ULTIMATE SOFTWARE GROUP INC
Form 10-Q/A
December 01, 2003

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

FORM 10-Q/A

AMENDMENT NO. 1

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003

[ ] 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 or organization	(I.R.S. Employer Identification No.)

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 [X] No [ ]

Indicate by check mark whether the Company is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

As of May 1, 2003 there were 17,332,768 shares of the Registrant's Common Stock, par value $.01, outstanding.

EXPLANATORY NOTE

The Ultimate Software Group, Inc. is filing this amendment to its Quarterly Report on Form 10-Q for the period ended March 31, 2003, originally filed on May 14, 2003, in response to comments received from the Securities and Exchange Commission in connection with their review of the Registration Statement on Form S-3 (File No. 333-107527) filed by The Ultimate Software Group, Inc. on July 31, 2003. This Amendment No. 1 on Form 10-Q/A includes the text of the Form 10-Q in its entirety and is being filed to:

(1) provide additional disclosure regarding critical accounting policies in "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Critical Accounting Policies and Estimates,"

(2) provide additional disclosure regarding the services provided under the Ceridian Services Agreement and the term of the Original Ceridian Agreement in "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Overview,"

(3) provide greater detail concerning the reduction in the number of license units sold and third-party licensed software in "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Results of Operations,"

(4) provide the disclosure required by Item 701 of Regulation S-K of the Securities Act of 1933 in Part II, "Changes in Securities and Use of Proceeds" and

(5) update the certifications of the chief executive and financial officers in light of intervening Securities and Exchange Commission rules.

This filing amends the items specified above and does not otherwise update the disclosures in the Form 10-Q as originally filed and does not reflect events occurring after the original filing of the Form 10-Q.

In addition, The Ultimate Software Group, Inc. has filed the following exhibits herewith:

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

32.2 Certification Pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARY

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PART 1--FINANCIAL INFORMATION

ITEM 1--FINANCIAL STATEMENTS

THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share data)

	As of March 31, 2003 (Unaudited)	Dec
ASSETS		
Current assets:		
Cash and cash equivalents	$ 8,394	$
Accounts receivable, net	7,794	
Prepaid expenses and other current assets	1,634	
Total current assets	17,822	
Property and equipment, net	6,917	
Capitalized software, net	2,372	
Other assets	542	
Total assets	$ 27,653	$
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 2,350	$
Accrued expenses	4,893	
Current portion of deferred revenue	20,145	

Current portion of capital lease obligations	637
Current portion of long term debt	497
Total current liabilities	28,522
Deferred revenue, net of current portion	4,954
Capital lease obligations, net of current portion	225
Long term debt, net of current portion	720
Total liabilities	34,421
Stockholders' deficit:	
Preferred Stock, $.01 par value, 2,000,000 shares authorized, no shares issued or outstanding in 2003 and 2002	--
Series A Junior Participating Preferred Stock, $.01 par value, 500,000 shares authorized, no shares issued or outstanding in 2003 and 2002, respectively	--
Common Stock, $.01 par value, 50,000,000 shares authorized, 17,590,415 and 15,869,043 shares issued in 2003 and 2002, respectively	176
Additional paid-in capital	71,830
Accumulated deficit	(77,720)
	(5,714)
Treasury stock, at cost, 257,647 and 240,447 shares in 2003 and 2002, respectively	(1,054)
Total stockholders' deficit	(6,768)
Total liabilities and stockholders' deficit	$ 27,653

The accompanying unaudited notes to condensed consolidated financial statements are an integral part of these financial statements.

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

	For the Three Months Ended March 31,	
	2003	2002

Revenues, net:		
License	$ 1,213	$ 1,395
Recurring	6,861	3,934
Services	6,328	5,627
Total revenues, net	14,402	10,956
Cost of revenues:		
License	243	140
Recurring	2,291	1,950
Services	4,435	4,558
Total cost of revenues	6,969	6,648
Operating expenses:		
Sales and marketing	4,089	4,538
Research and development	4,329	4,331
General and administrative	1,618	1,130
Total operating expenses	10,036	9,999
Operating loss	(2,603)	(5,691)
Interest expense	(53)	(72)
Interest and other income	20	40
Net loss	$ (2,636)	$ (5,723)
Net loss per share -- basic and diluted	$ (0.16)	$ (0.36)
Weighted average shares outstanding:		
Basic and diluted	16,718	15,885

The accompanying unaudited notes to condensed consolidated financial statements are an integral part of these financial statements.

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

	For the Three Months Ended March 31,	
	2003	2002

Cash flows from operating activities:		
Net loss	$ (2,636)	$ (5,72
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,300	1,43
Provision for doubtful accounts	161	3
Non-cash issuance of stock options for board fees	31	2
Changes in operating assets and liabilities:		
Accounts receivable	2,426	4,25
Prepaid expenses and other current assets	(361)	(9
Other assets	(13)	(
Accounts payable	(343)	26
Accrued expenses	(636)	(1,11
Deferred revenue	(2,716)	5,36
Net cash (used in) provided by operating activities	(2,787)	4,43
Cash flows from investing activities:		
Purchases of property and equipment	(605)	(62
Net cash used in investing activities	(605)	(62
Cash flows from financing activities:		
Repurchase of treasury stock	--	(11
Principal payments on capital lease obligations	(266)	(57
Principal payments on borrowings under Credit Facility	(129)	-
Net proceeds from issuances of Common Stock	3,207	
Net cash provided by (used in) financing activities	2,812	(68
Net (decrease) increase in cash and cash equivalents	(580)	3,12
Cash and cash equivalents, beginning of period	8,974	8,46
Cash and cash equivalents, end of period	$ 8,394	$ 11,58
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 43	$ 6

Supplemental disclosure of non-cash financing activities:

- The Company entered into capital lease obligations to acquire new equipment totaling $0 and $379 in the three months ended March 31, 2003 and 2002, respectively.

The accompanying unaudited notes to condensed consolidated financial statements are an integral part of these financial statements.

THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements of The Ultimate Software Group, Inc. and subsidiary (the "Company") 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 in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. The information in this report should be read in conjunction with the Company's consolidated audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002 filed with the SEC on March 31, 2003 (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 the Company's management, necessary for a fair presentation of the information for the periods presented. The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 months ended March 31, 2003 and 2002 are not necessarily indicative of operating results for the full fiscal years or for any future periods.

Reclassifications

Certain reclassifications have been made to prior year balances to conform to the current year presentation.

