

CBIZ, Inc.
Form 10-Q
November 09, 2006

Table of Contents

**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 September 30, 2006
OR**

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

**For the transition period from _____ to _____
Commission File Number 0-25890
CBIZ, INC.**

(Exact name of registrant as specified in its charter)

Delaware

22-2769024

(State or other jurisdiction of incorporation
or organization)

(I.R.S. Employer Identification No.)

6050 Oak Tree Boulevard, South, Suite 500,
Cleveland, Ohio

44131

(Address of principal executive offices)

(Zip Code)

(Registrant's telephone number, including area code) 216-447-9000

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

<u>Class of Common Stock</u>	<u>Outstanding at October 31, 2006</u>
Common Stock, par value \$0.01 per share	68,648,784

**CBIZ, INC. AND SUBSIDIARIES
TABLE OF CONTENTS**

	Page
<u>PART I. FINANCIAL INFORMATION:</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Balance Sheets – September 30, 2006 and December 31, 2005</u>	3
<u>Consolidated Statements of Operations – Three and Nine Months Ended September 30, 2006 and 2005</u>	4
<u>Consolidated Statements of Cash Flows – Nine Months Ended September 30, 2006 and 2005</u>	5
<u>Notes to the Consolidated Financial Statements</u>	6-23
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	24-44
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	45
<u>Item 4. Controls and Procedures</u>	45
<u>PART II. OTHER INFORMATION:</u>	
<u>Item 1. Legal Proceedings</u>	46
<u>Item 1A. Risk Factors</u>	46
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	46
<u>Item 6. Exhibits</u>	47
<u>Signature</u>	47
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

CBIZ, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (Unaudited)
(In thousands)

	SEPTEMBER 30, 2006	DECEMBER 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 15,477	\$ 8,909
Restricted cash	14,517	9,873
Accounts receivable, net	113,987	98,390
Notes receivable - current	2,084	6,042
Deferred income taxes - current	3,381	3,241
Other current assets	8,503	9,490
Assets of discontinued operations	205	8,696
Current assets before funds held for clients	158,154	144,641
Funds held for clients	62,270	65,669
Total current assets	220,424	210,310
Property and equipment, net	30,649	33,403
Notes receivable - non-current	2,599	3,575
Deferred income taxes - non-current	11,310	9,199
Goodwill and other intangible assets, net	206,729	184,462
Assets of deferred compensation plan	15,482	9,803
Other assets	6,707	3,832
Total assets	\$ 493,900	\$ 454,584
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 24,513	\$ 26,427
Income taxes payable	7,475	1,115
Accrued personnel costs	30,469	35,920
Other current liabilities	18,124	18,332
Liabilities of discontinued operations	2,991	5,991
Current liabilities before client fund obligations	83,572	87,785
Client fund obligations	62,270	65,669
Total current liabilities	145,842	153,454

Convertible notes	100,000	
Bank debt		32,200
Deferred compensation plan obligations	15,482	9,803
Other non-current liabilities	6,353	4,466
Total liabilities	267,677	199,923
STOCKHOLDERS EQUITY		
Common stock	1,013	984
Additional paid-in capital	463,848	450,734
Accumulated deficit	(73,347)	(94,714)
Treasury stock	(165,237)	(102,317)
Accumulated other comprehensive loss	(54)	(26)
Total stockholders equity	226,223	254,661
Total liabilities and stockholders equity	\$ 493,900	\$ 454,584

See the accompanying notes to the consolidated financial statements.

Table of Contents

CBIZ, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(In thousands, except per share data)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2006	2005	2006	2005
Revenue	\$ 143,382	\$ 135,345	\$ 467,201	\$ 430,189
Operating expenses	128,235	120,533	397,741	368,554
Gross margin	15,147	14,812	69,460	61,635
Corporate general and administrative expense	5,568	6,364	19,633	20,234
Depreciation and amortization expense	4,300	3,759	12,540	11,436
Operating income	5,279	4,689	37,287	29,965
Other income (expense):				
Interest expense	(844)	(787)	(2,503)	(2,413)
Gain on sale of operations, net	7	29	14	29
Other income, net	995	1,069	2,806	2,214
Total other income (expense), net	158	311	317	(170)
Income from continuing operations before income tax expense	5,437	5,000	37,604	29,795
Income tax expense	2,117	2,142	15,079	12,061
Income from continuing operations	3,320	2,858	22,525	17,734
Gain (loss) from operations of discontinued operations, net of tax	250	(1,625)	(1,664)	(4,929)
Gain on disposal of discontinued operations, net of tax	553	802	506	693
Net income	\$ 4,123	\$ 2,035	\$ 21,367	\$ 13,498
Earnings per share:				
Basic:				
Continuing operations	\$ 0.05	\$ 0.04	\$ 0.31	\$ 0.24
Discontinued operations	0.01	(0.01)	(0.01)	(0.06)
Net income	\$ 0.06	\$ 0.03	\$ 0.30	\$ 0.18

