating results, including:

- difficulties and costs of staffing and managing international operations;
- differing technology standards;
- difficulties in collecting accounts receivable and longer collection periods;
- political and economic instability;
- fluctuations in currency exchange rates;
- imposition of currency exchange controls;
- potentially adverse tax consequences;
- reduced protection for intellectual property rights in certain countries;
- dependence on local vendors;
- protectionist laws and business practices that favor local competition;
- compliance with multiple conflicting and changing governmental laws and regulations;
- seasonal reductions in business activity specific to certain markets;
- longer sales cycles;
- restrictions on repatriation of earnings;
- differing labor regulations;
- restrictive privacy regulations in different countries, particularly in the European Union;
- restrictions on the export of technologies such as data security and encryption; and
- import and export restrictions and tariffs.

Future acquisitions could prove difficult to integrate, disrupt our business, dilute stockholder value and strain our resources.

We intend to acquire companies, services and technologies that we feel could complement or expand our business, augment our market coverage, enhance our technical capabilities, provide us with important customer contacts or otherwise offer growth opportunities. Acquisitions and investments involve numerous risks, including:

- difficulties in integrating operations, technologies, services, accounting and personnel;
- difficulties in supporting and transitioning customers of our acquired companies;
- diversion of financial and management resources from existing operations;
- risks of entering new sectors of the nonprofit industry;
- potential loss of key employees; and
- inability to generate sufficient revenue to offset acquisition or investment costs.

Acquisitions also frequently result in recording of goodwill and other intangible assets, which are subject to potential impairments in the future that could harm our operating results. In addition, if we finance acquisitions by issuing equity securities or securities convertible into equity securities, our existing stockholders would be diluted, which, in turn, could affect the market price of our stock. Moreover, we could finance any acquisition with debt, resulting in higher leverage and interest costs. As a result, if we fail to evaluate and execute acquisitions or investments properly, we might not achieve the anticipated benefits of any such acquisition, and we may incur costs in excess of what we anticipate.

Claims that we infringe upon third parties intellectual property rights could be costly to defend or settle.

Litigation regarding intellectual property rights is common in the software industry. We expect that software products and services may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlaps. We may from time to time encounter disputes over rights and obligations concerning intellectual property. Although we believe that our intellectual property rights are sufficient to allow us to market our software without incurring liability to third parties, third parties may bring claims of infringement against us. Such claims may be with or without merit. Any litigation to defend against claims of infringement or invalidity could result in substantial costs and diversion of resources. Furthermore, a party making such a claim could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling our software. Our business, operating results and financial condition could be harmed if any of these events occurred.

In addition, we have agreed, and will likely agree in the future, to indemnify certain of our customers against certain claims that our software infringes upon the intellectual property rights of others. We could incur substantial costs in defending ourselves and our customers against infringement claims. In the event of a claim of infringement, we and our customers might be required to obtain one or more licenses from third parties. We, or our customers, might be unable to obtain necessary licenses from third parties at a reasonable cost, if at all. Defense of any lawsuit or failure to obtain any such required licenses could harm our business, operating results and financial condition.

If we become subject to product or general liability or errors and omissions claims, they could be time-consuming and costly.

Errors, defects or other performance problems in our software, as well as the negligence or misconduct of our consultants, could result in financial or other damages to our customers. They could seek damages from us for losses associated with these errors, defects or other performance problems. If successful, these claims could have a material adverse effect on our business. Although we possess product liability insurance and errors and omissions insurance, there is no guarantee that our insurance would be enough to cover the full amount of any loss we might suffer. Our license and service agreements typically contain provisions designed to limit our exposure to product liability claims, but existing or future laws or unfavorable judicial decisions could negate these limitation of liability provisions. A claim brought against us, even if unsuccessful, could be time-consuming and costly to defend and could harm our reputation.

If we were found subject to or in violation of any laws or regulations governing privacy or electronic fund transfers, we could be subject to liability or forced to change our business practices.

It is possible that the payment processing component of our web-based software is subject to various governmental regulations. Pending legislation at the state and federal levels could also restrict further our information gathering and disclosure practices. Existing and potential future privacy laws might limit our ability to develop new products and services that make use of data we gather from various sources. For example, our custom modeling and analytical services, including ProspectPoint and WealthPoint, rely heavily on securing and making use of data we gather from various sources and privacy laws could jeopardize our ability to market and profit from those services. The provisions of these laws and related regulations are complicated, and we do not have extensive experience with these laws and related regulations. Even technical violations of these laws can result in penalties that are assessed for each non-compliant transaction. In addition, we might be subject to the privacy provisions of the Health Insurance Portability and Accountability Act of 1996 and the Gramm-Leach-Bliley Act and related regulations. If we or our customers were found to be subject to and in violation of any of these laws or other privacy laws or regulations, our business would suffer and we and/or our customers would likely have to change our business practices. In addition, these laws and regulations could impose significant costs on us and our customers and make it more difficult for donors to make online donations.

Increasing government regulation could affect our business.

We are subject not only to regulations applicable to businesses generally but also to laws and regulations directly applicable to electronic commerce. Although there are currently few such laws and regulations, state, Federal and foreign governments may adopt laws and regulations applicable to our business. Any such legislation or regulation could dampen the growth of the Internet and decrease its acceptance. If such a decline occurs, companies may decide in the future not to use our products and services. Any new laws or regulations in the following areas could affect our business:

- user privacy;
- the pricing and taxation of goods and services offered over the Internet:
- the content of websites;
- copyrights;
- consumer protection, including the potential application of do not call registry requirements on our customers and consumer backlash in general to direct marketing efforts of our customers;
- the online distribution of specific material or content over the Internet; and
- the characteristics and quality of products and services offered over the Internet.

Our operations might be affected by the occurrence of a natural disaster or other catastrophic event in Charleston, South Carolina.

