FINAL TRANSCRIPT

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LWSN - Q2 2009 Lawson Software, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good afternoon, and thank you for standing by. All lines will be in listen-only until the question-and-answer portion of the call. (Operator Instructions). Today's call is being recorded. If you have any objections, you may disconnect at this time. Ma'am, you may begin.

Barbara Doyle - *Lawson Software, Inc. - VP, IR*

Thank you, Valerie, and good afternoon everyone on the call. Welcome to Lawson Software's fiscal 2009 second quarter conference call which covers the quarter ended November 30, 2008. With me on today's call are Harry Debes, Lawson's President and Chief Executive Officer, Rob Schriesheim, Executive Vice President and Chief Financial Officer, and Stefan Schultz, Senior Vice President of Finance. After completing our prepared remarks, we will take your questions as the operator described.

Now, please allow me to review our Safe Harbor statements. We would like to remind you that the 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 of 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. Our SEC filings contain further information about risk factors that could cause actual results to differ from management's expectations. We do not obligate ourselves to update forward-looking statements for circumstances or events that occur in the future. I would also remind you that in addition to reporting 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, please let me turn the call over to Harry Debes.

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

Thank you, Barbara, and good afternoon to everyone. During today's call, I will begin with some comments on the quarter, and Rob will cover our Q2 financial performance. And, we'll discuss our financial guidance for Q3. Then I'll wrap up the call with some closing comments, and we'll take your questions. So, let's begin.

Even with the negative impact of foreign currency exchange during the quarter, our Q2 revenues of $206.5 million met our guidance. Our non-GAAP earnings per share of $0.10 was at the top end of our guidance range. We delivered non-GAAP operating margin of 12%, and that's the highest operating margin we've achieved in any quarter since the merger with Intentia. Operating margin and earnings per share both increased year-over-year. We signed more than 250 software deals in the quarter. Two were greater than $1 million, and nine were greater than $500,000, and that was slightly up from last year.

Our healthcare vertical continues to excel, even during the challenging economic climate. When it comes to the manufacturing and distribution sector, we're finding that these industries are being most severely impacted by the current macroeconomic environments. Weaker demand from their customers means that these organizations are more cautious about undertaking major new capital projects. As a result, ancillary software sales were slower than last year in Europe as well as in the Americas.

When it came to new business, close rates were impacted by numerous customer deferrals as many prospects hit the pause button on new project. We did sign sixteen new deals, and there was at least $8 million of software business where Lawson was selected as the vendor of choice, but where prospective customers simply decided to wait for three to six months to see if the economy improves before they can commit funding to these projects. The silver lining to the quarter's license signing was that business with existing customers held up very well. Last year, we introduced a robust portfolio of new products and now our customers are finding immediate benefit and value in these solutions.

Overall, existing customers accounted for 80% of our total contracts in the quarter, and the average selling price of deals with customers rose 15% year-over-year. Consulting revenues were $86 million, up from the previous quarter but down for the same quarter last year. This is not a surprise as we have 154 fewer consultants than we had last year, and that translates to approximately $10 million per quarter in revenue. We have told you for some time that our plan is to gradually reduce the percentage of revenue that comes from consulting. At the time of the merger with Intentia, consulting revenue accounted for 47% of total revenue. In Q2 fiscal '09, services made up 42% of total revenue. We expect it to be 40% in Q3. And over the longer term, as we continue to build out our partner network, we should expect that direct services revenue from Lawson will be in the range of 35% of our total revenue.

At the same time, we remain focused on increasing our services margin. Margins in Q2 improved over Q, but did not improve compared to the same quarter last year. In November, we appointed Eric Verniaut to become our new Executive Vice President of Global Services. We also appointed a new head of services for EMEA, and he started on January 5th. Their mission is to improve our services margin.

When it comes to our maintenance business, we remain very pleased with the progress both in renewals, revenue growth, and pricing discipline. This is partly due to the focus we have on delivering more value to our customers, and we are doing so by improving our service levels and delivering innovative enhancements to their existing Lawson solutions. But, the highlight of the quarter is that despite the weak economic climate, we delivered one of the most profitable quarters in our history. This just proves that the adjustments in investments we have been making are starting to yield results. Now let me turn the call over to Rob Schriesheim for further discussion on our financial performance.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

Thanks, Harry, and good afternoon to everyone on the call. Non-GAAP earnings per share of $0.10 increased $0.01 year-over-year. Revenues declined by 6% year-over-year, reflecting the customer deferrals Harry discussed. A decline in consulting services revenue and a negative impact due to currency fluctuations in the quarter. Adjusting for the effects of currency, revenues declined 1%.

During the quarter, foreign currencies significantly weakened versus the US dollar. The Euro weakened by 16%. The Swedish Krona weakened by 26%, and the British Pound by 18%. With 40% of our Q2 revenues generated in EMEA, 4% in Asia-Pac regions, and 56% in the Americas, currency fluctuations had the effect of reducing revenues by 5% in total. However, there was no material impact on net income or EPS as expenses were equally reduced.

