FINAL TRANSCRIPT

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LWSN - Q3 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 in a listen-only mode. (OPERATOR INSTRUCTIONS). I would like to turn the meeting over to Barbara Doyle. Ma'am, you may begin.

Barbara Doyle - *Lawson Software - Media*

Thank you very much, Operator, and good afternoon to everyone on the call. Welcome to Lawson Software's fiscal 2008 third quarter conference call, covering the quarter ended February 29, 2008.

On today's call we have Harry Debes. Lawson's President and CEO, and Rob Schriesheim, Lawson's CFO. Stefan Schulz, our Senior Vice President of Finance is also on the meeting today. We will discuss our Q3 results and our future financial guidance. Then we will open up the call to your questions.

Please let me read our Safe Harbor statement before we begin. We would like to remind you that this call will include forward-looking statements, which are subject to risks and uncertainties. These forward-looking statements contain statements of intent, belief or current expectations Lawson Software and its management. Such forward-looking statements are not guarantees of future results and involve risks and uncertainties that may cause actual results to differ materially from the potential results discussed in the forward-looking statements. Our SEC filings contain further information about risk factors that could cause the actual results to differ from management's expectations. We do not obligate ourselves to update forward-looking statements or circumstances or events that occur in the future.

I would also like to remind you that in addition to reporting the financial results in accordance with Generally Accepted Accounting Principles, Lawson Software reports non-GAAP financial results. Discussion of our use of non-GAAP results as well as a reconciliation of our non-GAAP results to GAAP is included in our press release.

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

Harry Debes - *Lawson Software - President and CEO*

Thank you, Barbara, and good afternoon, everyone. I will begin by covering an overview of Q3, discuss some key metrics. I will highlight some client wins and then I'll turn the call to Rob Schriesheim, our CFO, and he will cover our financial results and also our guidance.

As you can see from our press release on a non-GAAP basis we earned $0.08 per shares on revenue of $213.1 million. EPS was at the top end of our guidance range on total revenues that were a few percentage points short of our expectations. The revenue shortfall was in our consulting services business, so let's address that right up front.

Services revenue was $96 million and services margin was 18%. Even though services revenue was up 5% from last year it was short of our expectations and forecasts. And when it comes to services margin at 18%, it's the highest in the Company's history, but once again it was short of our own expectations and internal forecasts.

These shortfalls were not due to macroeconomic conditions, but rather our own poor execution. Most of the shortfall occurred in Europe. Project transitions and clean-up of old premerger deals and management changes all contributed to the miss. I'm giving this to you by way of explanation, not excuse. We should have managed this better. To correct this we have taken measures which include personnel changes as well as changes to some internal procedures.

I continue to believe that we have considerable upside in our services margin and while Q3 did not live up to our expectations, we will make progress in this area and you can count on that. It may not always be in a straight line, and progress may not always be as quick as we would like, particularly as there's seasonality in our business. But we have set our sights on a mid 20% margin goal for our services business and over the next two years, we will achieve that goal.

It is also our plan to slow down the growth of our services business and to build a larger partner ecosystem. We made this clear at the partner summit we held in March and in the future we expect our services business to grow at low single digit rates so that we can push more work to our growing partner network.

Over the medium term, we expect this to create two results. First it will increase our global consulting capacity and thereby allow us to win more software deals. And, second, it will allow us at Lawson to focus on our own productivity as well as the higher value and higher margin work.

Now let's move on to talk about some other key metrics in our third quarter and I will remind you that all of these metrics are non-GAAP. Total revenues grew approximately 10% year-over-year and all of this was organic growth. License revenues grew 21% to $32 million and although we've stopped breaking out our contracting details -- that's contracting not revenue -- I will tell you that third quarter contracting was north of $40 million, making this the highest contracting quarter in the last six years.

Maintenance revenue also continued to make excellent progress and due to the growth in our software contracting, pricing improvements, and new maintenance offerings, year-over-year revenue and maintenance increased 14% to $84.9 million. Our non-GAAP operating margin was 9.6%, up 90 basis points over last year. Because our services business is currently 45% of total revenues, the lower-than-expected margin in service impacted Q3 operating margin by 1 full percentage point in the quarter.

Next I want to move on to spend some more time on the metric that you always ask about and that's software license contracting. As mentioned, our Q3 contracting was the second highest since Lawson's IPO in December of 2001, second only to our fourth quarter of last year. Contributing to this growth was a strategic M3 deal with Finning International. But even if we were to exclude that deal, our Q3 contracting increased by double digits.

Our pipeline conversion rate again, even without the largest deal, was the highest we have seen since our May 2006 quarter. And here are some statistics to back that up. In the quarter we signed 317 deals compared to 354 deals in the previous year's quarter. The average selling price of all deals, new and existing clients, was up more than 25% sequentially from Q2. A high percentage of our license contracting continues to come from new customers. In this quarter it was 40%, 41% of contracting was with new accounts.

We added 27 new name accounts with an average selling price of $646,000. This compares to an average selling price of $385,000 for deals over the last trailing 12 months. And while the Finning deal did certainly impact this ASP, there were other factors which likewise impacted the increase.

We closed only to deals greater than $1 million compared to $5 million a year ago. But we signed 13 deals between $500,000 and $1 million compared to four last year. And this is what is driving up the trend in our average selling price.

Now, we achieved these sales improvements with eight fewer AEs than the 200 we had at the beginning of the fiscal year. And I believe that our progress is driven by the following factors. First, the market wants choice and likes Lawson's deep vertical focus and our cultural differentiation from SAP and Oracle. Second, the new salespeople we hired last year now have 12 months' experience with Lawson and are starting to produce results. And, third, the changes we made to our sales leadership in September 2007 are having a positive impact on our results.

Now I'll move on to discuss some performance in our target verticals. You are already familiar with our largest win in the quarter, which I mentioned on our Q2 call, and that we formally announced two weeks ago. Finning International is the world's largest Caterpillar equipment dealer, and this particular deal is important not just because we beat Oracle and SAP, but for a few other reasons.