We depend on our principal executive offices and other facilities in Charleston, South Carolina for the continued operation of our business. Although we have contingency plans in effect for natural disasters or other catastrophic events, these events, including terrorist attacks and natural disasters such as hurricanes, which historically have struck the Charleston area with some regularity, could disrupt our operations. Even though we carry business interruption insurance policies and typically have provisions in our contracts that protect us in certain events, we might suffer losses as a result of business interruptions that exceed the coverage available under our insurance policies or for which we do not have coverage. Any natural disaster or catastrophic event affecting us could have a significant negative impact on our operations.

Outstanding employee stock options subject to variable accounting and recent changes to accounting standards could cause us to record significant compensation expense and could significantly reduce our earnings in future periods.

Prior to our initial public offering in July 2004, options to purchase approximately 6.6 million shares under two of our stock option plans were subject to variable accounting treatment. Options to purchase approximately 3.5 million shares continue to be subject to variable accounting treatment and there is volatility in our stock price which could affect operating results. Accordingly, we could record significant compensation expense at the end of future periods, particularly if our stock price increases significantly. For example, we recorded compensation expense attributable to these options of $27.5 million in 2003. This compensation expense could significantly reduce our earnings in future periods, which could cause our stock price to fall and, as a result, you could lose some or all of your investment. See our discussion of Stock option compensation in Management s discussion and analysis of financial condition and results of operations Critical accounting policies and estimates . In addition, on December 16, 2004, the Financial Accounting Standards issued Board Statement No. 123 (revised 2004), Share-Based Payment. Statement 123(R) would require us to measure all employee stock-based compensation awards using a fair value method and record such expense in our consolidated financial statements. In addition, the adoption of Statement 123(R) will require additional accounting related to the income tax effects and additional disclosure regarding the cash flow effects resulting from share-based payment arrangements. Statement 123(R) is effective beginning in our third quarter of fiscal 2005. We are still evaluating which transition method we will use to comply with Statement 123(R). The adoption of Statement 123(R) could have a material impact on our consolidated financial position, results of operations and cash flows.

The requirements of being a public company might strain our resources and distract management.

As a newly public company, we are subject to a number of additional requirements, including the reporting requirements of the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002 and new Nasdaq rules promulgated in response to the Sarbanes-Oxley Act. These requirements might place a strain on our systems and resources. The Securities Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and financial condition. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal controls for financial reporting. In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal controls over financial reporting, significant resources and management oversight will be required. As a result, our management s attention might be diverted from other business concerns, which could have a material adverse effect on our business, financial condition, results of operations and cash flows. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal controls over financial reporting and our independent registered public accounting firm s audit of that assessment will require the commitment of significant financial and managerial resources. In addition, we might need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge and we might not be able to do so in a timely fashion. Nasdaq rules require, among other things, that by July 2005 all of the members of the audit committee of our board of directors consist of independent directors. We might not be able to attract and retain independent directors for our audit committee in a timely fashion, or at all.

Risks related to purchasing our shares

We cannot assure you that a market will continue for our common stock or what the market price of our common stock will be.

Before our initial public offering in July 2004, there was no public trading market for our common stock, and we cannot assure you that one will be sustained. If a market is not sustained, it might be difficult for you to sell your shares of common stock at an attractive price or at all. We cannot predict the prices at which our common stock will trade. The offering price for our common stock covered by this prospectus will be determined through our selling stockholders negotiations with potential purchasers and might not bear any relationship to the market price at which it will trade after this offering or to any other established criteria of the value of our business. In future quarters our operating results might be below the expectations of public market analysts and investors and, as a result of these and other factors, the price of our common stock might decline.

The price of our common stock might be volatile.

Our stock price has been volatile and might continue to be, making an investment in our company risky. Between July 26, 2004, when our common stock started trading on the Nasdaq National Market, and March 2, 2005, the price of a share of our common stock varied from $8.30 to $15.22.

In the three years prior to 2003, technology stocks listed on The Nasdaq National Market experienced high levels of volatility and significant declines in value from their historic highs. The trading price of our common stock might fluctuate substantially. The price of the common stock that will prevail in the market might be higher or lower than the price you pay, depending on many factors, some of which are beyond our control and might not be related to our operating performance. The fluctuations could cause you to lose part or all of your investment in our shares of common stock. Those factors that could cause fluctuations in the trading price of our common stock include the following:

- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of software and technology companies;
- actual or anticipated changes in our earnings or fluctuations in our operating results or in the expectations of securities analysts;
- the amount of dividends we pay, if any;
- the amount of stock we purchase under our stock repurchase program, if any;
- economic conditions and trends in general and in the nonprofit industry;
- major catastrophic events, including terrorist activities, which could reduce or divert funding to, and technology spending by, our core nonprofit customer base;
- changes in our pricing policies or the pricing policies of our customers;
- changes in the estimation of the future size and growth of our market; or
- departures of key personnel.

In the past, following periods of volatility in the market price of a company s securities, securities class action litigation has often been brought against that company. Due to the potential volatility of our stock price, we might be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management s attention and resources from our business.

Insiders hold a significant percentage of our stock and could limit your ability to influence the outcome of key transactions, including a change of control, which could adversely affect the market price of our stock.

Assuming it sells all of its common stock registered under this prospectus, Hellman & Friedman Capital Partners III, L.P. and its affiliates will beneficially own approximately 47.55% of our common stock. In addition, our executive officers, directors and their affiliates will, in the aggregate, beneficially own or control approximately 54.93% of our common stock. As a result, Hellman & Friedman will have significant control with respect to all matters submitted to our stockholders for approval, including the election and removal of directors and the approval of any merger, consolidation or sales of all or substantially all of our assets. These stockholders might make decisions that are adverse to your interests. In addition, Hellman & Friedman and certain of its transferees will not be governed by Section 203 of the Delaware General Corporation Law. See Description of capital stock Anti-takeover effects of Delaware law and provisions of our certificate of incorporation and bylaws Delaware anti-takeover law for a discussion of Section 203. This fact might make it easier for Hellman & Friedman or its transferees to acquire your shares at a lower price than would otherwise be the case. This provision and the concentration of ownership could have the effect of delaying, preventing or deterring a change of control of our company, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and might ultimately affect the market price of our common stock.

