

NIC INC  
Form 10-Q  
August 04, 2008

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-Q

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

For the quarterly period ended June 30, 2008

Commission file number 000-26621

## NIC INC.

(Exact name of registrant as specified in its charter)

**Colorado**  
(State or other jurisdiction of  
incorporation or organization)

**52-2077581**  
(I.R.S. Employer  
Identification No.)

**25501 West Valley Parkway, Suite 300, Olathe, Kansas 66061**

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(877) 234-3468**

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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, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares outstanding of the registrant's common stock as of July 30, 2008 was 62,655,130.

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**PART I - FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****NIC INC.****CONSOLIDATED BALANCE SHEETS****(UNAUDITED)****thousands**

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 41,575	\$ 38,236
Short-term investments		17,600
Trade accounts receivable	34,388	28,149
Unbilled revenues	591	720
Deferred income taxes, net	7,008	6,746
Prepaid expenses & other current assets	1,647	2,143
Total current assets	85,209	93,594
Long-term investments	6,545	
Property and equipment, net	6,695	6,110
Deferred income taxes, net	6,914	10,809
Other assets	1,149	863
Total assets	\$ 106,512	\$ 111,376
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 37,964	\$ 36,498
Accrued expenses	6,949	6,848
Application development contracts	282	353
Other current liabilities	368	99
Total current liabilities	45,563	43,798
Other long-term liabilities	714	714
Total liabilities	46,277	44,512
Commitments and contingencies (Notes 1, 2 and 5)		
Shareholders' equity:		
Common stock, no par, 200,000 shares authorized 62,655 and 62,031 shares issued and outstanding		
Additional paid-in capital	153,542	165,934
Accumulated deficit	(92,734)	(98,902)
Accumulated other comprehensive loss	(405)	
	60,403	67,032
Less treasury stock	(168)	(168)
Total shareholders' equity	60,235	66,864
Total liabilities and shareholders' equity	\$ 106,512	\$ 111,376

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

## NIC INC.

## CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

thousands except for per share amounts

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
<b>Revenues:</b>				
Portal revenues	\$ 24,621	\$ 20,610	\$ 48,417	\$ 40,478
Software & services revenues	1,081	866	1,964	1,632
Total revenues	25,702	21,476	50,381	42,110
<b>Operating expenses:</b>				
Cost of portal revenues, exclusive of depreciation & amortization	13,006	10,419	25,711	20,873
Cost of software & services revenues, exclusive of depreciation & amortization	707	493	1,140	964
Selling & administrative	5,822	5,445	11,785	10,565
Depreciation & amortization	899	577	1,745	1,112
Total operating expenses	20,434	16,934	40,381	33,514
Operating income	5,268	4,542	10,000	8,596
<b>Other income (expense):</b>				
Interest income	110	317	443	897
Other expense, net			(20)	
Total other income (expense)	110	317	423	897
Income before income taxes	5,378	4,859	10,423	9,493
Income tax provision	2,198	2,107	4,255	3,995
Net income	\$ 3,180	\$ 2,752	\$ 6,168	\$ 5,498
<b>Basic net income per share</b>				
Basic net income per share	\$ 0.05	\$ 0.04	\$ 0.10	\$ 0.09
<b>Diluted net income per share</b>				
Diluted net income per share	\$ 0.05	\$ 0.04	\$ 0.10	\$ 0.09
<b>Weighted average shares outstanding:</b>				
Basic	62,497	61,769	62,309	61,711
Diluted	62,956	62,256	62,795	62,113

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

## NIC INC.

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

(UNAUDITED)

thousands

	Common Stock		Additional	Accumulated	Accumulated	Treasury	Total
	Shares	Amount	Paid-in	Deficit	Other	Stock	
			Capital		Loss		
<b>Balance, January 1, 2008</b>	62,031	\$	\$ 165,934	\$ (98,902)	\$	\$ (168)	\$ 66,864
Net income				6,168			6,168
Unrealized holding loss on investments (Note 1)					(405)		(405)
Cash dividends on common stock (Note 3)			(15,709)				(15,709)
Shares surrendered upon vesting of restricted stock to satisfy tax withholdings	(6)		(43)				(43)
Stock options exercises and restricted stock vestings	568		1,852				1,852
Stock-based compensation			1,228				1,228
Issuance of common stock under employee stock purchase plan	62		280				280
<b>Balance, June 30, 2008</b>	62,655	\$	\$ 153,542	\$ (92,734)	\$ (405)	\$ (168)	\$ 60,235

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

## NIC INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

thousands

	Six months ended June 30,	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 6,168	\$ 5,498
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation & amortization	1,745	1,112
Stock-based compensation expense	1,228	864
Application development contracts	(71)	(80)
Deferred income taxes	3,633	3,406
Loss on disposal of property and equipment	20	
Changes in operating assets and liabilities:		
(Increase) decrease in trade accounts receivable	(6,239)	417
Decrease in unbilled revenues	129	628
Decrease in prepaid expenses & other current assets	496	168
Decrease in other assets		2
Increase (decrease) in accounts payable	1,466	(4,022)
Increase in accrued expenses	58	1,096
Increase in other current liabilities	269	104
Increase in other long-term liabilities		122
Net cash provided by operating activities	8,902	9,315
Cash flows from investing activities:		
Purchases of property and equipment	(2,228)	(1,658)
Capitalized internal use software development costs	(408)	(181)
Purchases of investments	(1,000)	(2,000)
Sales and maturities of investments	11,650	45,008
Net cash provided by investing activities	8,014	41,169
Cash flows from financing activities:		
Cash dividends on common stock	(15,709)	(46,730)
Proceeds from employee common stock purchases	280	239
Proceeds from exercise of employee stock options	1,852	506
Net cash used in financing activities	(13,577)	(45,985)
Net increase in cash and cash equivalents	3,339	4,499
Cash and cash equivalents, beginning of period	38,236	36,745
Cash and cash equivalents, end of period	\$ 41,575	\$ 41,244
Other cash flow information:		
Income taxes paid	\$ 469	\$ 603

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



## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The consolidated interim financial statements of NIC Inc. and its subsidiaries ( "NIC" or the "Company" ) included herein have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ( "SEC" ). Certain information and disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In management's opinion, the unaudited consolidated interim financial statements reflect all adjustments (which include only normal recurring adjustments, except as disclosed) necessary to present fairly the consolidated financial position, results of operations and cash flows of the Company and its subsidiaries as of the dates and for the interim periods presented. These unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC on March 17, 2008, and Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Form 10-Q. The consolidated balance sheet data included herein as of December 31, 2007 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for the three- and six-month periods ended June 30, 2008 are not necessarily indicative of the results to be expected for the full year ending December 31, 2008.

### 1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### *The Company*

NIC Inc. is a provider of eGovernment services that helps governments use the Internet to increase internal efficiencies and provide a higher level of service to businesses and citizens. The Company accomplishes this currently through two divisions: its primary portal outsourcing businesses and its software & services businesses.

In its primary portal outsourcing business, the Company designs, builds and operates Internet-based portals on behalf of state and local governments desiring to provide access to government information and to complete government-based transactions online. These portals consist of Web sites and applications the Company has built that allow businesses and citizens to access government information online and complete transactions, including applying for a permit, retrieving driver's license records or filing a government-mandated form or report. Operating under multiple-year contracts (see Note 2), NIC markets the services and solicits users to complete government-based transactions and to enter into subscriber contracts permitting users to access the portal and the government information contained therein in exchange for transactional and/or subscription user fees. The Company manages operations for each contractual relationship through separate local subsidiaries that operate as decentralized businesses with a high degree of autonomy. NIC's self-funding business model allows the Company to reduce its government partners' financial and technology risks and generate revenues by sharing in the fees the Company collects from eGovernment transactions. The Company's government partners benefit through gaining a centralized, customer-focused presence on the Internet, while businesses and citizens receive a faster, more convenient and more cost-effective means to interact with governments. The Company is typically responsible for funding up front investment and ongoing operational costs of the government portals.

