

ULTIMATE SOFTWARE GROUP INC
Form 10-Q
August 09, 2010

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

FORM 10-Q

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

For the quarterly period ended June 30, 2010

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

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

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

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

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

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of August 3, 2010, there were 25,096,745 shares of the Registrant's Common Stock, par value \$0.01, outstanding.

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

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

| | As of June 30, 2010 | As of December 31, 2009 |
|--|---------------------------|-------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 22,691 | \$ 23,684 |
| Short-term investments in marketable securities | 8,169 | 8,079 |
| Accounts receivable, net of allowance for doubtful accounts of \$800 for 2010 and \$600 for 2009 | 42,099 | 38,450 |
| Prepaid expenses and other current assets | 18,358 | 15,594 |
| Deferred tax assets, net | 1,142 | 1,128 |
| Total current assets before funds held for customers | 92,459 | 86,935 |
| Funds held for customers | 48,444 | 23,560 |
| Total current assets | 140,903 | 110,495 |
| Property and equipment, net | 18,057 | 19,496 |
| Capitalized software, net | 3,790 | 4,463 |
| Goodwill | 3,025 | 3,198 |
| Long-term investments in marketable securities | 1,119 | 1,444 |
| Other assets, net | 11,318 | 12,298 |
| Long-term deferred tax assets, net | 20,246 | 19,736 |
| Total assets | \$ 198,458 | \$ 171,130 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 4,922 | \$ 4,476 |
| Accrued expenses | 12,026 | 9,972 |
| Current portion of deferred revenue | 61,468 | 60,980 |
| Current portion of capital lease obligations | 1,967 | 1,897 |
| Total current liabilities before customer funds obligations | 80,383 | 77,325 |
| Customer funds obligations | 48,444 | 23,560 |
| Total current liabilities | 128,827 | 100,885 |
| Deferred revenue, net of current portion | 7,536 | 7,579 |
| Deferred rent | 3,081 | 3,186 |
| Capital lease obligations, net of current portion | 1,803 | 1,710 |
| Total liabilities | 141,247 | 113,360 |
| Stockholders' equity: | | |

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| | | |
|---|------------|------------|
| Preferred Stock, \$.01 par value, 2,000,000 shares authorized, no shares issued or outstanding | - | - |
| Series A Junior Participating Preferred Stock, \$.01 par value, 500,000 shares authorized, no shares issued or outstanding | - | - |
| Common Stock, \$.01 par value, 50,000,000 shares authorized, 28,212,156 and 27,620,384 shares issued in 2010 and 2009, respectively | 282 | 276 |
| Additional paid-in capital | 196,311 | 184,256 |
| Accumulated other comprehensive income (loss) | 10 | (696) |
| Accumulated deficit | (54,749) | (54,410) |
| | 141,854 | 129,426 |
| Treasury stock, 3,385,925 and 2,985,425 shares, at cost, for 2010 and 2009, respectively | (84,643) | (71,656) |
| Total stockholders' equity | 57,211 | 57,770 |
| Total liabilities and stockholders' equity | \$ 198,458 | \$ 171,130 |

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

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (In thousands, except per share amounts)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|--|------------|--------------------------------------|------------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenues: | | | | |
| Recurring | \$ 41,365 | \$ 32,544 | \$ 80,813 | \$ 63,366 |
| Services | 13,032 | 13,407 | 28,613 | 29,322 |
| License | 320 | 1,274 | 948 | 3,275 |
| Total revenues | 54,717 | 47,225 | 110,374 | 95,963 |
| Cost of revenues: | | | | |
| Recurring | 12,048 | 9,534 | 23,452 | 18,407 |
| Services | 11,877 | 11,095 | 25,058 | 23,406 |
| License | 50 | 261 | 150 | 598 |
| Total cost of revenues | 23,975 | 20,890 | 48,660 | 42,411 |
| Gross profit | 30,742 | 26,335 | 61,714 | 53,552 |
| Operating expenses: | | | | |
| Sales and marketing | 14,580 | 12,884 | 29,696 | 26,719 |
| Research and development | 10,520 | 9,469 | 20,753 | 18,695 |
| General and administrative | 5,169 | 4,322 | 10,170 | 8,870 |
| Total operating expenses | 30,269 | 26,675 | 60,619 | 54,284 |
| Operating income (loss) | 473 | (340) | 1,095 | (732) |
| Other income (expense): | | | | |
| Interest expense and other | (61) | (28) | (106) | (64) |
| Other income, net | 45 | 39 | 67 | 111 |
| Total other income (expense), net | (16) | 11 | (39) | 47 |
| Income (loss) from continuing operations before income taxes | | | | |
| | 457 | (329) | 1,056 | (685) |
| (Provision) benefit for income taxes | (186) | 72 | (465) | 88 |
| Income (loss) from continuing operations | \$ 271 | \$ (257) | \$ 591 | \$ (597) |
| Loss from discontinued operations, net of income taxes | | | | |
| | (865) | (73) | (930) | (146) |
| Net loss | \$ (594) | \$ (330) | \$ (339) | \$ (743) |
| Basic earnings (loss) per share: | | | | |
| Earnings (loss) from continuing operations | \$ 0.01 | \$ (0.01) | \$ 0.02 | \$ (0.02) |
| Loss from discontinued operations | \$ (0.03) | - | \$ (0.04) | \$ (0.01) |
| Total | \$ (0.02) | \$ (0.01) | \$ (0.02) | \$ (0.03) |

Diluted earnings (loss) per share:

| | | | | |
|--|------------|------------|------------|------------|
| Earnings (loss) from continuing operations | \$ 0.01 | \$ (0.01) | \$ 0.02 | \$ (0.02) |
| Loss from discontinued operations | \$ (0.03) | – | \$ (0.03) | \$ (0.01) |
| Total | \$ (0.02) | \$ (0.01) | \$ (0.01) | \$ (0.03) |

Weighted average shares outstanding:

| | | | | |
|---------|--------|--------|--------|--------|
| Basic | 24,839 | 24,414 | 24,797 | 24,354 |
| Diluted | 26,972 | 24,414 | 26,911 | 24,354 |

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

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

| | For the Six Months Ended June 30, | |
|---|--------------------------------------|-----------|
| | 2010 | 2009 |
| Cash flows from operating activities: | | |
| Net loss | \$ (339) | \$ (743) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 6,108 | 5,914 |
| Provision for doubtful accounts | 1,038 | 528 |
| Non-cash stock-based compensation expense | 6,725 | 6,590 |
| Non-cash realized loss on foreign currency translation adjustment | 886 | - |
| Deferred income taxes | (524) | (140) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (4,687) | 3,958 |
| Prepaid expenses and other current assets | (2,764) | 576 |
| Other assets | 755 | 98 |
| Accounts payable | 446 | (3,778) |
| Accrued expenses and deferred rent | 1,949 | (1,418) |
| Deferred revenue | 445 | (1,005) |
| Net cash provided by operating activities | 10,038 | 10,580 |
| Cash flows from investing activities: | | |
| Purchases of marketable securities | (4,600) | (1,090) |
| Maturities of marketable securities | 4,835 | 5,295 |
| Net purchases of securities with customer funds | (24,884) | (1,574) |
| Capitalized software | - | (631) |
| Purchases of property and equipment | (2,401) | (2,109) |
| Net cash used in investing activities | (27,050) | (109) |
| Cash flows from financing activities: | | |
| Repurchases of Common Stock | (12,987) | - |
| Net proceeds from issuances of Common Stock | 4,936 | 1,719 |
| Excess tax benefit from employee stock plan | 950 | - |
| Shares acquired to settle employee tax withholding liability | (552) | - |
| Principal payments on capital lease obligations | (1,206) | (1,226) |