Future sales of our common stock might depress our stock price.

As of January 31, 2005, we had 42,801,424 shares of common stock outstanding. The 10,000,000 shares that may be sold by the selling stockholders under this prospectus will be freely tradable without restriction or further registration under federal securities laws unless purchased by our affiliates. If these or other stockholders sell substantial amounts of common stock in the public market, or if the market perceives that these sales may occur, the market price of our common stock might decline. We are unable to estimate the amount, timing or nature of future sales of outstanding common stock.

Investors in this offering will experience immediate and substantial dilution.

The public offering price of the common stock registered for resale by the selling stockholders under this prospectus is expected to be considerably more than the net tangible book value per share of our outstanding common stock. Accordingly, investors purchasing shares of common stock offered under this prospectus will pay a price per share that substantially exceeds, on a per share basis, the value of our assets after subtracting liabilities. Investors will suffer additional dilution to the extent outstanding stock options are exercised and to the extent we issue any restricted stock to our employees under our equity incentive plans.

We might need to raise capital, which might not be available.

We will not receive any of the proceeds from the sale of shares by the selling stockholders under this prospectus. Accordingly, the proceeds from any sales by the selling stockholders will not be available to us to pay dividends, repurchase shares of our outstanding common stock under our stock repurchase program, or finance our operations, capital expenditures or investment activities. We might need to raise funds to meet these or other needs, and we might not be able to obtain such financing on favorable terms, if at all. If we need capital and cannot raise it on acceptable terms, we might not be able to:

- develop enhancements and additional features for our products;
- develop new products and services;
- hire, train and retain employees;
- enhance our infrastructure;
- respond to competitive pressures or unanticipated requirements;
- pursue international expansion;
- pursue acquisition opportunities; or
- continue to fund our operations.

If any of the foregoing consequences occur, our stock price might fall and you might lose some or all of your investment.

Our certificate of incorporation authorizes our board of directors to issue new series of preferred stock that may have the effect of delaying or preventing a change of control, which could adversely affect the value of your shares.

Our certificate of incorporation provides that our board of directors is authorized to issue from time to time, without further stockholder approval, up to 20,000,000 shares of preferred stock in one or more series and to fix or alter the designations, preferences, rights and any qualifications, limitations or restrictions of the shares of each series, including the dividend rights, dividend rates, conversion rights, voting rights, rights of redemption, including sinking fund provisions, redemption price or prices, liquidation preferences and the number of shares constituting any series or designations of any series. Such shares of preferred stock could have preferences over our common stock with respect to dividends and liquidation rights. We may issue additional preferred stock in ways that might delay, defer or prevent a change of control of our company without further action by our stockholders. Such shares of preferred stock may be issued with voting rights that may adversely affect the voting power of the holders of our common stock by increasing the number of outstanding shares having voting rights, and by the creation of class or series voting rights.

Anti-takeover provisions under our charter documents and Delaware law could delay or prevent a change of control and could also limit the market price of our stock.

Our certificate of incorporation and our bylaws contain provisions that could delay or prevent a change of control of our company or changes in our board of directors that our stockholders might consider favorable, including the following:

- our board of directors will be classified into three classes, each of which will serve for staggered three year terms; and
- we will require advance notice for stockholder proposals, including nominations for the election of directors.

In addition, we are governed by the provisions of Section 203 of the Delaware General Corporate Law, which can prohibit certain business combinations with stockholders owning 15% or more of our outstanding voting stock, although our certificate of incorporation excludes Hellman & Friedman Capital Partners III, L.P. and its affiliates and transferees from the application of these anti-takeover provisions. These and other provisions in our certificate of incorporation and our bylaws and Delaware law could make it more difficult for stockholders or potential acquirors to obtain control of our board of directors or initiate actions that are opposed by the then-current board of directors, including delaying or impeding a merger, tender offer, or proxy contest or other change of control transaction involving our company. Any delay or prevention of a change of control transaction or changes in our board of directors could prevent the consummation of a transaction in which our stockholders could receive a substantial premium over the then current market price for their shares.

Risks relating to our dividend policy and stock repurchase program

You might not receive any dividends, and the reduction or elimination of dividends might negatively affect the market price of our common stock.

Dividend payments are not guaranteed and are within the absolute discretion of our board of directors. You might not receive any dividends as a result of any of the following factors:

- we are not obligated to pay dividends;
- while our dividend policy contemplates the distribution of a portion of the excess cash generated by our business in respect of each of the fiscal quarters in 2005, up to the intended dividend rate set forth in Dividend policy and restrictions, our board of directors could modify or revoke the policy at any time and for any reason;
- even if the dividend policy is not modified or revoked, our board of directors could decide to reduce dividends or not to pay any dividends at all, at any time and for any reason;
- the amount of dividends distributed is subject to state law restrictions;
- our credit facility limits the amount of dividends we are permitted to pay; and
- our stockholders have no contractual or other legal right to dividends.

Our dividend policy is based upon our current assessment of the cash needs of our business and the environment in which it operates. That assessment could change due to, among other things, changes in our results of operations, cash requirements, financial condition, contractual restrictions, growth opportunities, acquisitions, competitive or technological developments, provisions of applicable law and other factors that our board of directors might deem relevant. See Dividend policy and restrictions . The reduction or elimination of dividends might negatively affect the market price of our common stock.

Our dividend policy and stock repurchase program might limit our ability to pursue growth opportunities.

Our board of directors has adopted a dividend policy and a stock repurchase program which reflects an intention to distribute to our stockholders a portion of the cash generated by our business that exceeds our operating needs and capital expenditures as regular quarterly dividends. In developing the dividend policy and stock repurchase program, we have made assumptions for and judgments about 2005 as to our expected results of operations, anticipated levels of capital expenditures, income taxes and working capital. As a result of any payment made under the dividend policy or any purchases under our stock repurchase program, our ability to finance any material expansion of our business, including through acquisitions or increased capital spending, or to fund our operations might be more limited than if we had retained all of our cash flow from operations. See Dividend policy and restrictions .

