



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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended January 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 0-12456

AMERICAN SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

Georgia
(State or other jurisdiction of
incorporation or organization)

58-1098795
(IRS Employer
Identification Number)

470 East Paces Ferry Road, N.E., Atlanta, Georgia
(Address of principal executive offices)

30305
(Zip Code)

(404) 261-4381
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (check one): Large accelerated filer Accelerated filer Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.



AMERICAN SOFTWARE, I
FORM 10-Q

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Classes

Outstanding at March 7, 2006

Class A Common Stock, \$.10 par value
Class B Common Stock, \$.10 par value

20,789,929 Shares
3,424,994 Shares



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES

Form 10-Q

Quarter ended January 31, 2006

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

**American Software, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (unaudited)
(in thousands, except share data)**

	January 31, 2006	April 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 25,678	\$ 31,147
Investments	31,279	24,898
Trade accounts receivable, less allowance for doubtful accounts of \$584 at January 31, 2006 and \$638 at April 30, 2005:		
Billed	12,734	9,008
Unbilled	3,937	3,503
Prepaid expenses and other current assets	3,009	2,238
Total current assets	<u>76,637</u>	<u>70,794</u>
Investments - noncurrent	1,554	3,016
Property and equipment, net	7,789	7,977
Capitalized software, net	6,857	6,637
Goodwill	11,120	10,344
Other intangibles, net	2,016	2,138
Deferred income taxes	—	1,972
Other assets	1,565	1,466
	<u>\$107,538</u>	<u>\$104,344</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 845	\$ 1,313
Accrued compensation and related costs	3,552	1,975
Dividends payable	1,694	1,677
Other current liabilities	3,895	3,772
Deferred income taxes	76	121
Deferred revenue	14,754	13,731
Total current liabilities	<u>24,816</u>	<u>22,589</u>
Deferred income taxes	377	—
Minority interest	3,904	3,978
Shareholders' equity:		
Common stock:		
Class A, \$.10 par value. Authorized 50,000,000 shares: Issued 24,557,198 shares at January 31, 2006 and 24,224,198 shares at April 30, 2005	2,456	2,422
Class B, \$.10 par value. Authorized 10,000,000 shares: Issued and outstanding 3,424,994 shares at January 31, 2006 and 3,519,994 shares at April 30, 2005; convertible into Class A shares on a one-for-one basis	342	352
Additional paid-in capital	77,569	75,706
Accumulated other comprehensive income	140	139
Retained earnings	18,439	19,663
Class A treasury stock, 3,782,185 shares at January 31, 2006 and April 30, 2005	(20,505)	(20,505)
Total shareholders' equity	<u>78,441</u>	<u>77,777</u>
Commitments and contingencies	<u>\$107,538</u>	<u>\$104,344</u>

See accompanying notes to condensed consolidated financial statements - unaudited.



American Software, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations (unaudited)
(in thousands, except earnings per share data)

	Three Months Ended		Nine Months Ended	
	January 31,		January 31,	
	2006	2005	2006	2005
Revenues:				
License	\$ 4,952	\$ 3,760	\$13,385	\$ 8,864
Services and other	9,110	8,541	24,911	22,957
Maintenance	6,306	5,061	17,872	14,123
Total revenues	20,368	17,362	56,168	45,944
Cost of revenues:				
License	747	1,366	2,830	3,161
Services and other	7,110	6,019	18,602	16,072
Maintenance	1,769	1,705	4,976	4,205
Total cost of revenues	9,626	9,090	26,408	23,438
Gross margin	10,742	8,272	29,760	22,506
Research and development	1,743	1,320	4,856	3,601
Sales and marketing	3,675	3,275	10,311	9,061
General and administrative	3,019	2,883	9,429	7,562
Amortization of acquisition-related intangibles	88	79	263	117
Provision for doubtful accounts	98	183	256	258
Total operating expenses	8,623	7,740	25,115	20,599
Operating income	2,119	532	4,645	1,907
Other income (expense):				
Interest income	495	336	1,336	980
Other, net	876	496	1,353	1,088
Earnings before income taxes	3,490	1,364	7,334	3,975
Income tax expense	1,277	1,337	2,759	1,337
Minority interest	(226)	23	(745)	43
Net earnings	\$ 1,987	\$ 50	\$ 3,830	\$ 2,681
Earnings per common share:				
Basic	\$ 0.08	\$ 0.00	\$ 0.16	\$ 0.11
Diluted	\$ 0.08	\$ 0.00	\$ 0.15	\$ 0.11
Cash dividends declared per common share:	\$ 0.07	\$ 0.07	\$ 0.21	\$ 0.21
Shares used in the calculation of earnings per common share:				
Basic	24,088	23,781	24,017	23,679
Diluted	25,349	25,189	25,229	25,094

See accompanying notes to condensed consolidated financial statements - unaudited.



American Software, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (unaudited)
(in thousands)

	Nine Months Ended	
	January 31,	
	2006	2005
Cash flows from operating activities:		
Net earnings	\$ 3,830	\$ 2,681
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	2,437	3,224
Bond amortization	(63)	208
Net gain on investments	(1,020)	(670)
Tax benefit of options exercised	442	—
Minority interest in net earnings of subsidiary	745	(43)
Deferred income taxes	2,553	1,600
Investment impairment and other non-cash items	160	100
Changes in operating assets and liabilities:		
Purchases of trading securities	(17,104)	(13,001)
Proceeds from sale of trading securities	13,732	9,876
Proceeds from maturities of trading securities	2,003	1,900
Accounts receivable, net	(4,160)	(2,520)
Prepaid expenses and other assets	(1,030)	(1,117)
Accounts payable and other liabilities	1,182	656
Deferred revenue	1,023	2,136
Net cash provided by operating activities	<u>4,730</u>	<u>5,030</u>
Cash flows from investing activities:		
Capitalized computer software development costs	(1,968)	(2,535)
Intangible assets	(189)	—
Goodwill	(584)	—
Purchases of property and equipment, net of disposals	(538)	(814)
Proceeds from maturities of investments	71,077	70,955
Purchases of investments	(73,546)	(68,137)
Purchase of majority interest in subsidiaries, net of cash acquired	—	(8,691)
Proceeds from exercise of stock options received by subsidiary	548	—
Purchases of common stock by subsidiary	(659)	(633)
Proceeds from sale of life insurance policy	—	159
Net cash used in investing activities	<u>(5,859)</u>	<u>(9,696)</u>
Cash flows from financing activities:		
Proceeds from Dividend Reinvestment Plan and Stock Purchase Plan	32	—
Proceeds from exercise of stock options	698	1,066
Dividends paid	(5,070)	(4,726)
Net cash used in financing activities	<u>(4,340)</u>	<u>(3,660)</u>
Net change in cash and cash equivalents	<u>(5,469)</u>	<u>(8,326)</u>
Cash and cash equivalents at beginning of period	31,147	37,530
Cash and cash equivalents at end of period	<u>\$ 25,678</u>	<u>\$ 29,204</u>

See accompanying notes to condensed consolidated financial statements - unaudited.



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements - Unaudited
January 31, 2006

A. Basis of Presentation

The accompanying condensed consolidated financial statements are unaudited. Pursuant to the rules and regulations of the Securities and Exchange Commission (SEC), we have condensed or omitted certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles. You should review these condensed consolidated financial statements in conjunction with the consolidated financial statements and related notes contained in our Annual Report on Form 10-K for the fiscal year ended April 30, 2005, as filed with the SEC. The financial information we present in the condensed consolidated financial statements reflects all normal recurring adjustments, which are, in our opinion, necessary for a fair presentation of the period indicated. This information is not necessarily indicative of the results for the full year or for any other future period. Certain prior year balances have been reclassified to conform to the current year presentation.

