

ULTIMATE SOFTWARE GROUP INC  
Form 10-Q  
May 10, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2011

Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 0-24347

THE ULTIMATE SOFTWARE GROUP, INC.  
(Exact name of Registrant as specified in its charter)

Delaware 65-0694077  
(State or other jurisdiction of incorporation) (I.R.S. Employer Identification No.)  
or organization

2000 Ultimate Way, Weston, FL 33326  
(Address of principal executive offices) (Zip Code)

(954) 331 - 7000  
(Registrant's telephone number, including area code)

None  
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of May 4, 2011, there were 25,838,907 shares of the Registrant's Common Stock, par value \$0.01, outstanding.

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES (“ULTIMATE”)

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PART 1 – FINANCIAL INFORMATION  
Item 1 – Financial Statements  
THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except share data)

	As of March 31, 2011	As of December 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 48,022	\$ 40,889
Short-term investments in marketable securities	8,399	8,884
Accounts receivable, net of allowance for doubtful accounts of \$700 for 2011 and \$800 for 2010	45,644	47,570
Prepaid expenses and other current assets	20,360	18,613
Deferred tax assets, net	1,440	1,434
Total current assets before funds held for customers	123,865	117,390
Funds held for customers	255,999	72,875
Total current assets	379,864	190,265
Property and equipment, net	20,095	18,075
Capitalized software, net	2,777	3,115
Goodwill	3,025	3,025
Long-term investments in marketable securities	926	433
Other assets, net	11,921	11,656
Long-term deferred tax assets, net	22,843	22,988
Total assets	\$ 441,451	\$ 249,557
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 6,561	\$ 4,683
Accrued expenses	11,164	11,074
Current portion of deferred revenue	72,315	71,808
Current portion of capital lease obligations	2,552	2,551
Total current liabilities before customer funds obligations	92,592	90,116
Customer funds obligations	255,999	72,875
Total current liabilities	348,591	162,991
Deferred revenue, net of current portion	5,146	6,287
Deferred rent	3,391	3,022
Capital lease obligations, net of current portion	2,243	2,406
Income taxes payable	1,866	1,866
Total liabilities	361,237	176,572
Stockholders' equity:		

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Preferred Stock, \$.01 par value, 2,000,000 shares authorized, no shares issued or outstanding	-	-
Series A Junior Participating Preferred Stock, \$.01 par value, 500,000 shares authorized, no shares issued or outstanding	-	-
Common Stock, \$.01 par value, 50,000,000 shares authorized, 29,371,094 and 29,027,277 shares issued in 2011 and 2010, respectively	294	290
Additional paid-in capital	223,098	216,262
Accumulated other comprehensive income	187	126
Accumulated deficit	(51,925 )	(52,253 )
	171,654	164,425
Treasury stock, 3,594,825 shares, at cost, for 2011 and 2010	(91,440 )	(91,440 )
Total stockholders' equity	80,214	72,985
Total liabilities and stockholders' equity	\$ 441,451	\$ 249,557

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

	For the Three Months Ended March 31,	
	2011	2010
Revenues:		
Recurring	\$49,948	\$39,448
Services	13,729	15,581
License	828	628
Total revenues	64,505	55,657
Cost of revenues:		
Recurring	14,693	11,404
Services	13,929	13,181
License	173	100
Total cost of revenues	28,795	24,685
Gross profit	35,710	30,972
Operating expenses:		
Sales and marketing	17,123	15,116
Research and development	11,967	10,233
General and administrative	5,613	5,001
Total operating expenses	34,703	30,350
Operating income	1,007	622
Other (expense) income:		
Interest and other expense	(158 )	(45 )
Other income, net	34	22
Total other (expense) income, net	(124 )	(23 )
Income from continuing operations, before income taxes	883	599
Provision for income taxes	(555 )	(279 )
Income from continuing operations	\$328	\$320
Loss from discontinued operations, net of income taxes	-	(65 )
Net income	\$328	\$255
Basic earnings per share:		
Earnings from continuing operations	\$0.01	\$0.01
Loss from discontinued operations	\$-	\$-
Total	\$0.01	\$0.01
Diluted earnings per share:		
Earnings from continuing operations	\$0.01	\$0.01
Loss from discontinued operations	\$-	\$-
Total	\$0.01	\$0.01
Weighted average shares outstanding:		
Basic	25,594	24,755
Diluted	27,724	26,823