Payment of dividends or the repurchase of shares of common stock might be restricted under our credit facility

We are subject to certain restrictions on payment of dividends and the repurchase of outstanding shares of common stock under our $30 million credit facility which, if triggered, might result in our modification or elimination of dividends, cancellation of our stock repurchase program or being in default under the credit facility. See Dividend policy and restrictions. If we default under our credit facility, we might not have adequate access to capital to run our business or pursue growth opportunities.

Forward-looking statements

This prospectus contains forward-looking statements as defined in the Private Securities Litigation Reform Act. The forward-looking statements are contained principally in the sections entitled Prospectus summary, Risk factors, Management s discussion and analysis of financial condition and results of operations and Business. In some cases, you can identify forward-looking statements by terminology such as may, might, will, should, could, would, expect, plan, anticipate, believe, estimate, project, predict, intend, potential or the negative of suc expressions.

The forward-looking statements reflect our current expectations and views about future events and speak only as of the date the statements were made. The forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Given these risks and uncertainties, you should not place undue reliance on the forward-looking statements.

You should read this prospectus and the documents that we reference in this prospectus and have filed as exhibits to the registration statement, of which this prospectus is part, completely and with the understanding that our actual future results might be materially different from what we expect. We might not update the forward-looking statements, even though our situation might change in the future, unless we have obligations under U.S. federal securities laws to update and disclose material developments related to previously disclosed information. We qualify all of the forward-looking statements by these cautionary statements.

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

No action is being taken in any jurisdiction outside the United States to permit a public offering of common stock or possession or distribution of this prospectus in that jurisdiction. Persons who come into possession of this prospectus in jurisdictions outside the United States are required to inform themselves about and to observe any restrictions as to this offering and the distribution of this prospectus applicable to those jurisdictions.

Blackbaud and The Raiser s Edge are registered trademarks of Blackbaud, Inc. This prospectus also includes references to registered service marks and trademarks of other entities.

Use of proceeds

We will not receive any proceeds from the sale of the common stock by the selling stockholders. The selling stockholders will receive all net proceeds from any sales of shares of our common stock under this prospectus.

Market price of common stock

Our common stock began trading on the Nasdaq National Market under the symbol BLKB on July 26, 2004. The following table sets forth the high and low sales prices of our common stock, as reported on Nasdaq National Market.

	High	Low
Fiscal year ended December 31, 2004		
Third quarter beginning July 26, 2004	$12.65	$ 8.30
Fourth quarter	15.22	9.46
Fiscal year ending December 31, 2005		
First quarter (through March 2, 2005)	$15.01	$11.00

On March 2, 2005, the last reported sale price of our common stock on the Nasdaq National Market was $11.18 per share. As of January 31, 2005, there were 21 stockholders of record and approximately 1,769 beneficial owners of our common stock.

Dividend policy and restrictions

General

Our board of directors has adopted a dividend policy which reflects an intention to distribute to our stockholders a portion of the cash generated by our business that exceeds our operating needs and capital expenditures as regular quarterly dividends. This policy reflects our judgment that we can provide greater value to our stockholders by distributing to them a portion of the cash generated by our business.

We believe that our dividend policy will limit, but not preclude, our ability to pursue growth. This limitation could be significant, for example, with respect to any large acquisitions and growth opportunities that require cash investments in amounts greater than our available cash or external financing resources. In order to pay dividends at the level currently anticipated under our dividend policy and to fund any substantial portion of our stock repurchase program, we expect that we would need financing or borrowings to fund any significant acquisitions or to pursue growth opportunities requiring capital expenditures significantly beyond our anticipated capital expenditure levels. However, we intend to retain sufficient cash after the distribution of dividends and any repurchase of shares to permit the pursuit of growth opportunities that do not require a significant capital investment. For further discussion of the relationship of our dividend policy to our ability to pursue potential growth opportunities, see Assumptions and Considerations below.

In accordance with this dividend policy, we currently intend to pay quarterly dividends at an annual rate of $0.20 per share of common stock for each of the fiscal quarters in 2005. Dividends at this rate would total approximately $8.6 million in the aggregate on the common stock in 2005 (assuming 42,801,424 shares of common stock are outstanding). In determining our expected dividend level, we reviewed, analyzed and considered, among other things:

- our operating and financial performance in recent years;
- our anticipated capital expenditure requirements;
- our anticipated cash requirements associated with our stock repurchase program;
- our expected other cash needs, primarily relating to operating expenses and working capital requirements;
- the terms of our credit facility; and
- other potential sources of liquidity and various other aspects of our business.

Dividends on our common stock will not be cumulative. Consequently, if dividends on our common stock are not declared and/ or paid at the targeted level, our stockholders will not be entitled to receive such payments in the future.

As described more fully below, you might not receive any dividends as a result of the following factors:

- we are not obligated to pay dividends;
- our credit facility limits the amount of dividends we are permitted to pay;
- our board of directors could decide to reduce dividends or not to pay dividends at all, at any time and for any reason;
- the amount of dividends distributed is subject to state law restrictions;
- our stockholders have no contractual or other legal right to dividends; and

we might not have enough cash to pay dividends due to changes to our operating earnings, working capital requirements and anticipated cash needs.

For dividends declared for the second, third and fourth fiscal quarters of 2005, we intend to pay dividends on our common stock on the 15th day of May, August and November, respectively (or the next business day if the 15th day is not a business day), to holders of record on the 5th day of each such month (or the immediately preceding business day if the 5th day is not a business day).

Assumptions and Considerations

We estimate that the cash necessary to fund dividends on our common stock for 2005 at the rate described above is approximately $8.6 million (assuming 42,801,424 shares of common stock are outstanding). As of December 31, 2004, we had approximately $42.1 million in cash and cash equivalents.

In addition to our dividend policy, we have adopted a stock repurchase program to purchase up to $35.0 million of our outstanding shares of common stock in open market or privately negotiated transactions from time to time. Any open market purchases under the repurchase program will be made in compliance with Rule 10b-18 of the Securities Exchange Act of 1934 and all other applicable securities regulations. We might not purchase any shares of our common stock and our board of directors may decide, in its absolute discretion, at any time and for any reason, to cancel the stock repurchase program.