B. Principles of Consolidation

The consolidated financial statements include the accounts of American Software, Inc., and its wholly and majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Certain prior year balances have been reclassified to conform to the current year presentation.

C. Revenue Recognition

We recognize revenue in accordance with Statement of Position No. 97-2: Software Revenue Recognition, (SOP 97-2) and Statement of Position No. 98-9: Modification of SOP 97-2, Software Revenue Recognition With Respect to Certain Transactions (SOP 98-9).

License. License revenue in connection with license agreements for standard proprietary software is recognized upon delivery of the software, providing collection is considered probable, the fee is fixed or determinable, there is evidence of an arrangement, and vendor specific objective evidence (VSOE) exists with respect to any undelivered elements of the arrangement. For multiple-element arrangements, we recognize revenue under the residual method as permitted by SOP 98-9, whereby (1) the total fair value of the undelivered elements, as indicated by VSOE, is deferred and subsequently recognized in accordance with SOP 97-2 and (2) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements. We record revenues from sales of third-party products net of royalties, in accordance with Emerging Issues Task Force Issue 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent (EITF 99-19). Furthermore, in accordance with EITF 99-19, we evaluate sales through our indirect channel on a case-by-case basis to determine whether the transaction should be recorded gross or net, including but not limited to assessing whether or not we: 1) act as principal in the transaction, 2) take title to the products, 3) have risks and rewards of ownership, such as the risk of loss for collection, delivery, or returns, and 4) act as an agent or broker with compensation on a commission or fee basis. Accordingly, our sales through the DMI channel are typically recorded on a gross basis.

Maintenance. Revenue derived from maintenance contracts primarily includes telephone consulting, product updates, and releases of new versions of products previously purchased by the customer, as well as error reporting and correction services. Maintenance contracts are typically sold for a separate fee with initial contractual periods ranging from one to three years with renewal for additional periods thereafter. Maintenance fees are generally billed annually in advance. Maintenance revenue is recognized ratably over the term of the maintenance agreement. In situations where all or a portion of the maintenance fee is bundled with the license fee, VSOE for maintenance is determined based on prices when sold separately.

Services. Revenue derived from services primarily includes consulting, implementation, and training. Fees are billed under primarily time and materials arrangements and are recognized as services are performed. In accordance with the FASB's Emerging Issues Task Force Issue No. 01-14: Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred (EITF No. 01-14), the Company recognizes amounts received for reimbursement of travel and other out-of-pocket expenses incurred as revenue in the consolidated statements of operations under services and other.



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements – Unaudited (continued)
January 31, 2006

Indirect Channel Revenue. Revenues are recognized for sales made through indirect channels principally when the distributor makes the sale to an end-user, when the license fee is fixed or determinable, the license fee is nonrefundable, and all other conditions of SOP 97-2 and SOP 98-9 are met.

Deferred Revenue. Deferred revenue represents advance payments or billings for software licenses, services, and maintenance billed in advance of the time revenue is recognized.

D. Major Customer

One customer accounted for 15% and 13% of our total revenues for the three and nine months ended January 31, 2006 and one customer accounted for 17% and 14% of our total revenues for the three and nine months ended January 31, 2005. The related accounts receivable balance for the customer as of January 31, 2006 was approximately \$1.0 million.

E. Declaration of Dividend Payable

On November 18, 2005, our Board of Directors declared a quarterly cash dividend of \$0.07 per share of American Software Class A and Class B common stock. The cash dividend is payable on March 3, 2006 to Class A and Class B shareholders of record at the close of business on February 17, 2006.

F. Earnings Per Common Share

We compute basic net earnings per common share available to common shareholders based on the weighted-average number of Class A and B common shares outstanding, since we consider the two classes of common stock as one class for purposes of the per share computation. For periods in which we have net earnings, we base diluted net earnings per common share available to common shareholders on the weighted-average number of common shares outstanding and dilutive potential common shares, such as dilutive stock options.



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements – Unaudited (continued)
January 31, 2006

We use the same numerator in calculating both basic and diluted net earnings per common share for a given period. We base the denominator on the number of common shares as shown in the following table:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2006	2005	2006	2005
	(in thousands, except per share data)		(in thousands, except per share data)	
Common Shares:				
Weighted average common shares outstanding:				
Class A Shares	20,663	20,232	20,592	20,113
Class B Shares	3,425	3,549	3,425	3,566
Basic weighted average common shares outstanding	24,088	23,781	24,017	23,679
Dilutive effect of outstanding Class A common stock options outstanding, net of income taxes	1,261	1,408	1,212	1,415
Total	25,349	25,189	25,229	25,094
Net earnings	\$ 1,987	\$ 50	\$ 3,830	\$ 2,681
Earnings per common share:				
Basic	\$ 0.08	\$ 0.00	\$ 0.16	\$ 0.11
Diluted	\$ 0.08	\$ 0.00	\$ 0.15	\$ 0.11

For the three months ended January 31, 2006, we excluded options to purchase 233,721 shares of common stock and for the nine months ended January 31, 2006, we excluded options to purchase 278,950 shares of common stock from the computation of diluted earnings per share of common stock. For the three months ended January 31, 2005, we excluded options to purchase 287,486 shares of common stock from the computation of diluted earnings per share, and for the nine months ended January 31, 2005, we excluded options to purchase 292,244 shares of common stock from that computation. We excluded these option share amounts because the exercise prices of those options were greater than the average market price of the common stock during the applicable period. As of January 31, 2006, we had a total of 3,263,932 options outstanding and as of January 31, 2005 we had a total of 3,297,435 options outstanding.

G. Acquisitions

On September 30, 2004, our Logility subsidiary acquired, through a wholly-owned subsidiary, certain assets and the distribution channel of privately-held Demand Management, Inc. (“DMI”), a St. Louis-based provider of supply chain planning systems marketed under the Demand Solutions® brand, for \$9.5 million in cash, less working capital and cash on hand, for a net cash consideration of \$8.7 million. We have included the results of operations from DMI in the accompanying condensed consolidated financial statements effective October 1, 2004.

The following unaudited pro forma information presents our results of operations for the nine months ended January 31, 2005 as if the acquisition had taken place at the beginning of the periods presented (in thousands, except per share data):

	Nine Months Ended January 31, 2005
Total revenues	\$ 51,214
Net earnings	3,463
Net earnings per common share (basic)	0.15
Net earnings per common share (diluted)	\$ 0.14
Weighted average number of common shares outstanding (basic)	23,679
Weighted average number of common shares outstanding (diluted)	25,094



These pro forma results of operations include adjustments to the historical financial statements of the consolidated companies and have been prepared for comparative purposes only. These pro forma results do not purport to be indicative of our actual results of operations had the acquisition occurred at May 1, 2004 or which may occur in the future.

In accordance with SFAS No. 141, "Business Combinations," we have accounted for the acquisition under the purchase method of accounting. The fair values of the assets acquired and liabilities assumed represent management's estimates of current fair values. We allocated the total purchase price to the net tangible assets and intangible assets acquired based on management's estimates of fair value at the date of acquisition. We based the allocation of the total purchase price to the acquired technology and other intangible assets, including trade names and maintenance contracts, on such estimates. The estimating process included analyses based on income, cost, and market approaches. We initially allocated \$6.1 million of the total purchase price to goodwill, which is deductible for income tax purposes.



