EVOLVING SYSTEMS INC
Form 10-K
April 04, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2018

OR

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

For the transition period from to

Commission File Number: 001-34261

EVOLVING SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**84-1010843** (I.R.S. Employer Identification Number)
9800 Pyramid Court, Suite 400, Englewood, Colorado (Address of principal executive offices)	**80112** (Zip Code)

(303) 802-1000

(Registrant s telephone number, including area code)

Securities registered under Section 12(b) of the Act:

Common Stock, Par Value $0.001 Per Share (Title of Class)	**The Nasdaq Capital Market** (Name of exchange on which registered)

Securities registered under Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer , accelerated filer , smaller reporting company , and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o
Accelerated filer o

Non-accelerated filer x
Smaller reporting company x
Emerging growth companyo

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant, based upon the last sale price of the Common Stock reported on the Nasdaq Capital Market, was approximately $17,708,979 as of June 30, 2018.

The number of shares of Common Stock outstanding was 12,161,176 as of April 3, 2019.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III (Items 10, 11, 12, 13 and 14) is incorporated by reference to portions of the registrant s definitive proxy statement for the 2019 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the 2018 year. Except as expressly incorporated by reference, the Proxy Statement shall not be deemed to be a part of this report on Form 10-K.

EVOLVING SYSTEMS, INC.

Annual Report on Form 10-K

For the year ended December 31, 2018

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FORWARD-LOOKING STATEMENTS

Except for the historical information contained in this document, this report contains forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995, including estimates, projections, statements relating to our business plans, objectives and expected operating results and assumptions. These forward-looking statements generally are identified by the words believes, goals, projects, expects, anticipates, estimates, intends, strategy, or plan, and variations of these words and similar expressions. Forward-looking statements are based on current expectations, estimates, projections and assumptions regarding product, services, and customer support revenue; the expectations associated with our business, our subsidiaries operations and our short- and long-term cash needs and are subject to risks and uncertainties which may cause our actual results to differ materially from those discussed here. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the sections entitled Business, Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

ITEM 1. BUSINESS

INTRODUCTION

Evolving Systems provides real-time digital engagement solutions and services to more than 100 customers in over 65 countries worldwide. Our portfolio includes market-leading solutions and services for real-time analytics, customer acquisition and activation, customer value management and loyalty for the telecom industry promoting partnerships into retail and financial services.

Our acquisitions in 2017 of BLS Limited (EVOL BLS) and four Lumata Holdings subsidiaries, Lumata France SAS, Lumata Spain S.L., Lumata UK Ltd and Lumata Deutschland GmbH (collectively, Lumata Entities), along with the acquisition of RateIntegration d/b/a Sixth Sense Media (SSM) in 2015 ushered our entry into the high value digital engagement space and also initiated our adoption of a recurring revenue business model based on managed services and Software as a Service (SaaS).

We have transitioned from offering traditional software technology licensing, focused on cost savings, to offering business solutions focused on revenue growth and efficiency gains for the carrier. Our business model has moved from classic capital expenditure license and services to operating expense models based on managed services, including transaction and performance fees.

We offer real-time, interactive digital engagement solutions and services that drive increases in customer lifetime value for our enterprise clients:

- Acquisition and Activation Solutions that increase new subscriber enrollments through multiple channels and dealer networks, electronically authenticate customer identity and activate complex bundles of traditional telecom services (voice, messaging and data) and value-added network services;

- Retention and Loyalty Solutions that extend the duration of customer contracts by engaging them with the brand, interacting and rewarding them with personalized offers through loyalty and partner programs; and

- Analytics and Value Management Solutions that analyze consumer behavior in real-time and enable marketing departments to innovate, create and manage highly-personalized and contextually-relevant interactive campaigns that engage consumers with event-triggered offers that result in higher take-rates and increased customer revenue.

The combination of these offerings increases customer activations and activity, extends their lifecycle and increases customer spend resulting in increased customer lifetime value.

