

FINAL TRANSCRIPT

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LWSN - Q1 2008 Lawson Software, Inc. Earnings Conference Call

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PRESENTATION

Operator

Welcome and thank you for standing by. At this time, all participants are on a listen only mode until the question and answer session of today's conference. (OPERATOR INSTRUCTIONS) I would also like to remind parties this call is being recorded. If you have any objections please disconnect at this time.

I would now like to turn the call over to Barbara Doyle. Thank you. You may begin.

Barbara Doyle - *Lawson Software, Inc. - Vice President Investor Relations*

Thank you, Diane, and good afternoon to everyone on the call.

Welcome to Lawson Software's fiscal 2008 first quarter conference call covering results for the quarter ended August 31, 2007. On today's call, Harry Debes, Lawson's President and CEO, and Rob Schriesheim, Lawson's CFO will discuss our Q1 results and Q2 future guidance. We will then open up the call to your questions as the operator will describe.

Let me remind you that you can reference our press release and financial results tables on our investor website at www.Lawson.com/investor. Now allow me please to review our Safe Harbor statement. This call will include forward-looking statements that contain risks and uncertainties. These forward-looking statements contain statements of intent, belief, or current expectations of Lawson Software and its management. Such forward-looking statements are not guarantees of future results

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and involve risks and uncertainties that may cause actual results to differ materially from the potential results discussed in our forward-looking statements.

The Company is not obligated to update forward-looking statements based on circumstances or events that occur in the future. Risks and uncertainties that may cause such differences include, but are not limited to uncertainties in the Company's ability to realize synergies and revenue opportunities from the Intentia acquisition, uncertainties in the software industry, uncertainties as to when and whether the conditions for recognition of deferred revenues will be satisfied, global military conflicts or terrorist attacks or any future events in response to these developments, changes in conditions in the Company's targeted industries, increased competition, and other risk factors listed in the Company's recent 10-K filed with the Securities and Exchange Commission and available on our website.

With that, let me turn the call over to Harry Debes.

Harry Debes - Lawson Software, Inc. - President & CEO

Thank you, Barbara, and good afternoon, everyone.

As usual, I will begin with an overview of the quarter, discuss some sales metrics, cover the few client wins and then Rob Schriesheim, our CFO, will cover our financial results and guidance. So now that we've completed what is typically the weakest quarter of the year, and that's due to vacation schedules in Europe and as we are about one-third of the way into our second quarter, our perspective is that things are proceeding exactly as planned. We are doing what we said we would do and we have no changes to our view of fiscal 2008.

For our first quarter, total non-GAAP revenue was \$188 million and that's an increase of 13% year-over-year and I'll remind you that this is 100% organic growth. Maintenance revenues increased by 9% to \$79 million and with our new collection policy, our maintenance revenue and cash flow associated with this revenue stream is highly predictable.

Consulting services revenue increased 8% to \$83.6 million. As further color I can tell you that demand for Lawson consulting services continues to be very strong and we see this continuing for some time in the future. We plan to address this demand with a combination of our own resources, our global sourcing program, and with a commitment to grow our partner ecosystem.

We also had significant growth in license revenue in the quarter. License revenues grew 52% totaling \$25.5 million. You may recall that we had a very strong license contracting and revenue quarter in Q4. In our first quarter, we were a little weaker than expected in America and the deferred revenue roll in for Q1 was not as strong as it will be in future quarters but we were exceptionally strong in other parts of the world. So despite what I see as temporary softness in America, I'm pleased with the result. I'm also confident that America will post better results in the coming quarters, but overall, our revenue was and is in good shape.

Looking at the bottom line, our non-GAAP earnings per share was \$0.07 and that's up from \$0.02 a year ago. This once again demonstrates that we can effectively manage our costs. So in Q1, we met or exceeded financial guidance in every aspect.

Now, I'll review some of the sales metrics and key customer wins in Q1. In the quarter, we signed 294 deals, 29% more than we signed a year ago. Average selling price of all deals sold in the quarter was \$89,000. So with a company our size I feel it's more meaningful to compare deal metrics on a trailing 12 month basis rather than a 90 day period.

Over the last 12 months, the average selling price for all deals was \$77,000 and this includes the large volume of LSF deals which average only \$25,000, but we had to work all of last year and particularly in Q4 of last year, so this had a downward impact on ASP. In Q1, we signed 27 new name accounts with an average price of \$308,000. This compares to an average selling price of \$320,000 for new deals over the last trailing 12 months.

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This quarter's new deal average price is slightly lower than trailing 12 month trend but it is not something you should model as it is based on deal mix in the quarter and not necessarily a predictor of the future. When it comes to large deals, we closed six deals greater than \$1 million compared to four a year ago and we signed four deals between \$500,000 and \$1 million compared to six last year.

So let's talk about some of our Q1 wins. In our healthcare vertical, we signed Heartland Health, MedAmerica, and Public Health Foundation Enterprises and we beat Oracle in all cases.

In our public services vertical, we won the business of Anne Arundel County Public Schools, the City of Newport, Rhode Island and the City of Newport Schools, again all victories over Oracle. In our industry markets, we won the business of Global Container Terminals, a worldwide shipping services company, and this was a win over both SAP and Oracle.

In food and beverage, Champagne Laurent Perrier opted for Lawson over Oracle and over SAP. Other notable victories included LR Health and Beauty in Germany, Helly Hanson, Faiveley all significant wins in Europe and all against once again SAP and Oracle.

And in Australia and New Zealand, notables wins included Eagle's Plumbing and Lyttleton Port, again both victories over Oracle and finally, in Japan, we signed NIDEC Corporation and that was a win over SAP.