By line item of revenue, license fees were down 9% as reported or 4% to constant currency. Consulting revenues declined 15% or 10% at constant currency. Maintenance revenues increased 6% on a reported basis and 10% at constant currency. This is organic growth in maintenance and not artificially increased by any acquisitions. We have high customer renewal rates driven by our R&D investment in new products and in new service offerings such as managed care from which our customers derive value and benefit. The 10% decline in services revenues at constant currency reflects fewer billable consultants, primarily in Europe.

S3 consulting revenues remain largely unplanned. We anticipated lower services revenues as we balance capacity with demand forecasts and intentionally reduce services as a percent of our business mix. We called this out in our Q2 guidance. Consulting margin was lower than planned, however. Consulting margins of 15% while improved from Q, declined from 17% a year ago.

Our Manila team billed 50,000 service hours in Q2, up from 30,000 last year, so we are clearly making progress on our offshoring efforts. We continue to work on improving our utilization, however, as current rates are lagging our expectations, and we don't find them acceptable. Despite a drop in consulting margin, total gross margin increased year-over-year due primarily to a shift in the mix of revenues away from services and towards maintenance. On a year-to-date basis, maintenance comprises 45% of our revenues this year, compared to 40% last year.

Non-GAAP operating margin also increased year-over-year, by 200 basis points to 12%, and improved product mix, higher base of recurring revenues, stable business in our healthcare vertical, product add-on sales to existing customers, efficiencies in our operations, and sensible discretionary expense management helped offset lower software and services revenue. Our non-GAAP costs and expenses declined year-over-year by 3% at constant currency, driven by transformations in our global operations that began in early 2007. These actions are paying dividends now, accounting for approximately 100 basis points of margin improvement in Q2. In November, we announced cost reductions in light of the global economic environment. Many of the reductions were extensions of the transformational actions already underway, although the anticipated severity of the recession accelerated the pace of our initial plans. These actions are expected to reduce expenses by $40 million to $50 million annually, beginning with about $5 million of savings in Q3, growing to $10 million to $12 million a quarter by Q1 of fiscal 2010.

In combination with the changes we implemented in 2007, we have achieved a total of about $80 million in sustainable cost savings since the merger on an annual basis, driven by process reengineering and simplification that is more than arbitrary cost-cutting. For example, we built a more flexible global workforce. We have created shared services centers in Switzerland and Manila. We have simplified many operations across our Company, creating consistent, repeatable processes globally. We added resources in our targeted vertical business units, raising our Company's profile in these industries with customers, partners, and other influencers. And, we have invested in our infrastructure, implementing Lawson 9 globally, so we now have a uniform global general ledger system, adding business efficiencies and insight.

In aggregate, the business has successfully achieved a major transformation since the merger that is driving improved operating margins. The key remaining area for Lawson, or sustained improvement is required, is services. We have made progress, including 12% of our total billable hours now being delivered from Manila. However, more consistent services execution is needed to achieve acceptable margin targets. Improving services margins does get more complicated in a weakening economy, but we are focused on this goal. We have successfully addressed our other businesses' challenges, and we will do likewise with services.

Non-GAAP net income increased 6% year-over-year. EPS of $0.10 benefited by 400 basis points of improvement in our effective tax rate, and 10% fewer diluted shares outstanding year-over-year. Fully diluted shares currently stand at 164 million down from 182 million a year ago. The improved tax rate and lower shares offset a 66% decline in interest income. Cash flow from operations was negative $43 million which was consistent with our plans. Q2 is the low point in our fiscal year for cash given the timing of our maintenance contract renewal cycles that begins in the second half of each fiscal year.

Fiscal 2008 gives us a good view of our typical cycle. Cash flow from operations was negative $50 million in Q2 last year before turning to a positive $24 million in Q3 '08 and a positive $128 million in Q4 '08. We will see a similar pattern this year with negative cash flow in the first half and positive cash flow in the second half of the year.

Our cash position remains very healthy with $313 million of total cash and equivalents and $67 million of cash net of debt on the balance sheet. Our cash position will continue to strengthen in the second half of the year. Total deferred revenue of $198 million declined from $275 million in Q 1. Again, this is a typical pattern also influenced by the maintenance renewal schedule, as maintenance revenues recognized ratably over the twelve months following the renewal date. Within the deferred revenue balance, deferred license revenues of $50 million declined $7.7 million from Q1. We completed a major project milestone at Finning, a large M3 customer, and recognized nearly $3 million of license revenue associated with that major phase of the project. This was in our plan, and the milestone was completed on schedule. We do not have any project milestones as large as the Finning delivery for the remainder of the year, so the [roll-in] will be at a more even rate of between $8 million and $10 million per quarter.

Now let me move on to our guidance. For Q3, we anticipate total revenues in the range of $183 million to $187 million at current exchange rates. Given our non-GAAP effective tax rate of 35%, we expect non-GAAP EPS to be in the range of $0.07 to $0.09 per share and GAAP EPS to be in the range of $0.03 to $0.06. I would also like to provide some perspective on our guidance to give you the benefit of our thinking.