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements – Unaudited (continued)
January 31, 2006

The calculation of the total purchase price was as follows (in thousands):

Tangible Net Book Value	\$ 805
Business Restructuring	(15)
Acquisition Expenses	(358)
Intangible Asset to be Amortized	2,400
Goodwill	<u>5,809</u>
Net Cash Outlay	8,641
Working Capital Adjustment	640
Closing Cash	219
Total Purchase Price	<u>\$9,500</u>

The following allocation of the total purchase price reflects the fair value of the assets acquired and liabilities assumed as of September 30, 2004 (in thousands):

Accounts receivable	\$ 1,997
Deferred sales commissions	780
Prepaid expenses and other current assets	156
Property and equipment	26
Other non-current assets	179
Intangible assets ¹	2,400
Goodwill	5,809
Accounts payable	(1,043)
Accrued expenses and other current liabilities	(513)
Deferred revenue	<u>(1,150)</u>
Total Cash Outlay	8,641
Working capital adjustment	640
Cash and cash equivalents	219
Total Purchase Price	<u>\$ 9,500</u>

¹ Includes \$1 million for contractual distributor relationships, \$800,000 for customer relationships, and \$300,000 for trademarks, all of which are subject to straight-line amortization over a period of six years. Also includes \$300,000 for current technology, which is subject to straight-line amortization over a period of three years.

SFAS 141 requires that an acquiring enterprise allocate the cost of an entity acquired in a business combination to the individual assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The fair value of maintenance deferred revenues in a business combination generally is not readily available and, accordingly, in practice, the fair value of an assumed liability (which must arise from a legal performance obligation) related to deferred revenue is estimated based on the direct cost of fulfilling the obligation plus a normal profit margin thereon. Also, in practice, the normal profit margin is limited to the profit margin on the costs to provide the product or service (that is, the fulfillment effort).

Management has completed the purchase accounting related to this acquisition. During the quarter ended October 31, 2005, we reversed the purchase accounting accrual related to certain contingent liabilities, which totaled approximately \$294,000 and reduced goodwill by this same amount.



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements – Unaudited (continued)
January 31, 2006

Logility Share Repurchase

On June 27, 2005, Logility, Inc., our now approximately 88% owned subsidiary, purchased 247,189 shares of its common stock for approximately \$1.5 million. In accordance with SFAS No. 141, “Business Combinations,” we have accounted for this transaction under the purchase method of accounting. As mentioned in our Quarterly Report on Form 10-Q for the period ended July 31, 2005, we have completed the allocation process, which included analyses based on income, cost, and market approaches, of this transaction. As a result of our additional analyses, we determined that under step acquisition accounting a portion of the purchase should be allocated to goodwill, which reduced the non-cash tax effects by approximately \$358,000 and altered the allocation of the transaction amount to the various assets.

The adjusted total amount allocated from this transaction was \$1.2 million (previously \$1.6 million), which includes approximately \$237,000 (previously \$595,000) related to the non-cash tax effects of this treasury stock purchase. We have allocated the \$1.2 million to capitalized software development costs, totaling approximately \$318,000, intangible assets, totaling approximately \$305,000, and goodwill, totaling approximately \$584,000, based on management’s estimates of fair value at the date of the transaction. The costs allocated to capitalized software development costs and intangible assets are being amortized ratably based on the projected revenues associated with the related assets of Logility, Inc. or on a straight-line basis over three to six years, whichever method results in a higher level of amortization. Amortization of these capitalized costs is included in the cost of license revenues and general and administrative costs in the accompanying condensed consolidated statements of operations for capitalized software development costs and intangible assets, respectively. We expect to incur approximately \$81,000 of amortization expense related to this transaction in fiscal 2006.

H. Stock Compensation Plans

As permitted under SFAS No. 148, Accounting for Stock-Based Compensation – Transaction and Disclosure, which amended SFAS No. 123, Accounting for Stock-Based Compensation, we have elected to continue to follow the intrinsic-value based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations including Financial Accounting Standards Board (FASB) Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25, to account for our fixed-plan stock options. Under this method, we record compensation expense on the date of grant



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements – Unaudited (continued)
January 31, 2006

generally if the current market price of the underlying stock exceeds the exercise price. No stock-based employee compensation cost is reflected in operations, as all options granted under those plans have an exercise price equal to or above the market value of the underlying common stock on the date of grant.

The following table illustrates the proforma effect on net earnings as if we had applied the fair-value based method in each period:

	Three months ended January 31,		Nine months ended January 31,	
	2006	2005	2006	2005
	(In thousands, except per share data)		(In thousands, except per share data)	
Net earnings (loss) as reported	\$ 1,987	\$ 50	\$ 3,830	\$ 2,681
Less total stock-based compensation expense determined under fair value based method for all awards	(275)	(267)	(766)	(827)
Pro forma net earnings (loss)	<u>\$ 1,712</u>	<u>\$ (217)</u>	<u>\$ 3,064</u>	<u>\$ 1,854</u>
Basic earnings (loss) per share:				
As reported	\$ 0.08	\$ 0.00	\$ 0.16	\$ 0.11
Pro forma	\$ 0.07	\$ (0.01)	\$ 0.13	\$ 0.08
Diluted earnings (loss) per share:				
As reported	\$ 0.08	\$ 0.00	\$ 0.15	\$ 0.11
Pro forma	\$ 0.07	\$ (0.01)	\$ 0.12	\$ 0.07

On December 16, 2004, the FASB issued FASB Statement No. 123 (revised 2004), Share-Based Payment, which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. Statement 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123 (R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

Statement 123(R) must be adopted no later than May 1, 2006. Early adoption will be permitted in periods in which financial statements have not yet been issued.

Statement 123(R) permits public companies to adopt its requirements using one of two methods:

1. A “modified prospective” method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123(R) for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date.
2. A “modified retrospective” method, which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements – Unaudited (continued)
January 31, 2006

We will be adopting Statement 123(R) beginning May 1, 2006 and are currently in the process of evaluating the impact and which method will be adopted.

As permitted by Statement 123, we currently account for share-based payments to employees using APB Opinion 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of Statement 123(R)'s fair value method may have a significant impact on our results of operations. The impact of adopting Statement 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had the Company adopted 123(R) in prior periods, the Company believes the impact of that standard would have approximated the pro forma impact described above except for the impact of the write-off, against income tax expense, of the deferred tax asset associated with recognized compensation costs which were lower than those projected by the original valuation of the share-based payment. Statement 123(R) also requires the benefit of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under the current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. The Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options). In the past, the operating cash flows of the Company have not benefited from such excess deductions.

I. Comprehensive Income

We have adopted Statement of Financial Accounting Standards (SFAS) No. 130, Reporting Comprehensive Income. SFAS No. 130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. We have not included condensed consolidated statements of comprehensive income in the accompanying unaudited condensed consolidated financial statements since comprehensive income and net earnings presented in the accompanying condensed consolidated statements of operations would be substantially the same.