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	For the Three Months Ended March 31,	
	2011	2010
Cash flows from operating activities:		
Net income	\$ 328	\$ 255
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,859	3,021
Provision for doubtful accounts	560	554
Non-cash stock-based compensation expense	3,850	3,391
Income taxes	521	208
Excess tax benefit from stock-based payments	(382 )	(652 )
Changes in operating assets and liabilities:		
Accounts receivable	1,366	16
Prepaid expenses and other current assets	(1,747 )	(1,055 )
Other assets	(293 )	39
Accounts payable	1,878	1,433
Accrued expenses and deferred rent	459	(933 )
Deferred revenue	(634 )	(1,394 )
Net cash provided by operating activities	8,765	4,883
Cash flows from investing activities:		
Purchases of property and equipment	(3,995 )	(1,207 )
Purchases of marketable securities	(4,000 )	(2,100 )
Maturities of marketable securities	3,992	2,098
Net purchases of securities with customer funds	(183,124)	(50,254 )
Net cash used in investing activities	(187,127)	(51,463 )
Cash flows from financing activities:		
Repurchases of Common Stock	-	(3,684 )
Excess tax benefits from stock-based payments	382	652
Shares acquired to settle employee tax withholding liability	(2,376 )	(516 )
Principal payments on capital lease obligations	(680 )	(614 )
Net increase in customer fund obligations	183,124	50,254
Net proceeds from issuances of Common Stock	4,983	2,352
Net cash provided by financing activities	185,433	48,444
Effect of exchange rate changes on cash	62	35
Net increase in cash and cash equivalents	7,133	1,899
Cash and cash equivalents, beginning of period	40,889	23,684
Cash and cash equivalents, end of period	\$ 48,022	\$ 25,583
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 56	\$ 43
Cash paid for income taxes	\$ 267	\$ 18



Supplemental disclosure of non-cash financing activities:

- Ultimate entered into capital lease obligations to acquire new equipment totaling \$519 and \$869 for the three months ended March 31, 2011 and March 31, 2010, respectively.

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations

The Ultimate Software Group, Inc. and subsidiaries (“Ultimate,” “we,” “us” or “our”) is a leading provider of unified human capital management (“HCM”) software-as-a-service (“SaaS”) solutions for global businesses. Ultimate’s UltiPro software (“UltiPro”) is a comprehensive SaaS-based solution delivered primarily to organizations based in the United States and Canada and designed to deliver the functionality businesses need to manage the complete employment life cycle from recruitment to retirement. Ultimate’s solutions are marketed as two solution suites based on company size. UltiPro Enterprise (“Enterprise”) is designed to address the needs of companies with 1,000 or more employees. UltiPro Workplace (“Workplace”) is designed for companies with fewer than 1,000 employees. UltiPro is marketed primarily through our Enterprise and Workplace direct sales teams.

2. Basis of Presentation, Consolidation and the Use of Estimates

The accompanying unaudited condensed consolidated financial statements of Ultimate have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. The information in this quarterly report should be read in conjunction with Ultimate’s audited consolidated financial statements and notes thereto included in Ultimate’s Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed with the SEC on March 1, 2011 (the “Form 10-K”).

The unaudited condensed consolidated financial statements included herein reflect all adjustments (consisting only of normal, recurring adjustments) which are, in the opinion of Ultimate’s management, necessary for a fair presentation of the information for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Interim results of operations for the three months ended March 31, 2011 are not necessarily indicative of operating results for the full fiscal year or for any future periods.