We believe that our cash on hand and the cash flows we expect to generate from operations will be sufficient to meet our liquidity requirements through 2005, including dividends and purchases under our stock repurchase program. Our assumptions are based in part on our historical net cash provided by operating activities, which were approximately $25.0 million, $32.5 million, $36.6 million and $33.4 million for the years ended 2001, 2002, 2003 and the nine months ended September 30, 2004, respectively. Our cash and cash equivalents were $8.7 million, $18.7 million, $6.7 million and $33.4 million as of December 31, 2001, 2002, 2003 and September 30, 2004, respectively. The difference between cash provided by operating activities and cash and cash equivalents as of December 31, 2001, 2002, 2003 and September 30, 2004 are primarily due to repayments on long-term debt associated with our October 1999 recapitalization and capital lease obligations of $24.9 million, $20.5 million, $45.3 million and $5.1 million, respectively. As of the date of this prospectus, we have no outstanding debt other than that incurred in the ordinary course of our business, having repaid in the first quarter of 2004 the last $5.0 million related to the recapitalization.

If our assumptions as to operating expenses, working capital requirements and capital expenditures are too low or if unexpected cash needs arise that we are not able to fund with cash on hand or with borrowings under our credit facility, we would need to either reduce or eliminate dividends. If we were to use working capital or permanent borrowings to fund dividends, we would have less cash available for future dividends and other purposes, which could negatively impact our stock price, financial condition, our results of operations and our ability to maintain or expand our business.

We have estimated our initial dividend level only in respect of 2005, and we cannot assure you that during or following such periods that we will pay dividends at the estimated levels, or at all. We are not required to pay dividends, and our board of directors may modify or revoke our dividend policy at any time. Dividend payments are within the absolute discretion of our board of directors and will be dependent upon many factors and future developments that could differ materially from our current expectations. Indeed, over time our capital and other cash needs, including unexpected cash needs, will invariably change and remain subject to uncertainties, which could impact the level of any dividends we pay in the future.

We believe that our dividend policy will limit, but not preclude, our ability to pursue growth as we intend to retain sufficient cash after the distribution of dividends to permit the pursuit of growth opportunities that do not require material capital investments. In order to pay dividends at the level currently anticipated under our dividend policy and to fund any substantial portion of our stock repurchase program, we expect that we would need financing or borrowings to fund any significant acquisitions or to pursue growth opportunities requiring capital expenditures significantly beyond our anticipated capital expenditure levels. Management will evaluate potential growth opportunities as they arise and, if our board of directors determines that it is in our best interest to use cash that would otherwise be available for distribution as dividends to pursue an acquisition opportunity, to materially increase capital spending or for some other purpose, the board would be free to depart from, or change, our dividend policy at any time.

Restrictions on Payment of Dividends

Under Delaware law, we can only pay dividends either out of surplus (which is defined as total assets at fair market value minus total liabilities, minus statutory capital) or out of current or the immediately preceding year s earnings. As of December 31, 2004, we had approximately $42.1 million in cash and cash equivalents. In addition, we anticipate that we will have sufficient earnings in 2005 to pay dividends at the level described above. Although we believe we will have sufficient surplus and earnings to pay dividends at the anticipated levels for 2005, our board of directors will seek periodically to assure itself of this sufficiency before actually declaring any dividends.

Our credit facility restricts our ability to declare and pay dividends on our common stock as follows:

- when there are no outstanding amounts under the credit agreement, we may pay dividends to our stockholders and/or repurchase shares of our stock in an aggregate amount of up to 100% of our cash on hand as of the most recent fiscal quarter end; or

- when there are outstanding amounts under the credit agreement, we may pay dividends to our stockholders and/or repurchase shares of our stock in an aggregate amount of up to (1) 35% of our cash on hand as of the most recent fiscal quarter end, if the ratio of our total indebtedness to EBITDA (as calculated under the credit facility) as of the most recent quarter end is less than 1.00 to 1.00, or (2) 25% of our cash on hand as of the most recent fiscal quarter end, if such ratio is equal to or greater than 1.00 to 1.00.

In any event, in order to pay any dividends and/or repurchase shares of stock: (1) no default or event of default shall have occurred and be continuing under the credit agreement; (2) we must be in pro forma compliance with each of the financial covenants set forth in the credit agreement and (3) we must have cash on hand of at least $3,000,000; each after giving effect to the payment of dividends and/or the repurchase of shares.

In addition, if we pay dividends and/or make stock repurchases in an aggregate amount in excess of 70% of our cash on hand as of the most recent fiscal quarter end, we will not be permitted to request an extension of credit under the credit agreement for a period of 30 days following the date such dividend is paid and/ or shares of stock are repurchased. We currently have no amounts outstanding under the credit agreement, and do not foresee a need to request an extension of credit in 2005.

Capitalization

The following table sets forth our cash and cash equivalents and capitalization as of September 30, 2004. This table should be read in conjunction with Management s discussion and analysis of financial condition and results of operations and the consolidated financial statements and accompanying notes included elsewhere in this prospectus.

September 30, 2004 (unaudited) **(in thousands)**	
Cash and cash equivalents	$33,382
Stockholders equity:	
Common stock[(1)]	43
Additional paid-in capital	38,056
Deferred stock compensation	(1,405)
Accumulated other comprehensive income	176
Retained earnings	39,449
Total stockholders equity	76,319
Total capitalization	$76,319

(1) Excludes:

9,863,176 shares issuable upon the exercise of outstanding options awarded under our existing stock option plans at exercise prices ranging from $4.80 to $10.59 per share; and

670,260 shares authorized for future issuance under our existing stock option plans.