First it shows the broad capabilities of the new Lawson in that Finning licensed both M3 and S3 products. The deal is global in scope and shows another example of our ability to support large global customers. And, third, we are delivering this deal in partnership with IBM Global Services who are now building a meaningful practice around Lawson's solutions.

One more comment on the Finning deal. While it was signed in Q3 and while the customer has already paid us for the software, none of that software in this transaction was recognized in Q3. It all went to deferred revenue and we expect to be recognizing this software, either in Q2 or Q3 of FY 09.

There were some other important wins that I would like to highlight. In health care we had a new business win over Oracle at Ohio-based Premier Health Partners, which signed a multi suite S3 deal. We also won at Tennessee-based Blount Memorial Hospital and Missouri-based Skaggs Community Health Center and, finally, West Penn Allegheny Health System in Pennsylvania, a current Lawson customer, signed a significant new contract to add Lawson's HR and Payroll Suite along with a new platinum Total Care support and hosting agreement.

In public services we won the unified government of Wyandotte and Kansas City, Kansas, which signed for a multi-suite implementation including our S3 financials, HR and supply chain solutions.

In fashion, our quickstep implementation allowed us to win new fashion accounts in the UK, in Hong Kong and in the United States. In food and beverage we beat SAP at Sweden-based Milko, one of Sweden's largest dairies and Milko will be implementing M3. In distribution we beat Microsoft and SAP at Fetim, a Netherlands-based international trading corporation. And we also beat Microsoft and SAP at Trimark USA, a U.S.-based distributor of foodservice equipment and supplies. Both customers will be installing the M3 distribution solution.

Now I would also like to highlight some of the key announcements that were made subsequent to the quarter end. At our recent annual customer conference in March, we announced several new products and solutions. We announced the availability of Process Flow Integrator for our manufacturing and distribution customers. This is a business process automation tool for Lawson applications, focused on streamlining event-driven processes. The tool is a Web services solution, already available with S3 that we have now extended to our M3 clients.

For our food and beverage customers we announced M3 Trace Engine, an application that provides ingredient traceability, enterprise wide visibility and simplified compliance with U.S. and European food safety regulations.

Our product helps companies strengthen and simplify the process of tracking ingredients and finished products through complex global supply chains. For our public services customers we announced QuickStep for Government. Lawson's quickstep solutions are preconfigured software packages that provide industry-specific content and built-in best practices for that industry. This makes six QuickStep solutions that we have announced and we have now sold QuickStep to 40 different accounts. Our newest QuickStep is designed to address government's key administrative processes at the city, county and state agency levels.

The application will help reduce the time, cost and risks typically associated with an [ERP] software implementation by preconfiguring the key business processes required by government organizations.

For our fashion customers, we acquired the product lifecycle management software division of FreeBorders, which is based in San Francisco. Using these best-of-breed capabilities we can now help fashion manufacturing companies establish processes that will enable them to cut the lead time from product concept to production to actual delivery to the retail store shelf. We also introduced Smart Office, a personalized role-based user interface that allows users to directly access Lawson and Microsoft applications and update data pervasively through one interface.

Smart Office brings together Microsoft tools such as Excel, Outlook, Word, PowerPoint and Groove with Lawson enterprise applications and Lawson's Business Intelligence. So as user adoption is critical to the success of any ERP system, Smart Office will improve user acceptance and productivity and will therefore drive implementation success.

For our healthcare and hospitality customers we announced the acquisition of Vastech, a provider of advanced workforce management, staffing and scheduling solutions and services. The product is currently offered stand-alone to customers in the healthcare and hospitality industries but it will also be integrated into Lawson's new Strategic Human Capital Management solution.

And last but not least we announced the availability of the Talent Management Suite with our Strategic HCM solution and that now consists of Talent Management, Workforce Management and HR Management. And it is an SOA solution that we developed using our own Landmark Application Design tool.

This is a major new product from Lawson and we expect significant revenue opportunity from this solution over the next two to three years, because we are now the only enterprise software provider delivering an integrated set of modern Talent Management, Workforce Management and global HRMS offerings to customers and we can do that globally. We already have four early adopter customers who are implementing our new strategic HR Solution.

Now before I hand the call over to Rob, let me summarize my thoughts on our performance. I've acknowledged that in Q3 our services business did not execute as expected. But our overall performance, driven by consistent contracting and maintenance growth as well as effective expense control, demonstrates that we continue to make good progress. And when it comes to our customers, our recent conference was the largest in our Company history, with over 5200 attendees, we were able to show customers that we executed on everything we promised to do over the past year. And we presented a strong slate of new product and services offerings.

The overall feedback we received from both customers and partners at the event was very, very positive. As a result I can confidently say that despite our services speed bump and the ARS write-down, which Rob will explain, our business today is stronger than it has ever been.

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

Rob Schriesheim - *Lawson Software - CFO*

Thanks, Harry. I'll cover highlights of the Company's results for Q3 and provide our guidance. My comments will focus on non-GAAP with reconciliation between GAAP and non-GAAP in our press release as Barbara described. After my comments I'll turn the call back over to Harry to close our meeting before we take your questions.

Let me begin with the key drivers behind our financial results starting with revenue performance. Total revenues of $213.1 million increased 10% year-over-year, including increases in all geographies. Americas revenues increased 4.7% and accounted for 50% of total revenues. Americas sales productivity improved solidly over Q2, positively impacted by the largest deal in our quarter but up from Q2 even after excluding this deal.

We anticipate further increases in America's sales productivity in Q4, typically the strongest license sale quarter of our fiscal year.

EMEA revenues increased 17% year-over-year and represented 46% of total revenues in the quarter, up from 44% in Q2. EMEA has shown solid performance each quarter this year with sales productivity better than planned in Q3. I would also mention that the high productivity levels were achieved without any deals greater than $1 million signed in the EMEA region. The EMEA improvement is more about increasing the volume of average-sized deals which is our expectation in our international regions.