Diluted:				
Continuing operations	\$ 0.05	\$ 0.04	\$ 0.30	\$ 0.23
Discontinued operations	0.01	(0.01)	(0.01)	(0.05)
Net income	\$ 0.06	\$ 0.03	\$ 0.29	\$ 0.18
Basic weighted average shares outstanding	68,314	73,793	72,092	74,895
Diluted weighted average shares outstanding	70,421	75,988	74,406	76,886

See the accompanying notes to the consolidated financial statements.

Table of Contents

CBIZ, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In thousands)

	NINE MONTHS ENDED	
	SEPTEMBER 30,	
	2006	2005
Cash flows from operating activities:		
Net income	\$ 21,367	\$ 13,498
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Loss from operations of discontinued operations, net of tax	1,664	4,929
Gain on disposal of discontinued operations, net of tax	(506)	(693)
Gain on sale of operations, net	(14)	(29)
Life insurance benefit in excess of cash surrender value	(383)	
Bad debt expense, net of recoveries	2,504	3,831
Depreciation and amortization expense	12,540	11,436
Deferred income taxes	(3,093)	(4,358)
Stock-based compensation expense	2,777	160
<i>Changes in assets and liabilities, net of acquisitions and dispositions:</i>		
Restricted cash	(4,526)	987
Accounts receivable, net	(15,454)	(11,043)
Other assets	165	456
Accounts payable	(3,078)	(3,939)
Income taxes	5,556	8,649
Accrued personnel costs	(5,624)	7,370
Other liabilities	894	1,764
Net cash provided by continuing operations	14,789	33,018
Operating cash flows provided by discontinued operations	1,397	1,795
Net cash provided by operating activities	16,186	34,813
Cash flows from investing activities:		
Business acquisitions, net of cash acquired and contingent consideration earned	(20,578)	(11,014)
Acquisition of other intangible assets	(2,416)	
Proceeds from sales of divested operations and client lists	19	29
Proceeds from sales of discontinued operations	7,303	2,000
Proceeds from life insurance benefit	560	
Additions to property and equipment, net	(4,824)	(4,739)
Payments received on notes receivable	1,528	1,320
Net cash used in investing activities	(18,408)	(12,404)
Cash flows from financing activities:		
Proceeds from convertible notes	100,000	

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Proceeds from bank debt	142,900	203,100
Proceeds from notes payable		196
Payment of bank debt	(175,100)	(213,250)
Payment of notes payable and capitalized leases	(503)	(624)
Debt issuance costs	(3,561)	(40)
Payment for acquisition of treasury stock	(62,920)	(13,736)
Proceeds from exercise of stock options	5,265	2,169
Excess tax benefit from exercise of stock options	2,709	
Net cash provided by (used in) financing activities	8,790	(22,185)
Net increase in cash and cash equivalents	6,568	224
Cash and cash equivalents at beginning of year	8,909	5,291
Cash and cash equivalents at end of period	\$ 15,477	\$ 5,515

See the accompanying notes to the consolidated financial statements.

Table of Contents

CBIZ, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Summary of Significant Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the U.S. Securities and Exchange Commission. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements.

In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments (consisting solely of normal recurring adjustments) considered necessary to present fairly the financial position of CBIZ, Inc. and its consolidated subsidiaries (CBIZ) as of September 30, 2006, and December 31, 2005, the results of their operations for the three and nine months ended September 30, 2006 and 2005, and cash flows for the nine months ended September 30, 2006 and 2005. Due to seasonality, potential changes in economic conditions, interest rate fluctuations and other factors, the results of operations for such interim periods are not necessarily indicative of the results for the full year. For further information, refer to the consolidated financial statements and notes thereto included in CBIZ's Annual Report on Form 10-K for the year ended December 31, 2005, with subsequent reclassifications made thereto as filed on our Current Report on Form 8-K dated May 22, 2006 (collectively referred to as Annual Report).