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| | | |
|--|-----------|-----------|
| Net increase in customer fund obligations | 24,884 | 1,574 |
| Net cash provided by financing activities | 16,025 | 2,067 |
| Effect of exchange rate changes on cash | (6) | (15) |
| Net (decrease) increase in cash and cash equivalents | (993) | 12,523 |
| Cash and cash equivalents, beginning of period | 23,684 | 17,200 |
| Cash and cash equivalents, end of period | \$ 22,691 | \$ 29,723 |

Supplemental disclosure of cash flow information:

| | | |
|----------------------------|--------|--------|
| Cash paid for interest | \$ 100 | \$ 73 |
| Cash paid for income taxes | \$ 136 | \$ 128 |

Supplemental disclosure of non-cash financing activities:

- Ultimate entered into capital lease obligations to acquire new equipment totaling \$1.4 million and \$1.2 million for the six months ended June 30, 2010 and June 30, 2009, respectively.
- Ultimate entered into an agreement to purchase certain source code from a third-party vendor for \$2.0 million, of which \$0.5 million was paid during the six months ended June 30, 2009. There were no payments during the six months ended June 30, 2010 as this was fully paid as of June 30, 2009.

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

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND
 COMPREHENSIVE INCOME (LOSS)

(In thousands)

| | Common Stock | | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Accumulated Deficit | Treasury Stock | | Total Stockholders' Equity |
|--|--------------|--------|----------------------------------|---|------------------------|----------------|-------------|----------------------------------|
| | Shares | Amount | | | | Shares | Amount | |
| Balance, December 31, 2009 | 27,620 | \$ 276 | \$ 184,256 | \$ (696) | \$ (54,410) | 2,985 | \$ (71,656) | \$ 57,770 |
| Net loss | – | – | – | – | (339) | – | – | (339) |
| Realized foreign currency translation adjustment | – | – | – | 886 | – | – | – | 886 |
| Unrealized loss on foreign currency translation adjustments | – | – | – | (178) | – | – | – | (178) |
| Unrealized loss on investments in marketable securities | – | – | – | (2) | – | – | – | (2) |
| Comprehensive income (loss) | – | – | – | – | – | – | – | 367 |
| Issuances of Common Stock from exercises of stock options | 424 | 4 | 4,930 | – | – | – | – | 4,934 |
| Issuances of Common Stock from restricted stock releases | 168 | 2 | – | – | – | – | – | 2 |
| Shares acquired to settle employee tax withholding liability | – | – | (552) | – | – | – | – | (552) |
| Excess tax benefit from employee stock | – | – | 950 | – | – | – | – | 950 |

| | | | | | | | | |
|---|--------|--------|------------|-------|-------------|-------|-------------|-----------|
| plan | | | | | | | | |
| Repurchases of Common Stock | - | - | - | - | - | 401 | (12,987) | (12,987) |
| Non-cash stock-based compensation | - | - | 6,727 | - | - | - | - | 6,727 |
| Balance, June 30, 2010 | 28,212 | \$ 282 | \$ 196,311 | \$ 10 | \$ (54,749) | 3,386 | \$ (84,643) | \$ 57,211 |

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

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations

The Ultimate Software Group, Inc. and subsidiaries (“Ultimate,” “we,” “us,” or “our”) is the leading provider of unified, end-to-end human capital management (“HCM”) software-as-a-service (“SaaS”) solutions in North America. Ultimate’s solutions are available as two solution suites, based on company size. UltiPro Enterprise (“Enterprise”) was developed to address the needs of companies with 1,000 or more employees and UltiPro Workplace (“Workplace”) was developed for companies with fewer than 1,000 employees. UltiPro is marketed primarily through our Enterprise and Workplace direct sales teams.

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

The accompanying unaudited condensed consolidated financial statements of Ultimate have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. The information in this quarterly report should be read in conjunction with Ultimate’s audited consolidated financial statements and notes thereto included in Ultimate’s Annual Report on Form 10-K for the fiscal year ended December 31, 2009 filed with the SEC on March 5, 2010 (the “Form 10-K”).

The unaudited condensed consolidated financial statements included herein reflect all adjustments (consisting only of normal, recurring adjustments) which are, in the opinion of Ultimate’s management, necessary for a fair presentation of the information for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Interim results of operations for the three and six months ended June 30, 2010 and June 30, 2009 are not necessarily indicative of operating results for the full fiscal year or for any future periods.

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

The unaudited condensed consolidated statements of cash flows reflect certain reclassifications from cash flows from operations to cash flows from financing activities. This reclassification is immaterial to the presentation of the unaudited condensed consolidated statements of cash flows for the six months ended June 30, 2010 and 2009.

The presentation of the unaudited condensed consolidated statements of operations has been modified to conform with reporting requirements for discontinued operations. See Note 4 below for further explanation.

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3. Summary of Significant Accounting Policies and Recent Accounting Pronouncements

Summary of Significant Accounting Policies

Ultimate's significant accounting policies discussed in Note 3 to its audited consolidated financial statements for the fiscal year ended December 31, 2009, included in the Form 10-K, have not significantly changed.

Recently Issued Accounting Pronouncements

In April 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2010-17, "Revenue Recognition-Milestone Method (Topic 605) Milestone Method of Revenue Recognition" ("ASU 2010-17"). ASU 2010-17 provides guidance on defining a milestone and determining when the use of the milestone method of revenue recognition for research and development transactions is appropriate. It provides criteria for evaluating if the milestone is substantive and clarifies that a vendor can recognize consideration that is contingent upon achievement of a milestone as revenue in the period in which the milestone is achieved, if the milestone meets all the criteria to be considered substantive. ASU 2010-17 is effective prospectively for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early adoption is permitted. If a company elects early adoption and the period of adoption is not the beginning of its fiscal year, the requirements must be applied retrospectively to the beginning of the fiscal year. We do not believe the adoption of ASU 2010-17 will have a material impact on our consolidated financial statements.

In October 2009, the FASB issued ASU 2009-13 (EITF 08-1), "Multiple-Deliverable Revenue Arrangements" ("ASU 2009-13 (EITF 08-1)"). ASU 2009-13 (EITF 08-1) amends Accounting Standards Codification ("ASC") Subtopic 605-25, "Revenue Recognition-Multiple-Element Arrangements" ("ASC Subtopic 605-25"), which sets forth requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered.

ASC Subtopic 605-25 requires that there be objective and reliable evidence of the standalone selling price of the undelivered items which must be supported by either vendor-specific objective evidence ("VSOE") or third-party evidence ("TPE").

ASU 2009-13 (EITF 08-1) will eliminate the requirement that all undelivered elements have VSOE or TPE before an entity can recognize the portion of an overall arrangement fee that is attributable to items that already have been delivered. In the absence of VSOE or TPE of the standalone selling price for one or more delivered or undelivered elements in a multiple-element arrangement, entities will be required to estimate the selling prices of those elements. The overall arrangement fee will be allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on the entity's estimated selling price. Application of the "residual method" of allocating an overall arrangement fee between delivered and undelivered elements will no longer be permitted upon adoption of ASU 2009-13 (EITF 08-1). Additionally, the new guidance will require entities to disclose more information about their multiple-element revenue arrangements. ASU 2009-13 (EITF 08-1) is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. If a company elects early adoption and the period of adoption is not the beginning of its fiscal year, the requirements must be applied retrospectively to the beginning of the fiscal year. We are evaluating the impact of ASU 2009-13 (EITF 08-1) and do not believe the adoption of ASU 2009-13 (EITF 08-1) will have a material impact on our consolidated financial statements.