You'll note that I mentioned the victories over SAP and Oracle because it's important for people to know that we can and do compete against them in virtually every deal and when we stick to our vertical markets, we have a very good win rate, but overall, we started our new fiscal year with a good selling quarter. Our sales team in Europe had a particularly strong result, so congratulations to them.

Now, I want to briefly touch on services margin. In our fourth quarter we had services margins of 11% and at the time, I said that this performance was unacceptable and that we would work hard to fix it. I'm pleased to now report that we improved services margins to 15% this quarter, and this improvement comes in our weakest quarter for services revenues due to vacations of both customers and employees. I want to thank the services team for accepting the challenge and for delivering a much improved result, and now that the vacation period is largely over, and as we continue to leverage our global sourcing center, I'm confident that our services margins should continue to improve.

Finally, I'm happy to report that our long search for our new Executive Vice President of Global Sales is over. At the beginning of September, we appointed Eduardo Sanchez to the role. Eduardo was formerly the COO of Cartesis and before that he was the Head of Sales at MicroStrategy. He has an impressive track record of achievement and brings to us his extensive global sales leadership experience. He has already become actively involved in helping to improve the productivity of our sales organization and to help us win the business that we deserve to win.

Now, I'll turn the call over to Rob for a detailed review of our results.

Robert Schriesheim - Lawson Software, Inc. - CFO

Thanks, Harry.

I'll cover our non-GAAP results for Q1 and also review guidance for Q2, then turn the call back over to Harry for closing comments. So let's begin. Q1 results of 13% revenue growth and net earnings of \$0.07 per share showed substantially improved performance over last year. Q1 results were solidly in line with or above our expectations and all measurements represent organic growth after passing the one year anniversary of the Intenia acquisition in Q4 '07.

I'll note that currency had a beneficial impact on revenue contributing \$4.4 million of the reported U.S. dollar revenue or 3% to reported revenue growth. Currency also had the negative effect of increasing total expenses by approximately \$6 million on a

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year-over-year comparison. Because we operate in operating loss positions in certain geographies where the dollar weakened, the negative impact on expenses cost us a bit in terms of total operating income and EPS. It was less than \$0.01 on EPS so we're not considering that a material amount.

In terms of revenues, they grew in all geographies. Our revenues show the global nature of our business. The Americas continues to drive more than half of our revenues at 55% to total. Revenues in the America region increased 10% year-over-year. The EMEA region represented 41% of total revenues and increased 25%. The remaining 4% of our revenues were generated in the Asia-Pac region and increased 11%.

Revenues also increased in every line item. License revenues of \$25.5 million increased 52%, a healthy increase by any measure. This growth came from two factors. First, from an increase in Q1 contracting and second, from revenues we deferred in prior quarters and were able to recognize at the rate and pace we had forecast. Those deferrals that had a suppressive impact last year yield a net benefit to our results this year. Currency also contributed about 3% of the year-over-year increase.

In summary, we had strong license growth in the quarter that met our guidance, however, we believe we can still achieve better sales execution and higher count executive productivity rates in future quarters. Maintenance and professional services revenue also grew at healthy rates at 9% and 8% respectively on a non-GAAP basis. Currency benefited accounted for 2% of the maintenance growth and 4% of the services growth.

We have been and will continue to supplement our Lawson consultant resources with sub-contracted partner resources as we ramp up our consultant staff and productivity in Manila. This is not an ideal solution as it impacts margin growth in the near term, however we feel it is important to maintain adequate capacity to handle customer demand and continue to provide a high level of services.

Operating margin improved significantly year to year increasing to 8% from 3% a year ago. Gross margin increased 300 basis points to 53%. The increased gross margin reflects the benefit of higher license revenues as well as the improved consulting margin. Our 15% Q1 '08 consulting gross margin was up from 13% a year ago.

We continue to target services gross margins of an excess of 20% over time and will achieve this goal by meeting several key performance targets. These include utilization rates and service hours delivered from our Manila center as well as the productivity of the workers we currently have in Manila. Q1 billable utilization increased 200 basis points year-over-year and we delivered 10% of our billable hours from offshore resources up from 6% in Q4 '07 and 2% a year ago. We are on track so far in both of these areas but we still have work to do during the remainder of FY '08 to hit aggressive targets. These same factors will enable us to increase our operating profitability via a lower cost structure.

Reduced operating expenses as a percent of revenue also contributed to the improved operating margin. Operating expenses as a percent of revenues declined 300 basis points over last year. Higher sales and marketing expenses reflect increased investment in customer facing resources which were offset by decreases in G&A and R&D as a percent of revenue.

On the G&A side, we have made substantial progress on simplifying accounting processes and streamlining work to our European shared services center. This has resulted in decreased fees, expenses and contractor headcount, and we continue to see benefit in R&D expenses as we transition more work to Manila. To date we are making good progress on our operational efficiencies while incurring the expense and capital investments we need to support our growth and transformational initiatives.

We are still early in the process, however we will need to achieve further productivity improvements in Manila and our European shared services center in order to achieve our stretch goal of holding expense growth to 5% year-over-year. Another notable item on the Q1 income statement was in regards to taxes. The effective tax rate on a non-GAAP basis declined to 37% compared with 45% a year ago.

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The lower effective tax rate takes into consideration a projected increase in profitability in our international operations as well as the impact of our global legal entity restructuring that was implemented on July 1st consistent with our plans previously discussed. This restructuring allows us to better optimize international operations and global business synergies. This was a complex project that required significant effort to complete and we are very pleased with how well the team executed the strategy. Effective tax rates inherently contain sensitivities and may need to be revised during the year, but overall, we currently believe the rate will remain below 47%--below 40% which is a significant improvement over last year's average 47%.