COMPANY BACKGROUND

Evolving Systems was founded in 1985 to provide software and services to the U.S. telecommunications industry. During our early years we focused on providing solutions that supported number management and number porting. In November 2004, we expanded our product set and geographical reach with the acquisition of Tertio Telecoms Ltd. (Evolving Systems U.K.), a supplier of Operations Support Systems (OSS) software solutions for service activation and mediation to communication carriers throughout Europe, the Middle East, Africa and Asia. With this acquisition we not only expanded our markets beyond North America, we also added service activation and mediation solutions to our product portfolio. The acquisition significantly expanded our product and service capabilities, allowing us to address a larger portion of our customers OSS application needs with a balanced mix of products

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as well as services. We focused primarily on the wireless markets in the areas of subscriber activation, SIM card management and activation, self service mobile applications, data enablement solutions, connected device activation and management of services.

On October 24, 2013 we acquired privately held Telespree Communications (Telespree), now known as Evolving Systems Labs, Inc. (Evolving Systems Labs), for an initial payment of approximately $1.6 million comprised of approximately $0.8 million in cash and approximately $0.8 million in stock. The acquisition included technology used in the delivery and management of mobile data services and a portfolio of SaaS based solutions. We were not required to make the additional contingent payments potentially payable by us under the acquisition agreement and we recognized other income in 2016 and the three months ended June 30, 2018.

On September 30, 2015, we acquired privately held SSM, now known as Evolving Systems NC, Inc. (Evolving Systems NC) for an initial cash payment totaling approximately $9.75 million, plus customary working capital adjustments, and we agreed to make a payment of $250,000 on the one-year anniversary of the transaction, with such payment being available to secure SSM s representations and warranties under the acquisition agreement. This payment was offset against other obligations during 2018 and was not made. The acquisition included SSM s software solution, RLM, a platform which enables carrier marketing departments to innovate, execute and manage highly-personalized and contextually-relevant, interactive campaigns that engage consumers in real-time as well as a platform for Customer Loyalty and Retention.

On July 3, 2017, BLS Limited (EVOL BLS), a wholly owned subsidiary of the Company, completed the purchase of Business Logic Systems Limited (BLS), a provider of customer value management solutions and data driven marketing solutions. EVOL BLS and BLS are both companies incorporated under the laws of England and Wales. Under the terms of the Asset Purchase Agreement(the Purchase Agreement), BLS sold substantially all of its assets and transferred certain liabilities relating to BLS s business for £1.2 million ($1.6 million) in cash, plus (a) an additional sum of £0.1 million ($0.1 million), reduced by any sums paid by EVOL BLS for certain employee severance obligations (collectively, the Cash Payments); (b) a percentage of collections on certain receivables over a 24-month period; and (c) an earnout equal to 50% of BLS based revenue over defined threshold levels for a period of 3 years after the closing date. We made the earn-out payment in November 2018 of approximately $0.8 million. No future payments are expected at this time. BLS specializes in data-driven customer value management and customer engagement solutions that have been implemented in over 20 mobile operators in Europe, Africa, Asia-Pacific and the Caribbean. BLS solutions turn customer data into actionable insights and personalized contextual offers. Customer engagement occurs through in-bound and out-bound offers and is further extended through a suite of loyalty and retention solutions.

On September 7, 2017, Evolving Systems Holdings Limited (EVOL Holdings) acquired all of the issued and outstanding shares of four (4) Lumata Holdings (Seller) subsidiaries, (Lumata Entities), in exchange for a cash payment totaling 4.0 million ($4.8 million), subject to certain adjustments. In connection with the acquisition, EVOL Holdings entered into a Term Loan Facility Agreement, a Debenture and a Subordination Deed with East West Bank as lender in the amount of $4,730,000 (collectively, the Loan Facility Agreements).

The Lumata Entities are a leading global provider of real-time, next generation loyalty and customer lifecycle management software and services that allow businesses to analyze customer data for relevant and contextual insights that will support additional services. Its customers are mobile operators including Orange, Telefonica and other Tier-1 and emerging operators in Europe and around the world.

We are now a leading supplier of real-time digital engagement solutions and services that drive growth in customer acquisition and activation, extend customer lifetime and increase customer value and revenue in the converging mobile, entertainment, financial and retail services eco-system. Our platforms, together with our team of experienced industry experts, help service providers increase their customer lifetime value (CLV) over the course the customer lifecycle.