4. Discontinued Operations

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During the second quarter of 2010, Ultimate discontinued the operations of The Ultimate Software Group UK Limited, our wholly-owned subsidiary in the United Kingdom (the "UK Subsidiary"). Loss from discontinued operations, net of income taxes, for the three months ended June 30, 2010, was principally comprised of \$0.9 million from the realization of a non-cash foreign currency translation adjustment. The discontinuation of the operations of the UK Subsidiary was substantially complete as of June 30, 2010.

The financial results of discontinued operations of the UK Subsidiary are as follows (in thousands):

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|--|-----------|--------------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Total revenues | \$ 10 | \$ 80 | \$ 48 | \$ 160 |
| Pretax income (loss) from UK Subsidiary operations | \$ 18 | \$ (101) | \$ (59) | \$ (198) |
| Loss from disposal of UK Subsidiary (for foreign currency translation adjustment) | (886) | – | (886) | – |
| Pretax loss from discontinued operations | (868) | (101) | (945) | (198) |
| Income tax benefit | 3 | 28 | 15 | 52 |
| Loss from discontinued operations, net of income taxes | \$ (865) | \$ (73) | \$ (930) | \$ (146) |

The assets and liabilities of the UK Subsidiary were immaterial, both individually and in the aggregate, and, therefore, are not presented separately in the unaudited condensed financial statements and notes thereto.

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

We classify our investments in marketable securities with readily determinable fair values as available-for-sale. Available-for-sale securities consist of debt and equity securities not classified as trading securities or as securities to be held to maturity. Unrealized gains and losses on available-for-sale securities are reported as a net amount in accumulated other comprehensive income or loss in stockholders' equity until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. Included in accumulated other comprehensive loss was \$4 thousand and \$6 thousand of unrealized gains on available-for-sale securities at June 30, 2010 and December 31, 2009, respectively.

The amortized cost, net unrealized gain and fair value of our investments in marketable available-for-sale securities as of June 30, 2010 and December 31, 2009 are shown below (in thousands):

| | As of June 30, 2010 | | | As of December 31, 2009 | | |
|---------------------|---------------------|---------------------|------------|-------------------------|---------------------|------------|
| | Amortized Cost | Net Unrealized Gain | Fair Value | Amortized Cost | Net Unrealized Gain | Fair Value |
| Corporate | | | | | | |
| debtures – bonds | \$ 2,868 | \$ 1 | \$ 2,869 | \$ 3,025 | \$ 3 | \$ 3,028 |
| Commercial paper | 600 | – | 600 | 1,499 | – | 1,499 |
| Agency bonds | 2,419 | – | 2,419 | 1,407 | 1 | 1,408 |
| International | | | | | | |
| government bond | 305 | – | 305 | – | – | – |
| U.S. Treasury bills | 998 | 1 | 999 | 1,995 | 2 | 1,997 |
| U.S. Treasury | | | | | | |
| bonds | 1,004 | 2 | 1,006 | 501 | – | 501 |
| Certificates of | | | | | | |
| deposit | 1,090 | – | 1,090 | 1,090 | – | 1,090 |
| Total investments | \$ 9,284 | \$ 4 | \$ 9,288 | \$ 9,517 | \$ 6 | \$ 9,523 |

The amortized cost and fair value of the marketable available-for-sale securities by contractual maturity as of June 30, 2010 are shown below (in thousands):

| | As of June 30, 2010 | |
|-------------------------|---------------------|------------|
| | Amortized Cost | Fair Value |
| Due in one year or less | \$ 8,164 | \$ 8,169 |
| Due after one year | 1,120 | 1,119 |
| Total | \$ 9,284 | \$ 9,288 |

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

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

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

Our assets that are measured by management at fair value on a recurring basis are generally classified within Level 1 or Level 2 of the fair value hierarchy. We did not have available-for-sale securities within Level 3 as of June 30, 2010 and December 31, 2009. The types of instruments valued based on quoted market prices in active markets include most money market securities and certificates of deposit. Such instruments are generally classified within Level 1 of the fair value hierarchy. We did not have any significant transfers into and out of Level 1 and Level 2 during the six months ended June 30, 2010 and the twelve months ended December 31, 2009.

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The types of instruments valued by management, based on quoted prices in less active markets, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency, include Ultimate's corporate debentures and bonds, commercial paper, agency bonds, international government bond and U.S. Treasury bills and bonds. Such instruments are generally classified within Level 2 of the fair value hierarchy. Ultimate uses consensus pricing, which is based on multiple pricing sources, to value its fixed income investments.

The following table sets forth, by level within the fair value hierarchy, financial assets accounted for at fair value as of June 30, 2010 and December 31, 2009 (in thousands):

| | As of June 30, 2010 | | | As of December 31, 2009 | | |
|-------------------------|---------------------|---|--|-------------------------|---|--|
| | Total | Quoted Prices in Active Markets (Level 1) | Other Observable Inputs (Level 2) | Total | Quoted Prices in Active Markets (Level 1) | Other Observable Inputs (Level 2) |
| Corporate | | | | | | |
| debtentures-bonds | \$ 2,869 | \$ - | \$ 2,869 | \$ 3,028 | \$ - | \$ 3,028 |
| Commercial paper | 600 | - | 600 | 1,499 | - | 1,499 |
| Agency bonds | 2,419 | - | 2,419 | 1,408 | - | 1,408 |
| International | | | | | | |
| government bond | 305 | - | 305 | - | - | - |
| U.S. Treasury bills | 999 | - | 999 | 1,997 | - | 1,997 |
| U.S. Treasury bonds | 1,006 | - | 1,006 | 501 | - | 501 |
| Certificates of deposit | 1,090 | 1,090 | - | 1,090 | 1,090 | - |
| Total | \$ 9,288 | \$ 1,090 | \$ 8,198 | \$ 9,523 | \$ 1,090 | \$ 8,433 |

Financial assets and liabilities measured at fair value on a recurring basis were presented in the unaudited condensed consolidated balance sheet as of June 30, 2010 and in the audited consolidated balance sheet as of December 31, 2009 as short-term and long-term investments in marketable securities. There were no financial liabilities accounted for at fair value as of June 30, 2010 and December 31, 2009.

6. Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Property and equipment are depreciated using the straight-line method over the estimated useful lives of the assets, which range from two to twenty years. Leasehold improvements and assets under capital leases are amortized over the shorter of the estimated useful life of the asset or the term of the lease, which range from three to fifteen years. Maintenance and repairs are charged to expense when incurred; betterments are capitalized. Upon the sale or retirement of assets, the cost, accumulated depreciation and amortization are removed from the accounts and any gain or loss is recognized.

Property and equipment as of June 30, 2010 and December 31, 2009 consisted of the following (in thousands):

| | As of June 30, 2010 | As of December 31, 2009 |
|---|------------------------|----------------------------|
| Property and equipment | \$ 76,340 | \$ 72,717 |
| Less: accumulated depreciation and amortization | 58,283 | 53,221 |
| | \$ 18,057 | \$ 19,496 |

7. Earnings Per Share

Basic earnings per share is computed by dividing net income available to common stockholders (the numerator) by the weighted average number of common shares outstanding (the denominator) for the period. The computation of diluted earnings per share is similar to basic earnings per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares had been issued. Due to the discontinued operations of the UK Subsidiary, income from continuing operations was used in determining whether potential common shares are dilutive or anti-dilutive. For the three and six months ended June 30, 2010, potential common shares were dilutive due to income from continuing operations. For the three and six months ended June 30, 2009, potential common shares were anti-dilutive due to a loss from continuing operations.