Selected consolidated financial data

You should read the selected consolidated financial data set forth below in conjunction with Management s discussion and analysis of financial condition and results of operations and our financial statements and the related notes included elsewhere in this prospectus. The following data, insofar as it relates to each of the years 1998 2003, has been derived from annual financial statements, including the consolidated balance sheets at December 31, 2003 and 2002 and the related consolidated statements of operations, cash flows and shareholders equity (deficit) and comprehensive income for the three years ended December 31, 2003 and notes thereto appearing elsewhere herein. The consolidated financial statements for the year ended December 31, 1998 were audited by other auditors. The consolidated financial statements for the year ended December 31, 1999 were audited by Arthur Andersen LLP, which has ceased operations. The data for the nine months ended September 30, 2004 and 2003 has been derived from unaudited financial statements also appearing herein and which, in the opinion of management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the unaudited interim periods.

	Year ended December 31,						Nine months ended September 30,	
(in thousands, except per share data)	1998[2][3]	1999[2][3]	2000[3]	2001	2002	2003	2003	2004
Consolidated statements of operations data:								
Revenue								
License fees	$29,408	$37,938	$ 24,471	$19,300	$ 20,572	$ 21,339	$15,427	$ 18,614
Services	10,716	17,309	14,266	18,797	26,739	34,042	25,888	32,678
Maintenance and subscriptions	22,446	29,680	39,042	47,022	52,788	58,360	43,271	48,886
Other revenue	3,062	7,550	5,838	4,915	5,130	4,352	2,906	2,849
Total revenue	65,632	92,477	83,617	90,034	105,229	118,093	87,492	103,027
Cost of revenue								
Cost of license fees	709	989	1,284	1,726	2,547	2,819	2,110	2,733
Cost of services[1]	4,339	5,534	7,028	10,253	14,234	21,006	15,347	15,988
Cost of maintenance and subscriptions[1]	11,443	15,246	15,120	11,733	10,588	11,837	9,031	7,864
Cost of other revenue	1,559	2,160	1,972	2,750	3,611	3,712	2,556	2,577
Total cost of revenue	18,050	23,929	25,404	26,462	30,980	39,374	29,044	29,162
Gross profit	47,582	68,548	58,213	63,572	74,249	78,719	58,448	73,865
Sales and marketing	11,337	13,719	12,326	15,173	19,173	21,883	15,991	20,646
Research and development	9,604	13,923	13,912	14,755	14,385	15,516	11,506	13,245
General and administrative	8,938	12,833	10,390	9,031	10,631	11,085	8,042	9,093
Amortization	2,574	2,510	2,200	2,239	1,045	848	800	32
Cost of initial public offering								2,455
Stock option compensation						23,691	17,326	55
Total operating expenses	32,453	42,985	38,828	41,198	45,234	73,023	53,665	45,526
Income from operations	15,129	25,563	19,385	22,374	29,015	5,696	4,783	28,339
Interest income	1,032	716	241	96	138	97	70	133
Interest expense	(638)	(2,752)	(11,265)	(7,963)	(4,410)	(2,559)	(2,216)	(268)
Other income (expense), net	6,310	(79)	(185)	(113)	63	235	(100)	342
Income before provision for income taxes	21,833	23,448	8,176	14,394	24,806	3,469	2,537	28,546
Income tax provision (benefit)	158	(1,456)	3,080	5,488	9,166	3,947	2,886	11,619
Net income (loss)	$21,675	$24,904	$ 5,096	$ 8,906	$ 15,640	$ (478)	$ (349)	$ 16,927

Earnings (loss) per share								
Basic	$	$	$ 0.13	$ 0.21	$ 0.37	$ (0.01)	$ (0.01)	$ 0.40
Diluted	$	$	$ 0.13	$ 0.21	$ 0.37	$ (0.01)	$ (0.01)	$ 0.36
Common shares and equivalents outstanding								
Basic weighted average shares	N/A	N/A	40,277	41,492	42,360	42,396	42,391	42,480
Diluted weighted average shares	N/A	N/A	40,277	41,492	42,360	42,396	42,391	46,467
Summary of stock option compensation:								
Cost of services	$	$	$	$	$	$ 3,342	$ 2,291	$ (644)
Cost of maintenance and subscriptions						505	344	(106)
Total cost of revenue						3,847	2,635	(750)
Sales and marketing						1,817	1,201	(194)
Research and development						2,341	1,639	(517)
General and administrative						19,533	14,486	766
Total operating expenses						23,691	17,326	55
Total stock option compensation	$	$	$	$	$	$ 27,538	$ 19,961	$ (695)

(1) Includes stock option compensation as set forth in Summary of stock option compensation.

(2) Earnings per share not computed for this year because we were an S corporation until our recapitalization in October 1999 and therefore the information would not be meaningful.

(3) Certain amounts in the 1998, 1999 and 2000 financial statements have been reclassified to conform to the 2003 financial statement presentation. These reclassifications have no effect on previously reported net income (loss), shareholders equity or net income (loss) per share.

(in thousands)	December 31, 1999	2000	2001	2002	2003	September 30, 2004
						(unaudited)
Consolidated balance sheet data:						
Cash and cash equivalents	$ 4,558	$ 1,707	$ 8,744	$ 18,703	$ 6,708	$ 33,382
Deferred tax asset, including current portion	108,521	105,441	99,953	90,943	88,765	81,210
Working capital	(25,935)	(33,478)	(27,294)	(18,997)	(30,326)	(11,879)
Total assets	142,630	136,590	132,079	132,907	121,745	143,172
Deferred revenue	20,915	30,699	33,946	39,047	43,673	51,727
Long-term debt and capital lease obligations, excluding current portion	102,500	85,952	65,481	45,186	5,044	
Total liabilities	148,473	137,410	113,742	99,400	61,887	66,853
Common stock		740	10,740	10,740	41,613	43
Additional paid-in capital						38,056
Total stockholders (deficit) equity	$ (5,843)	$ (821)	$ 18,337	$ 33,507	$ 59,858	$ 76,319

Management s discussion and analysis of financial condition and results of operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with Selected consolidated financial data and our consolidated financial statements and related notes thereto appearing elsewhere in this prospectus. This discussion contains forward-looking statements as defined in the Private Securities Litigation Reform Act. These statements reflect our current view with respect to future events and financial performance and are subject to risks, uncertainties and assumptions, including those discussed in Risk factors . Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results might vary materially from those anticipated in the forward-looking statements.