INDUSTRY DYNAMICS

The market for digital engagement to increase customer lifetime value is growing. Several key factors are driving carrier demand for next generation solutions, supporting growth for specific products within the sector:

- Carriers are seeking to further monetize their customer relationships and associated demographic, behavioral, location and contextual information to up-sell their network services and open new channels for optimized and personalized third-party service revenues;

- Rapid adoption of smart phones and network-attached devices has resulted in increased usage of mobile data;

- On-going network investment in 5G and Internet of Things (IoT) networks is driving increased demand for digital engagement solutions;

- Carriers are experiencing pricing pressure driven by relatively flat subscriber growth, network upgrade costs, subscriber churn and increased competition from traditional and new market entrants such as Over-the-Top (OTT) services both in the developed and emerging markets; and,

- Adoption of the Enterprise Mobility and Machine to Machine (M2M) requirements are driving further demand.

Today, carriers are compelled to offer a growing array of services to deliver personalized and differentiated user experiences, reduce subscriber churn and maintain or grow market share. These value-added services have to be delivered to the market in ever shorter windows as competitive pressure has increased the velocity at which carriers deliver new products and services. To achieve these objectives, operators are increasingly reliant on flexible service enablement solutions that offer a myriad of options for their subscribers.

As network migrations to 5G, IoT and M2M accelerate, the SIM card and embedded SIM (eSIM) have emerged as vital links in the end-to-end value chain. Evolving Systems full life cycle management of SIMs and eSIMs from ordering, dynamically activating and managing the SIM card is becoming an important component in the service provider s infrastructure, both to reduce operating costs associated with the provisioning of SIM cards, as well as to improve the end-user experience. We are a pioneer and leader in this market and believe we are well-positioned to maintain our leadership role in this growth segment. To date our Subscriber Activation solution has activated over 700 million SIM cards, providing enhanced functionality and significant operator savings.

In a market where consumers perceive their telecom services as a commodity, maintaining or growing customer value and retaining valuable customers is a persistent challenge. Customers are demanding ever greater incentives for their loyalty, attracted by disruptive OTT alternatives and competitive offers on data, airtime, and SMS. This can lead to a spiral of price-driven value destruction unless a truly differentiated approach is used to stand out from the crowd and deliver superior value.

The digital revolution offers unparalleled opportunities to generate new revenue streams, create highly relevant and differentiated offerings, and deliver more engaging customer experiences to the growing universe of connected consumers. But a digital environment requires a whole new way of interacting with consumers in real-time, via multiple channels such as apps, web, email, as well as traditional SMS, in a highly contextual manner. Having a deep understanding of customer preferences and behavior is critical in this digital environment full of demanding customers.

Mobile service is ubiquitous and mobile operators are the digital enablers between consumers and brands, the trusted processors of customer data, uniquely able to bridge the digital and physical world through their technology infrastructure. The mobile industry is going through a transition period. Traditional voice and messaging revenues are in decline due to several factors including the over-the-top OTT players. Mobile data demand is growing. Service providers are focused on building upon their brand and their last mile connectivity to more actively engage their customers and to increase the customer wallet-share through digital and non-digital partnerships.

We help service providers navigate through the digital marketing jungle of fragmented technologies, converging communication channels and managing the data overload through our portfolio of digital engagement solutions. We combine big ideas and a deep understanding of mobile customer behavior with powerful software capabilities and expertise to create digital engagement & loyalty experiences that stand out from the crowd.

We sit at the intersection of technology and marketing. Our solutions leverage mechanics such as digital vouchering, digital badges, in-app engagement, etc. to drive a two-sided business model, where we generate value from 3rd party brands, as well as retail customers. It is a continuous circle where customers increase spending and extend tenure in return for perceived high value rewards and experiences, which brands provide in order to access a highly targeted mobile customer base.