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The Company's software & services businesses primarily include its Uniform Commercial Code ( UCC ) and corporate filings software development business and its ethics & elections business. The Company's UCC and corporate filings software development business, NIC Conquest, is a provider of software applications and services for electronic filings and document management solutions for governments. This business focuses on Secretaries of State, whose offices are state governments' principal agencies for UCC and corporate filings. Currently, NIC Conquest is primarily engaged in servicing its contract with the California Secretary of State and is not actively marketing its applications and services in respect of new engagements. The Company's ethics & elections business, NIC Technologies, designs and develops online campaign expenditure and ethics compliance systems for federal and state government agencies. Currently, NIC

Technologies is primarily engaged in servicing its contracts with the Federal Election Commission and the State of Michigan.

*Basis of presentation*

The Company classifies its revenues and cost of revenues into two categories: (1) portal and (2) software & services. The portal category includes revenues from the Company's subsidiaries operating government portals under long-term contracts on an outsourced basis. The software & services category includes revenues primarily from the Company's software & services businesses. The primary categories of operating expenses include: cost of portal revenues, cost of software & services revenues, selling & administrative, and depreciation & amortization. Cost of portal revenues consist of all direct costs associated with operating government portals on an outsourced basis including employee compensation (including stock-based compensation), telecommunications, credit card merchant fees, and all other costs associated with the provision of dedicated client service such as dedicated facilities. Cost of software & services revenues consist of all direct project costs to provide software development and services such as employee compensation (including stock-based compensation), subcontractor labor costs, and all other direct project costs including hardware, software, materials, travel and other out-of-pocket expenses. Selling & administrative costs consist primarily of corporate-level expenses relating to human resource management, administration, information technology, legal and finance, and all costs of non-customer service personnel from the Company's software & services businesses, including information systems and office rent. Selling & administrative costs also consist of stock-based compensation and corporate-level expenses for market development and public relations.

*Investments*

The Company accounts for investments in debt securities in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 115, Accounting for Certain Investments in Debt and Equity Securities. The Company's investments at June 30, 2008 and December 31, 2007, consisting entirely of student loan auction-rate securities ( SLARS ), were classified as available-for-sale at the time of purchase. The Company re-evaluates such designation at each reporting date. Investments are reported at fair value with any unrealized holding gains or losses included in accumulated other comprehensive income or loss, a component of shareholders' equity, net of tax, until realized. Realized gains or losses on the sale of investments are determined using the specific-identification method and have not historically been material.

The par and fair values of the Company's investments are as follows (in thousands):

June 30, 2008			December 31, 2007		
Par Value	Unrealized Loss	Fair Value	Par Value	Unrealized Gain (Loss)	Fair Value
\$ 6,950	\$ (405)	\$ 6,545	\$ 17,600	\$	\$ 17,600

The Company assesses other-than-temporary impairment of its investments in accordance with Financial Accounting Standards Board Staff Position No. 115-1, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments. The Company evaluates its investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and the Company's ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery of market value. The Company records an impairment charge to the extent that the carrying value of available-for-sale securities exceeds the estimated fair market value of the securities and the decline in value is determined to be other-than-temporary. For the three- and six-month periods ended June 30, 2008 and 2007, the Company did not recognize any other-than-temporary impairment charges on its investments.

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The Company's SLARS are structured with short-term interest rates that are reset through an auction process at 28-day intervals, but with contractual debt maturities that can be well in excess of 22 years. Historically, the Company has had the option to liquidate its SLARS whenever the interest rates on these securities were reset. Accordingly, such securities were classified as short-term at December 31, 2007. During January 2008, the Company began to liquidate its SLARS at each interest rate reset date in anticipation of paying a special cash dividend of \$0.25 per share on February 28, 2008, totaling approximately \$15.7 million (see Note 3). The Company had successful auctions on these securities with scheduled 28-day reset dates through mid-February 2008, at which time the Company had liquidated approximately \$11.6 million of its portfolio. Furthermore, there were

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successful auctions during January 2008 for each security the Company currently holds. Accordingly, the Company determined that there was no impairment of these investments at December 31, 2007. The Company encountered its first failed auction in mid-February 2008, as the amount of securities submitted for sale in those auctions exceeded the amount of bids. Subsequently, the Company has not had a successful auction related to the remaining SLARS it currently holds. Given the continued auction failures associated with these securities and the uncertainty as to when liquidity will return to the SLARS market, the Company classified these securities as long-term at June 30, 2008.

The Company's SLARS consist of the following taxable issues (in thousands) at June 30, 2008:

Security (Maturity)	Current Interest Rate	Next Interest Rate Reset Date	Par Value	Fair Value
SLM Student Loan Trust 2003-5 A-9 (6/17/2030)	3.96%	8/11/08	\$ 1,150	\$ 1,100
Missouri Higher Ed Loan Auth 2001 B (6/1/2031)	2.46%	8/12/08	1,000	938
Missouri Higher Ed Loan Auth 2002D (7/1/2032)	2.73%	8/11/08	2,800	2,628
NELNET Education Loan Funding 2003-1 A-6 (7/1/2043)	2.63%	8/05/08	1,000	922
Panhandle Plains Higher Ed Auth 2007 A-4 (8/1/2057)	3.71%	8/06/08	1,000	957
<b>Total</b>			<b>\$ 6,950</b>	<b>\$ 6,545</b>

The Company's SLARS are currently AAA-rated by one or more rating agencies and are secured by pools of student loans guaranteed by the U.S. Department of Education under the Federal Family Education Loan Program. This guarantee is based upon a sliding scale of 97% to 98% of the unpaid principal balance of eligible student loans, plus accrued interest, when the guarantor's claims experience is less than 5% of the original principal amount of the loans, and decreases to 75% if the guarantor's claims experience is greater than 9% of the original principal amount of the loans.

At December 31, 2007, the fair values of the Company's SLARS were based on market prices and broker-dealer quotes at the reporting date. Given the absence of quotes from the Company's broker-dealer and the lack of readily observable market quotes, the Company used valuation models for the determination of fair value at June 30, 2008. Based on management's assessment, the Company estimated the fair value of its SLARS to be approximately \$6.55 million at June 30, 2008. As a result, the Company has recorded unrealized holding losses of approximately \$0.1 million and \$0.4 million in accumulated other comprehensive loss, a component of shareholders' equity, related to the temporary impairment of its SLARS for the three- and six-month periods ended June 30, 2008. The Company believes this temporary impairment is primarily attributable to the illiquidity of these securities and not to the underlying credit quality of the issuers of its SLARS, which is further discussed above. To date the Company has collected all interest payable on all of its SLARS when due. For each unsuccessful auction, the interest rate moves to a maximum rate defined for each security. However, in certain situations, the maximum rate may be lower if historical average auction rates exceeded defined short-term interest benchmarks. The principal associated with failed auctions will not be accessible until a successful auction occurs, a buyer is found outside of the auction process, the issuers redeem the securities, the issuers establish a different form of financing to replace these securities, or final payments come due according to contractual maturities ranging from 22 to 50 years. The Company currently expects that it will receive the principal associated with its SLARS through one of the means described above.

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The valuation models used to estimate the fair value of the Company's SLARS at June 30, 2008 include numerous assumptions such as assessments of the underlying structure and collateral of each security, default risk, liquidity risk, expected cash flows, discount rates, issuer credit ratings, workout periods and overall capital market liquidity. These assumptions and assessments are subject to uncertainties, are difficult to predict

and require significant judgment. The use of different assumptions, applying different judgment to inherently subjective matters and changes in future market conditions could result in significantly different estimates of fair value. Although the Company currently believes that the decline in the fair value of these securities is temporary, there is a risk that the decline in value may ultimately be deemed to be other-than-temporary. Should the Company determine that the decline in value of these securities is other-than-temporary, it would result in a loss being recognized in its consolidated statements of income, which could be material.

#### *Fair Value Measurements*

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. Except for the portion of SFAS No. 157 that addresses nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, which has been deferred for one year, the Company adopted the provisions of SFAS No. 157 on January 1, 2008. The Company is currently evaluating the requirements of SFAS No. 157 that address nonfinancial assets and liabilities and has not yet determined the impact on its consolidated financial statements.