There are three primary factors to consider when comparing our Q3 guidance to the prior year. Currency rate fluctuations, resizing and transitioning our services business, and lower costs driven by restructuring. For context, our total revenues were $213 million in the comparable period last year, and non-GAAP EPS was $0.08. First, we estimate that currency will continue to negatively impact revenues in Q3 given current trends. We anticipate Q3 revenues will be down in the range of 12% to 14% year-over-year, with currency causing about 6% of the decline. Because of our large employee base outside the US, these currency fluctuations will also reduce expenses, resulting in minimal impact on EPS.

Besides currency, the other major differences in revenue year-over-year will be in services. As Harry discussed, we forecast a lower mix of consulting services revenues this year. We estimate services will be approximately 40% of total revenues in Q3, down from 45% last year. Maintenance revenues should continue to hold up well, although they may decline slightly sequentially due to currency impacts. And we continue to forecast conservative software contract close rates through the remainder of our fiscal year, given the global economy. As an indication, we had 196 AEs, on average, during fiscal '08, and we now have 178 AEs.

We anticipate that Q3 services gross margin will decline year-over-year which is clearly unacceptable to us. We have initiatives underway to address services performance. While we expect services margin to directionally improve in Q4, the full benefit will be seen in our quarter ended November, 2009, given the seasonally weak August quarter.

Regarding our cost structure, expenses will be lower year-over-year due to currency and the restructuring actions we announced in November, including the reduction of approximately 200 employees in December and January. These actions, in addition to the benefits we are accruing from the transformations in our global operations that began in early 2007, should help us to maintain or even slightly improve our non-GAAP operating margin year-over-year.

To summarize, we're operating our business to meet the challenges inherent in a difficult business environment. We have struck a balance between managing our costs while maintaining healthy levels of investing is in our product, people, and infrastructure. While we are cautious in this economy, we continue to focus on the goal of increasing our FY '09 operating margin over fiscal '08. With that, let me turn the call back over to Harry.

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

Thanks, Rob. By now, it's pretty clear to all of us that we are in the midst of a recession. The entire industry is experiencing a slowdown in demand. But ERP projects cannot be deferred indefinitely. Eventually, we will return to a more normal level of software buying behavior. When that happens, we at Lawson are well-positioned to deliver on our promise of mid- to high teen operating margins, and here is why. First, companies who have well tuned systems are better equipped to weather economic storms. Lawson Solutions have a long track record of helping our customers manage their businesses more effectively. Quite simply, we help our customers cut their costs. ERP may not be sexy, but it is mission-critical, and it is proven.

Second, while the current economy requires us to be cautious in our forecasts, it does it not in any way affect the confidence we have in our people or our business. About the progress we have made or the path we are on. We have a large, diverse, global customer base. We do business in multiple industries, including some with less cyclical nature than others. Our business model is strong and viable, and we have a multi-year history of delivering on our financial commitments.

And third, we have now completed most of the projects that were on our to do list to integrate the Lawson and Intentia businesses. Sure, we still have a few challenges that remain, but compared to where we were two years ago, they are relatively minor. The changes we have made in the last two years to streamline and transform our business, provide us with a very solid base to weather this economic cycle. Our focus on continuing to deliver strong operating margins is unwavering, and our Q2 results demonstrate our resolve in action. That concludes our prepared comments. Operators, please open up the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mark Murphy, from Piper Jaffray, you may ask your question.

Mark Murphy - *Piper Jaffray - Analyst*

Thank you. Congrats on the margin progress here during the quarter. Harry, from talking to a number of your partners, it sounds like they are actually seeing deal pipelines are up year-over-year, and so it probably becomes a question of close rates. Does that correlate to what you are seeing in the pipeline, and I guess, with respect to the Q2 guidance, can you talk to us about what your license close rate assumption might be versus historical norms?

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

Sure, Mark. First of all, you are right. We do feel good that we are building a solid pipeline. That our pipeline is, in fact, strong. But I think, as I mentioned in my prepared remarks, it is not that we're not winning deals. It is just that the deals, even when won, aren't being funded by the Board, by Boards of companies because they have some sense of nervousness about their predicaments, and I think they're in cash preservation mode right now. As I also said, I don't expect for that to go on forever. At some point, I think the dam is going to break here, and we are going to see back to normal kind of patterns. In terms of our close rates, I can't give you the exact percentage because I don't think we quote on that. But it's less than what it has been. For example, in fiscal 2008, when we weren't experiencing that -- this kind of anxiety in the market. Does that answer your question?

Mark Murphy - *Piper Jaffray - Analyst*

Yes, thank you very much. Just as a follow-up for Rob. I think you talked about maintenance pricing having been very healthy in the quarter. Have you seen any change in maintenance renewal rates? Or, are there any customers, even if they're small in number, that are attempting to say, hey, let's save a few bucks and see if we can, go a few months or even a year without the maintenance. And then, as a sub-question, how do you think the maintenance revenue would trend this year if 2009 does end up being a very challenging economic climate?