The following is a reconciliation of the shares used in the computation of basic and diluted earnings (loss) per share for the three and six months ended June 30, 2010 and 2009 (in thousands):

| | For the Three Months Ended June 30, | | For the Six Months ended June 30, | |
|---|--|--------|--------------------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Basic weighted average shares outstanding | 24,839 | 24,414 | 24,797 | 24,354 |
| Effect of dilutive equity instruments | 2,133 | – | 2,114 | – |
| Dilutive weighted average shares outstanding | 26,972 | 24,414 | 26,911 | 24,354 |
| Options to purchase shares of common stock and other stock-based awards outstanding which are not included in the calculation of diluted earnings (loss) per share because their impact is anti-dilutive | 59 | 6,317 | 56 | 6,361 |

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8. Comprehensive Income (Loss)

Comprehensive income (loss) represents all changes in equity that result from transactions and other economic events in a period other than transactions with owners. Accumulated other comprehensive income (loss), as presented in the accompanying unaudited condensed consolidated balance sheets, consists of unrealized gains and losses on available-for-sale securities and foreign currency translation adjustments, recorded net of any related income tax.

For the three and six months ended June 30, 2010, we realized a foreign currency translation adjustment for the discontinued operations of our UK Subsidiary. This was recorded in discontinued operations and represents the reclassification of prior period net unrealized losses from other comprehensive income (loss).

Comprehensive income (loss) for the three and six months ended June 30, 2010 and 2009 was as follows (in thousands):

| | For the Three Months ended June 30, | | For the Six Months ended June 30, | |
|--|--|-----------|--------------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Net loss (1) | \$ (594) | \$ (330) | \$ (339) | \$ (743) |
| Other comprehensive income (loss) | | | | |
| Realized foreign currency translation adjustment | 886 | – | 886 | – |
| Unrealized gain (loss) on investments in marketable securities available-for-sale | (1) | 2 | (2) | (1) |
| Unrealized gain (loss) on foreign currency translation adjustments | (41) | 456 | (178) | 395 |
| Comprehensive income (loss) | \$ 250 | \$ 128 | \$ 367 | \$ (349) |

- (1) Pursuant to applicable accounting rules, the amount attributable to the UK Subsidiary and accumulated in the translation adjustment component of equity became realized in the unaudited condensed consolidated statement of operations during the second quarter of 2010, the period in which discontinuation of the operations for the UK Subsidiary were substantially complete.

9. Foreign Currency

The financial statements of Ultimate's foreign subsidiaries have been translated into U.S. dollars. The functional currency of our wholly-owned subsidiary The Ultimate Software Group of Canada, Inc. is the Canadian dollar and the functional currency of the UK Subsidiary is the British pound. Assets and liabilities are translated into U.S. dollars at period-end exchange rates. Income and expenses are translated at the average exchange rate for the reporting period. The resulting translation adjustments, representing unrealized gains or losses, are included in unaudited condensed consolidated stockholders' equity as a component of accumulated other comprehensive income (loss). Realized gains and losses resulting from foreign exchange transactions are included in total operating expenses in the unaudited condensed consolidated statements of operations. For the three and six months ended June 30, 2010, Ultimate had a realized foreign currency translation loss of \$0.9 million included in loss from discontinued operations for its UK Subsidiary. There was no realized foreign currency translation gain or loss from discontinued operations for the three and six months ended June 30, 2009. For the three and six months ended June 30, 2010, Ultimate had cumulative unrealized translation losses of \$41 thousand and \$6 thousand, respectively. For the three and six months ended June 30, 2009, Ultimate had cumulative unrealized translation gains of \$456 thousand and \$395 thousand, respectively. Included in accumulated other comprehensive income (loss), as presented in the accompanying

unaudited condensed consolidated balance sheets, is \$6 thousand of unrealized translation gain at June 30, 2010 and \$0.7 million in unrealized translation losses at December 31, 2009.

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10. Stock-Based Compensation

Our Amended and Restated 2005 Equity and Incentive Plan (the “Plan”) authorizes the grant of options to non-employee directors, officers and employees of Ultimate to purchase shares of Ultimate’s Common Stock (“Options”). The Plan also authorizes the grant to such persons of restricted and non-restricted shares of Common Stock, stock appreciation rights, stock units and cash performance awards (collectively, the “Awards”). Prior to the adoption of the Plan, options to purchase shares of Common Stock were issued under Ultimate’s Nonqualified Stock Option Plan (the “Prior Plan”).

As of June 30, 2010, the aggregate number of shares of Common Stock authorized under the Plan and the Prior Plan was 12,500,000 and the aggregate number of shares of Common Stock that were available to be issued under all Awards granted under the Plan was 1,027,076 shares.

The following table sets forth the non-cash stock-based compensation expense resulting from stock-based arrangements that was recorded in our unaudited condensed consolidated statements of operations for the periods indicated (in thousands):

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|--|----------|--------------------------------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| Non-cash stock-based compensation expense: | | | | |
| Cost of recurring revenues | \$ 224 | \$ 171 | \$ 441 | \$ 336 |
| Cost of services revenues | 322 | 324 | 663 | 668 |
| Sales and marketing | 1,642 | 1,747 | 3,361 | 3,534 |
| Research and development | 341 | 308 | 668 | 610 |
| General and administrative | 805 | 724 | 1,592 | 1,439 |
| Total non-cash stock-based compensation expense | \$ 3,334 | \$ 3,274 | \$ 6,725 | \$ 6,587 |

Net cash proceeds from the exercise of stock options were \$2.6 million and \$4.9 million for the three and six months ended June 30, 2010, respectively, and \$1.3 million and \$1.7 million for the three and six months ended June 30, 2009, respectively. There was a \$0.3 million and \$0.9 million income tax benefit recognized in addition paid in capital from the realization of excess stock-based payment deductions during the three and six months ended June 30, 2010. There was no income tax benefit recognized from stock option exercises during the three and six months ended June 30, 2009.

Stock Option, Restricted Stock and Restricted Stock Unit Activity

There were no stock options granted during the six months ended June 30, 2010. The following table summarizes stock option activity (for previously granted stock options) for the six months ended June 30, 2010 (in thousands, except per share amounts):

| Stock Options | Shares | Weighted Average | Weighted Average Remaining Contractual | Aggregate Intrinsic Value |
|---------------|--------|---------------------|---|---------------------------------|
| | | | | |

| | | Exercise Price | Term (in Years) | |
|----------------------------------|--------|-------------------|--------------------|-----------|
| Outstanding at December 31, 2009 | 4,165 | \$ 17.79 | 5.55 | \$ 49,687 |
| Granted | — | — | | |
| Exercised | (424) | 11.64 | | |
| Forfeited or expired | (11) | 27.49 | | |
| Outstanding at June 30, 2010 | 3,730 | \$ 18.46 | 5.31 | \$ 53,813 |
| Exercisable at June 30, 2010 | 3,411 | \$ 17.50 | 5.08 | \$ 52,496 |

The aggregate intrinsic value of stock options in the table above represents total pretax intrinsic value (i.e., the difference between the closing price of Ultimate's Common Stock on the last trading day of the reporting period and the exercise price, times the number of shares) that would have been received by the option holders had all option holders exercised their options on June 30, 2010. The amount of the aggregate intrinsic value changes based on the fair value of Ultimate's Common Stock. Total intrinsic value of options exercised was \$6.2 million and \$9.2 million for the three and six months ended June 30, 2010, respectively, and \$1.6 million and \$2.2 million for the three and six months ended June 30, 2009, respectively. Total fair value of options vested during the three and six months ended June 30, 2010 was \$0.5 million and \$3.9 million, respectively, and \$0.5 million and \$3.7 million during the three and six months ended June 30, 2009, respectively.