J. Industry Segments

We have adopted SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. We operate and manage our business in three segments based on software and services provided in three key product markets: (i) Enterprise Resource Planning, which automates customers' internal financing, human resources, and manufacturing functions; (ii) Collaborative Supply Chain Management, which provides business-to-business collaborative commerce solutions to optimize supply chain operations for manufacturers, distributors and retailers; and (iii) IT Consulting, which consists of IT staffing and consulting services. The Collaborative Supply Chain Management segment represents the business of our 88%-owned subsidiary Logility, Inc., including its subsidiary, DMI. In the following table, we have broken down the intersegment transactions applicable to the three and nine months ended January 31, 2006 and January 31, 2005:



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements – Unaudited (continued)
January 31, 2006

	Three Months Ended		Nine Months Ended	
	January 31,		January 31,	
	2006	2005	2006	2005
Revenues:				
Enterprise Resource Planning	\$ 5,284	\$ 5,565	\$15,829	\$17,066
Collaborative Supply Chain Management	10,050	7,115	27,228	17,377
IT Consulting	5,034	4,682	13,111	11,501
	<u>\$20,368</u>	<u>\$17,362</u>	<u>\$56,168</u>	<u>\$45,944</u>
Operating income (loss) before intersegment eliminations:				
Enterprise Resource Planning	\$ 109	\$ 422	\$ 307	\$ 1,737
Collaborative Supply Chain Management	2,172	(224)	4,199	(502)
IT Consulting	(162)	334	139	672
	<u>\$ 2,119</u>	<u>\$ 532</u>	<u>\$ 4,645</u>	<u>\$ 1,907</u>
Intersegment eliminations:				
Enterprise Resource Planning	\$ (418)	\$ (427)	\$ (1,206)	\$ (1,180)
Collaborative Supply Chain Management	418	427	1,206	1,180
IT Consulting	—	—	—	—
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Operating income (loss) after intersegment eliminations:				
Enterprise Resource Planning	\$ (309)	\$ (5)	\$ (899)	\$ 557
Collaborative Supply Chain Management	2,590	203	5,405	678
IT Consulting	(162)	334	139	672
	<u>\$ 2,119</u>	<u>\$ 532</u>	<u>\$ 4,645</u>	<u>\$ 1,907</u>
Capital expenditures:				
Enterprise Resource Planning	\$ 210	\$ 89	\$ 391	\$ 587
Collaborative Supply Chain Management	61	127	147	227
IT Consulting	—	—	—	—
	<u>\$ 271</u>	<u>\$ 216</u>	<u>\$ 538</u>	<u>\$ 814</u>
Capitalized Software:				
Enterprise Resource Planning	\$ —	\$ 315	\$ (220)	\$ 451
Collaborative Supply Chain Management	537	703	1,771	2,084
IT Consulting	—	—	—	—
	<u>\$ 537</u>	<u>\$ 1,018</u>	<u>\$ 1,551</u>	<u>\$ 2,535</u>
Depreciation and amortization:				
Enterprise Resource Planning	\$ 219	\$ 315	\$ 760	\$ 839
Collaborative Supply Chain Management	387	725	1,675	2,383
IT Consulting	1	—	2	2
	<u>\$ 607</u>	<u>\$ 1,040</u>	<u>\$ 2,437</u>	<u>\$ 3,224</u>
			January 31,	April 30,
			2006	2005
Identifiable assets:				
Enterprise Resource Planning		48,703	52,747	
Collaborative Supply Chain Management		54,577	47,809	
IT Consulting		4,259	3,789	
		<u>107,539</u>	<u>104,345</u>	



AMERICAN SOFTWARE, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements – Unaudited (continued)
January 31, 2006

K. Leases

We have various operating and facilities leases. Expense under these operating and facilities leases was \$121,000 and \$572,000 for the three and nine months ended January 31, 2006 and \$330,000 and \$921,000 for the three and nine months ended January 31, 2005.

L. Subsequent Event

On February 21, 2006, our Board of Directors declared a quarterly cash dividend of \$0.07 per share of American Software Class A and Class B common stock. The cash dividend is payable on June 2, 2006 to Class A and Class B shareholders of record at the close of business on May 19, 2006.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

This report on Form 10-Q contains forward-looking statements relating to our future financial performance, business strategy, financing plans and other future events that involve uncertainties and risks. You can identify these statements by forward-looking words such as “anticipate”, “intend”, “plan”, “continue”, “could”, “grow”, “may”, “potential”, “predict”, “strive”, “will”, “seek”, “estimate”, “believe”, “expect”, and similar expressions that convey uncertainty of future events or outcomes. Any forward-looking statements we make herein are pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements include statements concerning future:

- results of operations;
- liquidity, cash flow and capital expenditures;
- demand for and pricing of our products and services;
- acquisition activities and the effect of completed acquisitions;
- industry conditions and market conditions; and
- general economic conditions.

Although we believe that the goals, plans, expectations, and prospects that our forward-looking statements reflect are reasonable in view of the information currently available to us, those statements are not guarantees of performance. There are many factors that could cause our actual results to differ materially from those anticipated by forward-looking statements made herein. These factors include, but are not limited to, continuing economic uncertainty, the timing and degree of business recovery, unpredictability and the irregular pattern of future revenues, competitive pressures, delays and other risks associated with new product development, the difficulty of predicting the effectiveness and duration of third-party marketing agreements, undetected software errors, and risks associated with market acceptance of our products and services. We discuss certain factors in greater detail in “Business Overview”, below. The terms “fiscal 2006” and “fiscal 2005” refer to our fiscal years ending April 30, 2006 and 2005, respectively.



ECONOMIC OVERVIEW

Corporate capital spending trends and commitments are the primary determinants of the size of the market for business software. Corporate capital spending is, in turn, a function of general economic conditions in the U.S. and abroad. In recent years, the weakness in the overall world economy, and the U.S. economy in particular, has resulted in reduced expenditures in the business software market. Overall Information Technology spending, while still relatively weak when compared to the period prior to the last economic downturn, appears to be improving steadily. We believe Information Technology spending has continued to improve during Fiscal 2006 and will continue to improve as increased global competition forces companies to improve productivity by upgrading their technology environment systems.

Although this improvement could slow or regress at any time, we believe that our organizational and financial structure will enable us to take advantage of any sustained economic rebound. While our sales pipelines are improving, customers continue to take longer to evaluate discretionary software purchases than generally was the case prior to the economic downturn.

BUSINESS OVERVIEW

American Software, Inc. (“American Software” or the “Company”) was incorporated as a Georgia corporation in 1970. We develop, market and support a portfolio of software and services that deliver enterprise management and collaborative supply chain solutions to the global marketplace. We have designed our software and services to bring business value to enterprises by supporting their operations over intranets, extranets, client/servers or the Internet. References to “the Company,” “our products,” “our software,” “our services” and similar references include the appropriate business unit actually providing the product or service.

We provide our software solutions through three major business segments, which are further broken down into a total of four major product and service groups. The three business segments are (1) Enterprise Resource Planning (“ERP”), (2) Collaborative Supply Chain Management (“SCM”), and (3) Information Technology (“IT”) Consulting. The Collaborative Supply Chain Management segment consists of Logility, Inc., an 88% owned subsidiary that provides collaborative supply chain solutions to streamline and optimize the production, distribution and management of products between trading partners. The ERP segment consists of (i) American Software ERP, which provides purchasing and materials management, customer order processing, financial, e-commerce, Flow Manufacturing and traditional manufacturing solutions, and (ii) New Generation Computing (NGC), which provides industry specific business software to both retailers and manufacturers in the Apparel, Sewn Products and Furniture industries. The IT Consulting segment consists of The Proven Method, an IT staffing and consulting services firm.

On September 30, 2004, Logility acquired certain assets and the distribution channel of privately-held Demand Management, Inc. (DMI), a St. Louis-based provider of supply chain planning systems marketed under the Demand Solutions® brand. The acquisition provided more than 800 active customers, which brought the Logility customer base to approximately 1,100 companies, located in 70 countries, and gives Logility what we believe to be the largest installed base of supply chain planning customers among application software vendors. Since the acquisition, Logility has continued to market and sell the Demand Solutions product line through Demand Management’s existing value-added reseller (VAR) distribution network. Logility also continues to offer the Logility Voyager Solutions™ suite to its traditional target market of upper-midsize to Fortune 1000 companies with distribution-intensive supply chains.