Overview

We are the leading global provider of software and related services designed specifically for nonprofit organizations. Our products and services enable nonprofit organizations to increase donations, reduce fundraising costs, improve communications with constituents, manage their finances and optimize internal operations. We have focused solely on the nonprofit market since our incorporation in 1982 and have developed our suite of products and services based upon our extensive knowledge of the operating challenges facing nonprofit organizations. In 2004, we had over 12,700 customers, over 12,300 of which pay us annual maintenance and support fees. Our customers operate in multiple verticals within the nonprofit market including religion, education, foundations, health and human services, arts and cultural, public and societal benefits, environment and animal welfare, and international foreign affairs.

We derive revenue from licensing software products and providing a broad offering of services, including consulting, training, installation, implementation, and donor prospect research and modeling services, as well as ongoing customer support and maintenance. Consulting, training and implementation are generally not essential to the functionality of our software products and are sold separately. Accordingly, we recognize revenue from these services separately from license fees.

Critical accounting policies and estimates

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenue and expenses during the reporting period and related disclosures of contingent assets and liabilities. The most significant estimates and assumptions relate to our allowance for sales returns and doubtful accounts, impairment of long-lived assets, valuation of stock option compensation and realization of deferred tax assets. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. On an ongoing basis, we reconsider and evaluate our estimates and assumptions. We are not aware of any circumstances in the past, which have caused these estimates and assumptions to be materially wrong. Furthermore, we are not currently aware of any material changes in our business that might cause these assumptions or estimates to differ significantly. In our discussion below of deferred taxes, the most significant asset subject to such assumptions and estimates, we have described the sensitivity of these assumptions or estimates to potential deviations in actual results. Actual results could differ from any of our estimates under different assumptions or conditions.

We believe the critical accounting policies listed below affect significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition

The Company s revenue is generated primarily by licensing its software products and providing support, training, consulting, technical, hosting and other professional services for those products. The Company recognizes revenue in accordance with the American Institute of Certified Public Accountants Statement of Position (SOP) 97-2, Software Revenue Recognition , as modified by SOPs 98-4 and 98-9, as well as Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants, and in accordance with the SEC Staff Accounting Bulletin No. 104, Revenue Recognition in Financial Statements .

Under these pronouncements, the Company recognizes revenue from the license of software when persuasive evidence of an arrangement exists, the product has been delivered, the fee is fixed and determinable and collection of the resulting receivable is probable. The Company uses a signed agreement as evidence of an arrangement. Delivery occurs when the product is delivered. The Company s typical license agreement does not include customer acceptance provisions; if acceptance provisions are provided, delivery is deemed to occur upon acceptance. The Company considers the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within the Company s standard payment terms. The Company considers payment terms greater than 90 days to be beyond its customary payment terms. The Company deems collection probable if the Company expects that the customer will be able to pay amounts under the arrangement as they become due. If the Company determines that collection is not probable, the Company postpones recognition of the revenue until cash collection. The Company sells software licenses with maintenance and, often times, professional services. The Company allocates revenue to delivered components, normally the license component of the arrangement, using the residual value method based on objective evidence of the fair value of the undelivered elements, which is specific to the Company. Fair value for the maintenance services associated with the Company s software licenses is based upon renewal rates stated in the Company s agreements, which vary according to the level of the maintenance program. Fair value of professional services and other products and services is based on sales of these products and services to other customers when sold on a stand-alone basis.

The Company recognizes revenue from maintenance services ratably over the contract term, which is one year. Maintenance revenue also includes the right to unspecified product upgrades on an if-and-when available basis. Subscription revenue includes fees for hosted solutions, data enrichment services and hosted online training programs. Subscription-based revenue and any related set-up fees are recognized ratably over the twelve-month service period of the contracts, as there is no discernible pattern of usage.

The Company s services, which include consulting, installation and implementation services, are generally billed based on hourly rates plus reimbursable travel and lodging related expenses. For small service engagements, less than $10,000, the Company frequently contracts for and bills based on a fixed fee plus reimbursable travel and lodging related expenses. The Company recognizes this revenue upon completion of the work performed. When the Company s services include software customization, these services are provided to support customer requests for assistance in creating special reports and other minor enhancements that will assist with efforts to improve operational efficiency and/or to support business process improvements. These services are not essential to the functionality of the Company s software and rarely exceed three months in duration. The Company recognizes revenue as these services are performed.

The Company sells training at a fixed rate for each specific class, at a per attendee price, or at a packaged price for several attendees, and revenue is recognized only upon the customer attending and completing training. The Company recognizes revenue from donor prospect research and data modeling service engagements upon delivery.

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

Deferred sales commission costs

Prior to July 1, 2004 we paid commissions to our sales representatives based on signing a contract for the sale of both software and services arrangements, other than training. This method was changed effective July 1, 2004 such that at the time the software and services are delivered and revenue is recognized, we pay commissions to our sales representatives on the services performed. Deferred sales commission costs relate to services not yet provided for which sales representatives were paid commissions prior to July 1, 2004.

Sales returns and allowance for doubtful accounts

We provide customers a 30-day right of return and maintain a reserve for returns. We estimate the amount of this reserve based on historical experience. Provisions for sales returns are charged against the related revenue items.

We maintain an allowance for doubtful accounts at an amount we estimate to be sufficient to provide adequate protection against losses resulting from extending credit to our customers. In judging the adequacy of the allowance for doubtful accounts, we consider multiple factors including historical bad debt experience, the general economic environment, the need for specific customer reserves and the aging of our receivables. Any necessary provision is reflected in general and administrative expense. A considerable amount of judgment is required in assessing these factors and if any receivables were to deteriorate, an additional provision for doubtful accounts could be required.