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

You know, we haven't experienced any change in our maintenance business. That's the simplest answer to your question.

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

And Mark, it's actually a little bit surprising because we expected that we might. Because we've heard all this noise about what's going on with SAP. But don't forget, our tactics and our response to the customer situation has been quite different from that of SAP's. Instead of raising rates to an unusual level, we figured out how to deliver more value for approximately the same rate that we've been charging Hicks historically, aside from normal increases. Instead of raising their rates to an unusual level, we've figured out how to deliver more value for approximately the same rates that we've been charging historically, aside from normal increases. So, we have had very little push-back from our customers. Nothing more than what we've had in the past. And I think you should remember that maintenance is also a bit of a lagging indicator of current economic times, right? So, take that into consideration.

Mark Murphy - *Piper Jaffray - Analyst*

One last one. Thinking about Q2, vis-a-vis the deals that may have slipped out of Q1. Is there a net benefit on your license line in Q2 by closing deals that slipped out of Q1? Or, is there an equal or even greater amount that slipped out at the end of Q2?

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

I would say there was a greater amount that slipped out of Q2. I think that in Q1, really we didn't feel the impact of the anxiety levels until very late in the quarter. In other words, the last week of the quarter. Don't forget, that was August, right? Last week of August. I think by the time we were in Q2 -- in our Q2, September, October, November -- we were well and truly in the midst of the maelstrom. The news media was full of bad news, and I think that people got caught up in that. We are right now in a confidence crisis, I think.

Mark Murphy - *Piper Jaffray - Analyst*

Thank you very much.

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

Sure.

Operator

Tom Ernest from Deutsche Bank, you may ask your question.

Tom Ernest - *Deutsche Bank - Analyst*

Good afternoon. Thank you. My question is around the services business. You have been able to significantly bring down the size of that business, and this has come although the licensing revenue has only been down slightly. I'm curious, how strong has been the uptake of third party service support, particularly in Europe, where I think your service revenues declined the most significantly on the M3 line? Are you getting a large number of partners to pick up that slack? Are you finding you are able to just eliminate the services need altogether with the customer?

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

No, in fact, Tom, there are a large number of new partnership arrangements that we have at an unprecedented level. If you remember back in the old Intentia days, they really didn't have a partner strategy at all. Pretty much 99% of all services work in Europe was, in fact, delivered by Intentia. We have changed that model. We, however, have criteria for what it takes to be a Lawson partner. We just don't sign up anybody who walks off the street. We need and expect our partners to have a certain level of confidence, and need to be certified to certain minimum standards. Because ultimately, what they do in our customers' sites is going to impact our reputation. So we are signing up new partners, but at the same time, we also expect them to live up to certain expectations. So it would be fair to say, we have a backlog of organizations who want to be partners but have not quite become authorized by us at this time.

Tom Ernest - *Deutsche Bank - Analyst*

Okay, I see. But, the actual uptake of third party partners doing new business that weren't last year at this time, for example? Is that equal to the magnitude of overall service decline in your business? In other words, your guidance is for somewhere around $74 million in services work plus or minus $2 million in Q3.

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

I would say that -- it would be fair to say that over the last two years that the number of partner -- and I'm going to restrict my comments mostly to Europe because this is where most of the phenomenon, in fact, has taken place. That, yes, it's approximate that the partners have picked up what has been declined, but the services revenue has declined at Lawson which is fine.

Tom Ernest - *Deutsche Bank - Analyst*

Okay, good. One final question. Which products are you seeing the best upselling in your customer base? I think you mentioned 80% of contracts in the quarter were upsold product. Is that a consistent amount in the revenue level? And then which products are the strongest?

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

Well, our Business Intelligence is strong. Our Human Capital Management solution is strong, especially our Talent Management Solution is strong. That's going pretty much as we expected. Our Business Analytics, as I have said, is strong. Also, the LSF version for M3 customers, the similar technology upgrade. That's gone exceptionally well. And then finally the 7.1 release which we released about eighteen months ago, the new version of the M3 product. We've had close to 300 customers accept that solution in the last eighteen months. So we're thrilled with that uptake.

Tom Ernest - *Deutsche Bank - Analyst*

Great, thanks again.

Operator

Peter Goldmacher, from Cowen and Company, you may ask your question.

Peter Goldmacher - *Cowen and Company - Analyst*

Rob, you had mentioned that you had taken AEs down from 196 in '08 to 178 in '09. Were the majority -- I assume some of that was just culling the herd, and is it safe to assume that most of that was on the M3 side?

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

Yes.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

Yes, it was throughout the organization. The answer is, yes, a substantial portion was, as you would put it -- culling the herd. But, it was also probably more weighted towards the M3 side than the S3 side.

Peter Goldmacher - *Cowen and Company - Analyst*

Can you talk a little bit more about the services business? What sort of programs are you putting in place internally to make sure that as you exit the services business internally, and you are partnering up externally, that you've got account coverage in the local geographies? And to ensure that you're getting internal participation with your third party delivery partners?