2. LIQUIDITY AND CAPITAL RESOURCES

The Company's cash flows from operations have historically been insufficient to fund its operations. Shortfalls in cash flows from operations have been funded primarily through the private and public sale of equity securities and, to a lesser extent, equipment financing and borrowing arrangements.

On January 23, 2003, the Company raised $0.2 million of capital through the private sale of 50,000 shares of the Company's common stock, par value $0.01 per share ("Common Stock"), and a warrant to purchase 5,000 shares of Common Stock at $4 per share to a shareholder of the Company. On March 13, 2003, the Company raised an additional $3.0 million of capital through the private sale of 750,000 shares of the Company's Common Stock and a warrant to purchase 75,000 shares of Common Stock at $4 per share to Ceridian Corporation ("Ceridian"). The additional capital raised in January 2003 and March 2003 is collectively referred to as "Recent Capital Raised."

On February 10, 2003, the Company entered into a services agreement with Ceridian (the "Ceridian Services Agreement") under which Ceridian will pay Ultimate Software a total of $2.25 million in four equal installments during each of the calendar quarters of 2003 in exchange for additional services provided by Ultimate Software in 2003. The Company received a payment of

$562,500 from Ceridian during March 2003. The Ceridian Services Agreement terminates on December 31, 2003.

On March 27, 2003, the Company amended its revolving line of credit agreement with Silicon Valley Bank (the "Credit Facility") to extend the expiration date of the agreement to May 28, 2004. The Company was not in compliance with the Quick Ratio financial covenant of the Credit Facility, as defined in the Credit Facility (the "Quick Ratio"), for the month ended March 31, 2003. On April 29, 2003, the Company and Silicon Valley Bank amended the Credit Facility to modify the Quick Ratio by reducing the requirement from a ratio of 2.0 to 1.0 to 1.75 to 1.0. This loan modification was effective for the month ended March 31, 2003 and each month thereafter through the revised expiration date of May 28, 2004. As a result of the loan modification, the Company is in compliance with all debt covenants pursuant to the Credit Facility, as amended from time to time.

The Company believes that cash and cash equivalents, cash generated from operations and available borrowings under the existing revolving line of credit with Silicon Valley Bank will be sufficient to fund its operations for at least the next 12 months. This belief is based upon, among other factors, management's expectations for future revenue growth, improvements in gross margins, controlled operating expenses and collections of accounts receivable. However, the Company may seek to raise additional funds during such period through the sale of additional shares of the Company's common stock, par value $0.01, or other securities. There can be no assurance that the Company will be able to raise such funds on terms acceptable to the Company.

3. CONCENTRATION OF REVENUES

During the three months ended March 31, 2003, one of the Company's customers, Ceridian, accounted for 15.8% of total revenues. No other customer accounted for more than 10% of total revenues in 2003 or 2002.

Of the 15.8% of total revenues recognized from Ceridian, 13.4% relates to recurring revenue recognized pursuant to the Original Ceridian Agreement, discussed below, and 2.4% relates to services revenue recognized under the Ceridian Services Agreement (see Note 2).

During 2001, the Company and Ceridian reached an agreement, as amended in 2002, which granted Ceridian a non-exclusive license to use Ultimate Software's UltiPro Workforce Management Software ("UltiPro") software as part of an on-line offering that Ceridian intends to market primarily to businesses with under 500 employees (the "Original Ceridian Agreement"). The aggregate minimum payments that Ceridian is obligated to pay the Company under the Original Ceridian Agreement over the minimum term of the agreement is $42.7 million. To date, Ceridian has paid to the Company a total of $16.5 million under the Original Ceridian Agreement. The earliest date upon which the Ceridian Agreement can be terminated by either party (except for an uncured material breach) is March 9, 2008, resulting in an expected minimum term of 7 years (the "Minimum Term"). Ceridian retains certain rights to use the software upon termination. A minimum of approximately $642,000 has been and will be recognized as subscription revenue, a component of recurring revenue, on a monthly basis, from the Original Ceridian Agreement for the period beginning August 28, 2002 through the end of the Minimum Term.

Services revenue from the Ceridian Services Agreement is recognized on a straight-line basis from the date of the agreement, February 10, 2003, through the expiration of such agreement, or December 31, 2003.

4. COMPREHENSIVE INCOME

Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income," establishes standards for the reporting and display of comprehensive income and its components in a full set of financial statements. The objective of SFAS No. 130 is to report a measure (comprehensive income) of all changes in equity of an enterprise that result from transactions and other economic events in a period other than transactions with owners. Comprehensive loss is equal to net loss for all periods presented.

5. EARNINGS PER SHARE

The following is a reconciliation of the shares used in the computation of basic and diluted net loss per share (in thousands):

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2003	2002
Weighted average shares outstanding	16,718	15,885
Effect of dilutive stock options	-	-
Dilutive shares outstanding	16,718	15,885
Options outstanding which are not included in the calculation of diluted loss per share because their impact is antidilutive	5,295	4,690

6. STOCK-BASED COMPENSATION

The Company accounts for employee stock options in accordance with Accounting Principles Board ("APB") No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under APB 25, the Company recognizes no compensation expense related to employee stock options since options are granted at a price equal to the market price of the underlying stock on the date of grant.

The Company's Nonqualified Stock Option Plan (the "Plan") authorizes the grant of options to directors, officers and employees of the Company for up to 9,000,000 shares of the Company's Common Stock. As of March 31, 2003, 3,460,145 shares of the Company's Common Stock are available for grant. Options granted generally have a 10-year term, vesting 25% immediately and 25% for each of the following three years.

The pro forma information below is based on provisions of Statement of Financial Accounting Standard ("SFAS") No. 123, "Accounting for Stock-Based Compensation ("SFAS No. 123"), as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No. 148").