SFAS No. 157 establishes a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure the fair value of financial instruments. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1      Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2      Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3      Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The Company's assets or liabilities required to be measured at fair value on a recurring basis within the valuation hierarchy of SFAS No. 157 consist entirely of its student loan auction-rate securities, or SLARS. The Company's SLARS are classified within Level 3 of the fair value hierarchy because there is currently limited, or no, trading activity due to continued failed auctions and therefore such securities have little, or no, price transparency. A variety of factors are reviewed and monitored to assess fair value of the Company's SLARS, as further discussed above under *Investments*.

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The following table presents a reconciliation for all financial instruments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three- and six-month periods ended June 30, 2008 (in thousands):

	Three months ended June 30, 2008	Long-term Investments	Six months ended June 30, 2008
Balance, December 31, 2007	\$		\$
Impact of adoption of SFAS No. 157			
Beginning Balance	\$	6,654	\$
Total losses (realized/unrealized):			
Included in earnings			
Included in accumulated other comprehensive loss		(109)	(405)
Purchases, issuances and settlements			
Sales and maturities			
Transfers in and/or out of Level 3			6,950
Balance, June 30, 2008	\$	6,545	\$ 6,545

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. The Company did not elect to choose the fair value option and record unrealized gains and losses in earnings for any of its financial instruments. Accordingly, the adoption of SFAS No. 159 on January 1, 2008 did not have any impact on the unaudited consolidated financial statements of the Company.

*Concentration of credit risk*

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents, investments in student loan auction-rate securities, or SLARS, and accounts receivable. The Company maintains cash balances in various domestic bank accounts above the Federal Deposit Insurance Corporation ( FDIC ) insurance limits. The Company attempts to limit its exposure to credit loss by depositing its cash with high credit quality financial institutions. At June 30, 2008, the amount of cash in domestic bank accounts above FDIC limits was approximately \$40.3 million. The Company performs ongoing credit evaluations of its customers and generally requires no collateral to secure accounts receivable.

The Company is subject to concentration of credit risk and interest rate risk related to its long-term investments, which consisted entirely of SLARS at June 30, 2008. See discussion above under *Investments*.

*Earnings per share*

Basic earnings per share are calculated on the basis of the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated on the basis of the weighted average number of common shares outstanding during the period and common stock equivalents that would arise from the exercise of stock options or the issuance of restricted stock awards to employees and nonemployee directors using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
<b>Numerator:</b>				
Net income	\$ 3,180	\$ 2,752	\$ 6,168	\$ 5,498
<b>Denominator:</b>				
Weighted average shares basic	62,497	61,769	62,309	61,711
Stock options and restricted stock awards	459	487	486	402
Weighted average shares diluted	62,956	62,256	62,795	62,113
<b>Basic earnings per share:</b>				
Net Income	\$ 0.05	\$ 0.04	\$ 0.10	\$ 0.09
<b>Diluted net income per share:</b>				
Net Income	\$ 0.05	\$ 0.04	\$ 0.10	\$ 0.09

Outstanding stock options totaling approximately 20,000 shares for each of the three- and six-month periods ended June 30, 2008 were not included in the computation of diluted weighted average shares outstanding because their exercise prices were in excess of the average stock price of the Company during the periods, and would result in the options being anti-dilutive. Outstanding stock options totaling approximately 0.3 million shares during the three- and six-month periods ended June 30, 2007 were not included in the computation of diluted weighted average shares outstanding because their exercise prices were in excess of the average stock price of the Company during the periods, and would result in the options being anti-dilutive.

*Recent Accounting Pronouncements*

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles in the United States for non-governmental entities. SFAS No. 162 is effective 60 days following approval by the Securities and Exchange Commission of the Public Company Accounting Oversight Board's amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Company does not expect SFAS No. 162 to have a material impact on the preparation of its consolidated financial statements.

## 2. OUTSOURCED GOVERNMENT PORTAL CONTRACTS

The Company's outsourced government portal contracts generally have an initial term of three to five years with provisions for renewals for various periods at the option of the government. The Company's primary business obligation under these contracts is to design, build and operate Internet-based portals on behalf of governments desiring to provide access to government information and to complete government-based transactions online. NIC typically markets the services and solicits users to complete government-based transactions and to enter into subscriber contracts permitting the user to access the portal and the government information contained therein in exchange for transactional and/or subscription user fees. The Company enters into separate agreements with various agencies and divisions of the government to provide specific services and to conduct specific transactions. These agreements preliminarily establish the pricing of the electronic transactions and data access services the Company provides and the division of revenues between the Company and the government agency. The government must approve prices and revenue sharing agreements.

The Company is typically responsible for funding up front investment and ongoing operational costs of the government portals and generally owns all the applications developed under these contracts. After completion of a defined contract term, the government agency typically receives a perpetual, royalty-free license to the applications for use only. If the Company's contract were not renewed after a defined term, the government agency would be entitled to take over the portal in place with no future obligation of the Company.

At June 30, 2008, the Company was bound by performance bond commitments totaling approximately \$3.3 million on certain portal outsourcing contracts. Under a typical portal contract, the Company is required to fully indemnify its government clients against claims that the Company's services infringe upon the intellectual property rights of others and against claims arising from the Company's performance or the performance of the Company's subcontractors under the contract.

The following is a summary of the Company's twenty-one outsourced state government portal contracts at June 30, 2008:

NIC Subsidiary	Portal Web Site (State)	Year Services Commenced	Contract Expiration Date (Renewal Options Through)
NICUSA	www.WV.gov (West Virginia)	2007	6/30/2008 (Contract has been temporarily extended to allow the state time to finalize contract terms and conditions)
NICUSA	www.AZ.gov (Arizona)	2007	6/26/2010 (6/26/2013)
Vermont Information Consortium	www.Vermont.gov (Vermont)	2006	10/15/2009 (10/14/2012)
Colorado Interactive	www.Colorado.gov (Colorado)	2005	5/19/2010 (5/19/2014)
South Carolina Interactive	www.SC.gov (South Carolina)	2005	7/15/2009
Kentucky Interactive	www.Kentucky.gov (Kentucky)	2003	1/31/2009 (1/31/2013)
Alabama Interactive	www.Alabama.gov (Alabama)	2002	2/28/09 (2/28/2012)
Rhode Island Interactive	www.RI.gov (Rhode Island)	2001	8/7/2010 (8/7/2012)
Oklahoma Interactive	www.OK.gov (Oklahoma)	2001	6/30/2009
Montana Interactive	www.MT.gov (Montana)	2001	12/31/2010
NICUSA	www.Tennessee.gov (Tennessee)	2000	8/27/2010
Hawaii Information Consortium	www.Hawaii.gov (Hawaii)	2000	1/3/2013 (unlimited 3-year renewal options)
Idaho Information Consortium	www.Idaho.gov (Idaho)	2000	6/30/2011 (6/30/2015)
Utah Interactive	www.Utah.gov (Utah)	1999	5/6/2009
Maine Information Network	www.Maine.gov (Maine)	1999	3/14/2012 (3/14/18)
Arkansas Information Consortium	www.Arkansas.gov (Arkansas)	1997	6/30/2010

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Iowa Interactive	<a href="http://www.Iowa.gov">www.Iowa.gov</a> (Iowa)	1997	3/31/2011 (3/31/2012)
Virginia Interactive	<a href="http://www.Virginia.gov">www.Virginia.gov</a> (Virginia)	1997	8/31/2012
Indiana Interactive	<a href="http://www.IN.gov">www.IN.gov</a> (Indiana)	1995	6/30/2010 (6/30/2014)
Nebraska Interactive	<a href="http://www.Nebraska.gov">www.Nebraska.gov</a> (Nebraska)	1995	1/31/2010
Kansas Information Consortium	<a href="http://www.Kansas.gov">www.Kansas.gov</a> (Kansas)	1992	12/31/2009

During the second quarter of 2008, the Company received one-year contract extensions from the states of South Carolina and Oklahoma, and a two-year contract extension from the state of Arkansas. The Company

also received a new three-year contract from the state of Idaho, which includes options for the government to extend the contract for two additional two-year terms.