As of June 30, 2010, \$1.9 million of total unrecognized compensation costs related to non-vested stock options is expected to be recognized over a weighted average period of 0.79 years.

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During the three months ended June 30, 2010 and June 30, 2009, we granted Restricted Stock Awards for 8,210 shares and 9,580 shares, respectively, of Common Stock to non-employee directors. There were 15,375 and 10,300 Restricted Stock Unit Awards granted to employees during the three months ended June 30, 2010 and June 30, 2009, respectively. During the three months ended June 30, 2010, there were no shares of Common Stock previously issued under Restricted Stock Awards that became vested. During the three months ended June 30, 2009, 35,000 shares of Common Stock previously issued under Restricted Stock Awards became vested. During the three months ended June 30, 2010, 3,006 shares became payable under Restricted Stock Unit Awards that vested during such period. 1,127 of such shares were retained by Ultimate and not issued, in satisfaction of withholding tax requirements applicable to payment of such Awards, and 1,879 of such shares were issued to the holders of such Awards. No Restricted Stock Unit Awards became vested and no payments were made under Restricted Stock Unit Awards during the three months ended June 30, 2009.

The following table summarizes restricted stock and restricted stock unit activity for the six months ended June 30, 2010 (in thousands, except per share amounts):

| | Restricted Stock Awards | | Restricted Stock Unit Awards |
|----------------------------------|-------------------------|--|------------------------------|
| | Shares | Weighted Average Grant Date Fair Value | Shares |
| Outstanding at December 31, 2009 | 1,405 | \$ 24.36 | 247 |
| Granted | 17 | 31.06 | 156 |
| Released | (105) | 21.60 | (82) |
| Forfeited or expired | — | — | (4) |
| Outstanding at June 30, 2010 | 1,317 | \$ 24.66 | 317 |

As of June 30, 2010, \$14.1 million of total unrecognized compensation costs related to non-vested Restricted Stock Awards were expected to be recognized over a weighted average period of 1.84 years. As of June 30, 2010, \$5.9 million of total unrecognized compensation costs related to non-vested Restricted Stock Unit Awards were expected to be recognized over a weighted average period of 2.15 years.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of the financial condition and results of operations of The Ultimate Software Group, Inc. and subsidiaries ("Ultimate," "we," "us," or "our") should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q (the "Form 10-Q") and in Ultimate's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, filed with the Securities and Exchange Commission (the "SEC") on March 5, 2010 (the "Form 10-K").

Ultimate's significant accounting policies discussed in Note 3 to its audited consolidated financial statements for the fiscal year ended December 31, 2009, included in the Form 10-K, have not significantly changed.

Overview

Ultimate is the leading provider of unified, end-to-end human capital management ("HCM") software-as-a-service ("SaaS") solutions in North America.

Ultimate's UltiPro software ("UltiPro") is a comprehensive Internet-based solution delivered primarily as an online service and designed to deliver the functionality businesses need to manage the complete employment life cycle from recruitment to retirement. The solution includes feature sets for talent acquisition and onboarding, HCM and compliance, benefits management and online enrollment, payroll, performance management, salary planning and budgeting for compensation management, reporting and analytical decision-making tools, time and attendance, and a self-service Web portal for executives, managers, administrators, and employees.

Our SaaS offering of UltiPro (the "SaaS Offering"), provides online access to comprehensive HCM functionality for organizations that want to simplify the information technology ("IT") support requirements of their business applications. We have found that our SaaS Offering is attractive to companies that want to focus on their core competencies to increase sales and profits. Through the SaaS Offering, we supply and manage the hardware, infrastructure, ongoing maintenance and backup services for our customers. Customer systems are managed at three data centers, one located in the Miami, Florida area, one in the Atlanta, Georgia area, and another in Toronto, Canada. All data centers are owned and operated by independent third parties.

UltiPro is available as two solution suites, based on company size. UltiPro Enterprise ("Enterprise") was developed to address the needs of companies with 1,000 or more employees and is delivered primarily through SaaS but is also available as an on-premise solution. UltiPro Workplace ("Workplace") was designed for companies with fewer than 1,000 employees and is delivered exclusively through SaaS. UltiPro Workplace provides medium-sized and smaller companies with nearly all the features that larger Enterprise companies have with UltiPro, plus a bundled services package. Since many companies in this market do not have information technology staff on their premises to help with system issues, UltiPro Workplace is designed to give these customers a high degree of convenience by handling system setup, business rules, and other situations for customers "behind the scenes." UltiPro is marketed primarily through Ultimate's Enterprise and Workplace direct sales teams.

In addition to UltiPro's core HCM functionality, Ultimate's customers have the option to purchase a number of additional features on a per-employee-per-month (or "PEPM") basis, which are available to enhance the functionality of UltiPro's core features based on certain business needs of the customers. These optional UltiPro features currently include (i) the talent management suite of products (recruitment, onboarding, performance management, salary planning and budgeting for compensation management, and employee relations tools for managing disciplinary actions, grievances, and succession planning); (ii) benefits enrollment; (iii) time, attendance and scheduling; (iv) time management, (v) tax filing; (vi) wage attachments; and (vii) other optional features (collectively, "Optional Features"). All Optional Features are individually priced solely on a subscription basis. Some of the Optional Features are available to both Enterprise and Workplace customers while others are available exclusively to either Enterprise or

Workplace customers, based on the needs of the respective customers, including their employee size and the complexity of their HCM environment.

The key drivers of our business are growth in sales production and the retention of the underlying customers, once our solutions are sold. For the quarter, our total revenues grew by 16% and our customer retention was 96%, on a trailing twelve-month basis.

Ultimate has two primary revenue sources: recurring revenues and services revenues. Revenues from our SaaS Offering and maintenance revenues are the primary components of recurring revenues in Ultimate's unaudited condensed consolidated statements of operations. The majority of services revenues are derived from implementation services and, to a lesser extent, training services.

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Effective April 1, 2009, Ultimate discontinued selling its on-site UltiPro solutions to new customers on a perpetual license basis, although we continue to sell on-site UltiPro solutions on a subscription basis (priced and billed to customers on a PEPM basis). We sell licenses to existing license customers but only in relation to the customer's employee growth or for Optional Features if they already have a perpetual license for the on-site UltiPro solutions. After the elimination of new sales of perpetual licenses, the variable costs associated with licenses, such as sales commissions, have also been eliminated. However, there remain certain fixed third-party costs that were formerly allocated to costs of license revenues (in proportion to their contribution to the total sales mix) which have been shifted to costs of recurring revenues. As perpetual license agreements were sold, annual maintenance contracts (priced as a percentage of the related license fee) accompanied those agreements. Maintenance contracts typically have a one-year term with annual renewal periods thereafter. We have historically maintained a steady customer retention rate for our renewal maintenance agreements and do not believe our decision to discontinue new sales of perpetual license agreements will materially affect our future maintenance revenues (as they relate to existing license customers).

As SaaS units are sold, the recurring revenue backlog associated with the SaaS Offering grows, enhancing the predictability of future revenue streams. SaaS sales of UltiPro include a one-time upfront (or setup) fee, priced on a per-employee basis, and ongoing monthly fees, priced on a PEPM basis. Revenue recognition for the SaaS Offering is triggered when the related customer processes its first payroll (or goes "Live"). When a SaaS customer goes Live, the related upfront fees are recognized as recurring subscription revenues ratably over the term of the related contract (typically 24 months) and we begin recognizing the associated ongoing monthly PEPM fees.