We derive revenues primarily from three sources: software licenses, services and other, and maintenance. We generally determine software license fees based on the number of modules, servers, users and/or sites licensed. Services and other revenues consist primarily of fees from software implementation, training, consulting and customization services. We bill under both time and materials and fixed fee arrangements, and recognize revenues as we perform services. We typically enter into maintenance agreements for a one- to three-year term at the time of the initial product license. We generally bill maintenance fees annually in advance under agreements with terms of one to three years, and then recognize the resulting revenues ratably over the term of the maintenance agreement. Deferred revenues represent advance payments or billings for software licenses, services and maintenance billed in advance of the time we recognize the related revenues.

Our cost of revenue for licenses includes amortization of capitalized computer software development costs, salaries and benefits, and royalties paid to third-party software vendors as well as agent commission expenses related to license revenues generated by the indirect channel primarily from DMI. Costs for maintenance and services include the cost of personnel to conduct implementations and customer support, consulting, and other personnel-related expenses as well as agent commission expenses related to maintenance revenues generated by the indirect channel primarily from DMI. We account for the development costs of software intended for sale in accordance with SFAS No. 86, “Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.” We monitor the net realizable value of our capitalized software on a quarterly basis based on an estimate of future product revenues. We currently expect to fully recover the value of the capitalized software asset recorded on our consolidated balance sheet; however, if future product revenues are less than management’s current expectations, we may incur a write-down of capitalized software costs.



Our selling expenses generally include the salary and commissions paid to our sales professionals, along with marketing, promotional, travel and associated costs. Our general and administrative expenses generally include the salary and benefits paid to executive, corporate and support personnel, as well as facilities related costs, utilities, communications expenses, and various professional fees. DMI sells its products primarily through indirect channels.

We currently view the following factors as the primary opportunities and risks associated with our business:

Strategic Relationships. We intend to expand the depth and number of strategic relationships with leading enterprise software, systems integrators and service providers to integrate our solutions into their services and products and to create joint marketing opportunities. We have a number of marketing alliances, including those with SAP, IBM and SSA Global Technologies. In addition, we have developed a network of international agents who assist in the sale and support of its products. We intend to utilize these and future relationships with software and service organizations to enhance our sales and marketing position.

Dependence on Capital Spending Patterns. There is risk associated with our dependence on, and the risks associated with, the capital spending patterns of U.S. and international businesses, which in turn are functions of economic trends and conditions over which we have no control.

Acquisition Opportunities. There are opportunities for select acquisitions or investments to provide opportunities to expand our sales distribution channels and/or broaden our product offering by providing additional solutions for our target markets.

Acquisition Risks. There are risks associated with acquisitions of complementary companies, products and technologies, including the risks that we will not achieve the financial and strategic goals that we contemplate at the time of the transaction. More specifically, in any acquisition we will face risks and challenges associated with the uncertain value of the acquired business or assets, the difficulty of assimilating operations and personnel, integrating acquired technologies and products and maintaining the loyalty of the customers of the acquired business.

Competitive Technologies. There is a risk that our competitors may develop technologies that are substantially equivalent or superior to our technology.

Competition in General. There are risks inherent in the market for business application software and related services, which has been and continues to be intensely competitive; for example, some of our competitors may become more aggressive with their prices and/or payment terms, which may adversely affect our profit margins.

Sarbanes-Oxley Section 404. Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include our assessment of the effectiveness of our internal control over financial reporting in our annual reports. Our independent registered public accounting firm is also required to attest to whether or not our assessment is fairly stated in all material respects and to separately report on whether or not they believe that we maintained, in all material respects, effective internal control over financial reporting. If for any fiscal year we fail to timely complete this assessment, or if our independent registered public accounting firm cannot timely attest to our assessment, we could be subject to regulatory sanctions and a possible loss of public confidence in the reliability of our financial reporting. Such a failure, as well as difficulties in implementing required new or improved controls, could result in our inability to provide timely and reliable financial information and could adversely affect our business.

A discussion of a number of additional risk factors associated with our business is included in our Annual Report on Form 10-K for the fiscal year ended April 30, 2005.



COMPARISON OF RESULTS OF OPERATIONS

Three-Month Comparisons. The following table sets forth certain revenue and expense items as a percentage of total revenues and the percentage changes in those items for the three months ended January 31, 2006 and 2005:

	Percentage of Total Revenues		Pct. Change in Dollars
	2006	2005	2006 vs 2005
Revenues:			
License	24%	22%	32%
Services and other	45	49	7
Maintenance	31	29	25
Total revenues	100	100	17
Cost of revenues:			
License	4	8	(45)
Services and other	35	34	18
Maintenance	9	10	4
Total cost of revenues	48	52	6
Gross margin	52	48	30
Research and development	9	8	32
Sales and marketing	18	19	12
General and administrative	15	18	5
Amortization of acquisition-related intangibles	—	—	nm
Provision for doubtful accounts	—	—	nm
Total operating expenses	42	45	11
Operating income	10	3	298
Other income:			
Interest income	2	2	47
Other, net	4	3	77
Earnings before income taxes	16	8	156
Income tax expense	(6)	(8)	(4)
Minority interest expense	(1)	—	nm
Net earnings (loss)	9%	—%	3,874%

nm - not meaningful



Nine-Month Comparisons. The following table sets forth certain revenue and expense items as a percentage of total revenues and the percentage changes in those items for the nine months ended January 31, 2006 and 2005:

	Percentage of Total Revenues		Pct. Change in Dollars
	2006	2005	2006 vs 2005
Revenues:			
License	24%	19%	51%
Services and other	44	50	9
Maintenance	32	31	27
Total revenues	100	100	22
Cost of revenues:			
License	5	7	(10)
Services and other	33	35	16
Maintenance	9	9	18
Total cost of revenues	47	51	13
Gross margin	53	49	32
Research and development	9	8	35
Sales and marketing	18	20	14
General and administrative	17	16	25
Amortization of acquisition-related intangibles	—	—	nm
Provision for doubtful accounts	—	1	nm
Total operating expenses	44	45	22
Operating income	9	4	144
Other income:			
Interest income	2	2	36
Other, net	2	2	24
Earnings before income taxes	13	8	85
Income tax expense	(5)	(3)	106
Minority interest expense	(1)	—	nm
Net earnings	7%	5%	43%

nm - not meaningful



COMPARISON OF RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED January 31, 2006 AND 2005

REVENUES:

For the three and nine months ended January 31, 2006, the increase in revenues from the three months ended January 31, 2005 was primarily attributable to an increase in license fees and maintenance revenues, and to a lesser extent an increase in services revenues. DMI contributed \$2.4 million in total revenues for the three months ended January 31, 2006, \$6.8 million in total revenues for the nine months ended January 31, 2006. International revenues represented approximately 7% and 8% of total revenues in the three and nine months ended January 31, 2006 and 7% and 6% for the three and nine months ended January 31, 2005. The year-to-date increase was due primarily to DMI which receives a larger portion of its revenue from international customers than Logility did prior to the acquisition. Our international revenues may fluctuate substantially from period to period primarily because we derive these revenues from a relatively small number of customers in a given period.

LICENSES. For the three and nine months ended January 31, 2006 the license fee revenues increased 32% and 51% when compared to the same periods in the prior year, due primarily to increased license fees from our Logility subsidiary as a result of an increase in overall license fees sales due to an improved selling environment and better sales execution and to a lesser extent the DMI acquisition. This increase was offset partially by a decrease in our ERP business unit. In the three months ended January 31, 2006, license fee revenues from Logility increased 65% to \$4.0 million, of which DMI contributed \$751,000. Logility constituted 81% and 75% of total license fee revenues for the three months and nine months ended January 31, 2006, compared to 65% and 51% for the three months and nine months ended January 31, 2005.