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

We have launched a formal partner program. We have a website. We have a certification program associated with that, as I said before. We have partner events, and we have partner training. We deliver the partners three copies of our software. We introduce them to our clients. They come to various user group events and meetings that we have. In certain parts of the world, we have a great staffing and great relationships. In other parts of the world, we still have some work to do.

Peter Goldmacher - *Cowen and Company - Analyst*

So when you look at this as a process, are you halfway through? And at some point, can you dial back the spending on the outreach and expect more profitability to flow through? And if so, where are we in that?

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

So first of all, I think what you are hinting at is that the partner program initiative is costing us a lot of money. It is not. It's a relatively small program, and we have some resources allocated to it. But we don't see that those resources that are allocated to this program will decline, because once you create a partner community, you need to feed that partner community with information and keep them current. So, it's not a large program. In terms of where we are, I'd say we're about a third of the way through. So, we still have a lot of work left to go before we feel comfortable that the partner ecosystem is fully up and running or staffed to the level that we would like to see it.

Peter Goldmacher - *Cowen and Company - Analyst*

Okay. Great. Then just one last question on the offshoring, and I apologize if you already spoke about this. But, where are you on the cost-benefit of taking out the big chunks of savings in the offshoring in Manila?

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

Taking out savings in Manila --?

Peter Goldmacher - *Cowen and Company - Analyst*

No, I'm sorry. Taking out costs for savings?

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

So Manila, as Rob said, we're very pleased with the progress. For example, 50,000 hours were delivered.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

Up from 30,000.

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

Up from 30,000 in the quarter. 12% of our total billable revenue. But, there is still more capacity there Peter, and I think that's the part that we're still working on. The capacity exists. We did go through a hiring and training phase. We are nearing the end of that phase now. We're not hiring actively any more. We are now -- our focus is on making those people that we have hired and trained productive. And there's some work, frankly, left for us to do there. We are not completely comfortable that the uptake is as broad -- as well accepted, as we would like it to be.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

Peter, I think the way we think about it is that -- look, you can clearly see that the overall margins of the business have dramatically improved. I think the first quarter, post-merger, it was 3%. Last year at this time, it was 10%. So, it's 12%. Clearly, a lot of that has come as a result of our utilization of Manila. But we always said -- we have always been open in saying that we wanted to get the utilization, the number of hours delivered to Manila to be about 20% to 25%. We are currently at 12%, and so we're clearly not where we need to be in terms of our utilization of the Manila resources. Now, again, I think that we have solved every other issue, we will address this issue also. We have it identified. It's just taking longer than we would have liked.

Peter Goldmacher - *Cowen and Company - Analyst*

One last question, competitively. Are you seeing a change from Oracle and SAP in your market? Are they retrenching? Or are they exiting your market to focus on their core strengths? How is that dynamic changing?

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

No real change, other than just the normal (inaudible) about, oh, Lawson is going to go out of business, or we're going to buy them in the next five minutes. That normal BS that they throw out when things get tight. Other than that --

Peter Goldmacher - *Cowen and Company - Analyst*

They're buying you? What are they going to pay for you?

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

I am just saying this is not what the corporate message is. This is what desperate AEs say to prospects when they run out of things to say.

Peter Goldmacher - *Cowen and Company - Analyst*

So there is no deal? You are not announcing anything?

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

Peter, if there's anything going to happen like that, we'll call you first, okay?

Peter Goldmacher - *Cowen and Company - Analyst*

Please do. (Laughter) Okay, thanks.

Operator

Steve Koenig from Keybanc Capital Markets, you may ask your question.

Steve Koenig - *Keybanc Capital Markets - Analyst*

Hi. Thank you, good afternoon. Quick housekeeping question or two, and then my primary question. Did you all happen to say how much contracting activity there was in the quarter?

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

No, we didn't give our contracting. We don't give that information.

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

256 deals.

Steve Koenig - *Keybanc Capital Markets - Analyst*

Okay. It seems we've had that in prior quarters. So that's something we should not expect from here on out?

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

We gave it in the first four quarters after the merger with Intentia because of complication of the revenue recognition, and establishment of the SOE and everything else. So that just giving people the recognized license revenue wasn't an adequate story, so we went further and gave contracting. We haven't given contracting a couple of quarters. Occasionally, we do. Most people can, I think, triangulate around it by looking at the total number of deals and the average price per deal.

Barbara Doyle - *Lawson Software, Inc. - VP, IR*

And it's in our press release.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

Which is in our press release.

Steve Koenig - *Keybanc Capital Markets - Analyst*

Thanks for the help on that. And can I infer from your comments about the roll-off of deferred that in this quarter, due to the Finning deal, it was maybe $3 million above what the normalized at $10 million was?

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

Yes.