During the second calendar quarter of 2010, Ultimate discontinued the operations of The Ultimate Software Group UK Limited, our wholly-owned subsidiary in the United Kingdom. Loss from discontinued operations, net of income taxes, for the three months ended June 30, 2010, was principally comprised of \$0.9 million from the realization of a non-cash foreign currency translation adjustment.

Critical Accounting Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Ultimate's critical accounting estimates, as discussed in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in the Form 10-K, have not significantly changed.

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Results of Operations

The following table sets forth the unaudited condensed consolidated statements of operations data of Ultimate, as a percentage of total revenues, for the periods indicated:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|--|----------|--------------------------------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenues: | | | | |
| Recurring | 75.6 % | 68.9 % | 73.2 % | 66.0 % |
| Services | 23.8 | 28.4 | 25.9 | 30.6 |
| License | 0.6 | 2.7 | 0.9 | 3.4 |
| Total revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of revenues: | | | | |
| Recurring | 22.0 | 20.2 | 21.2 | 19.2 |
| Services | 21.7 | 23.4 | 22.8 | 24.4 |
| License | 0.1 | 0.6 | 0.1 | 0.6 |
| Total cost of revenues | 43.8 | 44.2 | 44.1 | 44.2 |
| Operating expenses: | | | | |
| Sales and marketing | 26.7 | 27.3 | 26.9 | 27.8 |
| Research and development | 19.2 | 20.0 | 18.8 | 19.5 |
| General and administrative | 9.4 | 9.2 | 9.2 | 9.2 |
| Total operating expenses | 55.3 | 56.5 | 54.9 | 56.5 |
| Operating income (loss) | 0.9 | (0.7) | 1.0 | (0.7) |
| Other income (expense): | | | | |
| Interest expense and other | (0.1) | – | (0.1) | (0.1) |
| Other income, net | – | – | – | 0.1 |
| Total other income (expense), net | (0.1) | – | (0.1) | – |
| Income (loss) from continuing operations | | | | |
| before income taxes | 0.8 | (0.7) | 0.9 | (0.7) |
| (Expense) benefit for income taxes | (0.3) | 0.2 | (0.4) | 0.1 |
| Income (loss) from continuing operations | 0.5 | (0.5) | 0.5 | (0.6) |
| Loss from discontinued operations, net of taxes | (1.6) | (0.2) | (0.8) | (0.2) |
| Net income (loss) | (1.1) % | (0.7) % | (0.3) % | (0.8) % |

Revenues

Our revenues are derived from recurring revenues and services revenues and, to a lesser extent, license revenues. Our significant revenue recognition policies, as discussed in Note 3 to our audited consolidated financial statements for the fiscal year ended December 31, 2009, included in the Form 10-K, have not changed.

Total revenues, consisting of recurring, services and license revenues, increased 15.9% to \$54.7 million for the three months ended June 30, 2010 from \$47.2 million for the three months ended June 30, 2009, and 15.0% to \$110.4 million for the six months ended June 30, 2010 from \$96.0 million for the six months ended June 30, 2009.

Recurring revenues increased 27.1 % to \$41.4 million for the three months ended June 30, 2010 from \$32.5 million for the three months ended June 30, 2009, and 27.5% to \$80.8 million for the six months ended June 30, 2010 from

\$63.4 million for the six months ended June 30, 2009. The increases for the three and six months ended June 30, 2010 were primarily due to an increase in revenues from our SaaS Offering. Revenues from our SaaS Offering increased 40.7% and 41.0% for the three and six months ended June 30, 2010, respectively, in comparison to the same periods in 2009. The increases were based on the revenue impact of incremental units sold that have gone Live since June 30, 2009, including UltiPro and, to a lesser extent, Optional Features of UltiPro. Recognition of recurring subscription revenues from sales of our SaaS Offering begins when the related customer goes Live.

Services revenues decreased 2.8% to \$13.0 million for the three months ended June 30, 2010 from \$13.4 million for the three months ended June 30, 2009 and 2.4% to \$28.6 million for the six months ended June 30, 2010 from \$29.3 million for the six months ended June 30, 2009. The decreases for the three and six months ended June 30, 2010 were mainly due to (i) less billable hours from fewer Ultimate revenue-generating consultants for Enterprise sales and (ii) a decrease in the Enterprise blended net rate per hour, partially offset by (iii) higher implementation revenues recognized for Workplace sales.

License revenues decreased 74.9% to \$0.3 million for the three months ended June 30, 2010, from \$1.3 million for the three months ended June 30, 2009. For the six months ended June 30, 2010, license revenues decreased 71.1% to \$0.9 million from \$3.3 million for the six months ended June 30, 2009. Effective April 1, 2009, Ultimate discontinued selling its on-site UltiPro solutions to new customers on a perpetual license basis, although we continue to sell on-site UltiPro solutions on a subscription basis (priced and billed to customers on a PEPM basis). However, we did sell licenses of Optional Features to existing license customers during the first six months of 2010.

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Cost of Revenues

Cost of revenues primarily consists of the costs of recurring and services revenues. Cost of recurring revenues primarily consists of the cost of maintenance (which includes technical support to Ultimate's customers and the cost of providing periodic updates) and the cost of recurring subscription revenues ("SaaS costs"), including amortization of capitalized software. Cost of services revenues primarily consists of costs to provide implementation services and training to Ultimate's customers and, to a lesser degree, costs related to sales of payroll-related forms and costs associated with certain client reimbursable out-of-pocket expenses.

Total cost of revenues increased 14.8% to \$24.0 million for the three months ended June 30, 2010 from \$20.9 million for the three months ended June 30, 2009 and 14.7% to \$48.7 million for the six months ended June 30, 2010 from \$42.4 million for the six months ended June 30, 2009.

Cost of recurring revenues increased 26.4% to \$12.0 million for the three months ended June 30, 2010 from \$9.5 million for the three months ended June 30, 2009 and 27.4% to \$23.5 million for the six months ended June 30, 2010 from \$18.4 million for the six month ended June 30, 2009. The \$2.5 million and \$5.1 million increases in cost of recurring revenues for the three and six months ended June 30, 2010 were primarily due to increases in both maintenance costs and SaaS costs. Maintenance costs increased primarily due to higher labor costs commensurate with the growth in Ultimate's recurring revenues customer base. SaaS costs increased principally as a result of the growth in SaaS operations, increased sales, increased third-party data center costs, increased labor costs, and, to a lesser extent, increased third-party license fees to support the growth in sales from our SaaS Offering.

Cost of services revenues increased 7.0% to \$11.9 million for the three months ended June 30, 2010 from \$11.1 million for the three months ended June 30, 2009, and 7.1% to \$25.1 million for the six months ended June 30, 2010 from \$23.4 million for the six months ended June 30, 2009. Cost of services revenues increased for the three and six months ended June 30, 2010 primarily due to an increase in labor costs from Workplace implementation services as we continued to build the infrastructure for Workplace to support the growth in sales, and, to a lesser extent, increased third-party consulting costs.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries and benefits, sales commissions, travel and promotional expenses, and facility and communication costs for direct sales offices, as well as advertising and marketing costs. Sales and marketing expenses increased 13.2% to \$14.6 million for the three months ended June 30, 2010 from \$12.9 million for the three months ended June 30, 2009, and 11.1% to \$29.7 million for the six months ended June 30, 2010 from \$26.7 million for the six months ended June 30, 2009. The increases in sales and marketing expenses for the three and six month periods ended June 30, 2010 were primarily due to increased labor and related costs attributable to hiring additional personnel for the Workplace direct sales team and higher sales commissions principally related to increased recurring subscription revenues from our SaaS Offering for both Enterprise and Workplace and, to a lesser extent, increased advertising and marketing costs. Commissions on SaaS sales are amortized over the initial contract term (typically 24 months) commencing on the Live date, which corresponds to the revenue recognition for SaaS sales.