### **3. SPECIAL CASH DIVIDEND**

On February 4, 2008, the Company's Board of Directors declared a special cash dividend of \$0.25 per share, payable to shareholders of record as of February 18, 2008. The dividend, totaling approximately \$15.7 million, was paid on February 28, 2008 on 62,039,256 outstanding shares of common stock. A dividend equivalent of \$0.25 per share was also paid simultaneously on 790,032 unvested shares of restricted stock granted under the Company's 2006 Stock Option and Incentive Plan. The dividend was paid out of the Company's available cash and short-term investments.

The dividend may result in a partial return of capital to shareholders, with the balance being taxable to shareholders as a qualified dividend. The exact amount of the return of capital, if any, is dependent on the earnings of the Company, computed on a tax basis, through the end of its 2008 fiscal year.

### **4. SHAREHOLDERS' EQUITY - TREASURY SHARES**

During the second quarter of 2008, the Company was informed that the trustees of the National Information Consortium Voting Trust (the Voting Trust) dissolved the Voting Trust as of June 20, 2008. The Voting Trust, which was managed independently of NIC, was established on June 30, 1998 by the original investors of the Company and consisted of 142 beneficiaries. The Voting Trust held approximately 21.4 million shares of NIC common stock, or approximately 34 percent, of total shares outstanding. Of this balance, 116,441 shares were held on behalf of the Company by the Voting Trust, and have been recorded as treasury stock with an assigned value of \$168,000 in the consolidated balance sheets. Upon the Company's exchange of Voting Trust Units for NIC common stock, which is anticipated to occur during the third quarter of 2008, the Company expects to retire these treasury shares.

### **5. COMMITMENTS AND CONTINGENCIES**

#### *SEC Investigation*

As further discussed in Note 8 in the Notes to the Consolidated Financial Statements included in the Company's Form 10-K for the year ended December 31, 2007, filed with the SEC on March 17, 2008, the Company has been the subject of an informal SEC inquiry of expense reporting by certain officers of the Company and certain potentially related matters. In connection with that inquiry, a review was undertaken by the Audit Committee of the Company's Board of Directors, with the assistance of outside, independent counsel, which focused on such expense reporting. The review revealed that expense reimbursement deficiencies occurred during the period from January 2004 through October 2006 related to Jeffery S. Fraser, who was then the Company's Chief Executive Officer, that these expense reimbursement deficiencies were isolated to Mr. Fraser and that the amount of such deficiencies was not material to the Company's financial condition or results of operations. During the second quarter of 2008, the Company received notice from the SEC that a formal order of investigation has been issued with respect to these matters. As is frequently the case in such situations, the SEC has taken the step of obtaining a formal order of investigation to ensure the thoroughness of its investigation. The Company believes the investigation conducted by NIC's Audit Committee was thorough and independent.

and it is not anticipated that the SEC investigation will reveal any significant additional instances of misreporting of expenses by employees.

*Litigation*

The Company is involved from time to time in legal proceedings and litigation arising in the ordinary course of business. However, the Company is not currently involved with any legal proceedings.

**6. REPORTABLE SEGMENTS AND RELATED INFORMATION**

The Company's two reportable segments consist of its Outsourced Portal businesses and Software & Services businesses. The Outsourced Portals segment includes the Company's subsidiaries operating outsourced government portals and the corporate divisions that directly support portal operations. The Software & Services segment primarily includes the Company's UCC and corporate filings software development business (NIC Conquest) and ethics & elections filings business (NIC Technologies). Each of the Company's Software & Services businesses is an operating segment and has been aggregated to form the Software & Services reportable segment. Unallocated corporate-level expenses are reported in the reconciliation of the segment totals to the related consolidated totals as Other Reconciling Items. There have been no significant intersegment transactions for the periods reported.

The measure of profitability by which management evaluates the performance of its segments and allocates resources to them is operating income (loss). Segment asset or other segment balance sheet information is not presented to the Company's chief operating decision maker. Accordingly, the Company has not presented information relating to segment assets.

The table below reflects summarized financial information concerning the Company's reportable segments for the three months ended June 30 (in thousands):

	Outsourced Portals	Software & Services	Other Reconciling Items	Consolidated Total
<b>2008</b>				
Revenues	\$ 24,621	\$ 1,081	\$	\$ 25,702
Costs & expenses	14,048	952	4,535	19,535
Depreciation & amortization	787	24	88	899
Operating income (loss)	\$ 9,786	\$ 105	\$ (4,623)	\$ 5,268
<b>2007</b>				
Revenues	\$ 20,610	\$ 866	\$	\$ 21,476
Costs & expenses	11,531	556	4,270	16,357
Depreciation & amortization	539	6	32	577
Operating income (loss)	\$ 8,540	\$ 304	\$ (4,302)	\$ 4,542

The following is a reconciliation of total segment operating income to total consolidated income before income taxes for the three months ended June 30 (in thousands):

	2008	2007
Total operating income for reportable segments	\$ 5,268	\$ 4,542
Interest income	110	317
Consolidated income before income taxes	\$ 5,378	\$ 4,859



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The table below reflects summarized financial information concerning the Company's reportable segments for the six months ended June 30 (in thousands):

	Outsourced Portals	Software & Services	Other Reconciling Items	Consolidated Total
<b>2008</b>				
Revenues	\$ 48,417	\$ 1,964	\$	\$ 50,381
Costs & expenses	27,667	1,675	9,294	38,636
Depreciation & amortization	1,530	42	173	1,745
Operating income (loss)	\$ 19,220	\$ 247	\$ (9,467)	\$ 10,000
<b>2007</b>				
Revenues	\$ 40,478	\$ 1,632	\$	\$ 42,110
Costs & expenses	22,876	1,105	8,421	32,402
Depreciation & amortization	1,037	12	63	1,112
Operating income (loss)	\$ 16,565	\$ 515	\$ (8,484)	\$ 8,596

The following is a reconciliation of total segment operating income to total consolidated income before income taxes for the six months ended June 30 (in thousands):

	2008	2007
Total operating income for reportable segments	\$ 10,000	\$ 8,596
Interest income	443	897
Other expense, net	(20)	
Consolidated income before income taxes	\$ 10,423	\$ 9,493

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### **FORWARD-LOOKING STATEMENTS**

Safe Harbor statement under the Private Securities Litigation Reform Act of 1995: Statements in this Quarterly Report on Form 10-Q regarding NIC and its business, which are not current or historical facts, are forward-looking statements that involve risks and uncertainties. Certain matters discussed in this report may constitute forward-looking statements within the meaning of the federal securities laws that inherently include certain risks and uncertainties. Forward-looking statements include, but are not limited to, statements of plans and objectives, statements of future economic performance or financial projections, statements of assumptions underlying such statements, and statements of the Company's or management's intentions, hopes, beliefs, expectations or predictions of the future. For example, statements like we expect, we believe, we plan, we intend or we anticipate are forward-looking statements. Investors should be aware that our actual operating results and financial performance may differ materially from our expressed expectations because of risks and uncertainties about the future including those risks discussed in our 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 17, 2008 and in this Quarterly Report on Form 10-Q. In addition, we will not necessarily update the information in this Quarterly Report on Form 10-Q if any forward-looking statement later turns out to be inaccurate. Management continuously updates and revises these estimates and assumptions based on actual conditions experienced. However, it is not practicable to publish all revisions and, as a result, no one should assume that results projected in or contemplated by the forward-looking statements will continue to be accurate in the future. Investors are cautioned not to put undue reliance on any forward-looking statement.

There are a number of important factors that could cause actual results to differ materially from those suggested or indicated by such forward-looking statements. These include, among others, the success of the Company in signing contracts with new states and government agencies, including continued favorable government legislation; NIC's ability to develop new services; existing states and agencies adopting those new services; acceptance of eGovernment services by businesses and citizens; competition; and general economic conditions and the other factors discussed under CAUTIONS ABOUT FORWARD LOOKING STATEMENTS in Part I, RISK FACTORS in Part I, Item 1A of NIC's 2007 Annual Report on Form 10-K filed on March 17, 2008 with the Securities and Exchange Commission (SEC), and RISK FACTORS in Part II, Item 1A of this Form 10-Q. Investors should read all of these discussions of risks carefully.