The direct sales channel provided approximately 86% of license fee revenues for the three months ended January 31, 2006, compared to approximately 71% in the comparable quarter a year ago. This increase was due primarily to improved sales execution and sales environment within our direct channel. For the three months ended January 31, 2006, our margins after commissions on direct sales were approximately 84%, and our margins after commissions on indirect sales were approximately 53%. These margin calculations include only commission expense for comparative purposes and do not include other costs of license fees such as amortization of capitalized software.

SERVICES AND OTHER. For the three and nine months ended January 31, 2006, the increases in services and other revenues were due primarily to increased services revenues from our Logility and IT consulting segment. For the three months ended January 31, 2006, our IT Consulting segment's revenues increased 8% when compared to the prior year quarter, to \$5.0 million from \$4.7 million. For the three months ended January 31, 2006, services and other revenues from Logility increased 11%, to \$1.4 million. This increase was due primarily to increased license fees in recent periods and was slightly offset by services associated with DMI software due to timing of implementation projects. We have observed that there is a tendency for services and other revenues, other than IT consulting, to lag changes in license revenues by one to three quarters, as new licenses in one quarter often involve implementation and consulting services in subsequent quarters, for which we recognize revenues only as we perform those services.

MAINTENANCE. For the three and nine months ended January 31, 2006, maintenance revenues increased primarily from Logility which increased 36% and 41% to \$4.7 million and \$13.1 million. Logility constituted 75% of total maintenance revenues for the three month period ended January 31, 2006, compared to 68% of total maintenance for the corresponding prior year period. The increases in maintenance revenues for the three months ended January 31, 2006 were due primarily to increased maintenance revenues resulting from the acquisition of DMI and increased license fees in prior periods resulting in new maintenance revenue in the current quarter. Typically, our maintenance revenues have had a direct relationship to current and historic license fee revenues, since new licenses are the potential source of new maintenance customers.

GROSS MARGIN:

The following table provides both dollar amounts and percentage measures of gross margin:

	Three months ended January 31,				Nine months ended January 31,			
	2006		2005		2006		2005	
(\$000's omitted)								
Gross margin on license fees:	\$ 4,205	85%	\$2,394	64%	\$10,555	79%	\$ 5,703	64%
Gross margin on services and other:	\$ 2,000	22%	\$2,522	30%	\$ 6,309	25%	\$ 6,885	30%
Gross margin on maintenance:	\$ 4,537	72%	\$3,356	66%	\$12,896	72%	\$ 9,918	70%
Total gross margin:	\$10,742	53%	\$8,272	48%	\$29,760	53%	\$22,506	49%

For the three and nine months ended January 31, 2006, the increase in total gross margin percentage was due primarily to an increase in license fee gross margin and the maintenance gross margin partially offset by a decrease in the services and other.



LICENSES. For the three and nine months ended January 31, 2006, gross margin on license fees increased primarily due to higher license fee revenues, and to a lesser extent decreased expense related to amortization of capitalized software development costs. License fee gross margin percentage tends to be directly related to the level of license fee revenues due to the relatively fixed cost of computer software amortization expense and amortization of acquired software, which are the primary components of cost of license fees, and to a lesser degree are related to the variable expense of DMI's agent commissions. We expect capitalized software amortization to increase in the fourth quarter of fiscal 2006 as projects achieve "general availability" and amortization commences.

SERVICES AND OTHER. For the three and nine months ended January 31, 2006, the decrease in services and other gross margin percentage was due primarily to the lower margin nature of services provided by our IT consulting segment, which accounted for a larger proportion of our total services and other revenues in those periods.

MAINTENANCE. Maintenance gross margin percentage was higher for three and nine months ended January 31, 2006 when compared to the same periods last year due to the increase in overall maintenance revenue and the DMI acquisition for the following reason: the purchase accounting write-down in DMI's deferred revenues associated with technical support services resulted in lower maintenance revenues that would have otherwise been recognized in the prior year quarter had no impact on the current quarter so the gross margin improved. We expect maintenance revenues and related margins during comparable future periods to continue to increase slightly, assuming retention of the current customer base.

EXPENSES

Research and Development

Gross product research and development costs include all non-capitalized and capitalized software development costs. A breakdown of the research and development costs is as follows:

	Three months ended (in thousands)		
	January 31, 2006	Percent Change	January 31, 2005
Total capitalized computer software development costs	\$ 537	(24)%	\$ 703
Percentage of gross product research and development costs	24%		35%
Total research and development expense	1,743	32%	1,320
Percentage of total revenues	9%		8%
Total research and development expense and capitalized computer software development costs	\$ 2,280	13%	\$ 2,023
Percentage of total revenues	11%		12%
Total amortization of capitalized computer software development costs	\$ 241	(59)%	\$ 592

	Nine months ended (in thousands)		
	January 31, 2006	Percent Change	January 31, 2005
Total capitalized computer software development costs	\$ 1,771	(15)%	\$ 2,084
Percentage of gross product research and development costs	27%		37%
Purchase accounting impact on share repurchases by subsidiary and related tax effect	(220)	nm	—
Percentage of total revenues	0%		
Total research and development expense	4,856	35%	3,601
Percentage of total revenues	9%		8%
Total research and development expense and capitalized computer software development costs	\$ 6,407	13%	\$ 5,685
Percentage of total revenues	11%		12%
Total amortization of capitalized computer software development costs	\$ 1,228	(44)%	\$ 2,206

nm: not meaningful



For the three and nine months ended January 31, 2006, gross product research and development costs increased when compared to the same periods last year and capitalized software development costs decreased when compared to the same periods last year. These changes were primarily due to the DMI acquisition, which added gross R&D costs but did not capitalize any R&D costs during the period. We expect capitalized product development costs to be lower in coming quarters as a result of fewer capitalizable R&D projects in the pipeline. However, we expect capitalized software amortization to increase in the fourth quarter as projects achieve “general availability” and amortization commences.

Capitalized computer software development costs include the effects of applying purchase accounting as a result of Logility, Inc.’s share repurchases.

Sales and Marketing

For the three and nine months ended January 31, 2006, the increase in sales and marketing expenses when compared to the same period a year ago was due primarily to an increase in sales commissions as a result of higher license fee sales when compared to the same period last year. In addition, marketing expenses increased from the DMI acquisition. We generally include commissions on indirect sales in cost of sales.

General and Administrative

For the three and nine months ended January 31, 2006, the increases in general and administrative expenses were due to an accrual for performance based compensation expenses, an increase audit fees and expenses related to the DMI acquisition. At January 31, 2006 and the same period last year the total number of employees was 312.

Other Income

Other income is comprised of interest and dividend income, rental income and realized and unrealized gains and losses from investments. For both the three and nine months ended January 31, 2006, the increase in other income was due primarily to unrealized gains on investments when compared to the prior year period.

Income Taxes

In the three months ended January 31, 2006, we recorded income tax expense of approximately \$1.3 million and in the nine months ended January 31, 2006, we recorded income tax expense of approximately \$2.8 million compared to \$1.3 million income tax expense recorded in the three and nine month periods ended January 31, 2005. We recognize deferred tax assets and liabilities based on the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their tax bases. We measure deferred tax assets and liabilities using statutory tax rates in effect in the year in which we expect the differences to reverse. We establish a deferred tax asset for the expected future benefit of net operating loss and credit carry-forwards. Under Statement of Financial Accounting Standards No. 109 (“SFAS No. 109”), “Accounting for Income Taxes”, we cannot recognize a deferred tax asset for the future benefit of our net operating losses, tax credits and temporary differences unless we can establish that it is “more likely than not” that the deferred tax asset would be realized.