As far as cash, we had a \$20 million net use of cash from operations in Q1. Total cash used in the quarter was \$71 million which included \$54 million used for share repurchases in the quarter. We ended Q1 with \$490 million of cash, including \$7 million of restricted cash for the remaining minority shares of Intentia.

As we repeated in last year's conference calls we have a new pattern of cash flow resulting from moving to January 1 and June 1 maintenance contract renewal dates. We anticipate cash in flows in our February and May fiscal quarters based on these renewal dates, then in net use of cash in our August and November quarters. We'd likewise anticipate a net use of cash from operations in Q2 that will exceed the \$20 million in Q1 as the level of business activity and expenses increase sequentially from the summer quarter.

We also forecast higher capital expenditures in Q2 as capital projects approved in Q1 are executed. We had a relatively low capital expenditure rate in Q1 of about \$3 million. Our negative cash flow in Q1 and Q2 is on plan as expected and is simply timing. We anticipate healthy cash flow from operations and free cash flow on a full year basis. We certainly proved out this pattern last year with Q4 cash flow from operations of about \$115 million.

Before moving on to guidance I'd like to provide an update on two major transformational initiatives we are pursuing in fiscal '08. The establishment of our European shared services center and our progress in our Manila operations. We previously mentioned that we had begun to see some benefit from our European shared services center where we are centralizing and streamlining European accounting, treasury, contracting, and other G&A operations. We opened the center in Lausanne, Switzerland on July 1, 2007 and now have about 20 people on staff there. We're very pleased with the progress and the outcome so far.

I'm also happy to report that we increased our FTE's in Manila by 114 during the August quarter. In total we ended Q1 with 445 on staff in Manila, about half way toward the target of 800 to 900 that we want to have on board by the end of May of '08. The majority of our Manila staff works in the product development and services discipline but we have staff in Manila in every discipline.

We now have 15% of our total worldwide FTE's offshore versus 10% in the same quarter last year consistent with our restructuring plans announced in March. Our objective is to get to 20% of our FTE's offshore at much higher rates of productivity with more training and tenure. In services we delivered 10% of our hours using offshore resources in Q1 up from 2% a year ago. We are targeting to deliver upwards to 15% of our hours offshore by year-end. So we have made good progress, but also know we have work to do.

Now, briefly to cover guidance for Q2. We anticipate the total revenues will be between \$200 million and \$205 million, including license revenue growth of 20% to 30% year-over-year. GAAP EPS is anticipated to be in the range of \$0.02 to \$0.04 per fully diluted share. On a non-GAAP basis excluding the impacts which most of you model, EPS is expected to be \$0.06 to \$0.08.

Our estimate of Q1 non-GAAP EPS excludes \$9 million of pre-tax expenses related to the amortization of acquisition related intangibles, amortization of purchased maintenance contracts and stock based compensation charges. We anticipate an effective non-GAAP tax rate to likely remain under 40%.

While we have provided an EPS range, let me also provide some color. Our range reflects certain plans for duplicate staffing and systems expenses that impact us as we move to a more offshore model and more centralized, European processing model,

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however, depending on the timing of our implementation and how aggressive we can be, the impact may be more suppressive in the near term but will provide greater benefits in the medium to long term. Also by definition, currency rates fluctuate and are not always predictable.

So all in all we had a very strong quarter, and I'm pleased with the progress of the business. With that, I'll turn the call back over to Harry.

Harry Debes - Lawson Software, Inc. - President & CEO

Thanks, Rob.

Now I'd like to take just a moment to share with you our vision for our business. It's no secret that we have larger competitors, but every business has competition and for the most of us that competition is larger. When I ask our customers how they compete in their markets against larger competitors, their answer is always the same: Focus and better, more personal customer service.

At Lawson, our vision is to become the global leader in our target verticals. We don't need to be larger than SAP or Oracle, just better, and we can do that through a combination of focus and superior customer service. We don't try to meet the needs of 40 different verticals, instead, we focus on 10. We don't build our own database or middlewear, instead, we focus exclusively on application software, and we leverage industry leading middlewear from IBM. We don't enable our software for 190 different countries, instead, we focus on 40 countries that have the most potential.

And when it comes to customer service, that's where we offer our customers a much greater level of intimacy than any of our competitors. We do it because we think of our customers as business partners. We listen to them, we give them unrestricted access to our product managers and executives. We provide them with the option of working directly with Lawson, instead of pushing them to a third party services firm. Customer intimacy is in our DNA. It's not something you can measure or put on a balance sheet but it makes the difference in competitive sales situations more often than you can imagine.

Oh yes, we have larger competitors but the world needs and wants choice, and we intend to offer them not only an alternative but for those customers in our target markets we offer something that is better. That's why we win deals against SAP and Oracle today and that's why we will continue to win in the future.

Now before I close I'd like to share with you one last perspective. Over the last six weeks, I spent a great deal of time traveling with other Lawson executives on what we call our "What's Next" tour. During which we share our progress and also our vision for the future. During this tour, we met with more than 700 existing customers in 17 countries. Last year at a similar event, the customers of the former Intenia came to these meetings with a list of outstanding issues.

This year, the list they brought to the meeting was a shocking list. Specifically, they expressed interest in upgrading to our latest version of M3 and rolling out our solutions to more plants and countries. There was no mistaking the change of attitude among our customers and I came away from those meetings encouraged and energized not only about the progress we have made but about the potential for our future.