The following pro forma information regarding net loss and net loss per share, as required by SFAS No. 123, has been determined as if the Company had accounted for its stock-based compensation plan under the fair value method. The fair value of each option granted was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants: risk-free interest rates of 2.84% for 2003 and 2.72% for 2002, a dividend yield of 0% for all periods presented, expected volatility of 46% for 2003 and 68% for 2002 and an expected life of four years for each of the periods presented. The Company's pro forma information is as follows (in thousands, except per share amounts):

	FOR THE THREE MO ENDED MARCH 3 2003
Net loss:	
As reported	$(2,636)
Stock-based employee compensation as determined under fair value method for all awards	(493)
Pro forma	$(3,129)
Net loss per share:	
As reported, basic and diluted	$ (0.16)
Pro forma, basic and diluted	$ (0.19)

7. RECENT ACCOUNTING LITERATURE

SFAS No. 148, issued in December 2002, amends SFAS No. 123, to provide alternative methods of transition for a voluntary change to the fair-value-based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in not only annual, but also interim, financial statements about the effect the fair value method would have had on reported results. The transition and annual disclosure requirements of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The Company adopted the disclosure provisions of SFAS No. 148 as of January 1, 2003 and continues to follow APB No. 25 in accounting for employee stock options.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," ("FIN 45"). FIN 45 expands previously issued accounting guidance and disclosure requirements for certain guarantees and requires recognition of an initial liability for the fair value of an obligation assumed by issuing a guarantee. The provision for initial recognition and measurement of liability will be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The Company adopted FIN 45 as of January 1, 2003. Adoption did not have a material impact on the Company's unaudited consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities," ("FIN 46"). FIN 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," for certain entities that do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties or in which equity investors do not have the characteristics of a controlling financial interest ("variable interest entities"). Variable interest

entities within the scope of FIN 46 will be required to be consolidated by their primary beneficiary. The primary beneficiary of a variable interest entity is determined to be the party that absorbs a majority of the entity's expected losses, receives a majority of its expected returns, or both. FIN 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Company is currently evaluating

the impact of adopting FIN 46. However, the Company does not believe that it is party to any arrangement that would fall within the scope of FIN 46.

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. ("Ultimate Software" or the "Company") should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and Notes thereto included elsewhere in this Form 10-Q. This Form 10-Q contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from those contained in the forward-looking statements. Factors that may cause such differences include, but are not limited to, those discussed below and in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002 filed with the SEC on March 31, 2003, including Exhibit 99.1 thereto. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

Revenue Recognition

Sources of revenue for the Company include:

- Sales of perpetual licenses for UltiPro Workforce Management Software ("UltiPro"), a Web-based solution designed to deliver the functionality businesses need to manage the employee life cycle, whether their processes are centralized at headquarters or distributed across multiple divisions or branch offices;

- Sales of perpetual licenses for UltiPro in conjunction with services to host the UltiPro application (or "Hosting Services");

- Sales of the right to use UltiPro, including Hosting Services (the "Intersourcing Offering");

- Sales of Hosting Services on a stand-alone basis to customers who already own a perpetual license or are simultaneously acquiring a perpetual license for UltiPro, or ("Base Hosting");

- Sales of other services including implementation, training and other services, including the provision of payroll-related forms and the printing of Form W-2's for certain customers; and

- Recurring revenues derived from (1) maintenance revenues generated from maintaining, supporting and providing periodic updates for the Company's software and (2) subscription revenues generated from per employee per month ("PEPM") fees earned through the Intersourcing Offering, Base Hosting and the business service provider (BSP) sales channel (defined below), as well as revenues generated from the Original Ceridian Agreement.

Perpetual Licenses for UltiPro Sold With or Without Hosting Services

Sales of perpetual licenses for UltiPro and sales of perpetual licenses for UltiPro in conjunction with Hosting Services are multiple-element arrangements that involve the sale of software and consequently fall under the guidance of SOP 97-2 for revenue recognition.

The Company licenses software under non-cancelable license agreements and provides services including maintenance, training and implementation consulting services. In accordance with the provisions of

Statement of Position ("SOP") 97-2, "Software Revenue Recognition," license revenues are generally recognized when (1) a non-cancelable license agreement has been signed by both parties, (2) the product has been shipped, (3) no significant vendor obligations remain and (4) collection of the related receivable is considered probable. To the extent any one of these four criteria is not satisfied, license revenue is deferred and not recognized in the consolidated statements of operations until all such criteria is met.

For multiple-element software arrangements, each element of the arrangement is analyzed and the Company allocates a portion of the total fee under the arrangement to the element based on vendor-specific objective evidence of fair value of the element ("VSOE"), regardless of any separate prices stated within the contract for each element. Fair value is considered the price a customer would be required to pay when the element is sold separately.

The residual method is used to recognize revenue when a license agreement includes one or more elements to be delivered at a future date and vendor specific objective evidence of the fair value of all undelivered elements exists. The fair value of the undelivered elements is determined based on the historical evidence of stand-alone sales of these elements to third parties. Undelivered elements in a license arrangement typically include maintenance, training and implementation services (the "Standard Undelivered Elements"). The fair value for maintenance fees is based on the price of the services sold separately, which is determined by the annual renewal rate historically and consistently charged to customers (the "Maintenance Valuation"). Maintenance fees are generally priced as a percentage of the related license fee. The fair value for training services is based on standard pricing (i.e., rate per training day charged to customers for class attendance), taking into consideration stand-alone sales of training services through year-end seminars and historically consistent pricing for such services (the "Training Valuation") The fair value for implementation services is based on standard pricing (i.e., rate per hour charged to customers for implementation services), taking into consideration stand-alone sales of implementation services through special projects and historically consistent pricing for such services (the "Implementation Valuation"). Under the residual method (the "Residual Method"), the fair value of the undelivered elements is deferred and the remaining portion

of the arrangement fee attributable to the delivered element, the license fee, is recognized as revenue. If VSOE for one or more undelivered elements does not exist, the revenue is deferred on the entire arrangement until the earlier of the point at which (i) such VSOE does exist or (ii) all elements of the arrangement have been delivered.

Perpetual licenses of UltiPro sold without Hosting Services typically include a license fee and the Standard Undelivered Elements. Fair value for the Standard Undelivered Elements is based on the Maintenance Valuation, the Training Valuation and the Implementation Valuation. The delivered element of the arrangement, the license fee, is accounted for in accordance with the Residual Method.

Perpetual licenses of UltiPro sold with Hosting Services typically include a license fee, the Standard Undelivered Elements and Hosting Services. Fair value for the Standard Undelivered Elements is based on the Maintenance Valuation, the Training Valuation and the Implementation Valuation. Hosting Services are delivered to customers on a PEPM basis over the term of the related customer contract ("Hosting PEPM Services"). Upfront fees charged to customers represent fees for the hosting infrastructure, including hardware costs, third-party license fees and other upfront costs incurred by the Company in relation to providing such services ("Hosting Upfront Fees"). Hosting PEPM Services and Hosting Upfront Fees (collectively, "Hosting Services") represent undelivered elements in the arrangement since their delivery is over the course of the related contract term. The fair value for Hosting Services is based on standard pricing (i.e., rate charged per employee per month), taking into consideration stand-alone sales of Hosting Services through the sale of such services to existing customers (i.e., those who already own the UltiPro perpetual license at the time Hosting Services are sold to them) and historically consistent pricing for such services (the "Hosting Valuation"). The delivered element of the arrangement, the license fee, is accounted for in accordance with the Residual Method.