Connecting brands and consumers, via a digital platform, positions the mobile operator at the center of commerce, content and communication flows in the connected world. Using our solutions, mobile operators have access to accurate data on customer preferences, behavior, spending, etc. While it is critical to ensure customer opt-in for data use, industry research confirms that consumers will allow a trusted mobile operator to use their information in return for highly relevant and attractive incentives.

DIGITAL ENGAGEMENT SOLUTIONS PORTFOLIO

Acquisition and Activation

Our Subscriber Acquisition and Activation solutions support carriers in adding new subscribers to their network, beginning with the sales and contract process through the allocation of network and service resources and the activation of services to the mobile device.

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- ***Smart Dealer*** provides SIM retailers with a tool set that enables them to sell SIM cards efficiently and effectively. With Smart Dealer, the operator is able to communicate and guide dealers towards using the latest promotions, enabling instant reactions to competitor activities. Smart Dealer captures subscriber details for Know Your Customer prepaid registration, including biometric data, using standard, low cost devices.

- ***Dynamic SIM Allocation*™** is a SIM/eSIM Activation solution which is integrated into the carrier s signaling network, enabling new SIM cards or eSIMs that have not been pre-provisioned to be detected on first use in consumer and IoT Markets. This triggers an efficient, dynamic provisioning process and eliminates the need for pre-provisioning, thus lowering the operator s costs of subscriber acquisition and eSIM bootstrapping. The SIM/eSIM activation occurs only when a SIM/eSIM card is first used. During the activation process, the solution enables an on-device interaction with the end-user, delivering a differentiated user-experience, reducing customer churn and boosting revenue for the carrier.

- ***Tertio® Service Activation*** is used by carriers to activate a new subscriber or to add a new service to an existing subscriber. Our solution provides a flexible operating environment for carriers to manage their voice, data, and content service needs for both their traditional and broadband IP networks. It provides a point of flexibility in the carrier s OSS/BSS architecture, allowing fast introduction of new network technologies and easing the burden of integration with existing devices and systems. Service providers who use our Tertio solution can better plan, manage and execute the introduction of new services.

- ***Number Inventory and Management*** is a scalable and fully automated solution that enables operators to reliably and efficiently manage their telephone numbers (i.e. eSIMs and eSIM profiles, SIMs, MSISDNs, IMSIs, Integrated Circuit Card Identifiers (ICCIDs) as well as other communication identifiers such as Uniform Resource Locators or (URLs) and email addresses. Our solution focuses on the automation of all number resource management processes, allowing operators to adhere to regulatory requirements and effectively manage the lifecycle of telephone numbers, as well as benefit from time savings and reduced costs.

Customer Analytics and Value Management

Our Customer Analytics and Value Management solutions empower marketing departments to create and deploy highly personalized, location and contextually relevant, interactive customer engagement campaigns. Our most recent version of our cutting-edge ***Evolution*** platform launched in the first quarter of 2019 enables us to deliver a full-service solution at the client s site or hosted in our cloud and provided as SaaS subscription. The platform monitors customer events and behavioral patterns in real-time, building a profile of each subscriber. When the right conditions are met, the platform pushes the best match or a personalized offer or ad to the customer.

Compared with many other marketing campaign management systems, our solution more accurately targets marketing messages and campaigns that drive incremental revenue more quickly.

- ***The Profiling Engine*** supports static as well as ongoing dynamic profiling of subscribers. It fully supports any real-time or micro segmentation requirements as needed by the business. The Profiling Engine is a rules-driven flexible aggregator of subscriber baseline and usage data. It has been designed to handle any data model, including any data representation that may be available within the carrier s legacy billing and Customer Relationship Management (CRM) environment.

- ***The Campaign Engine*** is used to configure and deliver marketing campaigns and offers to subscribers. It includes a business-friendly dashboard that enables rapid configuration, testing and launching of new business campaigns. Through the dashboard the business user can target specific subscribers, define offers and rewards, and create personalized messages per campaign, interaction and subscriber. The dashboard provides a real-time view on each campaign s effectiveness and impact.

- ***Campaign Modules*** provide predefined templates for specific types of real-time mobile marketing tactics, including marketing for data bundles, digital services such as music, video, movies, gaming, entertainment, and mobile money as well as non-digital services including retail offers.