The unaudited condensed consolidated financial statements reflect the financial position and operating results of Ultimate and include its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

The unaudited condensed consolidated statement of cash flows for the three months ended March 31, 2010 reflects an immaterial correction of approximately \$0.1 million to properly classify excess tax benefits from stock-based payments and shares acquired to settle employee tax withholding liability in the statement of cash flows. In cash flows from operating activities, we changed the description from “tax charge for equity awards” in the prior period to “excess tax benefit from stock-based payments” to better describe the nature of the cash flow item. We also reclassified \$0.1 million from cash flows from operating activities to cash flows from financing activities and, within the cash flows from financing activities, we reflect the net correction of \$0.1 million in two separate descriptions—excess tax benefits from stock-based payments and shares acquired to settle employee tax withholding liability. Management evaluated the materiality of the statement of cash flows classification error from both qualitative and quantitative perspectives and determined that the revision was immaterial to the three months ended March 31, 2010.

The presentation of the unaudited condensed consolidated statement of income for the three months ended March 31, 2010 has been modified to conform with reporting requirements for discontinued operations.

### 3.Summary of Significant Accounting Policies and Recent Accounting Pronouncements

#### Summary of Significant Accounting Policies

Ultimate's significant accounting policies discussed in Note 3 to its audited consolidated financial statements for the fiscal year ended December 31, 2010, included in the Form 10-K, have not significantly changed with the exception of our revenue recognition policy due to the adoption of Accounting Standards Update No. 2009-13, "Multiple-Deliverable Revenue Arrangements" ("ASU 2009-13") as presented below.

#### Revenue Recognition

Effective January 1, 2011, we adopted ASU 2009-13 on a prospective basis. ASU 2009-13 requires the use of the relative selling price method of allocating the total consideration to units of accounting in a multiple element arrangement and eliminates the residual method. This new accounting principle requires an entity to allocate revenue to an arrangement using the estimated selling price ("ESP") of deliverables if it does not have vendor-specific objective evidence ("VSOE") or third-party evidence ("TPE") of selling price. The adoption of ASU 2009-13 did not have a material impact on our unaudited condensed consolidated financial statements.

VSOE is the price charged when the same or similar product or service is sold separately. We define VSOE as a median price of recent stand-alone transactions that are priced within a narrow range.

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TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately. However, due to the difficulty in obtaining sufficient information on competitor pricing and differences in our product offerings when compared with those of our peers, we generally are unable to reliably determine TPE.

ESP is our best estimate of the selling price of an element in a transaction. If we are unable to establish selling price using either VSOE or TPE, we will use ESP in our allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact if the product or service were sold by us on a stand-alone basis. Our determination of ESP involves the use of a customary discount from the list (or book) price for each element, with the discounted price applied within a narrow range. The customary discount is derived from historical data that has been analyzed to determine trends and patterns. We will analyze the customary discount used for determining ESP on no less than an annual basis.

We expect our products and services to continue to qualify as separate units of accounting under ASU 2009-13. We evaluate each deliverable in our arrangements to determine whether they represent a separate unit of accounting. A deliverable constitutes a separate unit of accounting when it has stand-alone value to the customers.

There are two major elements in our multiple element arrangements for the delivery of our SaaS offering (the "SaaS Offering"), which are recurring revenues and services revenues. Also included in our total revenues, to a much lesser degree, are the sales of software licenses.

We recognize revenues when all of the following criteria are met:

- persuasive evidence of an arrangement exists;
- delivery has occurred;
- the fees are fixed and determinable; and
- collection is considered probable.

If collection is not considered probable, we recognize revenues when the fees are collected. If the fees are not fixed and determinable, we recognize revenues when the fees become due from the customer. If non-standard acceptance periods or non-standard performance criteria are required, we recognize revenue when the acceptance period expires or upon the satisfaction of the acceptance/performance criteria, as applicable.