Okay, so let's sum up. Here is what we shared with you today. First, we delivered on our guidance. We demonstrated growth in our top and bottom line. We are starting to see real traction in M3 sales as predicted. We have a vision based on focus and greater customer intimacy, and finally, our customers around the world are embracing the new Lawson, and are showing their support of our progress with their checkbooks.

Operator, that concludes our comments. Now let's take some questions.

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QUESTIONS AND ANSWERS

Operator

Thank you. (OPERATOR INSTRUCTIONS) One moment, please, for the first question.

We have a question from Thomas Ernst. Your line is now open.

Greg Dunham - Deutsche Bank - Analyst

Hi, yes. Actually, this is Greg Dunham on behalf of Tom.

I guess first question, now that we're over a year with Intentia, would like a little perspective on salesforce productivity, where we think this can go, the impact of hiring Eduardo Sanchez in the near term and longer term, and just the tactical things you're doing there.

Harry Debes - Lawson Software, Inc. - President & CEO

Well, Greg, that's one of the reasons that we brought Eduardo to the team so that he could spend full time focusing on this very question, because undeniably though we added more salespeople in the last year, it wasn't just the 30% addition, don't forget there was also some culling and some turnover that we had in our sales force, so I would tell you probably closer to 50% of the total sales force of about 200 people is relatively new to the Company, and it takes a little while to get them trained, to get them involved in the pipeline development and to get true productivity, so the kind of things we're doing there is standardizing methodology, increased training and product certification, narrowing their focus so that they're actually pursuing leads and opportunities in our market so that we don't waste our time--our opportunity time pursuing non-critical transactions, and then of course ultimately holding them accountable to those things that we asked them to do. So this is a transformation activity, it takes time but at this point, we're making progress.

Greg Dunham - Deutsche Bank - Analyst

Okay, and one quick follow-up, if you permit. Thinking about maybe some of the weakness in North America this quarter, I know that you guys are doing well with the Movex brand and moving that over. Have you seen any change from a purchasing perspective? Is it economic, was it execution, or what are your thoughts there in terms of just some of the contracting weakness here?

Harry Debes - Lawson Software, Inc. - President & CEO

So let me first of all remind you that what I said is that I believe that that weakness that we had in the U.S. in particular is temporary.

Greg Dunham - Deutsche Bank - Analyst

Okay.

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Harry Debes - Lawson Software, Inc. - President & CEO

It was, I believe, a combination of a big Q4 and perhaps some execution issues, and--but however, I have no reservation about telling you that it's temporary.

Greg Dunham - Deutsche Bank - Analyst

That's helpful. Thank you.

Harry Debes - Lawson Software, Inc. - President & CEO

Okay.

Operator

Next question comes from Brad Smith.

Bradford Smith - Dougherty & Company - Analyst

Good afternoon, guys. Good job.

Just to follow-up on Greg's question on the sales perspective, just curious if your expectations around the pace of hiring for the full year have changed at all?

Harry Debes - Lawson Software, Inc. - President & CEO

I think we said, and I'll reiterate that we do plan to continue to hire, but not at the same pace that we hired last year. I think it's important to give the new people that we brought on board the chance to be trained and to be well integrated into the business and show what they can do, however, we do believe that there is still considerable demand for our product out there and that at this point, we're still only reaching a fraction of the potential that we could eventually achieve, so it's just a question of when do you make that investment and let's face it, it's an investment of approximately 12 months every time you bring an additional sales person on.

I think what we've decided and the board, and the management have collectively decided that this year--this fiscal '08 year we need to prove to ourselves and to the markets at large that we can run the business in a very effective way for a both top and bottom line and if we don't do that, we'll always constantly be in this phase of large, significant investments which never seem to pay off, and although as Rob would remind me, we do make investments, Capital Investments, Manila Investment, Services Investment so it's not like we're making any but if I use that as an excuse all the time at some point, you would doubt my credibility on it.

Bradford Smith - Dougherty & Company - Analyst

Okay.

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Harry Debes - Lawson Software, Inc. - President & CEO

This year is one that we expect our salespeople to start really performing and then I think later in the year once we see those results taking hold, we'll very likely start hiring again.

Bradford Smith - Dougherty & Company - Analyst

Okay, and then just on the LSF upgrade cycle, I think the demand has been pretty healthy there over the past couple of quarters. I think you mentioned that a little over half of your customers have upgraded. Just wondering if you can provide some commentary on around how you think that will play out for the rest of the year and where we are on that cycle and then one third one in here, if you could just touch on the MSF upgrade as well and that's it?

Harry Debes - Lawson Software, Inc. - President & CEO

So, sure, as you well know that Q4 was a very strong for us on the LSF side, we sold over 450 copies and we expected that therefore Q1 would be significantly weaker but we still signed 60 some LSF deals in Q1, so it wasn't like it went away, but it also was at a higher price. You may recall, we increased our prices permanently and it wasn't an insignificant price increase, it was substantial. We do expect now that volume will increase in future quarters and that although we may not have another 450 unit quarter, we do, however, plan to replace that product with other products that are at various stages of development and some at various stages of release. We just haven't had the volume shipment that we had in Q4, so it's not like we're out of product or out of ideas, there's lots of other things we can and will sell to the S3 customer base.

As far as MSF is concerned, sort of the Movex or M3 version of LSF, that was only released like a quarter and a half ago, so it's just following exactly the same pattern as LSF did with--first of all, an awareness campaign, what is this? What's it all about? What does it contain, what's the price tag, what does it mean followed by some early adopters, followed by gradually increasing volume of shipments. We're now in the early adoptive phase.