The Company's customer contracts are non-cancelable agreements. The Company does not provide for rights of return or price protection on its software. The Company provides a limited warranty that its software will perform in accordance with user manuals for varying periods, which are generally less than one year from the contract date. The Company's customer contracts generally do not include conditions of acceptance. However, if conditions of acceptance are included in a contract or uncertainty exists about customer acceptance of the software, license revenue is deferred until acceptance occurs.

Sales Generated from the Intersourcing Offering

Subscription revenues generated from the Intersourcing Offering, defined below, are recognized in accordance with Emerging Issues Task Force ("EITF") No. 00-21, "Revenue Arrangements with Multiple Deliverables" as a services arrangement since the customer is purchasing the right to use UltiPro rather than licensing the software on a perpetual basis. Fair value of multiple elements in Intersourcing arrangements is assigned to each element based on the guidance provided by EITF 00-21.

The elements that typically exist in Intersourcing arrangements include hosting services, the right to use UltiPro, maintenance of UltiPro (i.e., product enhancements and customer support) and professional services (i.e., implementation services and training in the use of UltiPro). The pricing for hosting services, the right to use UltiPro and maintenance of UltiPro is bundled (the "Bundled Elements"). Since these three Bundled Elements are components of recurring revenues in the consolidated statements of operations, allocation of fair values to each of the three elements is not necessary since they are not reported separately. Fair value for the Bundled Elements, as a whole, is based upon evidence provided by the Company's pricing for Intersourcing arrangements

sold separately. The Bundled Elements are provided on an ongoing basis and represent undelivered elements under EITF 00-21; they are recognized on a monthly basis as the services are performed, once the customer has begun to process payrolls used to pay their employees (i.e., goes "Live").

Implementation and training services (the "Professional Services") provided for Intersourcing arrangements are priced on a time and materials basis and are recognized as services revenue in the consolidated statements of operations as the services are performed. Under EITF 00-21, fair value is assigned to service elements in the arrangement based on their relative fair values, using the prices established when the services are sold on a stand-alone basis. Fair value for Professional Services is based on the respective Training Valuation and Implementation Valuation. If evidence of the fair value of one or more undelivered elements does not exist, the revenue is deferred and recognized when delivery of those elements occurs or when fair value can be established.

The Company believes that applying EITF 00-21 to Intersourcing arrangements as opposed to applying SOP 97-2 is appropriate given the nature of the arrangements whereby the customer has no right to the UltiPro license.

Sales of Base Hosting Services

Subscription revenues generated from Base Hosting are recognized in accordance with EITF 00-3, "Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware," which provides guidance as to the application of SOP 97-2 to hosting arrangements that include a license right to the software. The elements that typically exist for Base Hosting arrangements include hosting services and implementation services. Base Hosting is different than Intersourcing arrangements (described above) in that the customer already owns a perpetual license or is purchasing a perpetual license for UltiPro and is purchasing hosting services subsequently in a separate transaction whereas, with Intersourcing, the customer is purchasing the right to use (not license) UltiPro. Implementation services provided for Base Hosting arrangements are substantially less than those provided for Intersourcing arrangements since UltiPro is already implemented in Base Hosting arrangements and only needs to be transitioned to a hosted environment. Fair value for hosting services is based on the Hosting Valuation. Fair value for implementation services is assigned in accordance with guidelines provided by SOP 97-2 based on the Implementation Valuation.

Other Services, including Implementation and Training Services

Services revenues include revenues from fees charged for the implementation of the Company's software products and training of customers in the use of such products, fees for other services, including the provision of payroll-related forms and the printing of Form W-2's for certain customers, as well as certain reimbursable out-of-pocket expenses. Revenues for training and implementation consulting services are recognized as services are performed. Other services are recognized as the product is shipped or as the services are rendered.

Arrangement fees related to fixed-fee implementation services contracts are recognized using the percentage of completion accounting method, which involves the use of estimates. Percentage of completion is measured at each reporting date based on hours incurred to date compared to total estimated hours to complete. If a sufficient basis to measure the progress towards completion does not exist, revenue is recognized when the project is completed or when we receive final acceptance from the customer.

Recurring Revenues

Recurring revenues include maintenance revenues and subscription revenues. Maintenance revenues are derived from maintaining, supporting and providing periodic updates for the Company's software. Subscription revenues are principally derived from per employee per month ("PEPM") fees earned through the Intersourcing Offering (defined below), hosting services offered to customers that license UltiPro on a perpetual basis ("Base Hosting") and the business service provider (BSP) sales channel (defined below), as well as revenues generated from the Original Ceridian Agreement. Maintenance revenues are recognized ratably over the service period, generally one year. Maintenance and support fees are generally priced as a percentage of the initial license fee for the underlying products. To the extent there are upfront fees associated with the Intersourcing Offering, Base Hosting or the BSP sales channel, subscription revenues are recognized ratably over the term of the related contract upon the delivery of the product and services. PEPM fees from the Intersourcing Offering, Base Hosting and the BSP sales channel are recognized as subscription revenue as the services are delivered. Commencing on August 28, 2002, subscription revenues generated from the Original Ceridian Agreement are recognized ratably over the minimum term of the contract, which is expected to extend until March 9, 2008 (7 years from the effective date of the Original Ceridian Agreement). Subscription revenues of approximately $642,000 per month are based on guaranteed minimum payments from Ceridian Corporation of approximately $42.7 million over the contract term, including $16.5 million received to date.

Maintenance services provided to customers include product updates and technical support services. Product updates are included in general releases to the Company's customers and are distributed on a periodic basis. Such updates may include, but are not limited to, product enhancements, payroll tax updates, additional security features or bug fixes. All features provided in general releases are unspecified upgrade rights. To the extent specified upgrade rights or entitlements to future products are included in a multi-element arrangement, revenue is recognized upon delivery provided fair value for the elements exists. In multi-element arrangements that include a specified upgrade right or entitlement to a future product, if fair value does not exist for all undelivered elements, revenue for the entire arrangement is deferred until all elements are delivered or when fair value can be established.