### **WHAT WE DO - AN EXECUTIVE SUMMARY**

We are a leading provider of eGovernment services that help governments use the Internet to reduce costs and provide a higher level of service to businesses and citizens. We accomplish this currently through two divisions: our core portal outsourcing businesses and our software & services businesses.

In our core business, portal outsourcing, we enter into contracts primarily with state governments and design, build and operate Web-based portals on their behalf. We enter into long-term contracts, typically three to five years, and manage operations for each government partner through separate subsidiaries that operate as decentralized businesses with a high degree of autonomy. Our portals consist of Web sites and applications that we build, which allow businesses and citizens to access government information online and complete transactions, including applying for a permit, retrieving driver's license records or filing a form or report. We help increase our government partners' revenues by expanding the distribution of their information assets and increasing the number of financial transactions conducted with governments. We do this by marketing portal services and soliciting users to complete government-based transactions and to enter into subscriber contracts that permit users to access the portal and the government information contained therein in exchange for transactional and/or subscription user fees. We are typically responsible for funding up-front investment and ongoing operational costs of the government portals. Our unique self-funding business model allows us to reduce our government partners' financial and technology risks and obtain revenues by sharing in the fees



generated from eGovernment services. Our partners benefit because they gain a centralized, customer-focused presence on the Internet. Businesses and citizens gain a faster, more convenient and more cost-effective means to interact with governments.

On behalf of our government partners, we enter into separate agreements with various agencies and divisions of the government to provide specific services and to conduct specific transactions. These agreements preliminarily establish the pricing of the transaction and data access services we provide and the division of revenues between the Company and the government agency. The government must approve prices and revenue sharing agreements. We generally own all the applications developed under these contracts. After completion of a defined contract term, the government agency typically receives a perpetual, royalty-free license to the applications for use only. If our contract were not renewed after a defined term, the government agency would be entitled to take over the portal in place with no future obligation of the Company. In some cases, we enter into contracts to provide consulting, development and portal management services to governments in exchange for an agreed-upon fee.

Currently, we have contracts to provide portal outsourcing services for 21 states. Our closest competitor operates one state portal.

## **REVENUE RECOGNITION**

We classify our revenues and cost of revenues into two categories: (1) portal and (2) software & services. The portal category includes revenues and cost of revenues primarily from our subsidiaries operating government portals on an outsourced basis. The software & services category includes revenues and cost of revenues primarily from our UCC and corporate filings and ethics & elections businesses. We currently derive revenue from two main sources: transaction-based fees and fees for application development. Each of these revenue types and the corresponding business models are further described below.

### ***Our portal outsourcing businesses***

We categorize our portal revenues according to the underlying source of revenue. A brief description of each category follows:

- **DMV transaction-based**: these are transaction fees from the sale of electronic access to driver history records, referred to as DMV records, from our state portals to data resellers, insurance companies and other pre-authorized customers on behalf of our state partners, and are generally recurring.
- **Non-DMV transaction-based**: these are transaction fees from sources other than the sale of DMV records, for transactions conducted by business users and consumer users through our portals, and are generally recurring. For a representative listing of non-DMV services we currently offer through our portals, refer to Part I, Item 1 in our Form 10-K for the year ended December 31, 2007, filed with the SEC on March 17, 2008.

- Software development & portal management: these are fees from the performance of software development projects and other time and materials or fixed fee services for our government partners. While we actively market portal software development services, they do not have the same degree of predictability as our transaction-based or portal management revenues.

*Our software & services businesses*

Ethics & elections

Our ethics & elections business derives the majority of its revenues from time and materials application development and maintenance outsourcing contracts and recognizes revenues as services are

provided. At June 30, 2008, our ethics & elections business was primarily engaged in servicing its contracts with the Federal Election Commission and the state of Michigan.

### **UCC and corporate filings**

Our UCC and corporate filings software development business derives the majority of its revenues from fixed-price application development contracts and recognizes revenues on the percentage of completion method. At June 30, 2008, this business was primarily engaged in servicing its contract with the California Secretary of State and no longer markets its applications and services in respect of new engagements.

### **CRITICAL ACCOUNTING POLICIES**

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Form 10-K for the year ended December 31, 2007, filed with the SEC on March 17, 2008, except as follows:

#### *Valuation of Investments*

At June 30, 2008, our long-term investments consist entirely of student loan auction-rate securities, or SLARS. As further discussed in Note 1 in the Notes to the Unaudited Consolidated Financial Statements included in this Form 10-Q, due to the absence of quotes from our broker-dealer and the lack of readily observable market quotes, we used valuation models to estimate the fair value of our SLARS at June 30, 2008. These valuation models include numerous assumptions such as assessments of the underlying structure and collateral of each security, default risk, liquidity risk, expected cash flows, discount rates, issuer credit ratings, workout periods and overall capital market liquidity. These assumptions and assessments are subject to uncertainties, are difficult to predict and require significant judgment. The use of different assumptions, applying different judgment to inherently subjective matters and changes in future market conditions could result in significantly different estimates of fair value.

We assess other-than-temporary impairment of long-term investments in accordance with FASB Staff Position No. 115-1, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments. This assessment requires significant judgment. In making this determination, we employ a systematic methodology that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate general market conditions, earnings performance, credit rating, asset quality, and other key measures for our investments. We also consider the duration and extent to which the fair value has been less than cost, and our ability and intent to hold the investment. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded, a loss is recognized in our consolidated statements of income and a new cost basis in the investment is established. We have not recorded any other-than-temporary impairments on our investments. However, if market, industry and/or investee conditions deteriorate, we may record impairments in the future, which could be material.

**RESULTS OF OPERATIONS**

The following discussion summarizes the significant factors affecting operating results for the three- and six-month periods ended June 30, 2008 and 2007. This discussion and analysis should be read in conjunction with our unaudited consolidated interim financial statements and the related notes included in this Form 10-Q.

Key Financial Metrics	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Revenue growth - outsourced portals	19%	16%	20%	16%
Same state revenue growth - outsourced portals	13%	14%	13%	15%
Recurring portal revenue %	92%	95%	91%	94%
Gross profit % - outsourced portals	47%	49%	47%	48%
Selling & administrative expenses as % of portal revenues	24%	26%	24%	26%
Operating income margin % (operating income as a % of portal revenues)	21%	22%	21%	21%

**PORTAL REVENUES.** In the analysis below, we have categorized our portal revenues according to the underlying source of revenue (in thousands) with the corresponding percentage change from the prior year period.

	Three months ended June 30, %			Six months ended June 30, %		
	2008	Change	2007	2008	Change	2007
DMV transaction-based	\$ 11,790	5%	\$ 11,275	\$ 23,700	4%	\$ 22,736
Non-DMV transaction-based	9,050	25%	7,266	16,627	25%	13,281
Software development & portal management	3,781	83%	2,069	8,090	81%	4,461
Total	\$ 24,621	19%	\$ 20,610	\$ 48,417	20%	\$ 40,478

Portal revenues in the current quarter increased 19%, or approximately \$4.0 million, over the prior year quarter. This increase was mainly attributable to a 13% increase, or approximately \$2.6 million, in same state portal revenues (outsourced portals in operation and generating recurring revenues for two full periods), and a 6% increase, or approximately \$1.4 million, in revenues from our newer portals, including Arizona (\$1.0 million), which began to generate revenues in October 2007, and West Virginia (\$0.4 million), which began to generate DMV revenues in February 2008.

Our Indiana portal subsidiary signed a new long-term contract with the state of Indiana that commenced on July 1, 2006. The contract is based on a funding model that includes recurring fixed monthly fees for baseline services and primarily project-based pricing for variable services. Historically, the majority of revenues under this contract were DMV and non-DMV transaction-based. Under the new contract, the majority of revenues are classified as software development & portal management. Prior to July 1, 2006, we defined same state revenues as those from states in operation and generating DMV revenues for two full periods. Because the baseline revenues from the new Indiana contract are recurring, we have continued to include Indiana portal revenues in the calculation of same state revenue growth even though we no longer earn DMV transaction-based revenues under the contract. Same state portal revenues in the current quarter increased 13% over the prior year quarter due to increased transaction revenues from our Colorado, Indiana, Montana, Oklahoma, and Virginia portals, among others.