The remaining 4% of our revenues were generated in the Asia-Pacific region. Revenues from the APAC region increased more than 40% year-over-year.

Let me cover the currency impact on our results. The weakened U.S. dollar contributed 5% of our total revenue growth in the quarter. Recall that half of our revenues are from sales made outside the United States. Currency also has had a material negative effect by increasing our costs and expenses. The greater negative impact from currency on expenses cost us $0.03 per share for the nine-month year-to-date period.

Moving on to license revenues. We provided guidance for 20% licensed revenue growth and exceeded that slightly with Q3 license revenues of $32 million, up 21% year-over-year. The sales teams executed well on the pipeline in the quarter and sales productivity improved sequentially and year-over-year. Sales execution and productivity were strong in both the U.S. and EMEA. The enhanced level of sales and productivity reflects some of the revenue synergies we anticipated with the Intentia acquisitions that are now beginning to bear fruit.

Let me cover deferred revenues quickly. While we do have some year-over-year benefit and license revenues from the deferred account, the major driver of our license growth is from new sales. In fact our deferred license revenue balance has also continued to increase sequentially each quarter since the May 2006 quarter, when we closed the Intentia acquisition. Our deferred license revenue balance at the end of the February quarter was $45.3 million, up from $36 million sequentially from Q2. This reflects the typical quarterly increase we saw in Q1 and Q2 plus the impact of the largest deal in our quarter, which was completely deferred until the implementation of the solution is complete. We anticipate recognizing the revenue for this large deal in FY '09.

We continued to see steady growth in our maintenance revenue. Non-GAAP Q3 maintenance of $84.9 million grew 14% year-over-year. The growth reflects continued strong maintenance renewal rates as well as the beneficial impact of new licensed contracting that we've been seeing. We completed the second annual renewal cycle for our international customers in January with customer retention rates in the high 80% range for our international customers. Our renewal rates in the Americas remained at a steady mid 90s percent.

Now on to service revenues and margin. Q3 services gross margin of 18% was at the highest level since the merger. Our services margin has been trending higher over the last six quarters but the Q3 improvement was below our internal expectations. The shortfall in margin was primarily related to operational inefficiencies that I want to discuss in more detail.

Services revenues increased 5% year-over-year. As Harry mentioned, while license and maintenance revenues were in line with our internal expectations, services revenues were not. The root cause of the revenue shortfall was billed utilization rates approximately 10% below plan in the quarter. Q3 utilization was below historical trends as well as below plan. So it was an unfortunate and unanticipated development in the quarter, primarily in Europe but also in pockets in the U.S. resulting in the Company incurring consultant salary expenses without billing time.

After review the Q3 issues were isolated as project and timing-specific and not reflective of a change in demand for our consulting services. We have already implemented numerous actions to address the issues. I would also note that while this was the first services revenue miss since the merger, we do not find it acceptable since it was fundamentally an execution issue.

Our longer-term services initiatives remain focused on enhancing usage of our resources in Manila and expanding our SI Partner Network to help us meet the growing demand for our services at incrementally higher margins. As we indicated last quarter, in the near-term we are supplementing our resources with subcontracted third party hours. We anticipate that need will continue throughout the fourth quarter.

We have made progress with our Manila services team in terms of building a staff and seeing some initial productivity. We have nearly tripled the number of global delivery hours year-over-year. We estimate Manila has positively impacted services margins by about 90 basis points towards the 300 to 400 total basis point improvement targeted by FY 10. So we are ramping up and making steps in this process. We are simply focused on accelerating the pace in order to achieve our goal.

Moving on to our profit measurement. Q3 non-GAAP operating margin was 9.6% and that was a 90 basis point improvement year-over-year but this rate was lower than our internal target. Operating margin was negatively impacted by 100 basis points due to the lower than planned services gross margin. Aside from the services margin, license and maintenance gross margins are both on course at 88% and 82%, showing year-over-year improvement that are on plan.

As discussed we are aggressively managing the services margin to achieve our near-term 20% target. Given our business seasonality impact in our August quarter, we anticipate that we will be back on plan in Q2 of fiscal 2009. Total cost and expenses increased 9% year-over-year on a non-GAAP basis which was lower than the 10% growth in revenue. Non-GAAP operating expenses as a percent of revenues increased slightly year-over-year from 43% to 44% to revenue. The increases were primarily in sales and marketing.

As we have discussed, our operating plan includes investing in customer facing resources as we benefit from expense efficiencies and in other areas. We are comfortable with the overall management of our operating expenses.

Let me take a moment now to report on our progress in our operations in Manila. Throughout the last year, we have been aggressively hiring and building our Manila team. We grew to 685 employees in the Philippines at the end of February up from 507 in Q2. We now have 15% of our worldwide FTEs in Manila, compared to our objective of 20%.

Now that we are approaching our headcount targets, we plan to slow the hiring and focus our energies on achieving full productivity from our team. We have already begun to see some productivity benefit in our development and support functions as well as improved rates of backlog resolutions. And as I referred to earlier, we are making some progress in terms of Manila services productivity. We provided 11% of our billable hours via global sourcing in Q3 versus 9% in Q2 of '08. This was up from 4% a year ago in Q3 '07 and it was essentially 0 in Q1 of last year. While we have made good strides in building our team in Manila, we are now shifting our focus on achieving more rapid productivity gains each quarter in order to meet our near-term and long-term margin objectives.

Our Q3 effective tax rate on a non-GAAP basis was 39%, consistent with our Q2 rate. We continue to expect that the effective rate will remain below 40% on average for the year which is a significant improvement over last year's average annual rate of 47%. Non-GAAP net income for the quarter was $13.7 million, up 21% year-over-year or $0.08 per diluted share up from $0.06 a year ago.

Now let me cover the impairment charge noted in our press release. As noted last quarter, our investments include $63.7 million par value of auction rate securities, managed by a broker dealer and a discretionary account. These securities continue to experience failed auctions but remain current on all payment obligations.

