

GOLDEN TELECOM INC  
Form 10-Q  
August 09, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

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

For the quarterly period ended **June 30, 2006**

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission file number: 0-27423**

**Golden Telecom, Inc.**

(Exact name of registrant as specified in its charter)

**DELAWARE**

(State or other jurisdiction of  
incorporation or organization)

**51-0391303**

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

**Representative Office Golden TeleServices, Inc.**

**1 Kozhevnichecky Proezd**

**Moscow, Russia 115114**

(Address of principal executive office)

**115114**

(Zip Code)

**(011-7-501) 797-9300**

(Registrant's telephone number, including area code)

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

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer

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

At August 7, 2006, there were 36,628,413 outstanding shares of common stock of the registrant.

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\* Please refer to the special note regarding forward-looking statements in this section.

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

**GOLDEN TELECOM, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(In Thousands, Except Share Data)**  
**(Unaudited)**

	<b>December 31, 2005</b>	<b>June 30, 2006</b>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 67,176	\$ 36,411
Accounts receivable, net of allowance for doubtful accounts of \$27,327 and \$29,980 at December 31, 2005 and June 30, 2006, respectively	91,709	117,993
VAT receivable	21,986	18,290
Prepaid expenses	8,083	8,277
Taxes receivable, excluding VAT	181	2,634
Notes receivable	1,494	3,380
Deferred tax asset	8,994	10,620
Other current assets	11,334	13,426
<b>TOTAL CURRENT ASSETS</b>	<b>210,957</b>	<b>211,031</b>
Property and equipment, net of accumulated depreciation of \$247,096 and \$281,786 at December 31, 2005 and June 30, 2006, respectively	407,907	449,660
Goodwill and intangible assets:		
Goodwill	149,249	156,164
Intangible assets, net of accumulated amortization of \$60,648 and \$69,788 at December 31, 2005 and June 30, 2006, respectively	93,880	96,756
Net goodwill and intangible assets	243,129	252,920
Restricted cash	566	229
Other non-current assets	19,652	22,084
<b>TOTAL ASSETS</b>	<b>\$ 882,211</b>	<b>\$ 935,924</b>

See notes to unaudited condensed consolidated financial statements.

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**GOLDEN TELECOM, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In Thousands, Except Share Data)  
(Unaudited)

	<b>December 31, 2005</b>	<b>June 30, 2006</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued expenses	\$ 89,404	\$ 109,453
VAT payable	17,190	6,812
Debt maturing within one year		957
Current capital lease obligation	1,941	1,290
Deferred revenue	16,799	18,971
Due to affiliates and related parties	2,470	3,167
Other current liabilities	4,079	5,482
<b>TOTAL CURRENT LIABILITIES</b>	<b>131,883</b>	<b>146,132</b>
Long-term debt, less current portion	27	183
Long-term deferred tax liability	22,287	23,353
Long-term deferred revenue	30,878	33,531
Long-term capital lease obligations	2,340	1,944
Other non-current liabilities		1,460
<b>TOTAL LIABILITIES</b>	<b>187,415</b>	<b>206,603</b>
Minority interest	19,693	24,975
<b>SHAREHOLDERS EQUITY</b>		
Preferred stock, \$0.01 par value (10,000,000 shares authorized; none issued and outstanding at December 31, 2005 and June 30, 2006)		
Common stock, \$0.01 par value (100,000,000 shares authorized; 36,458,490 and 36,628,413 shares issued and outstanding at December 31, 2005 and June 30, 2006, respectively)	365	366
Additional paid-in capital	671,998	673,977
Deferred equity compensation	(455)	
Retained earnings	3,195	30,003
<b>TOTAL SHAREHOLDERS EQUITY</b>	<b>675,103</b>	<b>704,346</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 882,211</b>	<b>\$ 935,924</b>

See notes to unaudited condensed consolidated financial statements.