At this point I think we have between 25 and 40 and I don't know the exact number but in that range, number of customers who have already taken delivery of the product. I think once we have--turning these customers into reference sites and they can speak to the benefits that they've achieved from MSF, I think you're going to see increase in volumes in the future.

Bradford Smith - Dougherty & Company - Analyst

Okay, all right, thanks a lot, guys.

Harry Debes - Lawson Software, Inc. - President & CEO

Sure.

Operator

Next question comes from Mark Schappel.

Mark Schappel - Benchmark Capital - Analyst

Hi, good evening. Thanks for taking my call.

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Harry Debes - Lawson Software, Inc. - President & CEO

Sure.

Mark Schappel - Benchmark Capital - Analyst

Robert, I was wondering if you could just, excuse me, Harry, if you could just review how M3 did in the quarter, maybe just give us an update on where you are in sales with respect to the M3 product?

Harry Debes - Lawson Software, Inc. - President & CEO

I don't think we want to get into the detail M3/S3 break down, because the only reason is not because we're trying to not share information with you but I suppose at some point, if we had other products in the future, then we might have to list off 15 different products. I don't see Oracle breaking down or SAP breaking down their revenues by products, but I will tell you that directionally M3 is performing very very well. It's right on track. There was a very--we had a very good success in Europe and you know that M3 is stronger and 90 plus percent of our revenues in Europe are M3 but were also pleased with the progress making with M3 in Americas and that's where we have high hopes there for the balance of the year and again I'm very confident that we'll meet or exceed our expectations on M3 in Americas.

Mark Schappel - Benchmark Capital - Analyst

Okay, thanks and then with respect to your pipeline conversion rates, if I recall right, your conversion rates were extremely high last quarter, my memory has you up around 80%. You had guided I believe a little bit lower than that, like 70% for the balance of the year, I think I'm getting my numbers right. Could you just give us an update on how you did there?

Harry Debes - Lawson Software, Inc. - President & CEO

I don't think--oh, you're talking about revenue recognition conversion rates which is different than pipeline conversion rates. Rob, I'll let you deal with the revenue conversion rate question.

Robert Schriesheim - Lawson Software, Inc. - CFO

Yes, last year on average, our revenue recognition converts across all product lines was about 60% or between 60% and 65%. In the fourth quarter we did have a very high revenue recognition conversion rate but that was because the high volume of LSF sales that we had and they're recognized upon sale. This year, we did indicate that with the history we've established in M3 and a variety of other circumstances that we thought our revenue recognition rates would be higher than the 60% to 65% last year.

Harry Debes - Lawson Software, Inc. - President & CEO

Let me tell you why that is, this is not an accident. Last year, when the new Intenia--the former Intenia sales organization brought 70 salespeople to the table--to the equation who had never lived under U.S. Software Revenue Recognition Rules. So as you can imagine it was quite a change and there was a learning period. Not only that, many of the deals that were in the pipeline had been proposed to the customers under the old assumptions, and so it was challenging to convert those deals and then not lose them so we basically took the deals off the street but recognized that we would have to defer most of them which is what happened to us in the first two quarters. I think we've come a long way since that time, we've spent a lot of time training our people, RevRec team and the finance team is much more engaged with our salespeople, coaching them on the kind of

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language that contracts need to contain, so I mean I'm very pleased that this team is now coming together and we've made this transformation successful so that's why we anticipated and are seeing higher conversion rates.

Mark Schappel - *Benchmark Capital - Analyst*

Okay, great and then one final question. Rob, you went into quite a lot of detail and we thank you for that on some of the cost cutting initiatives that are underway. Just one question, I didn't hear anything on the global general ledger that you were implementing. Could you just give us an update on how that project is going?

Robert Schriesheim - *Lawson Software, Inc. - CFO*

Sure. Just one clarification. I know this might be splitting hairs over semantics. I don't necessarily view this as strictly cost cutting exercises, I think you appreciate that as well. I view this as productivity enhancements and it is a subtlety with an important distinction because what we're doing is not only lowering our cost structure by offshoring and standardizing procedures and taking complexity out of the business but we're also enlarging our capacity to take on more work but at lower cost.

As far as answering your direct question, yes, we are on track to implement our new chart of accounts and common general ledger on Lawson 9.0. We will be up on a global basis in the early part of January, which is consistent with what we had always scoped out and what we had previously laid out. So, we continue to make progress in terms of implementing the general ledger. We continue to make progress in terms of bringing on new people throughout the finance organization, both in Europe where we've hired a new EMEA Controller as well as in the states where we brought on a new Corporate Controller, and so we've got much more strength throughout the finance organization.

Mark Schappel - *Benchmark Capital - Analyst*

Thanks.

Operator

Next question comes from Alan Cooke. Your line is now open.

Alan Cooke - *Merrill Lynch - Analyst*

Great, thank you.

Harry, you mentioned that Americas was soft. Could you maybe go into a little bit more detail about why you think there was that softness and why you're confident that it will firm up as the year progresses?

Harry Debes - *Lawson Software, Inc. - President & CEO*

So the softness as I said was I think because we had a particularly strong Q4 and don't forget that incentive plan are highly leveraged against Q4--a year-end kind of result, so you could hardly blame salespeople for wanting to push as much traffic--as much of the pipeline into the year-end push as possible. That's how we reward them and they behave--they're cash oriented, who can blame them and to some degree perhaps they maybe were a little overly aggressive but at the same time I don't blame them and I think the result was the pipeline perhaps wasn't as short-term as it might have been, so that was one thing.