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Excluding Indiana, same state portal revenues in the current quarter increased 11% over the prior year quarter, with same state DMV transaction-based revenues increasing 1% and same state non-DMV transaction-based revenues increasing 25% (primarily due to the addition of several new revenue generating applications in existing portals). Our same state revenue growth in the current quarter was lower than the growth we achieved in the prior

year quarter primarily due to decreases in same state DMV and non-DMV transaction-based revenue growth. Same state DMV revenue growth in the current quarter was 1% compared to 10% in the prior year quarter. The higher growth in the prior year quarter was primarily due to the effect of DMV price increases in three of our portal states that went into effect in late 2006. Absent DMV price increases, same state DMV revenues have historically grown at a rate of 1% to 3% per year. Same state non-DMV transaction based revenue growth was 37% in the prior year quarter.

Portal revenues for the six months in the current period increased 20%, or approximately \$7.9 million, over the prior year period. Of this increase, 13%, or approximately \$5.0 million, was attributable to an increase in same state portal revenues and 7%, or approximately \$2.9 million, was attributable to our new portals including Vermont (\$0.3 million), which began to generate revenues in March 2007, Arizona (\$1.9 million), and West Virginia (\$0.7 million). Consistent with our results in the current quarter, same state portal revenues in the current-to-date period increased 13% over the prior year period. Excluding Indiana, same state portal revenues in the current year-to-date period increased 12% over the prior year period, with same state DMV transaction-based revenues increasing 1% and same state non-DMV transaction-based revenues increasing 25%.

**COST OF PORTAL REVENUES.** Cost of portal revenues for the current quarter increased 25%, or approximately \$2.6 million, over the prior year quarter. This increase was attributable to a 14% increase, or approximately \$1.5 million, in same state cost of portal revenues, and an 11% increase, or approximately \$1.1 million, in cost of portal revenues from our newer state portal businesses in Arizona and West Virginia.

The increase in same state cost of portal revenues in the current quarter was partially attributable to additional personnel in several of our portals due to our continued growth and reinvestment in our core business. Also contributing to this increase was an increase in bank fees. A growing percentage of our non-DMV transaction-based revenues are generated from online applications whereby users pay for information or transactions via credit cards. We typically earn a percentage of the credit card transaction amount, but also must pay an associated fee to the bank that processes the credit card transaction. We earn a lower gross profit percentage on these transactions as compared to our other non-DMV applications. However, we plan to continue to implement these services as they contribute favorably to our operating income growth.

Our portal gross profit rate was 47% for the current quarter and 49% in the prior year quarter. We carefully monitor our portal gross profit percentage to strike the balance between generating a solid financial return for our shareholders and delivering value to our government partners through reinvestment in our portals (which we believe also benefits our shareholders). We currently expect our portal gross profit percentage to range from 45% to 47% in 2008.

Cost of portal revenues for the six months in the current period increased 23%, or approximately \$4.8 million, over the prior period. Of this increase, 13%, or approximately \$2.6 million, was attributable to an increase in same state cost of portal revenues, and 10%, or approximately \$2.2 million, was primarily attributable to our new Arizona and West Virginia portals. Our portal gross profit rate for six months in the current year period was 47% compared to 48% in the prior year period, as cost of portal revenues grew at a higher rate (23%) than portal revenues (20%) in the current period, as further discussed above.

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**SOFTWARE & SERVICES REVENUES.** In the analysis below, we have categorized our software & services revenues by type of business (in thousands), with the corresponding percentage change from the prior year period.

	Three months ended June 30, %			Six months ended June 30, %		
	2008	Change	2007	2008	Change	2007
Ethics & elections	\$ 683	11%	\$ 614	\$ 1,368	20%	\$ 1,142
UCC & corporate filings						
software development	143	(24)%	189	294	(19)%	361
Other	255	305%	63	302	134%	129
<b>Total</b>	<b>\$ 1,081</b>	<b>25%</b>	<b>\$ 866</b>	<b>\$ 1,964</b>	<b>20%</b>	<b>\$ 1,632</b>

Software & services revenues in the current quarter and year-to-date periods increased 25% and 20%, respectively, or approximately \$0.2 million and \$0.3 million, over the prior year periods. This increase was primarily attributable to revenues generated from a consulting services engagement with a private company and to increased revenues from a contract renewal with the state of Michigan in our ethics and elections business that enhanced revenues we earn.

**SELLING & ADMINISTRATIVE.** Selling & administrative expenses in the current quarter and year-to-date periods increased 7% and 12%, respectively, or approximately \$0.4 million and \$1.2 million, over the prior year periods. The increase in selling & administrative expenses in the current quarter is primarily attributable to additional personnel to support and enhance corporate wide information technology security and portal operations, in addition to sales and marketing growth initiatives. Also, as discussed in Note 5 in the Notes to the Unaudited Consolidated Financial Statements in this Form 10-Q and in Item 1A, Item 3 and Note 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC on March 17, 2008, we have been the subject of an informal SEC inquiry of expense reporting by certain officers of our Company and certain potentially related matters. In connection with the SEC inquiry, a review was undertaken by the Audit Committee of our Board of Directors, with the assistance of outside, independent counsel, which focused on such expense reporting. The SEC issued a formal order of investigation in the second quarter of 2008. Selling & administrative expenses for the six-month period ended June 30, 2008 includes approximately \$0.5 million of legal fees and other expenses incurred in connection with the ongoing SEC investigation and the Audit Committee review. We could incur significant legal fees and other expenses in connection with the ongoing SEC investigation. The remaining year-to-date increase in selling & administrative expenses is primarily attributable to additional personnel across our corporate-level divisions, as further discussed above.

As a percentage of portal revenues, selling & administrative expenses were 24% in the current quarter and year-to-date periods compared to 26% in the prior year periods. We currently expect selling & administrative costs as a percentage of portal revenue to range from 24% to 25% in 2008.

**DEPRECIATION & AMORTIZATION.** Depreciation & amortization expense in the current quarter and year-to-date periods increased 56% and 57%, respectively, or approximately \$0.3 million and \$0.6 million, over the prior year periods. The increase was primarily attributable to capital expenditures in the current and prior periods for normal fixed asset additions in our outsourced portal business, including Web servers, purchased software and office furniture and equipment to support and enhance corporate-wide information technology security and portal

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operations, in addition to capital expenditures for furniture, fixtures and leasehold improvements made in the second half of 2007 for our new corporate headquarters.

As a percentage of portal revenues, depreciation & amortization was 4% in the current quarter and year-to-date periods compared to 3% in the prior year periods. We currently expect depreciation & amortization expense as a percentage of portal revenues to range from 3% to 4% in 2008, as we will continue to make key information technology infrastructure and security investments to support the long-term expansion of our portal business.

**INTEREST INCOME.** Interest income reflects interest earned on our investable cash and investment portfolio. We currently expect interest income in 2008 to continue to be lower than in 2007, primarily because of the declining short-term interest rate environment we are currently experiencing.

## **LIQUIDITY AND CAPITAL RESOURCES**

### Operating Activities

Net cash provided by operating activities was \$8.9 million in the current period as compared to \$9.3 million in the prior year period. The decrease in cash flow from operations in the current period was primarily the result of a year-over-year increase in operating income, excluding non-cash charges for depreciation & amortization and stock-based compensation, offset by an increase in accounts receivable and the timing of payments to certain of our government partners, which affected accounts payable. We typically see an increase in both accounts receivable and accounts payable in the second quarter of every year due to increases in revenues across our portal businesses as compared to the fourth quarter of the previous year, which is our seasonally lowest quarter due to the smaller number of business days and a lower volume of business-to-government and citizen-to-government transactions during the holiday periods. While a general increase in revenues in the current period contributed to the overall increase in our accounts receivable (approximately \$6.2 million overall), a substantial portion of the increase (approximately \$2.2 million) was attributable to an increase in accounts receivable relating to our Indiana portal contract, which was collected during July 2008.