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**GOLDEN TELECOM, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In Thousands, Except Per Share Data)  
(Unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>
REVENUE:				
Telecommunication services	\$ 164,392	\$ 195,242	\$ 319,990	\$ 371,889
Revenue from affiliates and related parties	1,117	1,726	1,984	3,219
<b>TOTAL REVENUE</b>	<b>165,509</b>	<b>196,968</b>	<b>321,974</b>	<b>375,108</b>
OPERATING COSTS AND EXPENSES:				
Access and network services (excluding depreciation and amortization)	86,191	105,608	166,188	199,001
Selling, general and administrative (excluding depreciation and amortization)	28,828	33,569	56,414	67,450
Depreciation and amortization	20,150	23,923	39,871	46,572
<b>TOTAL OPERATING COSTS AND EXPENSES</b>	<b>135,169</b>	<b>163,100</b>	<b>262,473</b>	<b>313,023</b>
<b>INCOME FROM OPERATIONS</b>	<b>30,340</b>	<b>33,868</b>	<b>59,501</b>	<b>62,085</b>
OTHER INCOME (EXPENSE):				
Equity in earnings (losses) of ventures	(70)	347	(168)	671
Interest income	524	156	900	803
Interest expense	(350)	(74)	(437)	(150)
Foreign currency gains (losses)	(603)	669	(239)	1,575
<b>TOTAL OTHER INCOME (EXPENSE)</b>	<b>(499)</b>	<b>1,098</b>	<b>56</b>	<b>2,899</b>
Income before income taxes and minority interest	29,841	34,966	59,557	64,984
Income taxes	9,355	11,356	18,498	20,770
Minority interest	719	965	1,265	2,103
Income before cumulative effect of a change in accounting principle	19,767	22,645	39,794	42,111
Cumulative effect of a change in accounting principle, net of tax of \$52				681

NET INCOME	\$ 19,767	\$ 22,645	\$ 39,794	\$ 41,430
Basic earnings per share of common stock:				
Income before cumulative effect of a change in accounting principle	\$ 0.54	0.62	\$ 1.10	1.15
Cumulative effect of a change in accounting principle				0.02
Net income per share basic	\$ 0.54	\$ 0.62	\$ 1.10	\$ 1.13
Weighted average common shares basic	36,334	36,600	36,329	36,537
Diluted earnings per share of common stock:				
Income before cumulative effect of a change in accounting principle	\$ 0.54	\$ 0.62	\$ 1.09	1.15
Cumulative effect of a change in accounting principle				0.02
Net income per share diluted	\$ 0.54	\$ 0.62	\$ 1.09	\$ 1.13
Weighted average common shares diluted	36,571	36,716	36,573	36,687
Cash dividends per common share	\$ 0.20	\$ 0.20	\$ 0.40	\$ 0.40

See notes to unaudited condensed consolidated financial statements.



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**GOLDEN TELECOM, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In Thousands)  
(Unaudited)

	<b>Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2006</b>
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 39,794	\$ 41,430
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	30,908	36,545
Amortization	8,963	10,027
Equity in (earnings) losses of ventures	168	(671)
Foreign currency (gain) losses	239	(1,575)
Bad debt expense	4,681	4,555
Stock appreciation rights compensation expense		2,273
Cumulative effect of a change in accounting principle, net of tax of \$52		681
Other	(1,445)	452
Changes in assets and liabilities:		
Accounts receivable	(11,126)	(27,855)
Accounts payable and accrued expenses	4,887	22,916
VAT, net	2,796	(6,552)
Other changes in assets and liabilities	6,367	(1,055)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>86,232</b>	<b>81,171</b>
<b>INVESTING ACTIVITIES:</b>		
Purchases of property and equipment and intangible assets	(44,362)	(81,206)
Acquisitions, net of cash acquired	(946)	(16,486)
Restricted cash	452	337
Other investing	1,300	(1,794)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(43,556)</b>	<b>(99,149)</b>
<b>FINANCING ACTIVITIES:</b>		
Net proceeds from exercise of employee stock options	565	2,306
Cash dividends paid	(14,543)	(14,622)
Other financing	(1,085)	(1,062)
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(15,063)</b>	<b>(13,378)</b>
Effect of exchange rate changes on cash and cash equivalents	(90)	591
Net increase (decrease) in cash and cash equivalents	27,523	(30,765)
Cash and cash equivalents at beginning of period	53,699	67,176

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 81,222	\$ 36,411
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See notes to unaudited condensed consolidated financial statements.