Research and Development

Research and development expenses consist primarily of software development personnel costs. Research and development expenses increased 11.1% to \$10.5 million for the three months ended June 30, 2010 from \$9.5 million for the three months ended June 30, 2009, and 11.0% to \$20.8 million for the six months ended June 30, 2010 from \$18.7 million for the six months ended June 30, 2009, principally due to higher labor costs related to the ongoing

development of core UltiPro and Optional Features.

General and Administrative

General and administrative expenses consist primarily of salaries and benefits of executive, administrative and financial personnel, as well as external professional fees and the provision for doubtful accounts. General and administrative expenses increased 19.6% to \$5.2 million for the three months ended June 30, 2010 from \$4.3 million for the three months ended June 30, 2009 and increased 14.7% to \$10.2 million for the six months ended June 30, 2010 from \$8.9 million for the six months ended June 30, 2009. The increases in general and administrative expenses were primarily due to an increase in the provision for doubtful accounts and, to a lesser extent, higher labor and related costs.

Income Taxes

Income taxes, related to continuing operations, for the three months ended June 30, 2010 and June 30, 2009 included a consolidated provision of \$0.2 million and a consolidated benefit of \$0.1 million, respectively. Income taxes, related to continuing operations, for the six months ended June 30, 2010 and June 30, 2009 included a consolidated provision of \$0.5 million and a consolidated benefit of \$0.1 million, respectively. The effective income tax rate related to continuing operations for the six months ended June 30, 2010 and June 30, 2009 was 44.0% and 12.8%, respectively. The effective income tax rate related to continuing operations for the three months ended June 30, 2010 and June 30, 2009 was 40.7% and 21.9%, respectively. The variation in tax rates for each of the two periods was primarily attributable to the proportional relationship of net permanent differences to the pre-tax net income for the three months and six months ended June 30, 2010, increasing the tax expense and rate, and the pre-tax net loss for the three months and six months ended June 30, 2009, decreasing the tax benefit and rate.

At December 31, 2009, we had approximately \$82.1 million and \$0.8 million of net operating loss carryforwards for Federal and foreign income tax reporting purposes, respectively, available to offset future taxable income. Of the total Federal and foreign net operating loss carryforwards, approximately \$82.1 million was attributable to deductions from the exercise of non-qualified employee, and non-employee director, stock options, the benefit of which will primarily be credited to paid-in capital and deferred tax assets when realized. Such carryforwards expire from 2011 through 2029. Utilization of such carryforwards may be limited as a result of cumulative ownership changes in Ultimate's equity instruments.

The balance of deferred tax assets, net of deferred tax liabilities, was \$21.4 million as of June 30, 2010. If estimates of taxable income are decreased, a valuation allowance may need to be provided for some or all deferred tax assets, which will cause an increase in income tax expense.

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Loss from Discontinued Operations

Loss from discontinued operations, net of income taxes, for the three and six months ended June 30, 2010, were \$865 thousand and \$930 thousand, respectively. The loss from discontinued operations, net of income taxes, for the three and six months ended June 30, 2010, was comprised of a \$21 thousand net income and a \$44 thousand net loss, respectively, from subsidiary operations and a \$886 thousand loss from the realization of a non-cash foreign currency translation adjustment. Loss from discontinued operations, net of income taxes, for the three and six months ended June 30, 2009, were a \$73 thousand net loss and a \$146 thousand net loss, respectively. There was no non-cash foreign currency translation adjustment for the three and six months ended June 30, 2009.

Liquidity and Capital Resources

In recent years, Ultimate has funded operations from cash flows generated from operations and, to a lesser extent, equipment financing and borrowing arrangements.

As of June 30, 2010, we had \$32.0 million in cash, cash equivalents and total investments in marketable securities, reflecting a net decrease of \$1.2 million since December 31, 2009.

The \$1.2 million decrease was primarily due to the repurchase of treasury stock, net of proceeds from the issuance of Common Stock from employee stock option exercises, of \$8.1 million and cash purchases of property and equipment (including principal payments on financed equipment) of \$3.6 million, partially offset by cash provided by operations of \$10.0 million.

Net cash provided by operating activities was \$10.0 million for the six months ended June 30, 2010 as compared to \$10.6 million for the six months ended June 30, 2009. This \$0.6 million decrease was primarily due to increased accounts receivable (net of deferred revenues) and prepaid expenses, partially offset by a decrease in vendor payments and accrued expenses.

Net cash used in investing activities was \$27.1 million for the six months ended June 30, 2010 as compared to \$0.1 million for the six months ended June 30, 2009. The increase of \$27.0 million was primarily attributable to an increase in funds received from and held on behalf of Ultimate's customers using the UltiPro tax filing offering ("UltiPro Tax Filing Customer Funds"), with such funds being invested by us in overnight repurchase agreements backed by U.S. Treasury or U.S. Government Agency securities of \$23.3 million, and an increase in cash purchases of marketable securities of \$3.5 million, partially offset by a decrease in cash provided from the maturities of marketable securities of \$0.5 million and, to a lesser extent, a decrease in capitalized software costs of \$0.6 million.

Net cash provided by financing activities was \$16.0 million for the six months ended June 30, 2010 as compared to \$2.1 million for the six months ended June 30, 2009. The \$13.9 million increase was primarily related to an increase of \$23.3 million in UltiPro Tax Filing Customer Funds received, and a \$3.2 million increase in proceeds from the issuance of Common Stock from stock option exercises, partially offset by a \$13.0 million increase in repurchases of Common Stock pursuant to Ultimate's stock repurchase plan.

Days sales outstanding, calculated on a trailing three-month basis, as of June 30, 2010 and June 30, 2009, were 70 days and 65 days, respectively.

Deferred revenues were \$69.0 million at June 30, 2010, as compared to \$68.6 million at December 31, 2009. The increase of \$0.4 million in deferred revenues was primarily due to higher deferred SaaS revenues and increased deferred service revenues, partially offset by decreased deferred maintenance revenues primarily due to decreased maintenance billings.

We believe that cash and cash equivalents, investments in marketable securities, equipment financing and cash generated from operations will be sufficient to fund our operations for at least the next 12 months. This belief is based upon, among other factors, management's expectations for future revenue growth, controlled expenses and collections of accounts receivable.

We did not have any material commitments for capital expenditures as of June 30, 2010.

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Off-Balance Sheet Arrangements

We do not, and as of June 30, 2010 we did not, have any off-balance sheet arrangements (as that term is defined in applicable SEC rules) that are reasonably likely to have a current or future material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

Quarterly Fluctuations

Our quarterly revenues and operating results have varied significantly in the past and are likely to vary substantially from quarter to quarter in the future. Our operating results may fluctuate as a result of a number of factors, including, but not limited to, increased expenses (especially as they relate to product development, sales and marketing and the use of third-party consultants), timing of product releases, increased competition, variations in the mix of revenues, announcements of new products by us or our competitors and capital spending patterns of our customers. We establish our expenditure levels based upon our expectations as to future revenues, and, if revenue levels are below expectations, expenses can be disproportionately high. A drop in near term demand for our products could significantly affect both revenues and profits in any quarter. Operating results achieved in previous fiscal quarters are not necessarily indicative of operating results for the full fiscal years or for any future periods. As a result of these factors, there can be no assurance that we will be able to maintain profitability on a quarterly basis. We believe that, due to the underlying factors for quarterly fluctuations, quarter-to-quarter comparisons of Ultimate's operations are not necessarily meaningful and that such comparisons should not be relied upon as indications of future performance.