Accounts receivable in the prior year period decreased primarily due to the timing of cash collections related to our Indiana portal contract (approximately \$2.8 million) during the second quarter of 2007. As discussed above, we signed a new contract with the state of Indiana that commenced on July 1, 2006. The new contract is based on a funding model that includes recurring fixed monthly fees for baseline services and primarily project-based pricing for variable services. As part of the transition process from the old contract to the new contract, we had not yet been paid at the end of 2006 for services performed since July 2006.

Accounts payable in the prior year period decreased by approximately \$4.0 million in part due to a \$2.5 million payment to the state of Indiana following the execution of the new portal contract discussed above. In addition, accounts payable in the prior year period decreased in part due to the timing of payments of year-end 2006 tax receipts that were remitted to our government partners in early January 2007.

We had a history of unprofitable operations prior to 2003 primarily due to operating losses incurred in our software & services businesses. These losses generated significant federal and state tax net operating losses, or NOLs. As a result of our NOL carryforwards, we are not currently paying federal income taxes, with the exception of amounts relating to alternative minimum tax, and are paying income taxes in only certain states. This positively impacts our operating cash flow and will continue to positively impact our operating cash flow during the NOL carryforward periods. Based on our current projections, we currently expect to fully utilize our federal NOL carryforwards by the end of 2009. For the six-month periods ended June 30, 2008 and 2007, combined federal and state income tax payments totaled approximately \$0.5 million and \$0.6 million, respectively.

### Investing Activities

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Investing activities in the current period primarily reflect the partial liquidation of our investment portfolio to pay the \$15.7 million special cash dividend in February 2008, and \$2.2 million of capital expenditures, which were primarily for normal fixed asset additions in our outsourced portal business, including Web servers, purchased software and office equipment. In addition, we capitalized approximately \$0.4 million of internal use software development costs relating to the standardization of customer management, billing and payment processing systems that support our portal operations and accounting systems. Cash provided by investing activities in the prior year period primarily reflects the liquidation of our investment portfolio to pay the \$46.7 million special cash dividend in February 2007, \$1.7 million of capital expenditures, which were primarily for normal fixed asset additions in our outsourced portal business.

Financing Activities

Financing activities in the current period primarily reflect payment of the \$15.7 million special cash dividend in February 2008, partially offset by receipt of \$1.9 million in proceeds from the exercise of employee stock options and \$0.3 million in proceeds from our employee stock purchase program. Financing activities in the prior year period primarily reflect payment of the \$46.7 million special cash dividend in February 2007, partially offset by receipt of \$0.5 million in proceeds from the exercise of employee stock options and \$0.2 million in proceeds from our employee stock purchase program.

Liquidity

We recognize revenue primarily from providing outsourced government portal services net of the transaction fees due to the government when the services are provided. The fees that we must remit to the government are accrued as accounts payable and accounts receivable at the time services are provided. As a result, trade accounts payable and accounts receivable reflect the gross amounts outstanding at the balance sheet dates. Gross billings for the three months ended June 30, 2008 and December 31, 2007 were approximately \$368.6 million and \$303.8 million, respectively. The Company calculates days sales outstanding by dividing trade accounts receivable at the balance sheet date by gross billings for the period and multiplying the resulting quotient by the number of days in that period. Days sales outstanding for the three-month periods ended June 30, 2008 and December 31, 2007 was 8 and 9, respectively.

We believe that working capital is an important measure of our short-term liquidity. Working capital, defined as current assets minus current liabilities, decreased to \$39.6 million at June 30, 2008 from \$49.8 million at December 31, 2007. Our current ratio, defined as current assets divided by current liabilities, at June 30, 2008 was 1.9 compared to 2.1 at December 31, 2007. The decrease in our working capital and current ratio was primarily attributable to the \$15.7 million special dividend paid out of the Company's available cash and investments in the current period as further discussed below and in Note 3 in the Notes to Unaudited Consolidated Financial Statements included in this Form 10-Q. Furthermore, we classified our investments in student loan auction rate securities, or SLARS, as long-term investments at June 30, 2008, which decreased our working capital by approximately \$6.5 million, as further discussed in Note 1 in the Notes to the Unaudited Consolidated Financial Statements included in this Form 10-Q.

At June 30, 2008, our total cash and short-term investment balance was \$41.6 million compared to \$55.8 million at December 31, 2007. As further discussed in Note 1 in the Notes to the Unaudited Consolidated Financial Statements included in this Form 10-Q, during January 2008, we began to liquidate our short-term investments portfolio in anticipation of paying a \$15.7 million special cash dividend on February 28, 2008. These securities consist entirely of SLARS, which are currently AAA-rated by one or more credit rating agencies and are secured by pools of student loans partially guaranteed by the U.S. Department of Education under the Federal Family Education Loan Program. The auction process is designed to provide a means by which these securities can be sold, and historically has provided a highly liquid market for these securities. We had successful auctions on our SLARS through mid-February 2008, at which time we had liquidated approximately \$11.6 million of our portfolio. We encountered our first failed auction in mid-February 2008, as the amount of securities submitted for sale in those auctions exceeded the amount of bids, and we have not subsequently had a successful auction related to the remaining \$7.0 million par value of these securities we currently hold. To date we have collected all interest payable on all of our SLARS when due. The principal associated with failed auctions will not be accessible until a successful auction occurs, a buyer is found outside of the auction process, the issuers redeem the securities, the issuers establish a different form of financing to replace these

securities, or final payments come due according to contractual maturities ranging from 22 to 50 years. We currently expect that we will receive the principal associated with these SLARS through one of the means described above.

On February 28, 2008, we paid a special cash dividend totalling approximately \$15.7 million out of available cash and short-term investments. We do not believe that this dividend will have a significant effect on our future liquidity. While the recent auction failures could limit our ability to liquidate our SLARS for some period of time, we believe that our currently available liquid resources, coupled with the unused portion of our line of credit of

approximately \$8.7 million and cash generated from operations, will be sufficient to meet our operating requirements, capital expenditure requirements and current growth initiatives for at least the next twelve months without the need of additional capital. However, we may need to raise additional capital within the next twelve months to further:

- fund operations if unforeseen costs arise;
- support our expansion into other states and government agencies beyond what is contemplated if unforeseen opportunities arise;
- expand our product and service offerings beyond what is contemplated if unforeseen opportunities arise;
- respond to unforeseen competitive pressures; and
- acquire technologies beyond what is contemplated.

Any projections of future earnings and cash flows are subject to substantial uncertainty. If our cash, investments and cash generated from operations are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity securities or issue debt securities. The sale of additional equity securities could result in dilution to the Company's shareholders. There can be no assurance that financing will be available in amounts or on terms acceptable to the Company, if at all. Further, we may draw on the remaining unused portion of our \$10 million line of credit.

We issue letters of credit as collateral for performance on certain of our outsourced government portal contracts, as collateral for certain performance bonds and as collateral for certain office leases. These irrevocable letters of credit are generally in force for one year, for which we currently pay bank fees of 1% of face value per annum. We had unused outstanding letters of credit totaling approximately \$1.3 million at June 30, 2008. We are not currently required to cash collateralize these letters of credit. However, even though we currently expect to be profitable in fiscal 2008 and beyond, we may not be able to sustain or increase profitability on a quarterly or annual basis. We will need to generate sufficient revenues while containing costs and operating expenses if we are to achieve sustained profitability. If we are not able to sustain profitability, our cash collateral requirements may increase. Had we been required to post 100% cash collateral at June 30, 2008 for the face value of all performance bonds (which are partially supported by letters of credit) and our line of credit in conjunction with a corporate credit card agreement, unrestricted cash would have decreased by approximately \$4.3 million and would have been classified as restricted cash.

At June 30, 2008, we were bound by performance bond commitments totaling approximately \$3.3 million on certain government portal outsourcing contracts. These performance bonds are collateralized by a \$1 million letter of credit. We have never had any defaults resulting in draws on performance bonds or letters of credit.