- ***Social Media Integration*** enables carriers to expand their engagement with subscribers beyond simple network usage and direct channels and can support social marketing campaigns that leverage the subscribers as a part of the marketing network.

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- ***App Promotion*** engages subscribers when they are first configuring new services or when they are upgrading to mobile devices with new capabilities. It enables carriers to promote the use of their own mobile applications for subscriber care, and also those of third-party app publishers, opening possibilities for new revenue streams.

Customer Retention and Loyalty

Our Customer Retention and Loyalty solutions help reduce churn, extend the customer lifecycle and generate more revenue from existing subscribers by using the latest innovative programs. Strong subscriber loyalty is created by rewarding subscribers via programs that offer additional carrier services or the services and products of participating partners.

Brand partnerships are the true differentiators given the commoditization of typical carrier offers in the market. Some of the examples of digital engagement concepts we have created include the first digital badges concept in the telecom sector with Orange, the largest and most successful film vouchering programs with Orange, & Everything Everywhere, innovative Recharge & Instant Win mechanics in prepaid markets, and two of the most successful loyalty programs in the tough African market. These concepts were designed with specific mechanics that work within the local market in conjunction with brand partners. They are successful solutions which endure, because of key ingredients such as simple customer journeys, perceived high value rewards and innovative engagement mechanics in conjunction with strategic brand partnerships.

The key modules include:

- ***Loyalty Points and Programs*** are used to reward mobile subscribers for use of the carrier s services. Credit is earned in the forms of status points and bonus points. Gamification can be used to encourage the collection of rewards by subscribers and comparison with others in their social group. Loyalty credit is then exchanged for services or discounts from the carrier, or for digital and physical goods from third party businesses and retail partners.

- ***Coupon, Voucher and Badges Management*** covers the whole lifecycle of coupons, vouchers and badges as a medium for delivering rewards. Our solution manages the interface with partners, the delivery of coupons to subscribers, redemption for digital or physical goods, and settlement between carrier and partner.

- ***Digital Engagement Engine*** includes several solution components:

- Proprietary framework for engagement concept design and partner selection;

- Flexible business rules to define tiers to earn, burn or transfer credits;

- Multi-variable definition to calculate loyalty, including spend, tenure, social advocacy, brand engagement, digital maturity, etc.;
- Intelligent predictive analytics engine and segmentation capability;
- Channel agnostic redemption capability with standard partner APIs to connect into Point of Sale retail systems and other redemption networks; and,
- Tier 1 carrier grade data capture and configurable provisioning engine.

MANAGED SERVICES (MARKETING AND EXPERT IT SERVICES)

Our Marketing Services team works through a five-stage approach to assist our clients marketing departments in growing their customer base and engaging and retaining their valuable customers:

- Engage: We design engagement plans that map against specific segments based on propensity to participate and lifetime value indicators.
- Interact: We design the push and real-time trigger-based interactions with customers to attract them into the program and keep them engaged.
- Reward: We define a broad range of trigger events and a variety of engagement mechanics (points, badges, instant wins, vouchers, etc.).
- Redeem: We work with partners to stitch together a redemption network online and offline, so customers have highly relevant, branded rewards (a key source of differentiation and program longevity) from which to choose.
- Optimise/Learn: We use program data, overlay program results from our global customer base, and apply an iterative process to reach the right customers with meaningful incentives.

Our experienced IT Services team provides expert consulting services for the customization, integration and deployment of our solutions. Our services cover all aspects of the project lifecycle, including system architecture, design, software development and customization, system integration, testing, live deployment and production support, program and project level management, post-implementation maintenance and domain and product expertise.

We deliver our Managed Services both on-site at a carrier s facilities or remotely. Services range from operational support of our software solutions, technical services to expand those solutions with new modules and functionality to support new business value, marketing and customer engagement consultancy that directly drives marketing campaigns for our customers and helps them achieve their business objectives. The Managed Services teams also offer their expertise and experience to create the maximum financial impact to the carrier from using our solutions.