Forward-Looking Statements

The foregoing Management's Discussion and Analysis of Financial Condition and Results of Operations and the following Quantitative and Qualitative Disclosures about Market Risk contain certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements represent our expectations or beliefs, including, but not limited to, our expectations concerning our operations and financial performance and condition. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," and similar expressions are intended to identify such forward-looking statements. These forward-looking statements are not guarantees of future performance and are subject to certain risks and uncertainties that are difficult to predict. Ultimate's actual results could differ materially from those contained in the forward-looking statements due to risks and uncertainties associated with fluctuations in our quarterly operating results, concentration of our product offerings, development risks involved with new products and technologies, competition, our contractual relationships with third parties, contract renewals with business partners, compliance by our customers with the terms of their contracts with us, and other factors disclosed in Ultimate's filings with the Securities and Exchange Commission. Other factors that may cause such differences include, but are not limited to, those discussed in this Form 10-Q and the Form 10-K, including the risk factors set forth in Part I, Item 1A of the Form 10-K. Ultimate undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

In the ordinary course of Ultimate's operations, we are exposed to certain market risks, primarily interest rate risk and foreign currency risk. Risks that are either non-financial or non-quantifiable, such as political, economic, tax, or regulatory risks, are not included in the following assessment of our market risks.

Interest Rate Risk. Ultimate is subject to financial market risks, including changes in interest rates and in the valuations of its investment portfolio. Changes in interest rates could impact Ultimate's anticipated interest income from interest-bearing cash accounts, or cash equivalents and investments in marketable securities. We manage financial market risks, including interest rate risks, in accordance with our investment guideline objectives, including:

- Maximum safety of principal;
- Maintenance of appropriate liquidity for regular cash needs;
- Maximum yields in relationship to guidelines and market conditions;
- Diversification of risks; and
- Fiduciary control of all investments.

Ultimate targets its fixed income investment portfolio to have maturities of 24 months or less. Investments are held to enhance the preservation of capital and not for trading purposes.

Cash equivalents consist of money market accounts with original maturities of less than three months. Short-term investments include obligations of U.S. government agencies and corporate debt securities. Corporate debt securities include commercial paper which according to Ultimate's investment guidelines must carry minimum short-term ratings of P-1 by Moody's Investor Service, Inc. ("Moody's") and A-1 by Standard & Poor's Ratings Service, a Division of The McGraw-Hill Companies, Inc. ("S&P"). Other corporate debt obligations must carry a minimum rating of A-2 by Moody's or A by S&P. Asset-backed securities must carry a minimum AAA rating by Moody's and S&P with a maximum average life of two years at the time of purchase.

As of June 30, 2010, total investments in available-for-sale marketable securities were \$9.3 million.

As of June 30, 2010, virtually all of the investments in Ultimate's portfolio were at fixed rates (with a weighted average interest rate of 0.5% per annum).

To illustrate the potential impact of changes in interest rates, Ultimate has performed an analysis based on its June 30, 2010 unaudited condensed consolidated balance sheet and assuming no changes in its investments. Under this analysis, an immediate and sustained 100 basis point increase in the various base rates would result in a decrease in the fair value of Ultimate's total portfolio of approximately \$50 thousand over the next 12 months. An immediate and sustained 100 basis point decrease in the various base rates would result in an increase of the fair value of Ultimate's total portfolio of approximately \$50 thousand over the next 12 months.

Foreign Currency Risk. Ultimate has foreign currency risks related to its revenue and operating expenses denominated in currencies other than the U.S. dollar. Management does not believe movements in the foreign currencies in which Ultimate transacts business will significantly affect future net income.

ITEM 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures. Ultimate carried out an evaluation, under the supervision and with the participation of Ultimate's management, including the Chief Executive Officer (the "CEO") and the Chief Financial Officer (the "CFO"), of the effectiveness of the design and operation of Ultimate's disclosure controls and

procedures as of the end of the period covered by this Form 10-Q pursuant to Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, Ultimate's management, including the CEO and CFO, concluded that, as of June 30, 2010, Ultimate's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in Ultimate's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events and thus has inherent limitations. Therefore, even those systems determined to be effective can only provide reasonable assurance as to the achievement of their objectives.

(b) Changes in internal control over financial reporting. There have been no changes during the quarter ended June 30, 2010 in Ultimate's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, Ultimate's internal control over financial reporting.

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PART II – OTHER INFORMATION

ITEM 1A. Risk Factors

The risk factors associated with Ultimate’s business, as disclosed in Part I, Item 1A, “Risk Factors,” in the Form 10-K, have not significantly changed.

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

(c) Purchases of Equity Securities by the Issuer. On October 30, 2000, Ultimate announced that its Board of Directors authorized a stock repurchase plan providing for the repurchase of up to 1,000,000 shares of Ultimate’s issued and outstanding Common Stock, which authorization has been increased from time to time (the “Stock Repurchase Plan”).

As of June 30, 2010, Ultimate had purchased 3,385,925 shares of Ultimate’s issued and outstanding Common Stock under the Stock Repurchase Plan, with 614,075 shares being available for repurchase in the future. The detail of Common Stock repurchases for the three months ended June 30, 2010, and the total cumulative number of shares purchased and the maximum number of shares that may yet be purchased under the Stock Repurchase Plan as of June 30, 2010, are as follows:

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Cumulative Number of Shares Purchased as Part Of Publicly Announced Plans or Programs (1) | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs |
|--------------------|--|---------------------------------------|--|--|
| April 1 – 30, 2010 | – | – | 3,105,925 | 894,075 |
| May 1 – 31, 2010 | 212,900 | 24.85 | 3,318,825 | 681,175 |
| June 1 – 30, 2010 | 67,100 | 25.00 | 3,385,925 | 614,075 |
| Total | 280,000 | \$ 33.22 | 3,385,925 | 614,075 |

(1) All shares were purchased through the publicly announced Stock Repurchase Plan in open-market transactions.

ITEM 6. Exhibits

| Number | Description |
|--------|-------------|
|--------|-------------|

- 10.1 Master Space Agreement between Quality Technology Services Miami LLC and Ultimate, dated June 1, 2009 *ü
- 10.2 Master Space Agreement between Quality Technology Services Metro LLC and Ultimate, dated June 1, 2009 *ü
- 10.3 Service Order Form between Verizon Canada Ltd. and Ultimate, dated September 23, 2009 *ü
- 10.4 Amended and Restated Change in Control Bonus Plan for Executive Officers dated April 26, 2010 *
- 31.1 Certification Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended *
- 31.2 Certification Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended *
- 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended *
- 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended *

* Filed herewith.

ü Confidential treatment has been requested with respect to certain portions of this exhibit pursuant to Rule 24b-2 of the Securities and Exchange Act of 1934, as amended, and these confidential portions have been omitted from the filing herewith. A complete copy of this exhibit, including the omitted portions, has been separately filed with the SEC.

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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.

The Ultimate Software Group, Inc.

Date: August 9, 2010

By: /s/ Mitchell K. Dauerman
Mitchell K. Dauerman
Executive Vice President, Chief
Financial Officer and Treasurer
(Authorized Signatory and Principal
Financial and Accounting Officer)