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**GOLDEN TELECOM, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**Note 1: Basis of Presentation**

Golden Telecom, Inc. (the Company) is a provider of a broad range of telecommunications services to businesses, other telecommunications service providers and consumers. The Company provides these services through its operation of voice, Internet and data networks, international gateways, local access and various value-added services in the Commonwealth of Independent States ( CIS ), primarily in Russia, and through its fixed line and mobile operations in Ukraine.

The financial statements included herein are unaudited and have been prepared in accordance with generally accepted accounting principles in the United States of America ( US GAAP ) for interim financial reporting and United States Securities and Exchange Commission ( SEC ) regulations. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with US GAAP and SEC rules and regulations have been condensed or omitted pursuant to such US GAAP and SEC rules and regulations. In the opinion of management, the financial statements reflect all adjustments of a normal and recurring nature necessary to present fairly the Company's financial position, results of operations and cash flows for the interim periods. These financial statements should be read in conjunction with the Company's 2005 audited consolidated financial statements and the notes related thereto. The results of operations for the three and six months ended June 30, 2006, may not be indicative of the operating results for the full year.

**Note 2: Summary of Significant Accounting Policies and Recent Accounting Pronouncements****Summary of Significant Accounting Policies***Intangible Assets*

The total gross carrying value and accumulated amortization of the Company's intangible assets by major asset class is as follows:

	Weighted Average Amortization Lives	As of December 31, 2005		As of June 30, 2006	
		Cost	Accumulated Amortization	Cost	Accumulated Amortization
(in thousands)					
Amortized intangible assets:					
Telecommunications service contracts	10 years	\$ 99,366	\$ (32,009)	\$ 103,668	\$ (37,712)
Contract-based customer relationships	5 years	36,849	(18,241)	37,091	(21,847)
Licenses	11 years	7,176	(3,182)	12,744	(3,565)
Other intangible assets	5 years	11,137	(7,216)	13,041	(6,664)
Total		\$ 154,528	\$ (60,648)	\$ 166,544	\$ (69,788)

Other intangible assets include software, Internet software and related content, as well as other intangible assets.

*Comprehensive Income*

Comprehensive income is defined as the change in equity of a business enterprise during a period from non-owner sources. For the three and six months ended June 30, 2005, and 2006, respectively, comprehensive income for the Company is equal to net income.

*Stock-Based Compensation*

Until January 1, 2006, the Company followed the provisions of Statement on Financial Accounting Standard ( SFAS ) No. 123, Accounting for Stock-Based Compensation, for its Equity Participation Plan and Stock Appreciation

Rights ( SAR s) Plans. SFAS No. 123 generally allowed companies to either account for stock-based compensation under the fair value method of SFAS No. 123 or under the intrinsic value method of Accounting Principles Board ( APB ) No. 25, Accounting for Stock Issued to Employees. The fair value method required compensation cost to be measured at the grant date based on the value of the award and to be recognized over the service period. The Company had elected to account for its stock-based compensation in accordance with the provisions of APB No. 25 and present pro forma disclosures of results of operations as if the fair value method had been adopted.