Off-Balance Sheet Arrangements, Contractual Obligations and Income Tax Uncertainties

We do not have off-balance sheet arrangements that are not recorded or disclosed in our financial statements. While we have significant operating lease commitments for office space, those commitments are generally tied to the period of performance under related contracts. We have income tax uncertainties of approximately \$0.7 million at June 30, 2008. These obligations are classified as other long-term liabilities in our consolidated balance sheet, as resolution is expected to take more than a year. We estimate that these matters could be resolved in one to three years. However, the ultimate timing of resolution is uncertain.

## RECENT ACCOUNTING PRONOUNCEMENTS

### *Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. Except for the portion of SFAS No. 157 that addresses nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, which has been deferred for one year, we adopted this standard effective January 1, 2008. The partial adoption of SFAS No. 157 did not have a material impact on our consolidated financial statements. We are currently evaluating the requirements of SFAS No. 157 that address nonfinancial assets and liabilities and have not yet determined the impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. We did not elect to choose the fair value option and record unrealized gains and losses in earnings for any of our financial instruments. Accordingly, the adoption of SFAS No. 159 on January 1, 2008 did not have any impact on our consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles in the United States for non-governmental entities. SFAS No. 162 is effective 60 days following approval by the Securities and Exchange Commission of the Public Company Accounting Oversight Board's amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. We do not expect SFAS No. 162 to have a material impact on the preparation of our consolidated financial statements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

**INTEREST RATE RISK.** As further discussed above in the Liquidity section of Item 2, our long-term investments consist entirely of student loan auction-rate securities, or SLARS, at June 30, 2008. Our SLARS are structured with short-term interest rates that are reset through an auction process at 28-day intervals, but with contractual debt maturities that can be well in excess of 22 years. These securities are currently AAA-rated by one or more credit rating agencies and are secured by pools of student loans partially guaranteed by the U.S. Department of Education under the Federal Family Education Loan Program. In mid-February 2008, liquidity issues in the global credit markets resulted in the failure of auctions representing all of the remaining SLARS we currently hold (totaling approximately \$7.0 million at par value), as the amount of securities submitted for sale in those auctions exceeded the amount of bids. For each unsuccessful auction, the interest rate moves to a maximum rate defined for each security. However, in certain situations, the maximum rate may be lower if historical average auction rates exceeded defined short-term interest benchmarks. To date we have collected all interest payable on all of our SLARS. The principal associated with failed auctions will not be accessible until a successful auction occurs, a buyer is found outside of the auction process, the issuers establish a different form of financing to replace these securities, or final payments come due according to contractual maturities ranging from 22 to 50 years.

Our cash equivalents and long-term investments portfolio are subject to market risk due to changes in interest rates. Floating rate securities may produce less income than expected if interest rates fall. Furthermore, the market value of SLARS may be adversely impacted due to a maximum interest rate cap if the spread between short-term rates and long-term rates increases. Due in part to these factors, our future interest income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to either changes in interest rates or discounts offered by prospective buyers of our SLARS. However, because we classify our debt securities as available for sale, no gains or losses are recognized in our consolidated statements of income due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary. Should the Company determine that the decline in value of these securities is other-than-temporary, it would result in a loss being recognized in its consolidated statements of income, which could be material.

Borrowings under our line of credit bear interest at a floating rate. Interest on amounts borrowed is payable at a base rate equal to the higher of the Federal Funds Rate plus 0.5% or the bank's prime rate. We currently have no principal amounts of indebtedness outstanding under our line of credit.

We do not use derivative financial instruments. A 10% change in interest rates would not have a material effect on our financial condition, results of operations or cash flows.

### ITEM 4. CONTROLS AND PROCEDURES

#### a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act)) that are designed to ensure that material information required to be disclosed in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the

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issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of such date.

**b) CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

**There have been no changes in our internal control over financial reporting that occurred during our second fiscal quarter of 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.**

**PART II. OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

The following risk factor disclosure is in addition to the disclosure of risks in **CAUTIONS ABOUT FORWARD LOOKING STATEMENTS** in Part I and **RISK FACTORS** in Part I, Item 1A of NIC's 2007 Annual Report on Form 10-K filed on March 17, 2008 with the Securities and Exchange Commission, and should be read in conjunction with those disclosures.

*The resale of shares of our common stock previously held by the National Information Consortium Voting Trust, or the perception that those sales may occur, might adversely affect our stock price.*

The National Information Consortium Voting Trust, which previously owned approximately 34% of our outstanding common stock, was dissolved as of June 20, 2008. As a result, there will be an increase in the number of shares available for resale in the public market at such time as the shares previously held by the Voting Trust may be traded under applicable securities laws. Sales of substantial amounts of shares of our common stock in the public market, or the perception that those sales may occur, could cause the market price of our common stock to decline or make it more difficult for us to sell equity securities in the future at a time and a price that we consider appropriate.

*We could incur substantial losses if one of the commercial banks we use in our operations would happen to fail.*

As cash collection and disbursement cycles vary significantly among our businesses, we frequently maintain cash balances in excess of Federal Deposit Insurance Corporation ( FDIC ) insurance limits of \$100,000. At June 30, 2008, we held approximately \$40.3 million of cash in excess of FDIC limits among 14 banks. As the fallout from the credit crisis persists, the financial strength of some banks has diminished and may continue to deteriorate. If one of the banks we use would happen to fail, the potential for financial loss could be material.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

(c) During the second quarter of 2008, the Company acquired shares of common stock surrendered by employees to pay income taxes due upon the vesting of restricted stock as follows:

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<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs</b>
May 1, 2008	1,829 \$	7.09	N/A	N/A
June 1, 2008	1,830 \$	8.07	N/A	N/A

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Company held its Annual Meeting of Shareholders on May 6, 2008. At the meeting, the following matters were voted upon by the shareholders:

1. The election of eight (8) Directors to serve for the upcoming year;
2. A proposal to amend the 2006 Amended and Restated Stock Option and Incentive Plan; and
3. A proposal to ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accountants for the fiscal year ending December 31, 2008.

The Board of Directors of the Company is composed of eight (8) members. The following were the nominees of management voted upon and elected by the holders of the Company's common stock as of the record date: Jeffery S. Fraser, Harry H. Herington, John L. Bunce, Jr., Art N. Burtscher, Daniel J. Evans, Ross C. Hartley, Alexander C. Kemper, and Pete Wilson. In the election of the directors, there were 57,023,695 votes for Jeffery S. Fraser and 2,275,085 votes withheld; 58,280,164 votes for Harry H. Herington and 1,018,616 votes withheld; 41,122,614 votes for John L. Bunce, Jr. and 18,176,166 votes withheld; 35,782,773 votes for Art N. Burtscher and 23,516,007 votes withheld; 57,841,722 votes for Daniel J. Evans and 1,457,058 votes withheld; 57,450,534 votes for Ross C. Hartley and 1,848,246 votes withheld; 57,816,657 votes for Alexander C. Kemper and 1,437,123 votes withheld; and 57,903,888 votes for Pete Wilson and 1,394,892 votes withheld.

The total votes cast pertaining to the proposed amendment to the 2006 Amended and Restated Stock Option and Incentive Plan to increase the number of shares of Common Stock which may be issued under the Plan from 9,286,754 to 19,286,754 shares were as follows: 12,336,214 votes for, 37,056,673 votes against and 77,466 abstained.

The total votes cast pertaining to the ratification of the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accountants for the fiscal year ending December 31, 2008 were as follows: 58,672,609 votes for, 454,665 votes against and 171,506 abstained.

**ITEM 6. EXHIBITS**

31.1 - Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 - Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 - Section 906 Certifications of Chief Executive Officer and Chief Financial Officer

**SIGNATURES**

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

NIC INC.

Dated: August 4, 2008

/s/Stephen M. Kovzan  
Stephen M. Kovzan  
Chief Financial Officer

**NIC Inc.**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
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31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Section 906 Certifications of Chief Executive Officer and Chief Financial Officer