Minority Interest

Minority interest is a function of our majority-owned subsidiaries’ earnings or losses, with minority interest losses recorded when these subsidiaries have earnings, and minority interest earnings recorded when they have losses. Due to Logility’s net earnings in the three and nine months ended January 31, 2006, we recorded minority interest expenses of approximately \$226,000 for the three months ended January 31, 2006 and \$745,000 for the nine months ended January 31, 2006. That is compared to our recording minority interest income of approximately \$23,000 and \$43,000 for comparable periods last year.

LIQUIDITY, CAPITAL RESOURCES AND FINANCIAL CONDITION

Sources and Uses of Cash

We have historically funded, and continue to fund, our operations and capital expenditures primarily with cash generated from operating activities. The changes in net cash that our operating activities provide generally reflect the changes in net earnings and non-cash operating items plus the effect of changes in operating assets and liabilities, such as investment trading securities, trade accounts receivable, trade accounts payable, accrued expenses and deferred revenue. We have no debt obligations or off-balance sheet financing arrangements, and therefore we used no cash for debt service purposes.

The following tables show information about our cash flows and liquidity positions during the nine months ended January 31, 2006 and January 31, 2005. You should read this table and the discussion that follows in conjunction with our condensed



consolidated statements of cash flows contained in “Item 1. Financial Statements” in Part I of this report and in our Annual Report on Form 10-K for the fiscal year ended April 30, 2005.

	Nine Months Ended January 31, (in thousands)	
	2006	2005
Net cash provided by operating activities	\$ 4,730	\$ 5,030
Net cash used in investing activities	(5,859)	(9,696)
Net cash used in financing activities	(4,340)	(3,660)
Net change in cash and cash equivalents	<u>\$ (5,469)</u>	<u>\$ (8,326)</u>

For the nine months ended January 31, 2006, the net decrease in cash provided by operating activities when compared to the same period last year was due primarily to the increase in accounts receivable. The decrease in cash used in investing activities when compared to the prior year period was due primarily to the purchase of DMI in the second fiscal quarter of fiscal 2005 for \$8.7 million. This was partially offset by increased purchase of treasury shares by our subsidiary. Cash used in financing activities increased when compared to the prior year period, due primarily to an increase in the quarterly dividends and less proceeds from the exercise of stock options.

During the period the Company recorded a receivable of approximately \$300,000 related to amounts due from a certain healthcare provider as a result of total claims expense incurred exceeding the aggregate cap for the year. This amount is included as component of Prepaid expenses and other current assets in the condensed consolidated balance sheet at January 31, 2006.

The following table shows net changes in total cash, cash equivalents, and investments, which is one measure management uses to view net total cash generated by our activities:

	As of January 31, (in thousands)	
	2006	2005
Cash and cash equivalents	\$25,678	\$29,204
Short and Long-Term Investments	32,833	27,705
Total cash and short and long-term investments	<u>\$58,511</u>	<u>\$56,909</u>
Net increase (decrease) in total cash and investments (nine months ended January 31)	\$ (550)	\$ (9,457)

Our total activities used cash and investments during the nine months ended January 31, 2006, when compared to the prior year period, due primarily to the changes in operating assets and liabilities noted above.

Days Sales Outstanding in accounts receivable were 76 days as of January 31, 2006, compared to 76 days as of January 31, 2005. This decrease was due primarily to improved collections. Our current ratio on January 31, 2006 was 3.1 to 1 and on January 31, 2005 was 3.2 to 1.

As a result of the positive cash flow from operations our business has generated in recent periods, and because we have \$58.5 million in cash and investments with no debt, we believe that our sources of liquidity and capital resources will be sufficient to satisfy our presently anticipated requirements during at least the next twelve months for working capital, capital expenditures and other corporate needs. However, at some future date we may need to seek additional sources of capital to meet our requirements. If such need arises, we may be required to raise additional funds through equity or debt financing. Neither we nor Logility currently have a bank line of credit. We can provide no assurance that bank lines of credit or other financing will be available on terms acceptable to us. If available, such financing may result in dilution to our shareholders or higher interest expense.

The sources of free cash flow that we have used for dividend payments include cash we generate through our operations (exclusive of cash that Logility generates), supplemented by our cash and investments (exclusive of Logility’s cash and investments).

On August 22, 2002, our Board of Directors approved a resolution authorizing the repurchase of up to 2.0 million shares of our Class A common stock. These repurchases have been and will be made through open market purchases at prevailing market prices. The timing of any repurchases will depend upon market conditions, the market price of our common stock and management’s assessment of our liquidity and cash flow needs. For this repurchase plan, through October 10, 2005, we have repurchased 247,232 shares of common stock at a cost of approximately \$1.1 million. We did not make any repurchases of our common stock in the quarter ended January 31, 2006. See Part II, Item 2 for a table summarizing stock repurchases in the last quarter and the number of remaining shares available for purchase under existing repurchase programs.



On December 15, 1997, our Board of Directors approved a resolution authorizing us to repurchase up to 350,000 shares of our common stock through open market purchases at prevailing market prices. We completed this repurchase plan in November 1998, at which time we adopted an additional repurchase plan for up to 800,000 shares. In February 2003, Logility's Board of Directors approved a resolution authorizing it to repurchase an additional 400,000 shares for a total authorized repurchase amount of 1,200,000 shares. The timing of any repurchases depends on market conditions, the market price of Logility's common stock and management's assessment of its liquidity and cash flow needs. For all repurchase plans, through October 10, 2005, Logility had purchased a cumulative total of approximately 1,281,000 shares at a total cost of approximately \$7.7 million. In the first quarter of fiscal 2006, Logility purchased approximately 272,000 shares of its common stock at an average price of \$6.00 per share for a total price of \$1.6 million. In the third quarter of fiscal 2006, Logility did not purchase any shares under this program. See Part II, Item 2 for a table summarizing stock repurchases in the last quarter and the number of remaining shares available for purchase under our existing repurchase program.

RECENT ACCOUNTING PRONOUNCEMENTS

On December 16, 2004, the FASB issued FASB Statement No. 123 (revised 2004), Share-Based Payment, which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. Statement 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123 (R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. Statement 123(R) must be adopted no later than May 1, 2006. Early adoption will be permitted in periods in which financial statements have not yet been issued.

Statement 123(R) permits public companies to adopt its requirements using one of two methods:

1. A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123(R) for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date.
2. A "modified retrospective" method, which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company will be adopting Statement 123(R) beginning May 1, 2006 and is currently in the process of evaluating its impact and which method it will adopt.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Critical accounting policies are those policies that are important to the portrayal of our financial condition and results of operations. These policies also require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. In our Annual Report on Form 10-K for the fiscal year ended April 30, 2005, as filed with the SEC, we described the policies and estimates relating to revenue recognition, allowance for doubtful accounts, valuation of acquired business, valuation of long-lived and intangible assets, valuation of capitalized software assets and income taxes as our critical accounting policies. Since then, we have made no changes to our reported critical accounting policies.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency. In the three and nine months ended January 31, 2006, we generated approximately 9% of our revenues outside the United States. We typically make international sales through our foreign subsidiaries or our Logility subsidiary and denominated those sales typically in U.S. Dollars, British Pounds Sterling or Euros. However, expenses incurred in connection with these sales are typically denominated in the local currencies. The effect of foreign exchange rate fluctuations on us in the three and nine months of fiscal 2006 were not material. In addition, a 10% movement in foreign currency rates would not have a material impact on our financial condition or results of operations. We have not engaged in any hedging activities.