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**GOLDEN TELECOM, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

The effect of applying SFAS No. 123 on the reported net income and net income per share for the three and six months ended June 30, 2005 is as follows:

	<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
	<b>(in thousands, except per share data)</b>	
Net income, as reported	\$ 19,767	\$ 39,794
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	149	330
Pro forma net income	\$ 19,618	\$ 39,464
Net income per share:		
Basic as reported	\$ 0.54	\$ 1.10
Basic pro forma	0.54	1.09
Diluted as reported	0.54	1.09
Diluted pro forma	0.54	1.08

In December 2004, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 123R (revised 2004), Share Based Payment , which is a revision of SFAS No. 123. SFAS No. 123R supersedes APB No. 25, and amends SFAS No. 95, Statement of Cash Flows . Under SFAS No. 123R, companies must calculate and record the cost of equity instruments, such as stock options or restricted stock, awarded to employees for services received in the income statement; pro forma disclosure is no longer permitted. The cost of the equity instruments is to be measured based on the fair value of the instruments on the date they are granted or, if the number of shares to be issued or the exercise price is unknown, remeasured at each reporting date and is required to be recognized over the period during which the employees are required to provide services in exchange for the equity instruments. In April 2005, the Securities and Exchange Commission delayed the effective date of SFAS No. 123R until January 1, 2006 for calendar year companies.

The Company adopted SFAS No. 123R as of January 1, 2006 using the modified prospective method which requires the application of SFAS No. 123R in its accounting for SAR s and stock options. Prior to the adoption of SFAS No. 123R, the Company accounted for SARs by remeasuring the intrinsic value of the SARs at each reporting period and adjusted compensation expense and the related liability for the change in the intrinsic value. From January 1, 2006, the Company accounts for SARs at fair value. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123R.

The impact of the adoption of SFAS No. 123R was an increase in cost of revenue of approximately \$0.2 million, an increase in selling, general and administrative expense of approximately \$2.1 million, including the associated payroll taxes, and a deferred tax benefit of approximately \$0.4 million for the six months ended June 30, 2006. In addition, the Company recorded a cumulative effect of a change in accounting principle of \$0.7 million, net of tax, representing the difference between the fair value and the intrinsic value of SARs at January 1, 2006. The total impact of the adoption of SFAS No. 123R was a reduction in net income of approximately \$2.6 million, net of tax, for the six months ended June 30, 2006, equivalent to \$0.07 per common share basic and \$0.07 per common share diluted, representing compensation expense in connection with SARs (see note 6). Compensation expense recorded in connection with outstanding stock options was negligible for the six months ended June 30, 2006.

The impact of the adoption of SFAS No. 123R was an increase in selling, general and administrative expense of approximately \$0.5 million, including the associated payroll taxes, and a deferred tax benefit of approximately \$0.1 million for the three months ended June 30, 2006. The total impact of the adoption of SFAS No. 123R was a reduction in net income of approximately \$0.4 million, net of tax, for the three months ended June 30, 2006, equivalent to \$0.01 per common share basic and \$0.01 per common share diluted, representing compensation expense in connection with SARs (see note 6). Compensation expense recorded in connection with outstanding stock options was negligible for the three months ended June 30, 2006.

*Income Taxes*

The Company accounts for income taxes using the liability method required by SFAS No. 109, Accounting for Income Taxes. For interim reporting purposes, the Company also follows the provisions of APB No. 28, Interim Financial Reporting, which requires the Company to account for income taxes based on the Company's best estimate of the effective tax rate expected to be applicable for the full fiscal year on a current year-to-date basis. The rate so determined is based on the tax rates currently applicable to the Company in the United States and to the Company's subsidiaries in Russia and other CIS countries and includes the Company's best estimate of the annual tax effect of non-deductible expenses, primarily related to amortization of intangible assets, foreign exchange and other permanent differences as well as estimates as to the realization of certain deferred tax assets. Deferred income taxes result from temporary differences between the tax basis of assets and liabilities and the basis as reported in the consolidated financial statements. The Company does not provide for deferred taxes on the undistributed earnings of its foreign subsidiaries, as such earnings are generally intended to be reinvested in those operations permanently. In the case of non-consolidated entities, where the Company's partner requests that a dividend be paid, the amounts are not expected to have a material impact on the Company's income tax liability. It is not practical to determine the amount of unrecognized deferred tax liability for such reinvested earnings.