Valuation of long-lived and intangible assets and goodwill

We review identifiable intangible and other long-lived assets for impairment when events change or circumstances indicate the carrying amount may not be recoverable. Events or changes in circumstances that indicate the carrying amount may not be recoverable include, but are not limited to, a significant decrease in the market value of the business or asset acquired, a significant adverse change in the extent or manner in which the business or asset acquired is used or significant adverse change in the business climate. If such events or changes in circumstances are present, the undiscounted cash flow method is used to determine whether the asset is impaired. Cash flows would include the estimated terminal value of the asset and exclude any interest charges. To the extent that the carrying value of the asset exceeds the undiscounted cash flows over the estimated remaining life of the asset, the impairment is measured using discounted cash flows. The discount rate utilized would be based on our best estimate of the related risks and return at the time the impairment assessment is made. In accordance with Statement of Financial Accounting Standard, or SFAS, No. 142, Goodwill and Other Intangible Assets, we test goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test compares the fair value of the asset with its carrying amount. If the carrying amount of an intangible asset exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, which could materially adversely impact our financial position and results of operations. All of our goodwill was associated with a single acquisition and was assigned to a single reporting unit.

Stock option compensation

We account for stock option compensation under the provisions of Accounting Principles Board Opinion, or APB, No. 25, Accounting for Stock Issued to Employees. Under this pronouncement, there is generally no cost associated with options that are granted with an exercise price equal to or above the fair value per share of our common stock on the date of grant. Because there was no public market for our stock prior to our initial public offering in July 2004, our board of directors estimated the fair value of our common stock by considering a number of factors, including our operating performance, significant events in our history, trends in the broad market for technology stocks and the expected valuation we would obtain in an initial public offering. Grants under two of our option plans, covering approximately 6.5 million shares, contain provisions that result in them being treated as variable awards under APB No. 25. The effect of this accounting is that an amount equal to the difference between the exercise price of the options and the estimated current fair value is charged to deferred compensation and amortized as an expense over the related vesting periods of the grants using the accelerated method outlined in FASB Financial Interpretation Number 28, or FIN No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Awards Plans. Under variable award accounting, the affected option grants continue to be marked to market until such time as the amount of related compensation is deemed fixed. Options for approximately 3.0 million shares are no longer being accounted for as variable awards following the occurrence of our initial public offering in July 2004. The remaining 3.5 million options, which are held by our Chief Executive Officer, will continue to be accounted for as a variable award until the options are fully exercised.

We have separately disclosed stock option compensation throughout this discussion and in our financial statements and we have shown a reconciliation of stock option compensation as it relates to sales and marketing, research and development, and general and administrative expenses on the statements of operations because, in managing our operations, we believe such costs significantly affect our ability to better understand and manage other operating expenses and cash needs.

We have also disclosed in note 1 of the Notes to the consolidated financial statements the pro forma effects of accounting for our stock option compensation in accordance with SFAS No. 123, Accounting for Stock Based Compensation.

Deferred taxes

Significant judgment is required in determining our interim income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in a net deferred tax asset, which is included on our consolidated balance sheet. The final tax outcome of these matters might be different than that which is reflected in our historical income tax provisions, benefits and accruals. Any difference could have a material effect on our income tax provision and net income in the period in which such a determination is made.

Prior to October 13, 1999, we were organized as an S corporation under the Internal Revenue Code and, therefore, were not subject to federal income taxes. We historically made distributions to our shareholders to cover the shareholders anticipated tax liability. In connection with the recapitalization agreement, we converted our U.S. taxable status from an S corporation to a C corporation. Accordingly, since October 14, 1999 we have been subject to federal and state income taxes. Upon the conversion and in connection with the recapitalization, we recorded a one-time benefit of $107.0 million to establish a deferred tax asset as a result of the recapitalization agreement.

We must assess the likelihood that the net deferred tax asset will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance, we must include an expense within the tax provision in the statement of operations. We have not recorded a valuation allowance as of September 30, 2004 or as of December 31, 2003, because we expect to be able to utilize all of our net deferred tax asset. The ability to utilize our net deferred tax asset is solely dependent on our ability to generate future taxable income. Based on current estimates of revenue and expenses, we expect future taxable income will be more than sufficient to recover the annual amount of tax amortization permitted. Even if actual results are significantly below our current estimates, the recovery still remains likely and no valuation allowance would be necessary.

Our deferred tax assets and liabilities are recorded at an amount based upon a U.S. Federal income tax rate of 34%. This rate is based on our expectation that our deductible and taxable temporary differences will reverse over a period of years during which we will have average annual taxable income not exceeding $10.0 million per year. If our results of operations improve in the future, such that our average annual taxable income will be expected to exceed $10.0 million, we will record our deferred tax assets and liabilities at an amount reflecting an average expected U.S. Federal income tax rate of up to 35%, consistent with the corresponding expectation of higher taxable income. If such change is determined to be appropriate, it will affect the provision for income taxes during the period that the determination is made.

Contingencies

We are subject to the possibility of various loss contingencies in the normal course of business. We accrue for loss contingencies when a loss is estimable and probable.

Acquisitions

In July 2002, we acquired substantially all of the assets of AppealMaster Ltd., a software company located in the United Kingdom, for $500,000 and additional contingent payments based on future performance, which have been recorded as additional purchase price. This purchase price has been allocated to the assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition. The excess consideration above the fair value of net assets acquired of approximately $852,000 was recorded as goodwill in July 2002.

As a result of payments of contingent consideration of approximately $431,000 in 2003 and an increase of approximately $103,000 resulting from foreign currency translation in 2003, the balance of goodwill at December 31, 2003 was approximately $1,386,000. In addition, in 2002 we paid approximately $62,000 to the previous controlling shareholder for consulting services and recorded this amount as an expense.

During the three-year period ended December 31, 2003 we made other acquisitions that were not significant. These acquisitions were accounted for under the purchase method of accounting and the results of operations of the acquirees have been included in the consolidated statement of operations since the acquisition dates. There were no acquisitions during the nine month period ended September 30, 2004.

Results of operations

The following table sets forth our statements of operations data expressed as a percentage of total revenue for the periods indicated.

Consolidated statements of operations, percent of revenue

	Year ended December 31,	Nine months ended