The liquidity and fair value of the securities continue to be impacted by the uncertainty in the credit markets and these securities' exposure to the financial condition of the bond insurance companies such as MBIA, AMBAC, and FGIC. Based on market information provided by our broker-dealer and independent valuation adviser and management assessments, the fair value of the auction rate securities we hold was estimated to be $48.5 million as of February 29, 2008 -- a $10.2 million decrease from the $58.7 million estimated fair value at the end of our November quarter.

As a result the Company recorded an additional permanent impairment charge of $8.1 million as well as a temporary impairment charge of $2.1 million to reduce the value of our auction rate securities with their estimated fair value during the third quarter. The $8.1 million permanent impairment charge is recorded as a non-operating charge that reduces GAAP income by the same amount, because there is no tax effect as it is a capital loss for which we currently do not have any capital gains to offset. That impacted GAAP EPS by $0.05 in the quarter although there is no impact to non-GAAP measurements for the charge. The remaining $2.1 million is a temporary impairment that flows to the shareholders' equity section of the balance sheet, not the income statement.

Fully diluted shares outstanding were 178.8 million down 5% year-over-year. During the quarter we repurchased 5.5 million shares at an average price of $8.96 for a total of $49 million. That brings the total to 18 million shares repurchased since inception of the program in November of 2006 at an average price of $8.94. This represents a buyback of 9.6% of our outstanding shares. Through February 29 we utilized $160.5 million of our $200 million authorization.

On to cash flow. As we had projected our cash flow from operations turned positive in Q3 driven by the invoicing and collection of our international maintenance contract renewals. We generated $24 million of cash from operations in the quarter, boosted by approximately $60 million in international maintenance contract renewal payments. We ended Q3 with $390 million of cash, equivalents, marketable securities and investments.

I will remind you, we generate the majority of our cash flow in our fourth fiscal quarter, consistent with the invoicing of nearly two-thirds of our annual maintenance renewals due by May 31st.

Now I'll cover our financial guidance. For Q4 we anticipate the total revenues will be between $225 million and $230 million and GAAP EPS is expected to be $0.07 to $0.10 per fully diluted share exclusive of further impairments and auction rate securities if any are deemed necessary. On a non-GAAP basis, excluding the impact which most of you model, EPS is expected to be in the range of $0.08 to $0.11. Our Q4 EPS range reflects impacts of lower interest yields on our cash balance and investments given current market rates and our movement to investments with shorter term maturities.

Specifically, our net other income is expected to be less than $1 million, considering current interest income assumptions. Our estimate of Q4 non-GAAP EPS excludes $10 million of pre-tax expenses related to the amortization of acquisition-related intangibles, amortization of purchase maintenance contracts and stock-based compensation charges. We anticipate an effective non-GAAP tax rate to likely remain in the range of 37 to 40%.

In summary, a transition story such as Lawson's has managed to demonstrate progress over time. While we have not met all of our internal targets, we have continued to deliver on our commitments to customers and shareholders. We feel very positive about where we are today and the extensive progress we have made. We continue to feel confident about our competitive positioning and the path that we are on because we are delivering on what we said we would do.

On a year-over-year basis, total revenues are up 10%, license revenues up 21%, maintenance revenues up 14% and gross margin has increased 240 basis points to nearly 54%. Taxes and shares outstanding are down substantially and we hit the high end of our EPS range in line with consensus.

Over a 12-month period we have demonstrated significant progress. That said, as a management team, we are not satisfied. We know it's not a linear path forward but we always strive to deliver on our commitments to our customers, employees and shareholders.

Now I'll turn the call back over to Harry.

Harry Debes - *Lawson Software - President and CEO*

Thanks, Rob. There's one more thing I'd like to cover and that is the macroeconomic climate. We understand the impact that a sudden downturn in the economy can have on the ability of our customers to purchase software and services. But in Q3 we did not see such an impact and so far in Q4 we have not seen the economy as a negative factor in any of our transactions.

But we are aware that such impacts could occur late in the quarter. And therefore our Q4 guidance reflects not only our visibility into our pipeline and our committed deals but we are also taking possible negative economic factors into consideration when we give you guidance.

And finally and just before we end, let me summarize today's key messages.

In many ways, Q3 was another solid core for the Company. It was dampened a bit by our Services business but I am confident that we have taken the right actions to correct this. During the quarter, we announced a robust set of new solutions, which will help us to be more competitive in the future. We completed two small acquisitions that add strength in the health care and fashion industry and, driven by license contracting, our business is growing at a rate that exceeds the projected market growth; and at least for the short-term we see that growth continuing.

So while there is still much to do, we believe we are making good progress.

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

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Thomas Ernst. Deutsche Bank.

Thomas Ernst - *Deutsche Bank - Analyst*

Rob, I think you gave us some explanation on the services thing. Maybe the question here is, was the issue more that you had some services opportunity that you couldn't mobilize for? Or was it just purely that you employed third party services when it wasn't necessary? Which were you saying?

Rob Schriesheim - *Lawson Software - CFO*

It's really -- there were a number of factors. What we were saying is that it was an issue of how we allocated, it was an issue of how we allocated the resources. There were certain projects that ended and certain projects that began and there were some transitions. And as a result we had a number of consultants that essentially we were carrying the expenses for but we were not billing their time for.

Thomas Ernst - *Deutsche Bank - Analyst*

Got it. So it was more just your employment of third party services, that maybe you didn't need to or was there also some services opportunities that you passed up because people were tied up?

Harry Debes - *Lawson Software - President and CEO*

The third party services component is these things aren't -- these things are committed, signed up and committed both internally and from a third party perspective a month in advance. So that really didn't have a major impact. I would say it was projects that were transitioning that were being completed and new projects that weren't starting quite at the same time as we look back.

We didn't really get true visibility of that until late in the quarter. And we really didn't have a chance to react quickly enough.

Thomas Ernst - *Deutsche Bank - Analyst*

Okay. Then maybe back to the license line. The guidance for next quarter is very healthy. I think in particular, when we look back to last year, you had I believe you said a $6 million effect from the promotional pricing expiration on Lawson's System Foundation 9. That gives as a tough compare this year.