Organization

CBIZ is a diversified services company which, acting through its subsidiaries, provides professional business services primarily to small and medium-sized businesses, as well as individuals, governmental entities, and not-for-profit enterprises throughout the United States and Toronto, Canada. During the first quarter of 2006, CBIZ realigned its operations into four client-centric practice groups: Financial Services, Employee Service, Medical Management Professionals, and National Practices. A further description of changes made during the first quarter of 2006, as well as products and services offered by each of the practice groups, is provided in Note 9.

Principles of Consolidation

The accompanying consolidated financial statements reflect the operations of CBIZ and all of its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The accompanying consolidated financial statements do not reflect the operations or accounts of variable interest entities as the impact is not material to the financial condition, results of operations or cash flows of CBIZ. See further discussion under Variable Interest Entities below.

Use of Estimates

The preparation of consolidated 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, the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Management's estimates and assumptions include, but are not limited to, estimates of collectibility of accounts receivable and unbilled revenue, the realizability of goodwill and other intangible assets, accrued liabilities (such as incentive compensation), income taxes and other factors. Management's estimates and assumptions are derived from and are continually evaluated based upon available information, judgment and experience. Actual results could differ from those estimates.

Reclassifications

Certain amounts in the 2005 consolidated financial statements have been reclassified to conform to the current year presentation. Reclassifications include: interest income earned by our payroll unit previously reported as other income which is now reported as revenue; and certain expenses reimbursable to CBIZ by its clients previously netted against revenue which are now reported as operating expenses. These reclassifications did not impact CBIZ's reported income from continuing operations.

Table of Contents

CBIZ, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

Prior period financial statements and disclosures have been reclassified to reflect discontinued operations. In addition, for the nine-month period ended September 30, 2006 CBIZ has separately disclosed the operating and investing portions of the cash flows attributable to its discontinued operations, which were combined and reported as a single amount in the comparable period of 2005. Prior periods have been revised to conform to the current year presentation. There were no financing activities attributable to the operations of discontinued operations during the nine months ended September 30, 2006 or 2005.

Revenue Recognition and Valuation of Unbilled Revenues

Revenue is recognized only when all of the following are present: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, our fee to the client is fixed or determinable, and collectibility is reasonably assured. These criteria are in accordance with GAAP and SEC Staff Accounting Bulletin No. 104 (SAB 104). CBIZ offers a vast array of products and business services to its clients. Those services are delivered through four practice groups. A description of revenue recognition, as it relates to those groups, is provided below.

Financial Services Revenue consists primarily of fees for accounting services, preparation of tax returns, consulting services including Sarbanes-Oxley consulting and compliance projects, and valuation services including fairness opinions, business plans, litigation support, purchase price allocations and derivative valuations. Revenues are recorded in the period in which services are provided and meet revenue recognition criteria in accordance with SAB 104. CBIZ bills clients based upon a predetermined agreed-upon fixed fee or based on actual hours incurred on client projects at expected net realizable rates per hour, plus agreed-upon out-of-pocket expenses. The cumulative impact on any subsequent revision in the estimated realizable value of unbilled fees for a particular client project is reflected in the period in which the change becomes known.

Through one of its Financial Services units, CBIZ provides flexible benefits administration services to clients, grants access of its proprietary software to third parties, and provides hosting services to these parties. Revenue associated with set up and license fees related to our flexible benefits services are deferred and recognized pro rata over the life of the contract.

Employee Services Revenue consists primarily of brokerage and agency commissions, payroll service fees, interest on client funds, and fee income for administering health and retirement plans. A description of the revenue recognition, based on the service provided, insurance product sold, and billing arrangement, is described below.

Commissions relating to brokerage and agency activities whereby CBIZ has primary responsibility for the collection of premiums from insureds (agency or indirect billing) are recognized as of the latter of the effective date of the insurance policy or the date billed to the customer; commissions to be received directly from insurance companies (direct billing) are recognized when the policy becomes effective; and life insurance commissions are recognized when the policy becomes effective. Commission revenue is reported net of sub-broker commissions, and reserves for estimated policy cancellations and terminations. The cancellation and termination reserve is based upon estimates and assumptions using historical cancellation and termination experience and other current factors to project future experience. CBIZ periodically reviews the adequacy of the reserve and makes adjustments as necessary. The use of different estimates or assumptions could produce different results.