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Next, I think there were some execution issues in terms of execution on a couple of transactions. Some as a result of which were deferred. I won't talk about that right now because I don't want to go to that deferred excuse. We had a lot of that going on last year, this is not an issue. We had some deferrals this year, but that's also why--look, I look at our pipeline and I look at our closes and I look at the short-term deals three or four times a day. I think Eduardo is going to look at it 8 to 10 times a day, so that means I can cut back to maybe twice a day, but knowing that and knowing where we are in the quarter and knowing what's ahead of us, I feel good about Q2 in the Americas specifically.

Alan Cooke - Merrill Lynch - Analyst

Okay and how does your pipeline look versus say six months ago or whatever period of comparison you want to do it against?

Harry Debes - Lawson Software, Inc. - President & CEO

Well let me do it compared to last year and I think during our Analyst Day meeting that we had in New York in early August, I think our pipeline is the thing that's probably the hidden secret message in this whole combination story. Our pipeline has grown over 100%, almost across the board, and in some cases, in some parts of our world even more than 100%. M3 U.S. alone I'll give you that as a data point, it's not like this around the world but M3 in the U.S., which we said was a very important factor in this combination and that we were prepared to be measured by, M3 in the U.S. pipeline last June, so June '06, \$10 million, June '07, \$97 million.

Alan Cooke - Merrill Lynch - Analyst

Okay.

Harry Debes - Lawson Software, Inc. - President & CEO

So that's why I'm confident.

Alan Cooke - Merrill Lynch - Analyst

Okay and do you have concern about any particular verticals where you're playing in, in terms of the spending by your customers?

Harry Debes - Lawson Software, Inc. - President & CEO

No, my closing comments about our target verticals is an indication to you and to everyone inside the Company and to our customer set is that we are narrowing our focus to 10 verticals, even there we have five what we consider A-verticals and five B-verticals which sort of support both our spending on development, our spending on marketing and our focus, and that basically says that these are the markets we've chosen, but a lot of input, a lot of consideration from both existing customers, what the market potential holds and where we see ourselves winning and becoming in fact global leaders.

So in those segments that I've talked about or that even in the 10, I don't see any slow down in spending. In fact across the board, at this time, I do not see slow down in spending. Spending slow downs look like this: The CEO, CFO, CIO starts an evaluation exercise, we go through a three to six month exercise, they take it to the board, the board says we don't feel good about the economy, we're not giving you the dollars. I've lived through that five or six times, that's a cycle. We're not in that cycle right now.

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Alan Cooke - Merrill Lynch - Analyst

Okay, great, and could you tell us what the progress of getting S3 products into Europe?

Harry Debes - Lawson Software, Inc. - President & CEO

Yes, that hasn't gone very fast. We didn't think it would go fast, by the way, because the S3 products weren't as globalized as the M3 products. The former Intenia, because it had been working in the European theatre out of necessity learned how to deal with internationalizing the product sets almost right from the beginning. This is not something that the former Lawson spent much time on, we were primarily a U.S. based company, we had 100 or so customers outside the U.S., but it wasn't our number one focus, so as a result, our market potential so far, so historically, has been limited but that's changing over time and you'll see announcements from us over the next quarter or two that will change that dynamic.

Alan Cooke - Merrill Lynch - Analyst

Okay, great, and Rob, the deferred license balance was flat quarter-over-quarter. Do you think it's reached that point of equilibrium that you'd been talking about a few months ago?

Robert Schriesheim - Lawson Software, Inc. - CFO

No, I think we probably have another quarter or two before we reach equilibrium. It is true the deferred license balance was flat at about 35 I think as I recall, and so the in's and out's were about the same, but I don't think we've quite reached the point of equilibrium.

Alan Cooke - Merrill Lynch - Analyst

All right, and one last question. The R&D costs in dollar terms were down and do you expect that they will continue at that same sort of run rate through the rest of the fiscal year?

Harry Debes - Lawson Software, Inc. - President & CEO

Okay, I don't think you should read down meaning less effort, I think you should start to see a similar effort, different—we're getting greater value because we're using offshoring. That was the whole point of this thing and I will tell you that if our Head of Development, Guenther were here to talk to you today, he would be very pleased with the progress that our Manila team is working but there's more to come from that.

Alan Cooke - Merrill Lynch - Analyst

Sure, I appreciate that. I was just wondering if that was going to be the dollar level of expenditure that you're going to continue with on a go-forward basis?

Harry Debes - Lawson Software, Inc. - President & CEO

I think you should think more about the percentage rather than the fixed dollar amount, because I think that ultimately, we may get down to an 8% or 9% number but that's on a much larger revenue stream basis than the one we're at today. This is one of those questions where you have to take the right balance and the proper equilibrium between how much do you spend

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in the future versus how much do you save or become more efficient, so at some point it becomes unhealthy going down to 3% or 5% is not a healthy way to think about the business long term and we don't intend to go there.

Robert Schriesheim - *Lawson Software, Inc. - CFO*

I think in the near term we've always talked about R&D particularly for this year in total being in the range of 9% to 10% of our revenues, and over three years being in the range of somewhere in that same range actually 9% to 10% or 8% to 10% actually and it's consistent with the comments I made on the call in the sense of getting more productivity and utilization of the Manila resources.

Alan Cooke - *Merrill Lynch - Analyst*

Okay, thank you very much.

Robert Schriesheim - *Lawson Software, Inc. - CFO*

Sure.

Operator

Next question comes from Adam Holt. Your line is open.

Nitin Doke - *JPMorgan - Analyst*

Good afternoon. This is Nitin Doke for Adam actually. Thanks for taking my question.

You clearly had a good census in getting your install base to LSF. I was wondering has it still been the catalyst for footprint expansion in terms of application sales as well, and what are your expectations there?