Our teams work closely with customers and integration partners and have established long-term relationships with operators in the Americas, Europe, the Middle East, Africa and Asia Pacific regions.

PRODUCT DEVELOPMENT

We develop most of our products and services internally in our innovation labs in North Carolina, France, Romania and India. Internal development allows us to maintain competitive advantages that come from product differentiation and closer technical control over our products and services. It also allows us to decide which modifications and enhancements are most important and when they should be implemented. Generally, we also create product documentation internally. We conduct research to identify specific industry and client business needs as well as market requirements and we use that information to determine our investment in product development. We evaluate the market for new products and we leverage our existing product capabilities with enhancements of existing products. We build investment plans for our principal product areas and we make other investments in tools and product extensions to accelerate the development, implementation and integration process for customer solutions.

We are currently continuing our on-going investment in our Evolution platform, a combination of software capabilities achieved through each of our acquisitions, which will provide a powerful environment to configure and operate rich Customer Lifecycle Journeys from acquisition to retention through a variety of engagement models, offer and loyalty programs. Primarily designed to address integrated mobile digital engagement needs it can accommodate any type of customer and any type of use case. The platform s Customer Journey Manager will be responsible for profiling individual engagements to enable better insights and more automation. This approach produces more relevant and engaging predictions and offers for us to present to customers.

The platform will provide service providers with unmatched artificial intelligence based on smart data and operational predictive analytics functions enabling to improve efficiency and to maximize revenues, all the while reducing time and effort to execute hundreds of micro-segmented engagements and offers. We intend to take our digital engagement readiness solution for carriers beyond just enabling clients to use their traditional data. The new platform will move beyond its current SQL engine to using a Kafka-engine-powered big data platform. This will enable the real-time processing of multiple data-streams for unlimited flexibility and scalability.

Our Evolution platform will be used to operate the most innovative large-scale loyalty programs, as well as to provide unique mechanics enabling gamification, optimization and personalization across a variety of channels. It will enable our clients to engage with their customers at all stage of their lifecycle, providing interactive dialogue and smart recommendations through all available traditional and digital channels. The platform will seamlessly integrate within the service provider s IT infrastructure, either on-premise or on a private cloud. It will be operated or managed as a service depending on the market needs.

SALES AND MARKETING

Our sales force is primarily a field organization structured to focus on specific geographical territories around the world including North America, Latin America, Europe, Middle East, Africa, the Commonwealth of Independent States (comprised of Russia and other former Soviet Republics), South Asia and Asia Pacific. Our sales activities cover direct sales to enterprise customers as well as sales through partners and resellers. Partners include Ericsson, Gemalto and Idemia who include our products as part of their wider solution offerings and systems integrators such as IBM, Amdocs and Atos, who license our technology to customers as part of their delivery engagements. The resellers include regional or country specific companies that manage our customer relationships in countries where English is not the primary language.

Our solutions and our customers infrastructures are complex and require a high degree of consultative selling which often results in a long sales cycle in excess of twelve months. In addition, our business relies on incremental revenue from existing customers, which requires regular interaction with customers to discuss enhancements to our existing solutions as well as the introduction of new features and functionality. The sales team is also responsible for making proactive proposals to prospects, as well as managing and delivering responses to competitive tenders. This complex, highly interactive approach, typically results in a long sales cycle, requiring us to invest a considerable amount of time developing business opportunities without guaranteed sales.

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Our marketing organization supports our sales activities by identifying markets for our products and establishing an awareness of our offerings in those markets through a combination of direct marketing, web marketing, and participation in shows, conferences, and industry bodies. The marketing organization is responsible for maintaining our web site and creating electronic and print-based sales collateral to support our sales activities and lead generation.

COMPETITION

The market for telecommunications OSS products and mobile analytics and advertising is highly competitive and subject to rapid technological change, changing industry standards, regulatory developments and consolidation. We face increasing demand for improved product performance, enhanced functionality, rapid integration capabilities, all in the context of continuing pricing pressure. Our existing and potential competitors include many large domestic and international companies that often have substantially greater financial, technological, marketing, distribution and other resources, larger installed customer bases and longer-standing relationships with telecommunications customers. The market for telecommunications OSS software and services is extremely large and we currently hold only a small portion of total market share. Nonetheless, we believe our work in subscriber acquisition and activation and Digital Engagement Customer Value Management, Retention and Loyalty has resulted in our achieving a measurable and reasonable market share in those areas.