Subscription revenues generated from the BSP sales channel include both the right to use UltiPro and maintenance. The BSP is charged a fee on a per employee per month basis and, in several cases, is subject to a monthly minimum amount for the term of the related agreement. Revenue is recognized on a per employee per month basis. The Company generally does not host UltiPro for the BSP sales channel.

The Company recognizes revenue in accordance with the SEC Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101"). Management believes the Company is currently in compliance with the current provisions set forth in SOP 97-2, SOP 98-9, EITF 00-21, EITF 00-3 and SAB No. 101.

Concentration of Revenues

During the three months ended March 31, 2003, one of the Company's customers, Ceridian Corporation, accounted for 15.8% of total revenues. No other customer accounted for more than 10% of total revenues in 2003 or 2002. Due to the significant concentration of total revenues with this single customer, the Company has exposure if this customer loses its credit worthiness. See Note 3 of

the unaudited Notes to Condensed Consolidated Financial Statements.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts at an amount estimated to be sufficient to provide adequate protection against losses resulting from collecting less than full payment on accounts receivables. In assessing the adequacy of the allowance for doubtful accounts, the Company considers multiple factors including historical bad debt experience, the general economic environment, and the aging of its receivables. A considerable amount of judgment is required when the realization of receivables is assessed, including assessing the probability of collection and current credit-worthiness of each customer. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional provision for doubtful accounts may be required.

Software Development Costs

SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed," requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon completion of a working model. There were no software costs capitalized during 2003 and 2002. Annual amortization is based on the greater of the amount computed using (a) the ratio that current gross revenues for the related product bears to the total of current and anticipated future gross revenues for that product or (b) the straight-line method over the remaining estimated economic life of the product including the period being reported on. Capitalized software is amortized using the straight-line method over the estimated useful lives of the assets which are typically three years. Amortization of capitalized software was $380,000 and $455,000 for the three months ending March 31, 2003 and 2002, respectively. Accumulated amortization of capitalized software was $3.3 million for the period ended March 31, 2003 and $1.6 million for the period ended March 31, 2002. The Company

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evaluates the recoverability of capitalized software based on estimated future gross revenues reduced by the estimated costs of completing the products and of performing maintenance and customer support. If the Company's gross revenues were to be significantly less than its estimates, the net realizable value of the Company's capitalized software intended for sale would be impaired, which could result in the write-off of all or a portion of the unamortized balance of such capitalized software.

OVERVIEW

Ultimate Software designs, markets, implements and supports payroll and workforce management solutions.

Ultimate Software's UltiPro Workforce Management Software ("UltiPro") is a Web-based solution designed to deliver the functionality businesses need to manage the employee life cycle, whether their processes are centralized at headquarters or distributed across multiple divisions or branch offices. UltiPro's human resources ("HR") and benefits management functionality is wholly integrated with a flexible payroll engine, reporting and analytical decision-making tools, and a central Web portal that can serve as the customer's gateway for its workforce to access company-related and personal information. Ultimate Software believes that UltiPro helps customers streamline HR and payroll processes to significantly reduce administration and operational costs, while also empowering executives and staff to access critical information

quickly and perform routine business activities efficiently.

UltiPro Workforce Management is marketed both through the Company's direct sales team as well as through alliances with business service providers (BSPs) that market co-branded UltiPro to their customer bases. Ultimate Software's direct sales team focuses on companies with more than 500 employees and sells both on a license (typically in-house) and service basis (typically hosted and priced on a per-employee-per-month basis). The Company's BSP alliances focus primarily on companies with under 500 employees and typically sell an Internet solution, which includes UltiPro priced on a monthly/service basis. When the BSP sells its Internet solution, incorporating UltiPro in the offering, the BSP is obligated to remit a fee to the Company, typically measured on a per employee per month basis and, in some cases, subject to a monthly minimum amount.

The Company's direct sales force markets UltiPro as an in-house payroll and workforce management solution and alternatively as the Intersourcing Offering. Intersourcing provides Web access to comprehensive workforce management functionality for organizations that need to simplify the information technology (IT) support requirements of their business applications. Ultimate Software believes that Intersourcing is attractive to companies that are striving to focus on their core competencies to increase sales and profits. Through the Intersourcing model introduced in 2002, the Company provides the hardware, infrastructure, ongoing maintenance and backup services for its customers at a BellSouth data center.

Intersourcing Offering

In 2002, the Company introduced the Intersourcing Offering, which is a hosting service through which the Company provides the hardware, infrastructure, ongoing maintenance and back-up services for its customers at a BellSouth data center. Different types of hosting arrangements include the sale of hosting services as a part of the Intersourcing Offering, discussed below, and, to a lesser extent, the sale of hosting services to customers that license UltiPro on a perpetual basis. Hosting services, available in a shared or dedicated environment, provide Web access to comprehensive workforce management functionality for organizations that need to simplify the information technology (IT) support requirements of their business applications and are priced on a per-employee-per-month basis. In a shared environment, commonly used for Intersourcing, Ultimate Software provides an infrastructure with applicable servers shared among many customers who use a Web browser to access the application software through the data center. In a dedicated environment, servers are dedicated to specific customers that purchase this particular service. The majority of the Company's hosting arrangements are provided through a shared environment.

The Intersourcing Offering is designed to provide an appealing pricing structure to customers who prefer to minimize the initial cash outlay associated with typical capital expenditures. Intersourcing customers purchase the right to use UltiPro on an ongoing basis for a specific term in a shared or dedicated hosted environment. The pricing for Intersourcing, including both the hosting element as well as the right to use UltiPro, is on a per-employee-per-month basis.

Ceridian Services Agreement

On February 10, 2003, Ultimate Software entered into a services agreement (the "Ceridian Services Agreement") with Ceridian Corporation ("Ceridian"). Under the Ceridian Services Agreement, Ultimate Software is,

through December 31, 2003, required to:

1) locate an employee at Ceridian's office in Atlanta, Georgia dedicated to assist Ceridian in the resolution of any issues concerning the development, integration and troubleshooting of UltiPro as used by Ceridian;

2) provide work space at Ultimate Software's headquarters in Weston, Florida for an employee of Ceridian for the purpose of ongoing coordination and understanding of general and technical product requirements, integration requirements and general communication of development status and issue resolution;

3) allow Ceridian to provide input related to development plans (with no approval rights granted to Ceridian and without any obligation on Ultimate Software's part to incorporate such input into its development plans) for UltiPro and to grant Ceridian access to the early stages of upcoming product releases; and

4) test methodologies which could extend performance and scalability of UltiPro in the service bureau environment and consider methodologies which can improve performance and scalability.