Steve Koenig - *Keybanc Capital Markets - Analyst*

Okay. So that leads me to what I really wanted to ask you about. In terms of your -- the growth rate that you expect to see for contracting going forward, I guess the -- when I look at the guidance for Q3, it looks to me as if your expectations for contracting, at least for license revenue, is a bit weaker than certainly what I expected. And what I think is implied, and perhaps in some of the consensus expectations. I'm wondering, is there something -- is that something to -- am I reading that wrong? Or is that something to do -- is it solely due to the roll-off in deferred and that change with finning? Or, are you building in sufficient -- making sure that you don't disappoint? How do I read that when it looks like the number looks a little soft for me, even taking into account the consulting revenue. How you are managing consulting revenue down?

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

I feel like saying yes to all the above.

Steve Koenig - *Keybanc Capital Markets - Analyst*

Okay.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

But the answer is, listen, every quarter we're questioned on the guidance we give. Is it conservative? We try to give realistic guidance. I think, obviously, in this environment, there are some companies that have decided not to give guidance at all. Because even though we feel pretty strongly that we have a rigorous process in place, we do all the normal things that every Software Company does, and probably then some. The normal historical data in trends, etcetera, doesn't necessarily apply in this environment because we can't control what's going on in the minds of a potential purchaser in a recession. And particularly a recession that's as severe as this one. And so, when we gave our guidance, and I tried to give an unusual amount of color behind the thinking around our guidance. The fact is, the definition of a recession, particularly one that's this severe is, you are in a contracting economy. And I tried to also point out the data that we've reduced pretty significantly the number of people in our salesforce. And Harry also talked about the level of deferrals that we experience, where we were selected as vendor of choice, but we were deferred until the companies can be more comfortable in making a commitment. So, I think what we gave was guidance that we're comfortable with. It's always difficult when someone says, well, gee, is that conservative? Or, is there anything odd going on in your business? There's nothing odd going on in our business except for the fact that we're operating in a recession that most people characterize as being the worst recession since the Great Depression.

Steve Koenig - *Keybanc Capital Markets - Analyst*

Right. That's a good answer.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

The other thing I would offer is that, look, we just had a pretty good quarter, I think, a reasonably good quarter. When you look at our margins, and you look at our overall performance. And particularly on a year-over-year basis, in a pretty bad recessionary environment. So we're trying to do our best to manage the business in that type of environment.

Steve Koenig - *Keybanc Capital Markets - Analyst*

Terrific. Thank you very much.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

Sure.

Operator

Richard Williams from Cross Research, you may ask your question.

Richard Williams - *Cross Research - Analyst*

Thank you. Wonder if Harry, if you could give me some geographic color, and a follow-up after that.

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

About 55% of our business came from the Americas. I think, historically, about 4% or 5% comes from Asia, and the balance comes from Europe.

Richard Williams - *Cross Research - Analyst*

In terms of strength, weakness, products --

Barbara Doyle - *Lawson Software, Inc. - VP, IR*

The biggest decline was in EMEA, and a lot of that decline, Richard, was driven by currency.

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

By currency, yes. Our biggest strength actually was Asia. Unfortunately, Asia is relatively small. But actually Asia, the performance, which leads to you think there wasn't anything going on over there, in terms of recession, they actually exceeded their targets for the quarter. So we're very pleased about what they did. But, it's a small portion of our business today.

Barbara Doyle - *Lawson Software, Inc. - VP, IR*

From a performance perspective, the revenues from the Americas was actually up 1%. Total revenues from EMEA were down 15% as reported, but when you adjust that for currency they were only down about 5%. And then as Harry said, Asia Pacific was up about 14%.

Richard Williams - *Cross Research - Analyst*

And of the $8 million in deals that got pushed out, are there any commonalities, any industries in particular, products?

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

Manufacturing, mostly manufacturing distribution related industries.

Richard Williams - *Cross Research - Analyst*

Okay. And were they of a similar size as customers go?

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

Actually, they were all over the map. A couple were quite large. Multiple millions of dollars in terms of license, and then a bunch of medium size deals as well. I'm not including everything. I'm not including small projects, but I know for a fact of about six, seven deals that were meaningful.

Richard Williams - *Cross Research - Analyst*

From your perspective, do you get the sense that the credit crisis is still getting worse, or is it leveling out, or how do you see it?

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

I don't know what's going on in the credit crisis. I know probably less than you know in terms of I read the papers, and I watch CNBC like everybody else. I don't know what's going on in the credit crisis. All I know is that from our customers' perspective, some industries are severely impacted, others, like healthcare, apparently, aren't as severely impacted, because right now, certainly what we've seen to date is that their desire to invest in ERP systems seems to remain pretty darn strong right now. I'm hoping that that will continue, but it's difficult to predict. Maybe they're spending old budgets.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

What we do know is that, look, in this environment, every Company that we're aware of is going through their own replan exercise. And if they're on a calendar year fiscal year, they have now just put in place their new budget. And from what we can tell, for certainly the first half of calendar year '09, people will be very, very cautious on spending. That's what we know.

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

Absolutely correct. As I have been traveling around for the last six months, meeting with customers. I've done a lot of traveling in the last six months, it's pretty much -- their story sounds a lot like our story. For the first half of calendar 2008, everything was going great. And then since around July, August, everything is on hold, and Rob is absolutely right, they all had replans. Some of them have had major restructurings. Under those circumstances, they're reluctant to spend -- take on new spending initiatives. So, that's kind of what we're seeing right now.