Our principal competitors for subscriber acquisition and activation are vendors such as Nokia, Amdocs and Huawei, as well as billing vendors and other vendors such as Ericsson, 6D, HP and a few other smaller regional competitors.

Competitors for Digital Engagement Customer Value Management, Retention and Loyalty, include specialist vendors such as Pontis (acquired by Amdocs), CRM software from vendors such as Amdocs Limited, Analytics software from vendors like SAS and a few independent software companies like FlyTxt and Pelatro.

For all of our products, our ability to compete successfully depends on a wide range of factors. First and foremost is our ability to deliver both marketing services and expert services based on our solutions platform, which offers a cost-effective way for our customers to benefit from our many years of experience and product investment. We deliver value by offering competitively priced quality solutions, tailored specifically to our customers network and IT infra-structure. After a customer implements our products, we often receive subsequent orders for enhancements to add functionality or increase capacity. Complex solutions tailored to customers needs are expensive and time consuming to replace, thus providing us with an incumbent advantage. Furthermore, many of our customer relationships span five years or more. We believe all of these factors give us a competitive advantage and can be a barrier to entry for potential competitors.

SIGNIFICANT CUSTOMERS

For the year ended December 31, 2018 one significant customer accounted for 11% of revenue from operations. This customer is a large telecommunications operator in Europe. For the year ended December 31, 2017 one significant customer accounted for 11% of revenue from operations. This customer is a large telecommunications operator in Europe.

INTELLECTUAL PROPERTY

We rely on a combination of patents, copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. We have 9 patents in the U.S. on elements of our DSA and mobile broadband enablement products and patents pending in other countries on elements of our DSA and other products.

EMPLOYEES

As of December 31, 2018, we employed 280 people including 17 in the United States, 117 in the United Kingdom and European Union and 146 in India. Of our worldwide staff, 78% are involved in product delivery, development, support and professional services, 6% in sales and marketing, and 16% in general administration. The number and mix of our staff stabilized after the integration of the prior year acquisitions, however changes may occur in the coming year related to changes in the business and our market strategies. We also engage with multiple contractors in various countries to allow us to service our global clients.

AVAILABLE INFORMATION

You can find out more information about us at www.evolving.com. In addition, we use social media to communicate to the public. It is possible that the information we post on social media could be deemed to be material to investors. We encourage investors, the media, and others interested in Evolving Systems to review the information we post on the social media channels listed on our website. The information on or accessible through our website or on social media is not incorporated into this Annual Report on Form 10-K. Our Annual Reports on Form 10-K, our Quarterly Reports on Form 10-Q, and our Current Reports on Form 8-K and any amendments to those reports are available free of charge on our Internet website as soon as reasonably practicable after we electronically file or furnish such material with the SEC. Additionally, these reports are available at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 or on the SEC s website at www.sec.gov.

ITEM 1A. RISK FACTORS

General Risk Statement

Our operations and financial results are subject to various risks and uncertainties, many of which are driven by factors we cannot control or predict. An investment in our common stock involves a high degree of risk. The risks that we have highlighted here represent the material risks known to us, but they are not the only ones that we face. If any of the risks actually occur, our business, financial condition, results of operation and cash flows could be negatively affected. You should carefully consider these risks and uncertainties before investing in our securities.

Risks Related to Our Business and Industry

We operate a global business that exposes us to currency, economic, regulatory and tax risks.

Our revenue comes primarily from sales outside the U.S. and our growth strategy is largely focused on emerging markets. Our success delivering solutions and competing in international markets is subject to our ability to manage various risks and difficulties, including, but not limited to:

- our ability to effectively staff, provide technical support and manage operations in multiple countries;
- fluctuations in currency exchange rates;
- timely collecting of accounts receivable from customers and resellers located outside of the U.S.;
- our ability to repatriate cash from foreign locations and manage potential adverse tax consequences in connection with repatriating funds;

- trade restrictions, political instability, disruptions in financial markets, and deterioration of economic conditions;

- compliance with the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act and other anti-bribery laws and regulations;

- variations and changes in laws applicable to our operations in different jurisdictions, including enforceability of intellectual property and contract rights; and,

- compliance with export regulations, tariffs and other regulatory barriers.