Harry Debes - *Lawson Software, Inc. - President & CEO*

Yes, it's quite normal for a customer that buys LSF to also consider additional applications, but usually, there are some transactions that they purchase LSF and additional applications but actually, there are many that don't, and because we're encouraging them to do one step at a time. Upgrade your technology. That gives you lots and lots of benefits. It gives you performance benefits, it gives you security benefits, it gives you SOA benefits, and that's a fairly low cost, low risk exercise, so most of our customers are going down that road, however, once they're on the new platform, the new technology platform, it opens up many many opportunities for them and many new opportunities for us to have supplied them with new software, new application software which is built on the assumption of LSF as a starting point.

Nitin Doke - *JPMorgan - Analyst*

And in terms of--could you give us an update on the uptick of the premium maintenance plans? Has that been a significant factor yet or when do you think that's going to move the needle?

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Harry Debes - Lawson Software, Inc. - President & CEO

So, listen, we've sold silver, gold, and platinum to quite a number of clients across the board but as you know, maintenance is annualized and so then it is factored over the year, so I don't think that it's made a meaningful difference to our total maintenance revenue dollar yet. Before that has a meaningful moving the needle kind of impact for the total maintenance revenue and margin, I think it's going to take about two years but I think you'll see us continue to build up and sell those.

The good news is that many of our salespeople are now positioning gold maintenance right at the beginning of an engagement and then customers are buying it right from the start so we don't have to go back years later and have that discussion because they're seeing the value of application management or, yes, application management services, they see the value of that right from the beginning.

Nitin Doke - JPMorgan - Analyst

Great, and one final question from me, is you're obviously entering Q2 this year with a much stronger salesforce plan than last year and have you made any changes to your close rate or coverage exemptions for this Q2 as you build up your guideline for Q2 versus a year ago?

Harry Debes - Lawson Software, Inc. - President & CEO

No, we've tracked our close rate now for about three years, every quarter for three years and so we're pretty good about knowing what the range is and even though it might vary by country in any given quarter for pick a reason, there could be any number of reasons, overall, companywide, it remains pretty consistent in a fairly tight range and so we feel pretty confident and comfortable that that will continue going forward.

Nitin Doke - JPMorgan - Analyst

Great. That's it for me. Thank you, guys.

Harry Debes - Lawson Software, Inc. - President & CEO

Thanks.

Barbara Doyle - Lawson Software, Inc. - Vice President Investor Relations

Operator?

Operator

I don't show anymore questions.

Barbara Doyle - Lawson Software, Inc. - Vice President Investor Relations

Okay.

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Harry Debes - Lawson Software, Inc. - President & CEO

Well, in that case, thank you for joining us today. Once again, as I sort of--to summarize, I think we've had an excellent start. We're enthusiastic about the new people--new leadership people in sales, Eduardo and the people that Rob mentioned in finance that have joined us in the last little while. We're enthusiastic about the growth we're making in our sales team, the pipeline opportunities, the improvements in our services margins, the great quarter we had in EMEA and the vision that we now have and that we're now beginning to execute on which allows us to focus in a few segments and become the world leader in those segments.

So thank you for joining our call today and we look forward to speaking with you at the end of our second quarter.

Operator

Excuse me, I do show a few more questions that came in.

Harry Debes - Lawson Software, Inc. - President & CEO

Okay, well, do I have to repeat my summary again? No, okay I'm just joking.

Go ahead. What's the question?

Operator

I have a question from Ajay Kasargod.

Ajay Kasargod - Piper Jaffray, Inc. - Analyst

Yes, thanks, I'm glad we're not done, but congratulations especially on the cost cutting measures in the quarter, Rob.

I just wanted to talk a little bit about the spend in the sales and marketing. I know when the quarter was up about 17% but that's excluding the stock based comp. What were you spending the dollars on in the quarter and that type of growth rate year-over-year, will that growth rate come down as we look forward?

Robert Schriesheim - Lawson Software, Inc. - CFO

Well, year-over-year, if you look quarter-over-quarter on sales and marketing, the big difference is the number of people we have in the sales organization, Q1 of last year to Q1 of this year, we ended Q1 of this year with about 200 sales reps, we started out the merger with somewhere around 154 sales reps. So obviously, most of the increase you're seeing is in the direct investment in the sales force, and that's the reason, and as Harry said, we don't see during the course of the year that level of increase in spending going forward. We'll--as the year progress, we might bring on some more people, but in general, we're comfortable with where we're at for right now.

Ajay Kasargod - Piper Jaffray, Inc. - Analyst

And then to maybe just focus the second question just on growth, and talking about M3, I know at the Analyst Day you spent a lot of time talking about lead generation to basically help your sales force out. Can you give us any updates on your lead generation activities and how that's impacting productivity of your salespeople?

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Harry Debes - Lawson Software, Inc. - President & CEO

No, we were pleased with the people that we brought--I mean, we brought a lot of good, new talented people to our organization around the world who were focused on what we--our definition of marketing is, which is generating leads, not trying to brand the Company and take out ads in airports or at the Super Bowl. That's not what we do and so we wanted to make sure that we had people that had the same mindset, and so they've done a great job so far. I think you saw it reflected in our pipeline which really was weak a year ago which has gotten better and now we're just asking them to do more of the same.

Ajay Kasargod - Piper Jaffray, Inc. - Analyst

Okay, and then when I look, this is the last question here, when you look at--Harry, you spent a lot of time visiting about 700 customers and I think the general consensus that we've been hearing is that a lot of spend that will happen in the second half of this year as people go through their budgets but there starts to be some questions about the first half of '08. Can you maybe give us a little bit more granularity from what your customers are talking about regarding their spend, for not just the balance of this calendar year but as you look into the '08 calendar year?