Your guidance would seem to imply that we should see about the same sort of licensing number in Q4 this year. Is that correct? That's a pretty healthy growth.

Harry Debes - *Lawson Software - President and CEO*

Absolutely correct. And that is why I said that I am very encouraged by both in our pipeline, the deals we know we have already won and the productivity of our salespeople is very healthy.

Thomas Ernst - *Deutsche Bank - Analyst*

One final follow-up and I will let others ask. You mentioned that salespeople are down 8 since the beginning of the year. Is that something that you are planning? We had been in expanded mode before and what should we expect as you look forward over the next few quarters?

Harry Debes - *Lawson Software - President and CEO*

It wasn't something we plan, but we did take out some non-performers. There's some normal natural attrition that happens. We just haven't recruited as aggressively as we did last year. I think you should see that by the end of this year sort of late -- we are recruiting now. By the end of year we should be back north of 200 and that we will continue to hire not as quickly as we did in the previous year. I think that was a onetime catch-up. You can probably expect us to add net, net of any turnover about 10 to 15% over the FY '09 period.

Operator

Peter Goldmacher. Cowen and Company.

Peter Goldmacher - *Cowen and Company - Analyst*

Two questions. First of all can you talk to me -- can you help explain why maintenance was down sequentially and also can you talk a little bit about some of the dynamics of the -- particularly, the large deal that you had to defer the entire deal and just remind us of your rev-rec policy that is so conservative that all of your license growth or the bulk of the real license growth doesn't show up on the income statement, but shows up in deferreds? Thanks.

Harry Debes - *Lawson Software - President and CEO*

I will take the second question. Love your questions, Peter. So here's the deal. The policy on rev-rec is not Lawson specific, it's the law. I think all software companies are subject to it.

In the case of this particular transaction there are some customizations that are involved. And you know they are not enormous, but they are significant enough as you can imagine and there are some interfaces that we have to develop between Finning and the Caterpillar organization.

So in order to make the solution a complete solution there's some work that we have to do, which is underway now. It's going very well and that is why I think I told you in my comments that we would likely recognize it late in the second quarter or early in the third quarter of FY '09.

So is this frustrating? You bet. But you know what? These are the rules. We all live by those rules and that's what it is.

So yes. But it's not a reflection of the Company's lack or inability to sign. It is just that these are increasingly how deals get done. I would tell you what other phenomenon that we are observing. Increasingly customers are insisting on fixed-price projects and once that happens, automatically 100% of the software is deferred.

So in this case it is not a completely fixed-price project but a lot of our transaction -- there were other large deals that happened this quarter that were also deferred and I would highlight an example.

There was a recent press release by Waste Management that highlighted a major problem with an SAP implementation. I think there's a $100 million or so lawsuit going on there where they're claiming the project was not really completed. And so these revenue recognition rules are designed to make sure that software companies don't get ahead of themselves. They haven't completed the solution before they recognize the software.

So we and our auditors and our Board and our policies are simply, we believe abiding by the rules. We are not being overly conservative.

Rob, you want to take the maintenance question?

Rob Schriesheim - *Lawson Software - CFO*

Sure. As far as maintenance, yes. We did $84.9 million in maintenance revenue this quarter which was up 14% over the 75 million in Q3 of '07 and we did $85 million, $85.1 million actually in the second quarter. If you recall in the second quarter call we noted that there were several one-time items in the maintenance line item in Q2, including some billing catch-up that we did. And that was not in our, did not recur in Q3. That's why we called out in Q2.

What I like to look at is the trend and if I look at Q3 maintenance of '07 it was $75 million. Q4 maintenance in '07 was $79 million. Q1 maintenance was $79 million; Q2 was 85; Q3 was 85. So I'm pretty pleased with the trend, the fact that we are up 14%.

Harry Debes - *Lawson Software - President and CEO*

Yes. You should not see this as any lowering of renewals in any way. In fact renewals are up and positive. And as you also know, Peter, Q4 is our very significant maintenance renewal period for our S3 customers. And we are pretty much on track with that program.

Rob Schriesheim - *Lawson Software - CFO*

The only other thing I want to get to is remember and I know you know this, Peter, that our balance sheet is showing very healthy increases in our deferred license revenue balance. It went from $36 million in Q2 to $45 million in Q3 and that was despite the fact that we showed recognized license revenue of $32 million which was in excess of our guidance.

So we don't have an overly conservative policy. And our balance sheet is capturing the fact that we are growing the revenues.

Peter Goldmacher - *Cowen and Company - Analyst*

I did notice that. Thank you.

Operator

Alan Cooke. Merrill Lynch.

Alan Cooke - *Merrill Lynch - Analyst*

Rob, could you give us a little more details in terms of your license expectations for Q4? Perhaps as a percentage of total revenues as you have in the past?

Rob Schriesheim - *Lawson Software - CFO*

You know, no.

Harry Debes - *Lawson Software - President and CEO*

It's going to grow.

Rob Schriesheim - *Lawson Software - CFO*

You know what we, what I felt comfortable in doing this year as we've gotten better at giving guidance and we have done a good job, I think, over the last six quarters at giving guidance and meeting our guidance. You can do the math and, based upon where we gave our full year revenue estimates and what our fourth quarter guidance was for total revenues and EPS and where we've been year-to-date, I think you can draw your own conclusions.

I think one of the previous questions actually was from Tom. He noted that it seemed like our license revenues for the fourth quarter if you did the math would imply that our fourth quarter of '08 was going to be roughly similar with fourth quarter of '07, which was a very tough compare, by the way. Because fourth quarter of '07 included quite a bit of Lawson System Foundation 9 technology platform sales.

But we are still very comfortable that despite the fact that it is a tough compare, we think we will be roughly similar in license with fourth quarter of '07.

Alan Cooke - *Merrill Lynch - Analyst*

And in terms of.