Commissions which are based upon certain performance targets are recognized at the earlier of written notification that the target has been achieved, or cash collection.

Fee income is recognized in the period in which services are provided, and may be based on actual hours incurred on an hourly fee basis, fixed fee arrangements, or asset-based fees.

Payroll Revenue is recognized when the actual payroll processing occurs.

Table of Contents

CBIZ, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

Medical Management Professionals Fees for services are primarily based on a percentage of net collections on our clients' patient accounts receivable. As such, revenue is determinable, earned, and recognized, when payments are received by our clients on their patient accounts.

National Practices The business units that comprise this practice group offer a variety of services. A description of revenue recognition associated with the primary services is provided below.

Technology Consulting Revenue associated with hardware and software sales is recognized upon delivery and acceptance of the product. Revenue associated with installation is recognized as services are performed, and revenue associated with service agreements is recognized on a straight-line basis over the period of the agreement. Consulting revenue is recognized on an hourly or per diem fee basis as services are performed.

Health Care Consulting CBIZ bills clients based upon a predetermined agreed-upon fixed fee or based on actual hours incurred on client projects at expected net realizable rates per hour, plus agreed-upon out-of-pocket expenses, or as a percentage of savings after contingencies have been resolved and verified by a third party.

Mergers & Acquisitions and Capital Advisory Revenue associated with non-refundable retainers is recognized on a pro rata basis over the life of the engagement. Revenue associated with success fee transactions is recognized when the transaction is completed.

Certain of our client arrangements encompass multiple deliverables. CBIZ accounts for these arrangements in accordance with Emerging Issues Task Force No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* (EITF 00-21). If the deliverables meet the criteria in EITF 00-21, the deliverables are divided into separate units of accounting and revenue is allocated to the deliverables based on their relative fair values. Revenue for each unit is recognized separately in accordance with CBIZ's revenue recognition policy for each unit. For those arrangements where the deliverables do not qualify as a separate unit of accounting, revenue from all deliverables are treated as one accounting unit and evaluated for appropriate accounting treatment based upon the underlying facts and circumstances.

Operating Expenses

Operating expenses represent costs of service and other costs incurred to operate our business units, and are primarily comprised of personnel and occupancy related expenses. Personnel costs include base compensation, commissions, payroll taxes, income or losses earned on assets of the deferred compensation plan, and benefits, which are recognized as expense as they are incurred. Personnel costs also include stock-based and incentive compensation costs, which are estimated and accrued on a monthly basis. The ultimate determination of incentive compensation is made after year-end results are finalized, and therefore estimates are subject to change. Total personnel costs were \$94.7 million and \$88.2 million for the three months ended and \$296.2 million and \$269.6 million for the nine months ended September 30, 2006 and 2005, respectively.

The largest components of occupancy costs are rent expense and utilities. Base rent expense is recognized over respective lease terms, while utilities and common area maintenance charges are recognized as incurred. Total occupancy costs were \$9.5 million and \$8.9 million for the three months ended and \$28.4 million and \$26.4 million for the nine months ended September 30, 2006 and 2005, respectively.

Accounts Receivable and Allowance for Doubtful Accounts

CBIZ carries accounts receivable at their face amount less allowances for doubtful accounts, and carries unbilled revenues at estimated net realizable value. Assessing the collectibility of receivables (billed and unbilled) requires management judgment. When evaluating the adequacy of the allowance for doubtful accounts and the overall collectibility of receivables, CBIZ analyzes historical bad debts, client credit-worthiness, the age of accounts receivable and current economic trends and conditions.

Table of Contents

CBIZ, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

Funds Held for Clients and Client Fund Obligations

Payroll services provided by CBIZ include the preparation of payroll checks, federal, state, and local payroll tax returns, and flexible spending account administration. In relation to these services, CBIZ collects funds from its clients' accounts in advance of paying these client obligations. Funds that are collected before they are due are segregated and reported separately as funds held for clients in the consolidated balance sheets, and may include cash, cash equivalents and short-term investments. Other than certain federal and state regulations pertaining to flexible spending account administration, there are no regulatory or other contractual restrictions placed on these funds. Funds held for clients and the related client fund obligations are included in the consolidated balance sheets as current assets and current liabilities, respectively. The amount of collected but not yet remitted funds may vary significantly during the year.