Ceridian is required to pay Ultimate Software a total of $2.25 million in four equal installments during each calendar quarter of 2003 in exchange for the services provided by Ultimate Software. Ceridian paid Ultimate Software the first installment of $562,500 during March 2003. Services revenue is recognized on a straight-line basis from February 10, 2003 through December 31, 2003.

Original Ceridian Agreement

During 2001, Ultimate Software and Ceridian reached an agreement, as amended in 2002, which granted Ceridian a non-exclusive license to use UltiPro software as part of an on-line offering that Ceridian intends to market primarily to businesses with under 500 employees (the "Original Ceridian Agreement"). The aggregate minimum payments that Ceridian is obligated to pay Ultimate Software under the Original Ceridian Agreement over the minimum term of the agreement is $42.7 million. To date, Ceridian has paid to Ultimate Software a total of $16.5 million under the Original Ceridian Agreement. The earliest date upon which the Ceridian Agreement can be terminated by either party (except for an uncured material breach) is March 9, 2008, resulting in an expected minimum term of 7 years. Ceridian retains certain rights to use the software upon termination.

Company Background

The Company is a Delaware corporation formed in April 1996 to assume the business and operations of The Ultimate Software Group, Ltd., a limited partnership founded in 1990. Ultimate Software's headquarters are located at 2000 Ultimate Way, Weston, Florida 33326 and its telephone number is (954) 331-7000. To date, the Company derives no revenue from customers outside of the United States and has no assets located outside of the United States.

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RESULTS OF OPERATIONS

The following table sets forth the Statement of Operations data of the Company, as a percentage of total revenues, for the periods indicated.

	For the Three Months Ended March 31,	
	2003	2002
Revenues:		
License	8.4%	12.7%
Recurring	47.7	35.9
Services	43.9	51.4
Total revenues	100.0	100.0
Cost of revenues:		
License	1.7	1.3
Recurring	15.9	17.8
Services	30.8	41.6
Total cost of revenues	48.4	60.7
Operating expenses:		
Sales and marketing	28.4	41.4
Research and development	30.1	39.5
General and administrative	11.2	10.3
Total operating expenses	69.7	91.2
Operating loss	(18.1)	(51.9)
Interest expense	(0.3)	(0.6)
Interest and other income	0.1	0.3
Net loss	(18.3)%	(52.2)%

Revenues

The Company's revenues are derived from three principal sources: software licenses ("license revenues"), recurring revenues and services revenues.

License revenues include revenues from software license agreements for the Company's products, entered into between the Company and its customers in which the license fees are noncancellable. License revenues are generally recognized upon the delivery of the related software product when all significant contractual obligations have been satisfied. Until such delivery, the Company records amounts received when contracts are signed as customer deposits that are included with deferred revenues in the condensed consolidated balance sheets.

Recurring revenues include maintenance and subscription revenues. Maintenance revenues are derived from maintaining, supporting and providing periodic updates for the Company's software. Subscription revenues are principally derived from per employee per month ("PEPM") fees earned through the Intersourcing Offering, Base Hosting and the BSP sales channel, as well as revenues generated from the Original Ceridian Agreement. Maintenance revenues are recognized ratably over the service period, generally one year. Subscription revenues are recognized ratably over the term of the related contract upon the delivery of the product and services. All of the Company's customers that purchased software during 2003 and 2002 also purchased maintenance and support

service contracts. Maintenance and support fees are generally priced as a percentage of the initial license fee for the underlying products.

Services revenues include revenues from fees charged for the implementation of the Company's software products and training of customers in the use of such products, fees for other services, including the provision of payroll-related forms and the printing of Form W-2's for certain customers, as well as revenue

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generated from the Ceridian Services Agreement and certain reimbursable out-of-pocket expenses. Service revenues are recognized as services are performed and delivered.

Total revenues, consisting of license, recurring and services revenues, increased 31.5% to $14.4 million for the three months ended March 31, 2003 from $11.0 million for the three months ended March 31, 2002.

License revenues decreased 13.1% to $1.2 million for the three months ended March 31, 2003 from $1.4 million for the three months ended March 31, 2002. The decrease in license revenues for the three-month period was primarily due to a reduction in the number of units sold by the Company's direct sales channel during the first quarter of 2003. The reduction in the number of license units sold was due to a decrease in sales of UltiPro to existing clients using the Company's DOS-based product, UltiPro for Lan ("DOS Clients"). Sales of the UltiPro product to DOS Clients ended during the last fiscal quarter of 2002, shortly before support services for UltiPro for Lan were discontinued (in January 2003). Prior to discontinuing support services, the Company actively marketed the UltiPro product to DOS Clients as part of a loyalty program designed to encourage these clients to purchase UltiPro before support services for UltiPro for Lan were discontinued. More than half of the DOS Clients converted to the UltiPro product in 2002.

Recurring revenues increased 74.4% to $6.9 million for the three months ended March 31, 2003 from $3.9 million for the three months ended March 31, 2002. The increase in the three month period is primarily due to (i) the recognition of subscription revenue, beginning on August 28, 2002, under the Original Ceridian Agreement, as amended from time to time, (ii) an increase in maintenance revenues generated from incremental licenses sold in 2002 and, to a lesser extent, (iii) revenues recognized pursuant to the Intersourcing Offering, which was introduced in 2002.

Services revenues increased 12.5% to $6.3 million for the three months ended March 31, 2003 from $5.6 million for the three months ended March 31, 2002. The increase in services revenues for the three-month period was principally due to the revenue recognized under the Ceridian Services Agreement beginning February 10, 2003, and, to a lesser extent, an increase in reimbursable out-of-pocket expenses and an increase in training revenues.

Cost of Revenues

Cost of revenues consists of the cost of license, recurring and services revenues. Cost of license revenues primarily consists of fees payable to a third party for software products distributed by the Company and, to a lesser degree, amortization of capitalized software costs. UltiPro includes third-party software for enhanced report writing purposes. When UltiPro licenses are sold, customers pay the Company on a per user basis for the license rights to the third-party report writing software. Capitalized software is amortized using the straight-line method over the estimated useful life of the related asset, which is typically three years. Cost of recurring revenues consists of

costs to provide maintenance and technical support to the Company's customers, the cost of periodic updates and the costs of subscription revenues, including costs associated with the Intersourcing Offering and amortization of capitalized software. Cost of services revenues primarily consists of costs to provide implementation services and training to the Company's customers and, to a lesser degree, costs, costs related to sales of payroll-related forms and costs associated with reimbursable out-of-pocket expenses.