Richard Williams - *Cross Research - Analyst*

Okay. Well, thanks very much, and best of luck to you.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

Thank you.

Operator

Brad Sills, from Barclays Capital, you may ask your question.

Brad Sills - *Barclays Capital - Analyst*

Thanks for taking my question. You mentioned that healthcare was strong for S3. Can you comment on some of the other professional services verticals, and what you might have seen there?

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

In terms of verticals with S3, our focus is on healthcare, first of all, and public sector secondly. Public sector had a pretty good Q1. Q2, not quite as strong. We think that there is business there, there's opportunity there. But it's paled compared to what we've been seeing in healthcare. We don't really focus on a lot of other service industries besides those two. Remember, our message and our whole vision has been to narrow our focus into a few select industries and do an outstanding job there. So it's not like we're trying to hit seventeen different industries at that time same time.

Brad Sills - *Barclays Capital - Analyst*

Got you. Thanks. You showed good improvement on deal size. Any color on what's driving that? It sounds like you are able to get more of the cross-sell in there. Is it simply just a result of that, selling more modules into accounts?

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

I will tell you it is a conscious decision we made some years ago. When we first launched LSF. We realized during that exercise, that if we could package meaningful pieces of software that were easy to install, easy to fund, and could be sold to some degree in either an over-the-phone or in a Webinar type environment, that -- so we could ship those deals, and customers would accept them in volume. If you are talking about a $200,000 to $500,000 piece of software, that typically requires an extensive review. And maybe even Board approval. But if you are talking about a $50,000 to $100,000 software, obviously smaller -- the deal. Many times these are departmental approval levels, and we can get them through a Company's approval cycle very, very quickly. That was an eye-opening experience for us. And as a result, we've made a conscious decision three years ago to start packaging a number of our enhancements and additional products in that same vein. And you are just seeing now the result of that as we packaged a number of different offerings this way. You are seeing customers accept them. And I think, we expect this to continue. In fact, we're counting on it to continue, particularly in the second half of this fiscal year.

Brad Sills - *Barclays Capital - Analyst*

Okay, good. And then, just last question. Good progress on the services margin this quarter, quarter-on-quarter. But it sounds like it's not where you want it, and you see directionally that going higher. Is it just simply a matter of staffing more hours to Manila? I know that that's part of the goal, but is it that you need to find more consultants in Manila? Or you need to ramp up what you already have there? Or is it simply just a case of staffing and utilization?

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

You know, it's not all about Manila. Can I just tell you that. Certainly on the Manila front, that's part of that story. On the Manila front, we're very pleased that every quarter the number of hours we deliver from there is improving and we're getting great customer success stories from the work that those folks are doing. So that is all positive. But what we've done is, we've created a capacity that isn't utilized to the extent we'd like it at this point. So maybe we staffed too quickly. I don't know. Maybe we haven't done a good enough job of educating our project leaders and various persons around the world of how to use Manila effectively, but clearly that's an initiative that Eric has on his plate. That's one part of the story. I would tell that you in different parts of the world also there's a utilization issue. There is a pricing issue, and there's just also, in some cases, a cultural issue. Don't forget, again, in the former Intentia, services was -- it was probably primarily a services business, frankly, about 60% of the business was services. What we're seeing is we're more of a software Company than we are a services Company. We acknowledge and accept that services is an integral part of what we do, but there's other things we do that are also important, and we just need to understand how to work together. And as we mentioned before, part of that strategy is to have a partner ecosystem. So as we're going through these sort of dynamic changes, some of that needs to just be understood and absorbed by local management, local staff, and I think we have some work left to do there.

Brad Sills - *Barclays Capital - Analyst*

Got it. Thanks a lot.

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

Sure.

Operator

Our final question comes from David Bayer from Cantor Fitzgerald. Sir, you may ask your question.

David Bayer - *Cantor Fitzgerald - Analyst*

Afternoon. Thanks for taking the questions.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

Sure.

David Bayer - *Cantor Fitzgerald - Analyst*

So I'd like to sort of go into -- and I think some people have delved into it already today, but I'd just like to make sense of it a little bit. It has to do with revenues and related cash flows from them. With the AE headcount reduction, just wanted to know if, in a sense, we're hurting the development of the pipelines. And I realize that we had some deferred deals, but it seems like significant parts of the business is moving towards working with the installed base. And I'm just wondering if we've cut to the bone too much on the AE side in terms of expanding to new customers. Maybe a little bit of color there, and then I'll have a follow-up.