Rob Schriesheim - *Lawson Software - CFO*

Similar or a little bit up.

Alan Cooke - *Merrill Lynch - Analyst*

Sure and in terms of deferral of license revenues, it looks like you are still contracting more license than you are actually recognizing. I remember three or four quarters ago we talked about getting to an equilibrium point in the midpoint of this fiscal year where you would be recognizing about the same amount of revenue or have it rolling off the balance sheet, as you would have going onto the balance sheet from newly contracted deals. When do you think you are going to get to that equilibrium point?

Harry Debes - *Lawson Software - President and CEO*

You know what? I don't know the answer to that question because it is very deal-specific, but frankly I think it is a good trend. I mean if we're basically signing a lot of software that's a good thing. We can't always defect the deal and/or I suppose what we could do is we could give deeper discounts to try to get concessions from customers so that we could recognize it this quarter. But I don't think that's healthy for the business frankly.

Rob Schriesheim - *Lawson Software - CFO*

And one thing Harry often says is that you can't look at this business on a quarter-by-quarter basis, because there are significant variances in any given quarter. So you need to look at it over a three or four quarter basis. So it is very difficult to predict in what quarter are we going to reach a state of dynamic equilibrium.

You are absolutely right. That is something that I predicted last year. I think we will get there but obviously we had a large contract this quarter. It was deferred. So you know, you saw the results.

Alan Cooke - *Merrill Lynch - Analyst*

Then my last question is with respect to your Q4 EPS guidance it's a little bit below consensus. Is it primarily do you think because of the lower interest yields that you mentioned? And could you also talk a little bit more about your progress towards eliminating the duplicate headcount as you're offshore some functions?

Rob Schriesheim - *Lawson Software - CFO*

Yes, well, certainly the fact that the interest yields and the credit markets and the impact of the credit markets on the interest rate environment, because everybody is going to safe havens, that -- combined with the fact that we moved most of the types of funds that we're invested in have moved to significantly shortened their maturities, has significantly reduced the rates of return that we are earning. And that is about $0.01 per share in the fourth quarter, actually. A little bit more than that. And so that is what impacts the guidance by $0.01 per share that you noted.

Your other question about the duplicative staffing. We said at the beginning of the year or the fourth quarter of '07 that duplicative staffing would be on the order of about $15 million of expenses for this year. And we continued to move through the process of moving more of our billable hours offshore.

As we get those resources in Manila productive, that is when we can eliminate the duplicative staffing. We always said that that would happen Q4 '08, Q1 '09, Q2 '09 and we are still on that path.

Operator

Aaron Schwartz with JPMorgan.

Aaron Schwartz - *JPMorgan - Analyst*

I just wanted to follow up on the comments made about your recruiting activities. Is that something that you planned on slowing down? Or is that in response to some of the macro uncertainty? I know you said he didn't see anything in your business model, but there certainly are some more uncertainties out there. So did you change your recruiting plans around that or was that something you had planned?

Harry Debes - *Lawson Software - President and CEO*

We planned it.

Aaron Schwartz - *JPMorgan - Analyst*

Okay and just to revisit the question on the earnings guidance that was just asked. I understand the impact of lower interest income, but it wasn't completely clear. I know you are not guiding to specific line items, but have you changed your internal target around EBITDA or operating income? Or is this 100% a function of the lower investment income?

Rob Schriesheim - *Lawson Software - CFO*

We haven't changed any of our internal targets.

Barbara Doyle - *Lawson Software - Media*

And our guidance on a full year basis for EPS was $0.30 to $0.34.

Rob Schriesheim - *Lawson Software - CFO*

Our guidance for the full year was $0.30 to $0.34 and for the first three quarters, we did $0.23, and so this obviously gets you to $0.31 to $0.34. You take the midpoint of that obviously and we are still at the upper end of our guidance range which is what we said last quarter. So it's still consistent with that, despite the fact that we have to deal with the decrease in interest yields on our cash balances given the conservative nature of our investment policy which I just think is prudent in this environment.

Aaron Schwartz - *JPMorgan - Analyst*

That's helpful. Then the last question I have is, given all the commentary you've made around your services business, can you just provide some high-level commentary about the trajectory of that growth going forward, given your efforts to embrace partners more? Should we think about a slightly more muted forecast there in the interim or do think you can achieve the same growth rates --?

Harry Debes - *Lawson Software - President and CEO*

We are actually consciously slowing the growth down as I mentioned in my comments for a couple of reasons. Number one, we do believe it is healthy to have a bigger ecosystem. You recall that with the Intentia acquisition, we inherited a business that was very very services-intensive. That was the nature of the business. Intentia acquired its reseller and services partners. That is how they grew the company.

So there was almost 60% of the revenue of Intentia was services. In our combined business now it is about 45%. That's still a significant part of our revenue stream. We would like to see, obviously, we would like to see the software component be higher as a percentage of revenue and the maintenance be higher. But we are not sure that we want the services to be high. We probably want the services over time to come down.

One way of doing that is to slow down the growth. Even though the growth is there. There's no mistaking it's there.

We think it is healthy to have a larger partner ecosystem because ultimately that helps us sell more software. We can also as a result focus on what we think do best and that provides a higher value-add and perhaps the higher margin services.

Aaron Schwartz - *JPMorgan - Analyst*

So longer-term it just sounds like your efforts to embrace a mix shift in revenue to the, as you just said, higher value, higher margin businesses.

Harry Debes - *Lawson Software - President and CEO*

That's very much, that's not an accident. That is an absolute key part of our plan. We publicly told our partners that about a month ago and we are sticking to that.

Operator

Ajay Kasargod with Piper Jaffray.

Ajay Kasargod - *Piper Jaffray - Analyst*

Harry, just to come through, I know this question has been asked over and over. But with your strategy shifting and growing your overall partner ecosystem, what is a better -- give us a better perspective on what kind of growth rate, what should we expect on professional services. Or how should we look at that lagging license growth?