Total cost of revenues, consisting of license, recurring and services revenues, increased 4.8% to $7.0 million for the three months ended March 31, 2003 from $6.6 million for the three months ended March 31, 2002.

Cost of license revenues increased 73.6 % to $243,000 for the three months ended March 31, 2003 from $140,000 for the three months ended March 31, 2002 primarily due to an increase in third party fees. Cost of license revenues, as a percentage of license revenues, increased to 20.0% for the three months ended March 31, 2003 as compared to 10.0% for the three months ended March 31, 2002 principally due to lower license revenues.

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Cost of recurring revenues increased 14.2% to $2.3 million for the three months ended March 31, 2003 from $2.0 million for the three months ended March 31, 2002. The increase in the three-month period was primarily attributable to costs associated with the Intersourcing Offering, including depreciation and amortization of related computer equipment, and increased costs of maintenance revenues principally due to higher labor costs. Cost of recurring revenues, as a percentage of recurring revenues, decreased to 33.4% for the three months ended March 31, 2003 as compared to 49.6% for the three months ended March 31, 2002. The decrease in the three-month period ended March 31, 2003 was primarily a result of the absorption of these costs into an increased recurring revenue base.

Cost of services revenues decreased 2.7 % to $4.4 million for the three months ended March 31, 2003 from $4.6 million for the three months ended March 31, 2002. The decrease in the three-month period was primarily due to lower labor costs for implementation services. Cost of services revenues, as a percentage of services revenues, for the three months ended March 31, 2003 decreased to 70.1% as compared to 81.0% for the three months ended March 31, 2002. The decrease in the three-month period was primarily due to a reduction in the labor costs as well as an expanded services revenue base.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries, 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 decreased 9.9 % to $4.1 million for the three months ended March 31, 2003 from $4.5 million for the three months ended March 31, 2002 primarily due to lower labor costs, including sales commissions. Sales and marketing expenses, as a percentage of total revenues, decreased to 28.4% as compared to 41.4% for the three months ended March 31, 2003 and 2002, respectively. The decrease in the three-month period was primarily a result of the combination of a reduction in labor costs and an increase in the total revenue base.

Research and Development

Research and development expenses consist primarily of software development personnel costs. Research and development expenses of $4.3 million for the three-month period ended March 31, 2003 were consistent with the prior

year comparable period. A slight increase in labor costs, principally benefit costs, was offset by a decrease in the amortization of capitalized software due to the cessation of the capitalizable period for certain software. Research and development expenses, as a percentage of total revenues, decreased to 30.0% for the three months ended March 31, 2003 as compared to 39.5% for the period ended March 31, 2002 principally due to the absorption of these costs in an increased total revenue base.

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 43.2% to $1.6 million for the three months ended March 31, 2003 from $1.1 million for the three months ended March 31, 2002. General and administrative expenses, as a percentage of total revenues, increased to 11.2% for the three months ended March 31, 2003 as compared to 10.3% for the three months ended March 31, 2002. The increase in general and administrative expenses was primarily due to an increase in the provision for doubtful accounts and higher professional fees principally as a result of compliance with recent corporate governance rules.

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Interest Expense

Interest expense decreased 26.4% to $53,000 for the three months ended March 31, 2003 from $72,000 for the three months ended March 31, 2002. The decrease in interest expense for the three-month period was primarily due to a decrease in capital lease obligations.

Interest and Other Income

Interest and other income decreased 50.0% to $20,000 for the three months ended March 31, 2003 from $40,000 for the three months ended March 31, 2002. The decrease in interest and other income for the three-month period was primarily due to the reduction of funds available for investment in 2003.

Income Taxes

No provision or benefit for federal, state or foreign income taxes was made for the three months ended March 31, 2003 due to the operating losses and operating loss carryforwards from prior periods incurred in the respective periods. Net operating loss carryforwards available at December 31, 2002 expire at various times through the year 2022, and are available to offset future taxable income. The timing and levels of future profitability may result in the expiration of net operating loss carryforwards before utilization. Additionally, utilization of such net operating losses may be limited as a result of cumulative ownership changes in the Company's equity instruments.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash flows from operations have historically been insufficient to fund its operations. Shortfalls in cash flows from operations have been funded primarily through the private and public sale of equity securities and, to a lesser extent, equipment financing and borrowing arrangements.

As of March 31, 2003, the Company had $8.4 million in cash and cash equivalents, reflecting a net decrease of $0.6 million since December 31, 2002. The working capital deficit was $10.7 million and $9.7 million as of March 31,

2003 and December 31, 2002, respectively. The decrease in working capital resulted primarily from the funding of operations, partially offset by Recent Capital Raised, as defined below.

Net cash used in operating activities was $2.8 million for the three months ended March 31, 2003 as compared to cash provided by operating activities of $4.4 million for the three months ended March 31, 2002. During February 2002, the Company received $6.0 million from Ceridian as a prepayment by Ceridian of minimum guaranteed payments for 2003 due to the Company pursuant to the Original Ceridian Agreement, as amended from time to time. During the three months ended March 31, 2003, the Company received $0.6 million from Ceridian pursuant to the Ceridian Services Agreement.

Net cash used in investing activities totaling $0.6 million for the three months ended March 31, 2003 was consistent with the prior year comparable period due to similar capital expenditures for both periods.

Net cash provided by financing activities for the three months ended March 31, 2003 was $2.8 million as compared to net cash used in financing activities of $0.7 million for the three months ended March 31, 2002. The increase in net cash provided by financing activities was primarily due to the proceeds from Recent Capital Raised.

Days sales outstanding, calculated on a trailing three-month basis ("DSO"), as of March 31, 2003 and 2002, were 49 days and 80 days, respectively. The decrease in DSO's in 2003 was the result of (1) the recognition of additional subscription revenue in the three months ended March 31, 2003 (i.e., increase of $1.9 million from the same period in 2002) from the Original Ceridian Agreement which does not have related accounts receivable; (2)

an improvement in the quality of accounts receivable; and (3) the Company's change in business strategy to focus on both license sales (as in the past) and Intersourcing sales (beginning in 2002 and strengthening in 2003).