Interest rates and other market risks. We manage our interest rate risk by maintaining an investment portfolio of trading and held-to-maturity investments with high credit quality and relatively short average maturities. These instruments include, but are not limited to, money-market instruments, bank time deposits, and taxable and tax-advantaged variable rate and fixed rate obligations of corporations, municipalities, and national, state, and local government agencies, in accordance with an investment policy approved by our Board of Directors. These instruments are denominated in U.S. dollars. The fair market value of securities as of January 31, 2006 was approximately \$57.7 million.

We also hold cash balances in accounts with commercial banks in the United States and foreign countries. These cash balances represent operating balances only and are invested in short-term time deposits of the local bank. Such operating cash balances held at banks outside the United States are denominated in the local currency and are minor.

Many of our investments carry a degree of interest rate risk. When interest rates fall, our income from investments in variable-rate securities declines. When interest rates rise, the fair market value of our investments in fixed-rate securities declines. In addition, our investments in equity securities are subject to stock market volatility. Due in part to these factors, our future investment income may fall short of expectations or we may suffer losses in principal if forced to sell securities, which have seen a decline in market value due to changes in interest rates. We attempt to mitigate risk by holding fixed-rate securities to maturity, but, if our liquidity needs force us to sell fixed-rate securities prior to maturity, we may experience a loss of principal. We believe that a 10% fluctuation in interest rates would not have a material effect on our accompanying statements of operations.

Inflation. Although we cannot accurately determine the amounts attributable thereto, we have been affected by inflation through increased costs of employee compensation and other operational expenses. To the extent permitted by the marketplace for our products and services, we attempt to recover increases in costs by periodically increasing prices.

Item 4. Controls and Procedures

Management's Report on Internal Control Over Financial Reporting

As of the end of the period covered by this report, our management evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) under the supervision and with the participation of our chief executive officer and chief financial officer. Based on and as of the date of such evaluation, the aforementioned officers have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were not effective.

In our Annual Report on Form 10-K for the fiscal year ended April 30, 2005, management identified material weaknesses in internal control over financial reporting related to Revenue Recognition and Accounting for Income Taxes. Accordingly, management concluded that our internal control over financial reporting was not effective as of April 30, 2005. Since that time, we implemented additional internal control over financial reporting to remediate these material weaknesses. These control improvements included:

Revenue recognition

- We have implemented a policy which lowered the threshold of license revenue contracts that must be reviewed by corporate headquarters.
- We have implemented lower thresholds for required reviews of revenue related analyses and calculations for license revenue contracts including a secondary review of the Company's non-standard multiple element arrangements.
- We have implemented the use of review templates to help ensure accuracy and identify changes to standard terms and conditions

Accounting for income taxes

- We have implemented enhanced procedures for the preparation and review of the accounting for income taxes, including hiring a regional accounting firm to further assist in the preparation on a quarterly and annual basis.
- We implemented review procedures to monitor and evaluate the realization of our deferred tax assets.
- We have accelerated the timing of the preparation of the quarterly and annual income tax provision and enhancing the levels of review of supporting documentation.



- We have engaged a regional accounting firm specializing in, among other things, tax and consulting services, to further assist the Company in its preparation of the quarterly and annual income tax provision.

In addition, we are in the process of making further changes to our internal control over financial reporting as described below:

Revenue recognition

- We are carrying out additional training of accounting personnel as it relates to revenue recognition standards.

These changes are part of our overall program that is intended to remediate all material weaknesses by April 30, 2006.

As of April 30, 2005, we excluded the internal controls of Demand Management, Inc. (“DMI”) from our assessment of internal controls. DMI was acquired in September 2004 by Logility, Inc., an 88%-owned subsidiary of the Company as of January 31, 2006, and DMI constituted 11% of our consolidated assets at January 31, 2006 and 12% of our consolidated revenues for the three months ended January 31, 2006.



PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are not currently involved in legal proceedings requiring disclosure under this item.

Item 1A. Risk Factors

We have no material changes to the risk factors as described in our Annual Report on Form 10-k for our fiscal year ended April 30, 2005.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes repurchases of our stock in the three months ended January 31, 2006:

Fiscal Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs*
November 1, 2005 through November 30, 2005	0	\$ 0.00	0	1,752,768
December 1, 2005 through December 31, 2005	0	\$ 0.00	0	1,752,768
January 1, 2006 through January 31, 2006	0	\$ 0.00	0	1,752,768
Total Fiscal 2006 Third Quarter	0	\$ 0.00	0	1,752,768

* Our Board of Directors approved the above share purchase authority on August 19, 2002, when the Board approved a resolution authorizing the Company to repurchase up to 2.0 million shares of Class A common stock. This action was announced on August 22, 2002. The authorization has no expiration date.

The following table summarizes repurchases of stock made by our Logility subsidiary in the three months ended January 31, 2006:

Fiscal Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs*
November 1, 2005 through November 30, 2005	0	\$ 0.00	0	268,896
December 1, 2005 through December 31, 2005	0	\$ 0.00	0	268,896
January 1, 2006 through January 31, 2006	0	\$ 0.00	0	268,896
Total Fiscal 2006 Third Quarter	0	\$ 0.00	0	268,896

* The Logility Board of Directors approved the above share purchase authority in November 1998 and in February 2003, when the Logility Board approved resolutions authorizing Logility to repurchase an aggregate of up to 1.2 million shares of common stock. These actions were announced in November 1998 and on February 19, 2003, respectively. The authorizations have no expiration dates.



Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibits 31.1-31.2. Rule 13a-14(a)/15d-14(a) Certifications

Exhibit 32.1. Section 906 Certifications

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AMERICAN SOFTWARE, INC.

Date: March 9, 2006

By: /s/ James C. Edenfield
 James C. Edenfield
 President, Chief Executive Officer and Treasurer

Date: March 9, 2006

By: /s/ Vincent C. Klinges
 Vincent C. Klinges
 Chief Financial Officer

Date: March 9, 2006

By: /s/ Herman L. Moncrief
 Herman L. Moncrief
 Controller and Principal Accounting Officer



EXHIBIT 31.1

RULE 13a-14(a)/15d-14(a) CERTIFICATION

I, James C. Edenfield, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of American Software, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 9, 2006

By: /s/ James C. Edenfield
James C. Edenfield
Chief Executive Officer



EXHIBIT 31.2

RULE 13a-14(a)/15d-14(a) CERTIFICATION

I, Vincent C. Klinges, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of American Software, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 9, 2006

By: /s/ Vincent C. Klinges
Vincent C. Klinges
Chief Financial Officer



Exhibit 32.1

**Certifications Pursuant to Section 906 of
The Sarbanes-Oxley Act of 2002 (18 U.S.C Section 1350)**

The undersigned, as the Chief Executive Officer of American Software, Inc., certifies that, to the best of his knowledge and belief, this report on Form 10-Q for the fiscal quarter ended January 31, 2006 (the "Report"), which accompanies this certification, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of American Software, Inc. at the dates and for the periods indicated. The foregoing certification is made pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350) and shall not be relied upon for any other purpose.

This 9th day of March, 2006

/s/ James C. Edenfield
James C. Edenfield
Chief Executive Officer

The undersigned, as the Chief Financial Officer of American Software, Inc., certifies that, to the best of his knowledge and belief, this report on Form 10-Q for the fiscal quarter ended January 31, 2006 (the "Report"), which accompanies this certification, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of American Software, Inc. at the dates and for the periods indicated. The foregoing certification is made pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350) and shall not be relied upon for any other purpose.

This 9th day of March, 2006

/s/ Vincent C. Klinges
Vincent C. Klinges
Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to American Software, Inc. and will be retained by American Software, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

The information in this Exhibit 32.1 shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.