One of the business units classified as a discontinued operation collects funds from clients' accounts in advance of paying the related client obligations. These funds and related liabilities are reported as assets of discontinued operations and liabilities of discontinued operations, respectively, in the accompanying consolidated balance sheets.

Stock-Based Awards

On January 1, 2006, CBIZ adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which requires the measurement and recognition of compensation cost for all share-based payment awards made to employees and directors based on estimated fair values. SFAS 123R also amends FASB Statement No. 95, Statement of Cash Flows, to require that excess tax benefits, as defined, realized from the exercise of stock options be reported as a financing cash inflow rather than as a reduction of taxes paid in cash flows from operations. In March 2005, the Securities and Exchanges Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 107, which summarizes the SEC's views regarding the interaction between SFAS 123R and certain SEC rules and regulations, as well as the SEC's views regarding the valuation of share-based payment arrangements. CBIZ applied the provisions of SAB 107 in its adoption of SFAS 123R.

Prior to the adoption of SFAS 123R, CBIZ accounted for its stock-based compensation related to stock options under the intrinsic value recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and the disclosure alternative prescribed by SFAS No. 123 Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Accordingly, CBIZ presented pro forma information for the periods prior to the adoption of SFAS No. 123R and no compensation cost was recognized for stock options granted prior to January 1, 2006.

CBIZ adopted SFAS 123R using the modified prospective transition method. Accordingly, CBIZ has recorded stock compensation expense for all awards granted after the adoption date (January 1, 2006) and for the unvested portion of previously granted awards outstanding with unrecognized expense as of the adoption date. Expense recognized for the unvested portion of awards granted prior to January 1, 2006, are based on the estimated grant date fair value as determined under the original provisions of SFAS No. 123. CBIZ's consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R.

CBIZ recognizes stock-based compensation costs for only those shares expected to vest, on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of up to five years. The impact of forfeitures that may occur prior to vesting is also estimated and considered in the amount of expense recognized. Forfeiture estimates will be revised, if necessary, in subsequent periods if actual forfeitures differ from

those estimates. In CBIZ's pro forma information required under SFAS 123 for periods prior to adoption of SFAS 123R, CBIZ accounted for forfeitures as they occurred. Stock-based compensation expense is recorded in operating expenses or corporate general and administrative expenses depending on where the respective individual's compensation is recorded.

Table of Contents**CBIZ, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

CBIZ utilizes the Black-Scholes option-pricing model to determine the fair value of stock options on the date of grant. The fair value of stock options granted during 2006 and 2005 were determined using the following weighted average assumptions:

	2006	2005
Weighted average grant-date fair value of options granted	\$ 3.59	\$ 1.65
Expected volatility (1)	48.23%	49.71%
Expected option life (years) (2)	4.25	5.00
Risk-free interest rate (3)	4.85%	3.90%
Expected dividend yield (4)	0.00%	0.00%

- (1) The expected volatility assumption was determined based upon the historical volatility of CBIZ's stock price, using daily price intervals. CBIZ believes that the future volatility of its stock price will not differ significantly from its history.
- (2) The expected option life assumption was determined by considering the vesting and contractual terms of the respective options.
- (3) The risk-free interest rate assumption was based upon zero-coupon U.S. Treasury bonds with a term approximating the expected life of the respective options.
- (4) The expected dividend yield assumption was determined in view of CBIZ's historical and estimated dividend payouts. CBIZ does not expect to change its dividend payout policy in the foreseeable future. CBIZ has granted various stock-based awards under its 1996 Employee Stock Option Plan and 2002 Stock Incentive Plan, which are described in further detail in our 2005 Annual Report. The terms and vesting schedules for stock-based awards vary by type and date of grant. Compensation cost recognized in the consolidated statements of operations for these awards during the three and nine months ended September 30, 2006 and 2005 was as follows (in thousands):

THREE MONTHS ENDED SEPTEMBER 30, 2006	NINE MONTHS ENDED SEPTEMBER 30,
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