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

First of all, as you would imagine, in any organization when you have 200 sales persons, not everyone is performing up to the level that you expect them to do. So obviously, we look at that question first. Do we have some nonperformers, or some people who we don't believe in the long term are going to be able to deliver on their commitments or on their targets? So that's the first thing we looked at. Secondly, in a normal environment, when you cull your sales organization, you replace them immediately. In this environment, given that we have been observing a slowdown in demand, and we're not convinced as to when that's going to be turning around, we simply haven't replaced them. And I think if we had -- if I was telling you today, hey, great news, we've got 220 AEs, compared to -- everybody on this call would probably be asking me, what am I doing? What are we doing here? So what we've done is we've taken the conservative view, which is right now, at this stage, it's probably not the best idea in the world to increase our costs, because hiring new AEs today means they're not going to be productive for at least nine months. And so is that what our shareholders would like to us do, or is that the right thing for the business to do when demand at this point is uncertain? In fact, you could say the opposite. Could you say demand is weak, probably today weaker than it was some time ago. So for those reasons, we haven't replaced the AEs, David, that we culled. But every performance organization knows that you do periodically review your headcount and say, who is a keeper, who is not? And that's what we did.

David Bayer - *Cantor Fitzgerald - Analyst*

Okay, that makes sense to me. The second line of question I'd have has to do with some thoughts just sort of magnitudinally on cash flow levels for the year as a whole. Do you think that they would be down a meaningful percentage from last year's cash flows as a whole? Or is your goal to keep it reasonably close? Just sort of give us a little color on that. And then, related to that, I realize that you have not talked about Q4 exclusively, but do you think it will be up less than Q3, in terms of less up than it normally has been, or could it conceivably be flattish or even down? Any thoughts at all? Obviously you are looking at a pipeline of some level. Maybe a little thoughts along those lines.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

On our cash flow, our cash flow is really largely driven, obviously, by our maintenance collection cycle. And since our maintenance business is in very good shape, I don't really see much change between last year and this year in our cash flow. That should answer -- that's a pretty direct response, and I just don't see any change. What exactly was your --

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

On Q4, David, we expect Q4 to be stronger than any of the quarters we've had, but will it be as good as last year? Probably not. Last year was actually exceptionally strong. Recall, $51 million of contracting last year. Really, we really hit pretty much -- we exceeded every target that we set for that quarter. So it's very unlikely that we'll get to that same level. However, we do still, because our customers understand the buying cycles, many of our AEs have worked deals to coincide with Q4. That's at a time when commission rates are at their highest. So like most software companies, we still expect Q4 to be pretty strong.

David Bayer - *Cantor Fitzgerald - Analyst*

Right.

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

But you know what, we're just reluctant to give specifics at this time, because let's get through Q3, and then we'll update you in March when we have our call.

David Bayer - *Cantor Fitzgerald - Analyst*

No, I certainly understand that. When you think about your budgeting for the out year, are you thinking about maybe small growth year-over-year, or sort of any preliminary thoughts there?

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

No, listen, I appreciate the question. We're all kind of smiling at each other, because we appreciate you're in that business, and I guess I wouldn't respect you if you didn't ask that question, but we're just not in a position at this point where we want to even give preliminary thoughts on fiscal year '10. We're obviously, as I indicated before, in this environment, it's challenging enough to give visibility for the full year.

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

Unless you can tell us what the economy is going to do and what the exchange rates are going to do and what the stimulus package is going to do and how the banks are going to do. If you can answer all those questions, we may be able to answer the first. But, we just don't know. It's too difficult to predict.

Rob Schriesheim - *Lawson Software, Inc. - CFO & EVP*

I just don't think it would be helpful to the Company or to any of our constituents, anyone in the investment community for us to begin commenting on fiscal year '10.

David Bayer - *Cantor Fitzgerald - Analyst*

Got it.

Barbara Doyle - *Lawson Software, Inc. - VP, IR*

Other than currency, David, the biggest impact we're seeing is in our business is very specifically driven by the economy. So until there's more clarity on the overall global macroeconomic conditions, it's very hard to predict.

David Bayer - *Cantor Fitzgerald - Analyst*

Okay. Well, let's hope things improve for you and for the economy as a whole.

Barbara Doyle - *Lawson Software, Inc. - VP, IR*

In the meantime, we're very focused on the margin and continue to deliver on our margin goals. So that's -- those are the things we can control.

David Bayer - *Cantor Fitzgerald - Analyst*

Thank you very much.

Barbara Doyle - *Lawson Software, Inc. - VP, IR*

Operator, any more questions?

Operator

There are no further questions.

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

Alright. Just in closing, then, thank you for joining us today. On behalf of everyone, I would like to thank our employees, first of all, for working through what is a difficult time. In Q2, we had a restructuring. We had to take some tough measures. It's always difficult when you have to lose employees because the economy is uncertain. And for the good of the business as a whole, we had to make some tough decisions. We also thank our customers for their ongoing support. I thank my management team for having helped work through a very difficult time, and as I said, as Barbara mentioned, we're very much focused on operating margin. Making sure that even in this difficult time for the full year, our operating margin is delivered at a better rate than what we ended last year. And I think if we accomplish that, then I think we should all feel good about the work we've done. So thank you. We'll see you on the next earnings call.

Operator

This concludes your conference call. You may now disconnect. Thank you.