I want to get an understanding because I know that you're clearly having a successful transition to use more third parties. But what does that mean for the model?

Harry Debes - *Lawson Software - President and CEO*

Our services as I mentioned is low single digits. So that's our plan going forward. So you'd think of it as 3 to 5% growth in that range. That is our plan.

I think you know it could easily be double that, frankly, but that is not what we plan to do. However where we plan to focus and you heard me say that I think two or three times and you heard Rob say it and we repeated it on purpose because we wanted to get this message out. Our focus will not be so much on topline growth. It will be on margin growth and we do expect in a couple of years to be in the mid-20s.

Ajay Kasargod - *Piper Jaffray - Analyst*

And then also could you also maybe remind us or give us and update, are there any -- can you give us update on the decommission schedule if there is anything coming up? And also just any thoughts on pricing in this environment? Any discounts are like last year or are any expected in your model?

Harry Debes - *Lawson Software - President and CEO*

As far as decommissioning of older versions -- are you talking about older versions of the software?

Ajay Kasargod - *Piper Jaffray - Analyst*

Right.

Harry Debes - *Lawson Software - President and CEO*

We are still working through the final communication of that with our with the chairmen of the various user groups around the world and that should be out, I would say in the next two weeks or so. But we work very collaboratively with our user groups before we set decommissioned dates. However maybe implied in your question was, is there a date for the new, the latest version of LSF? Is there a new date and at which point pricing will increase again?

The answer is yes and that is on May 15th. We hit another sort of timetable, a milestone at which point customers must purchase LSF and commit to an implementation which gives them an extended support period. And the pricing goes up beyond that as well.

So we do expect perhaps not as large a push as we saw last year, but we do expect to see a nice little bump in LSF revenues again this quarter.

Ajay Kasargod - *Piper Jaffray - Analyst*

Great. The last question and I know that you haven't specifically broken out numbers on regarding verticals, but could you talk to us about the performance of the different verticals that you focus on your seven key areas? And I will just leave it at that. Thanks.

Harry Debes - *Lawson Software - President and CEO*

As I mentioned, you know I mentioned the verticals. Healthcare had a very, very strong quarter. M3, as you know, M3 is in a couple of different verticals. It is in food, it's in fashion. It is in this new vertical we call Equipment Service Management. That is going to be an increasingly important vertical for us in the future.

Clearly, Finning is in that space, but we have other customers besides Finning. By the way, we also have the number two largest Caterpillar dealer. We haven't talked about that for a while, but a year ago a little over a year ago we sold a company called Zeppelin, which is in Germany and has Germany and Eastern Europe as its distribution rights from Caterpillar. So we won them as well and we are working on a couple of other dealers now as well.

So Equipment Service Management is a growing vertical. I think it is going to be pretty significant for us going forward.

But in the quarter in Q3 specifically, we saw strength across the board in all of our target verticals. As I mentioned healthcare was the leader, but we had a very strong public sector quarter as well so those are both S3 verticals. And on the M3 side I mentioned a couple of deals in food. I mentioned some deals in fashion and also in wholesale distribution.

So those are the key targets and I was very pleased with the progress we were making in those.

Ajay Kasargod - *Piper Jaffray - Analyst*

And Harry you made last year in the fall - this is kind of a follow-up to that. You went on tour, you talked to a lot of your customers, you had a pretty positive sales adviser, part of the buying bias. Any change to -- when revisiting customers have you any change to that outlook from them?

Harry Debes - *Lawson Software - President and CEO*

No, in fact, the contrary. The momentum continues. It was incredibly encouraging and uplifting after we left the User Conference that took place in March. By the way that tour, we call it the What's Next Tour that we did last year. That was Version 2. We are now planning Version 3. It takes place in Asia-Pacific in August and it takes place in Europe in October.

That's a great way to connect with customers. Share with them the latest news and the latest message and our plans, hear back from them how they are receiving the news. But I can tell you that the M3 customers in particular who, I think, for perhaps a couple of years prior to Lawson and Intentia getting together were feeling a little bit unloved. I would tell you they feel a lot different today and they are responding. They are showing their affection back to us in the form of purchasing software and services from us and renewing maintenance.

So the investments we've made, which have taken time to bear fruit whether you are talking about product investments, services investments, offshoring investments, hiring of salespeople, marketing investments -- these things don't -- you don't invest in month 1 and then month 3 you get results. We are starting to see them bearing fruit now and I think that will continue.

Operator

Mark Schappel. Benchmark.

Mark Schappel - *Benchmark - Analyst*

Most of my questions have been answered, but just one question for Harry. Harry, in your prepared remarks you made mention of some personnel changes in Europe that have already taken place in the Services business. I was wondering if maybe you could just speak to how high up the changes went and maybe also speak to how comfortable you are that you have taken some of the necessary actions to mitigate any kind of disruptions you may see in that business?

Harry Debes - *Lawson Software - President and CEO*

There were some headcount reductions in parts of the Europe that were not producing particularly well where we had excessive bench time and where we felt like the people perhaps their forecasts and their abilities weren't going to be able to produce long-term results. We also made changes to some country managers and some services directors, where we felt that they weren't on top of the business as well as they should be.

So that's where we made the changes. Those happened at the end of the quarter in late February and in early March.

Mark Schappel - *Benchmark - Analyst*

Thanks.

Harry Debes - *Lawson Software - President and CEO*

I feel good where we are now. I think that going forward -- look, there's always challenges. I mean whenever you make changes, there's always a period of disruptions and there's a settling in period of new personnel, etc. But at the same time I feel much better where we are today and I'm also confident that we won't repeat that bump.

Operator

Alan Weinfeld. Henley & Company.

Alan Weinfeld - *Henley and Company - Analyst*

Solid quarter all around. I'd just like to know, you invested in some of these far-off countries -- Greece, Czechoslovakia, Brazil, Obviously -- made that investment in the channel hoping to get it up to 30% this year. You know, what was the percentage sold in the channel this quarter? And what do you think you can really get it up to by the end of this year? Realistically?