During the first quarter of 2003, the Company raised an aggregate total of $3.2 million of capital through the private sales of 800,000 shares of the Company's Common Stock and warrants to purchase 80,000 shares of the Company's Common Stock at $4 per share ("Recent Capital Raised"). As the Company's revenue mix shifts from license revenue to recurring revenue, particularly through the Intersourcing Offering, and cash inflow consequently shifts from relatively large, one-time upfront payments to recurring monthly payments, the Company may continue to seek to raise additional funds through the sale of additional shares of Common Stock or other securities.

The Company has a revolving line of credit (the "Credit Facility") with Silicon Valley Bank, which is secured by all of the Company's assets, including a negative pledge on intellectual property, and bears interest at a rate equal to Prime Rate plus 1.0% per annum (reduced to Prime Rate plus 0.5% per annum upon two consecutive quarters of net profitability). The Credit Facility provides working capital financing for up to 75% of the Company's eligible accounts receivable, as defined, financing for eligible equipment purchases for up to $2.5 million with additional limits for software purchases, and stand-by letters of credit for up to $0.5 million. The maximum amount available under the Credit Facility is $5.0 million. The Credit Facility, as amended, expires on May 28, 2004. As of March 31, 2003, the Company had $1.2 million outstanding under the eligible equipment purchases portion of the Credit Facility, with an aggregate of $3.8 million available under the Credit Facility. The Company was not in compliance with the Quick Ratio financial covenant of the Credit Facility, as defined in the Credit Facility (the "Quick Ratio"), for the month

ended March 31, 2003. On April 29, 2003, the Company and Silicon Valley Bank amended the Credit Facility to modify the Quick Ratio by reducing the requirement from a ratio of 2.0 to 1.0 to 1.75 to 1.0. This loan modification was effective for the month ended March 31, 2003 and each month thereafter through the revised expiration date of May 28, 2004. As a result of the loan modification, the Company is in compliance with all debt covenants pursuant to the Credit Facility, as amended from time to time. Under the terms of the Credit Facility, no dividends may be paid on the Company's Common Stock without the consent of Silicon Valley Bank.

The Company believes that cash and cash equivalents, cash generated from operations, including Recent Capital Raised, and available borrowings under the Credit Facility will be sufficient to fund its operations for at least the next 12 months. This belief is based upon, among other factors, management's expectations for future revenue growth, improvements in gross margins, controlled operating expenses and collections of accounts receivable. However, as discussed above, the Company may seek to raise additional funds during such period through the sale of additional shares of Common Stock or other securities. There can be no assurance that the Company will be able to raise such funds on terms acceptable to the Company.

QUARTERLY FLUCTUATIONS

The Company's quarterly revenues and operating results have varied significantly in the past and are likely to vary substantially from quarter to quarter in the future. The Company's 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 and sales and marketing), timing of product releases, increased competition, variations in the mix of revenues, announcements of new products by the Company or its competitors and capital spending patterns of the Company's customers. The Company establishes its expenditure levels based upon its expectations as to future revenues, and, if revenue levels are below expectations, expenses can be disproportionately high. A drop in near term demand for the Company's 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 the Company will be able to establish or, when established, maintain profitability on a quarterly basis. The Company believes that,

due to the underlying factors for quarterly fluctuations, period-to-period comparisons of its 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 contains 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 the Company's expectations or beliefs, including, but not limited to, statements concerning the Company's 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. The Company's actual results could differ materially from those contained in the forward-looking

statements. Factors that may cause such differences include, but are not limited to, those discussed in the foregoing Management's Discussion and Analysis of Financial Condition and Results of Operations as well as those discussed in the Company's Form 10-K, including Exhibit 99.1 thereto. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the ordinary course of its operations, the Company is exposed to certain market risks, primarily interest rates. Uncertainties that are either non-financial or non-quantifiable, such as political, economic, tax, other regulatory or credit risks are not included in the following assessment of the Company's market risks.

Interest rates. Cash equivalents consist of money market accounts with original maturities of less than three months. Interest on the Credit Facility, as amended, which expires on May 28, 2004, is based on Prime Rate plus 1.0% per annum. As of March 31, 2003, $1.2 million was outstanding under the Credit Facility and the interest rate was 5.75% per annum. Changes in interest rates could impact the Company's anticipated interest income from interest-bearing cash accounts, or cash equivalents, as well as interest expense on current and future borrowings under the Credit Facility.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures. Within the 90 days prior to the filing date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company'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 our disclosure controls and procedures pursuant to Securities Exchange Act of 1934 Rule 13a-15. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information required to be included in the Company's periodic SEC reports. In addition, there have been no significant changes in the Company's internal controls or in other factors that could significantly affect those controls subsequent to the date of their evaluation, including any corrective actions with respect to significant deficiencies or material weaknesses. 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 there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

(b) Changes in internal controls. There have been no significant changes in internal controls or other factors that could significantly affect our internal controls subsequent to the date of such evaluation.

PART II -- OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

(c) Unregistered shares sold by the Company. During the three months ended March 31, 2003, the Company raised an aggregate of $3.2 million of additional capital through the private sales of 800,000 shares of the Company's common stock and warrants to purchase 80,000 shares of the Company's common stock at $4.00 per share to "accredited investors" as defined in Rule 501(a) under the Securities Act of 1933, as amended (the "Securities Act").

All of the shares of common stock and warrants sold during the three months ended March 31, 2003 were sold in private sales pursuant to Section 4(2) of the Securities Act. The Company did not offer or sell the securities by any form of general solicitation or general advertising. An underwriter was not used. The Company received representations from each of the purchasers in connection with the sale of securities, including that (i) such purchaser is an "accredited investor", (ii) such purchaser has the appropriate business or financial experience, (iii) such purchaser is able to bear the economic risk of such investment and (iv) such purchaser is purchasing the securities for its own account for investment purposes only and not with a view to or for distributing or reselling such securities.

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The warrants have an exercise price of $4.00 per share, are fully vested and exercisable and expire four years after the date of issuance. In the event of a reorganization, recapitalization, stock split, stock dividend, merger, sale of all or substantially all assets or other change in our corporate structure or shares, our Board of Directors is required to change the number and kind of shares (including by substituting shares of another corporation) subject to the warrants and/or the exercise price of the warrants in the manner that our Board of Directors reasonably deems equitable and appropriate.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

NUMBER	DESCRIPTION
10.10	Fourth Loan Modification Agreement dated April 29, 2003 by and between the Company and Silicon Valley Bank
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*
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*

*Filed herewith.

(b) Reports on Form 8-K

No report on Form 8-K was filed with the SEC during the quarter ended March 31, 2003.

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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: December 1, 2003

By: /s/ Mitchell K. Dauerman

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