The majority of services revenues are recognized over the implementation period, which is from the contract execution date until the customer processes its first payroll using UltiPro (also referred to as going "Live"). SaaS revenues are recognized over the contract term, beginning in the month the customer goes Live. There was no significant change to the pattern or timing of revenue recognition for either services or SaaS elements as a result of adopting ASU 2009-13.

### Recurring Revenues

Recurring revenues consist of subscription revenues recognized from our SaaS Offering, as well as customer support and maintenance revenues.

i) SaaS subscription revenues are principally derived from per-employee-per-month ("PEPM") fees earned from the SaaS Offering and from sales of hosting services on a stand-alone basis to customers who already own a perpetual license ("Base Hosting"). To the extent there

are upfront or setup fees associated with our SaaS Offering, the related SaaS subscription revenues are recognized ratably over the term

of the related contract, commencing when the customer goes Live. Ongoing PEPM fees from the SaaS Offering and Base Hosting are

recognized as subscription revenues as the services are delivered commencing when the customer goes Live.

ii) Customer support and maintenance revenues are derived from maintaining, supporting, and providing periodic updates of our software

for our hosting services.

Under our SaaS Offering, our customers do not have the right to take possession of our software and these arrangements are considered service contracts. Fair value of multiple elements in SaaS arrangements is derived for each element based on the guidance provided by ASU 2009-13. The multiple elements that typically exist in SaaS arrangements include hosting services, the right to use UltiPro, maintenance of UltiPro (i.e., product enhancements, updates and customer support) and professional services (i.e., primarily implementation services).

The pricing for the three elements that pertain to recurring revenues (i.e., hosting services, the right to use UltiPro and maintenance of UltiPro) is bundled. Since these three bundled elements are components of recurring revenues in the unaudited condensed consolidated statements of income, allocation of fair values to each of the three elements is not necessary and they are not reported separately. Fair value for the bundled elements, as a whole, is determined on the basis of renewal pricing, without taking into consideration potential price increases or changes in the number of underlying employees caused by potential changes in the size of the customer in the future due to the uncertainties surrounding these potential occurrences. These bundled elements are provided on an ongoing basis, represent undelivered elements and are recognized on a monthly basis as the related services are performed, commencing once the customer goes Live.

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Services Revenues

Services revenues primarily include revenues from fees charged for the implementation of our product solutions and, to a lesser extent, training of customers in the use of our products and fees for other services, including the provision of payroll-related forms, sales of timeclocks and the printing of W-2 forms for certain customers, as well as certain reimbursable out-of-pocket expenses. Revenues from implementation services comprise the majority of total services revenues.

Revenues from implementation consulting services billed on a time and materials basis (at an hourly rate) are recognized as these services are performed. The total arrangement consideration is allocated to service elements in the arrangement based on their relative fair values, using the prices established when the services are sold on a stand-alone basis. Other services are recognized as the product is shipped or as the services are rendered, depending on the specific terms of the related arrangement.

Revenues from implementation consulting services sold on a fixed-fee basis are recognized using the percentage of completion accounting method, which involves the use of estimates. Percentage of completion is measured at each reporting date based on progress made to date compared to the total estimate to complete the implementation job.

License Revenues

From our inception through March 31, 2009, we sold perpetual licenses of UltiPro, which resulted in license revenues recognized for that period of time. Customer support and maintenance revenues, from previously sold perpetual licenses, are derived from maintaining, supporting, and providing periodic updates of our software. Maintenance revenues are recognized ratably over the service period, generally one year, and are included in recurring revenues. Annual maintenance renewal fees which occur subsequent to the initial contract period are also recognized ratably over the related service period.

While we still sell on-site licenses of UltiPro on an infrequent basis, sales to new customers are only on a subscription basis (priced and billed to our customers on a PEPM basis). We no longer sell our on-site UltiPro solutions to new customers on a perpetual license basis. We do sell licenses to existing license customers but only in relation to the customer's employee growth or for products complementary to UltiPro for which the customer already has a perpetual license. Any such licenses are recognized as license revenues in our unaudited condensed consolidated financial statements upon the delivery of the related software product when all significant contractual obligations have been satisfied.