Harry Debes - *Lawson Software - President and CEO*

There are two parts really to your question. In terms of some of the countries you've named, Greece, Czechoslovakia, Turkey, etc., we are actually -- we have reseller channels. Reseller partners. And I think if you look through the Q3 press releases, you'll note that we have both a combination and we've actually signed up quite a few -- and this was a conscious decision that we took about six, nine months ago. We signed up quite a few of reseller partners in countries where we don't have a direct presence, but where possibly our customers might have branch operations, or where we felt the market was underserved with ERP vendors and there was potential for our solution. And that those partners had the ability to localize the product and take it to market. So that is one kind of channel.

Secondly, we have also been aggressively signing services partners who had skill sets or vertical expertise and if you look through the announcements you'll see a good combination of both types of partnerships. So when you say pushing a certain amount of volume through to partners or through the channels, some of these partners are pretty new.

So again you don't expect that in a one quarter or a couple months after you sign them. They aren't necessarily going to count for a lot of business. It takes them some time to ramp up.

But over time, we do expect that as we said at the Partner Event and I know you were there, that we expect 30% of future services and engagements at least to be pushed through our various services partners. Now that is the short-term goal.

Longer-term we may even increase that target, but let's get there first. And again I remind everyone on the call what we inherited in the Intentia side was 95% of the services work was taken by Intentia directly. And that is the transition we are making and it is one step at a time. Alan, does that answer your question?

Alan Weinfeld - *Henley and Company - Analyst*

Yes and obviously that would make the goal by 2010 to have right now you are 56% U.S. and then by 2010, you could be 70, 75% --.

Harry Debes - *Lawson Software - President and CEO*

Total revenue, Alan, is about 50 -- just over 50% U.S. right now and it's 49 something percent international. So we think that there is tremendous potential, growth potential in some of the developing countries such as China. We recently opened our own operation in India as well as we have partners in India and Sri Lanka. We are planning to expand our presence in Brazil, Argentina and Chile, again, because our customers have operations there. But we are also expanding our partnerships in those countries.

So depending on the economy and where we think the growth potential is, we may go direct like in Brazil. ? And in other places we may work through a partner like in Greece.

Barbara Doyle - *Lawson Software - Media*

We've got time for one more question, please.

Operator

Steve Koenig. KeyBanc.

Steve Koenig - *Keybanc - Analyst*

Quick question, just in terms of looking at the revenue performance this quarter. I understand that consulting and particularly in Europe suffered from some utilization challenges, but also it looks to us like America's revenue growth of just under 5% looks a little light. Looks to be decelerating from prior quarters.

I'm curious how did Americas perform relative to your plan. And if this isn't a function of macro weakness, what's behind the deceleration there that we see in looking at the numbers?

Harry Debes - *Lawson Software - President and CEO*

Are you talking only about the services business or Americas in total?

Steve Koenig - *Keybanc - Analyst*

Americas in total.

Harry Debes - *Lawson Software - President and CEO*

I will remind you that the largest couple of contracts we had in the quarter were over 100% deferred; and they were both in the Americas. So I don't think that's a reflection the Americas business is slowing down. It's just a reflection of how that particular deal was recognized.

Steve Koenig - *Keybanc - Analyst*

Okay.

Harry Debes - *Lawson Software - President and CEO*

For a guy like me or for Rob, we do our jobs, we sign the contract and then by the way the customer pays us 100% of the contract in advance. But we don't recognize it to our P&L. I mean those are the rules we have to live by.

Steve Koenig - *Keybanc - Analyst*

That's fair. Okay. Good. I appreciate that. That answers my question.

Harry Debes - *Lawson Software - President and CEO*

I don't think that is a reflection that the business is slowing down at all.

Rob Schriesheim - *Lawson Software - CFO*

No and actually it's productivity for sales rep.

Harry Debes - *Lawson Software - President and CEO*

Productivity for sales rep is way up. So we are happy about that.

Steve Koenig - *Keybanc - Analyst*

Should we expect to say that growth rate, will it not be until Q2 or Q3 next year that we see it come back or should we see a more normalized level of growth for Americas next quarter, for example?

Harry Debes - *Lawson Software - President and CEO*

We expect a pretty strong quarter in Q4 as we always have and that's kind of implied in our guidance. Q1 will be seasonally weak because as you know, again, we have a significant part of our business is in Europe and in Europe, they kind of move -- as you move from the Northern countries through Germany and France, people take a month or so vacation at a time.

So we do, we will have some seasonal weakness in Q1 as we always do, but then we expect Q2 to be very strong and Q3 as well next year.

Now at this point we are not willing to give you an FY 09 guidance and so we will certainly do that in July when we have our Q4 earnings call. But right now all indications are that Q2 should be very strong.

Operator

I would now like to turn the conference back to Mr. Harry Debes for closing comments. Sir.

Harry Debes - *Lawson Software - President and CEO*

Thank you, Operator. Just to wrap up very quickly. As I mentioned we in our guidance going forward we are looking at both the pipeline, our productivity, the deals that we know are already committed, the fact that we do know we will have a smaller but nevertheless significant positive impact from Q4 sales of LSF and I will also tell you we introduced MSF. So the M3 version of LSF which is also now starting to have some traction, so from a contracting perspective we expect Q4 to be strong and we also, because those transactions typically get recognized in the quarter in which they're signed, because they are fairly straightforward -- we do expect our revenue, not just contracting but revenue to be strong.

And because on the macroeconomic side, I know I get asked this a lot and sure it's on your mind as we see other software vendors announce weakness because of macroeconomic factors, I will tell you that I understand that it's very possible. But we focus on value, we focus on a return on investment and our customers are cost justifying very carefully these purchases. And at this point we have not seen pushback from CFOs, CEOs or Boards.

It is always possible that that could happen sometime down the road. At this point we haven't seen it. And so the guidance we gave you is realistic. And I think I'd probably like to stay there because we think it is realistic and prudent.

So thank you very much for your call. Speak to you at the end of our next quarter.