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**GOLDEN TELECOM, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

*Functional Currency*

The functional currency of the Company's foreign subsidiaries is the United States dollar ( USD ) because the majority of their revenues, expenses, property and equipment purchased and debt and trade liabilities are either priced, incurred, payable or otherwise measured in USD. Accordingly, transactions and balances not already measured in USD, primarily transactions in local currencies of the Company's CIS subsidiaries, have been re-measured into USD in accordance with the relevant provisions of SFAS No. 52, Foreign Currency Translation . The objective of this re-measurement process is to produce largely the same results that would have been reported if the accounting records had been maintained in USD.

In the second quarter of 2006, EDN Sovintel LLC ( Sovintel ), the Company's wholly-owned Russian subsidiary, introduced fixed USD ruble exchange rate for settlements with some of its customers. Sovintel plans to introduce this fixed rate for the majority of its customers in the third quarter of 2006. However, this fixed rate is applicable only if the official USD exchange rate set by the Central Bank of Russia ( CBR ) is below the fixed level. If the ruble depreciates against the USD so that the CBR exchange rate exceeds the fixed level, Sovintel will resume applying the CBR exchange rate, or floating rate, for settlements with its customers. The Company is currently evaluating the effect of the introduction of the fixed exchange rate in conjunction with various functional currency indicators established by SFAS No. 52 in order to determine if the change in functional currency for the Company's Russian operations may be required in subsequent periods.

*Use of Estimates in Preparation of Financial Statements*

The preparation of these consolidated financial statements, in conformity with US GAAP, requires management to make estimates and assumptions that affect amounts in the financial statements and accompanying notes and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Comparative Figures*

Certain prior year amounts have been reclassified to conform to the presentation adopted in the current year. Such reclassifications did not affect the consolidated statements of operations.

***Recent Accounting Pronouncements****Exchanges of Nonmonetary Assets*

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets . SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets. SFAS No. 153 amends APB No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of SFAS No. 153 are effective for financial statements for fiscal years beginning after June 15, 2005. The adoption of the provisions of SFAS No. 153 did not have a material impact on the Company's results of operations, financial position or cash flow.

*Accounting Changes and Error Corrections*

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections , which is a replacement of APB No. 20, Accounting Changes and SFAS No. 3, Reporting Changes in Interim Financial Statements . SFAS No. 154 applies to all voluntary changes in accounting principle and changes the accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. In addition, SFAS No. 154 requires that a change in method of depreciation, amortization, or depletion for long-lived, nonfinancial assets be accounted for as a change in accounting estimate that is effected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of the provisions of SFAS No. 154 did not have a material impact on the Company's results of operations, financial position or cash flow.





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**GOLDEN TELECOM, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

In June 2006, the FASB issued FASB Interpretation No. 48 ( FIN No. 48 ), Accounting for Uncertainty in Income Taxes an interpretation of SFAS Statement 109 , which clarifies the accounting for uncertainty in tax positions. FIN No. 48 creates a single model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN No. 48 scopes out income taxes from SFAS No. 5, Accounting for Contingencies . The provisions of FIN 48 are effective for financial statements for fiscal years beginning after December 15, 2006. The Company is currently examining FIN No. 48 to determine whether it will have a material impact on the Company s financial position, results of operations, or cash flow.

**Note 3: Net Income Per Share**

Basic earnings per share at June 30, 2005 and 2006 are computed on the basis of the weighted average number of common shares outstanding. Diluted earnings per share at June 30, 2005 and 2006 are computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding employee stock options using the treasury stock method. The number of stock options excluded from the diluted earnings per share computation, because their effect was antidilutive for the three and six months ended June 30, 2005 and 2006 was 10,000 stock options.

The components of basic and diluted earnings per share were as follows:

<b>Three Months</b>		<b>Six Months Ended June</b>	
<b>Ended June 30,</b>		<b>30,</b>	
<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>
<b>(in thousands, except per share data)</b>			