4. Discontinued Operations

Ultimate discontinued and liquidated the operations of The Ultimate Software Group UK Limited, our wholly-owned subsidiary in the United Kingdom (the "UK Subsidiary") during the year ended December 31, 2010. There were no discontinued operations for the three months ended March 31, 2011. Discontinued operations, net of income taxes, resulted in a loss of \$65 thousand for the three months ended March 31, 2010.

5. Investments in Marketable Securities and Fair Value of Financial Instruments

We classify our investments in marketable securities with readily determinable fair values as available-for-sale. Available-for-sale securities consist of debt and equity securities not classified as trading securities or as securities to be held to maturity. Unrealized gains and losses on available-for-sale securities are reported as a net amount in accumulated other comprehensive income in stockholders' equity until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. Included in accumulated

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other comprehensive income was \$3 thousand and \$7 thousand of unrealized gains on available-for-sale securities at March 31, 2011 and December 31, 2010, respectively.

The amortized cost, net unrealized gain and fair value of our investments in marketable available-for-sale securities as of March 31, 2011 and December 31, 2010 are shown below (in thousands):

	As of March 31, 2011			As of December 31, 2010		
	Amortized Cost	Net Unrealized Gain	Fair Value	Amortized Cost	Net Unrealized Gain	Fair Value
Corporate debentures and bonds	\$4,023	\$ 1	\$4,024	\$2,903	\$ 4	\$2,907
Commercial paper	2,299	–	2,299	2,599	–	2,599
U.S. Agency bonds	1,005	1	1,006	1,513	1	1,514
U.S. Treasury bills	1,201	1	1,202	1,504	2	1,506
Non U.S. government bond	304	–	304	301	–	301
Certificates of deposit	490	–	490	490	–	490
Total investments	\$9,322	\$ 3	\$9,325	\$9,310	\$ 7	\$9,317

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The amortized cost and fair value of the marketable available-for-sale securities by contractual maturity as of March 31, 2011 are shown below (in thousands):

	As of March 31, 2011	
	Amortized Cost	Fair Value
Due in one year or less	\$ 8,396	\$ 8,399
Due after one year	926	926
Total	\$ 9,322	\$ 9,325

We classify and disclose fair value measurements in one of the following three categories of fair value hierarchy:

- Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets and liabilities.
- Level 2: Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly.
- Level 3: Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Our assets that are measured by management at fair value on a recurring basis are generally classified within Level 1 or Level 2 of the fair value hierarchy. The types of instruments valued based on quoted market prices in active markets include certificates of deposit. Such instruments are generally classified within Level 1 of the fair value hierarchy. We did not have any significant transfers into and out of Level 1 and Level 2 during the three months ended March 31, 2011 and the twelve months ended December 31, 2010.

The types of instruments valued by management, based on quoted prices in less active markets, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency, include Ultimate's corporate debentures and bonds, commercial paper, agency bonds, U.S. Treasury bills and non U.S. government bonds. Such instruments are generally classified within Level 2 of the fair value hierarchy. Ultimate uses consensus pricing, which is based on multiple pricing sources, to value its fixed income investments. The following table sets forth, by level within the fair value hierarchy, financial assets and liabilities accounted for at fair value as of March 31, 2011 and December 31, 2010 (in thousands):

	As of March 31, 2011			As of December 31, 2010				
	Total	(Level 1)	(Level 2)	(Level 3)	Total	(Level 1)	(Level 2)	(Level 3)
Corporate debentures and bonds	\$4,024	\$-	\$4,024	\$-	\$2,907	\$-	\$2,907	\$-
Commercial paper	2,299	-	2,299	-	2,599	-	2,599	-
U.S. Agency bonds	1,006	-	1,006	-	1,514	-	1,514	-



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U.S. Treasury bills	1,202	–	1,202	–	1,506	–	1,506	–
Non U.S. government bond	304	–	304	–	301	–	301	–
Certificates of deposit	490	490	–	–	490	490		