Harry Debes - Lawson Software, Inc. - President & CEO

So the pipeline we have is significantly larger, the pipeline covers not just the next quarter, it covers the next six or seven quarters. All I can tell you is when customers make commitments, the commitments rarely are for one quarter at a time, it's only when they buy look an LSF deal that it's one quarter at a time. Most of our engagements include software maintenance and services that span a 18 to 36 month horizon, so they're committing spending right now for the next three or four years. As I said our pipeline is strong, not just for the quarter we're in and not just for the next quarter but for the next few quarters, so unless we've completely misread that, and right now I don't think that's the case, I don't see any weakness on the horizon.

Ajay Kasargod - Piper Jaffray, Inc. - Analyst

Very good. Congratulations on your quarter, continue blocking (inaudible). Thanks for the time.

Robert Schriesheim - Lawson Software, Inc. - CFO

Thank you.

Harry Debes - Lawson Software, Inc. - President & CEO

We'll do that.

Operator

Next question comes from Joe [Delcaller].

Peter Goldmacher - Cowen and Company - Analyst

Hi, guys, it's Peter Goldmacher. Can you hear me?

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Harry Debes - Lawson Software, Inc. - President & CEO

Hey, Peter, nice disguise.

Peter Goldmacher - Cowen and Company - Analyst

I tried logging in on my name and you weren't letting me in so I had to get my associate to login.

Harry, you need to buy Rob a new calculator, because if I look at his guidance, he's talking about basically flat growth, sequential growth in Q2 for licenses, so if you could help us understand what's going on there, the sequential growth I think is single digit, and also, when you talk about your gross margins on services I think I heard you say that it's 20% but it seems like if you're offshoring a lot of that to the Philippines, is 20% an initial goal with closer to 30% to 40% over time? Help us think through that, and then generally, sort of rate and pace on the margin improvement from offshoring would be very helpful.

Harry Debes - Lawson Software, Inc. - President & CEO

Okay, Peter, I'll take your second question first. We did some really interesting benchmarking of services revenue at a number of different firms and we had an outside firm help us. We evaluated what we call Small ERP vendors, the ones that are \$200 million to \$300 million in revenue and their services margin in particular, we evaluated large ERP vendors, I think we know who they are. We evaluated SI's and then we evaluated the offshore, the pure offshore services vendors, like the Wipro, Infosys, and Tata, etc. We looked at all of their margins and their revenue per employee, their approximate R&D rates, their utilization rates, so we have all of that data in place now. We mapped where we are against those particular people, and then we also figured out where we want to be, so right now, I'll tell you that we are almost at where the major, the large ERP vendors are, or we certainly will be very very soon, like in 60 days.

That, however, in our opinion is not good enough and we think there's much greater potential there. Our goal is to fall somewhere between where the SI's are and where the pure play offshore based companies are, and so that range is somewhere between 30% and 45%, but I don't want you to start creating a new model that says, oh, we're going to be there by the end of this year because that's just not physically possible. The difference is that those guys have had a 15 year head start.

Secondly, they--at least the pure play offshore companies started in India. Okay? We started in Stockholm and in Chicago and in St. Paul, so it's going to take us some time, but we now have clear evidence of what's possible. We think we know the levers we have to pull, but we also have an idea that it's going to take us multiple years so that's the first part.

Second part I have Rob's calculator in my hand. It's a Hewlett Packard circa 1975 calculator and you're right, I am going to get him a new one because I think it's just a good idea to replace his high school calculator. But on the question of guidance, let me ask him to respond directly.

Robert Schriesheim - Lawson Software, Inc. - CFO

Yes, first of all, Peter, a couple of points. One, on the margins on the services, we've always said that we were targeting being at 20% by the end of this year and if you look at the progress we've made, I would challenge anyone to debate with us the progress the organization has made given the fact that in one year we've gone from providing 2% of billable hours to offshore resources to 10% of billable hours offshore. Of course we would like to be above that but the reality of doing the actual property transfer is a limitation as to how fast you can do that offshoring without impacting your customer satisfaction levels which are very important to us.

I think over time, obviously we're going to target higher gross margins but we've always been very consistent about where we felt we could get this year and I think Harry and I are in complete alignment on the future. As far as the guidance, look, I guess

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I gave license guidance of 20% to 30% growth for year-over-year quarters. We're seeing healthy contracting growth in line with or above the rates of growth in the middle market and our guidance is our guidance and so far, we have delivered on our guidance each and every quarter and we expect to continue to deliver on our guidance.

And the software business is a volatile business, you've got some accounts that go from one quarter to the next quarter but the bottom line is we make commitments to our investors and we meet them. So I don't feel--I feel pretty good about the growth that we have in our license business and I think we're making good progress, and my calculator, it's an HP12Z. I've used it since I worked in a private equity firm on Wall Street and people still use these so I think the calculator is fine.

Peter Goldmacher - Cowen and Company - Analyst

Were you really in high school in 1975?

Robert Schriesheim - Lawson Software, Inc. - CFO

No, I graduated high school in 1978.

Peter Goldmacher - Cowen and Company - Analyst

Okay, thanks, guys.

Robert Schriesheim - Lawson Software, Inc. - CFO

All right, thanks.

Harry Debes - Lawson Software, Inc. - President & CEO

All right, I'm not going to repeat my summary, but thanks for joining us and we'll look forward to speaking with you in about 90 days. Good-bye.

Operator

That concludes today's conference. Thank you for participating. You may disconnect at this time.

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