Approximately 60% of our revenue is transacted in currencies other than the U.S. dollar (e.g. British Pound Sterling, Swiss Franc and Euro). As a result, when the U.S. dollar strengthens, our revenue, when converted to U.S. dollars, is reduced. At the same time, approximately 96% of our operating expenses are incurred overseas. The strengthening dollar, conversely, lowers expenses outside of the U.S. Although this has provided some defense against currency fluctuations for our bottom-line results, we may not be able to maintain this ratio of revenue to expense in the future. In addition, we may not be able to repatriate cash without incurring substantial risks involving floating currency exchange rates, or to recover or apply withholding taxes remitted to foreign governments.

There is additionally considerable uncertainty about the economic and regulatory effects of the United Kingdom s exit from the European Union (commonly referred to as Brexit). The UK is one of our largest markets in Europe, but we also presently provide services to UK customers from EU countries. Brexit may result in greater regulatory complexity surrounding the services we provide to our UK customers and financial results could be negatively impacted.

Any of the foregoing factors may have a material adverse impact on our business, financial condition and results of operations. We conduct business globally and, as a result, Evolving Systems, Inc. or one or more of our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. Throughout the world, in the normal course of business, we are subject to examination by taxing authorities up until, two years in the U.K. and Europe and four years in India,

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following the end of the accounting period. As of the date of this report, three of our income tax returns in India are under examination and we do not expect the results of the examination will have a material effect on our financial statements.

We face intense competition for our products and services, which may lead to lower revenue or operating margins.

Our competitors range in size from diversified global companies with significant research and development resources to small, specialized firms. Many of the areas in which we compete evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. Our ability to remain competitive depends on our success in making innovative products, devices, and services that appeal to businesses and their customers.

Our revenue, earnings and profitability are affected by the length of our sales cycle, and a longer sales cycle could adversely affect our results of operations and financial condition.

Our business is impacted by the length of our sales cycles. Our customers have relatively complex businesses and the purchase of large communications solutions used for enterprise-wide, mission-critical purposes, involve significant capital expenditures and lengthy implementation plans. Prospective customers often take a long period of time to evaluate our products and services and require us to spend substantial time, effort and money educating them about our solutions. The purchase of the types of products and services we offer typically also requires coordination and agreement across many departments within a customer s organization. This process often results in a lengthy sales cycle, typically ranging between three and twelve months. Mergers and acquisitions of large communications companies, as well as the formation of new alliances, have also resulted in purchasing delays. Further lengthening of our sales cycle could hinder growth in our revenue and result in increased cost of sales, thereby reducing our profitability.

We incurred debt in connection with our recent acquisitions of Lumata and SSM which could adversely affect our financial condition and restrict our operating flexibility.

In connection with our acquisition of Lumata Entities completed on September 4, 2017, we entered into a Term Loan Facility Agreement with East West Bank as lender in the amount of $4.7 million (the Lumata Facility) and we used the full amount of the Lumata Loan Facility to fund the acquisition. The Lumata Facility requires us to make monthly principal payments of approximately $0.1 million, which commenced July 31, 2018 and interest at the greater of (a) 3.5% or (b) the variable rate of interest that appears in the Wall Street Journal on a monthly measurement date, plus in either case 1.5%. The Lumata Facility is secured by substantially all of our assets. The unpaid balance of the Lumata Facility is due on August 16, 2021.

In connection with our acquisition of SSM in September 2015, we increased our revolving credit facility with East West Bank from $5.0 million to $10.0 million (the Revolving Facility) and we used the full amount of the Revolving Facility to fund the acquisition. On February 29, 2016, we retired the Revolving Facility and we entered into a term loan agreement with East West Bank (Term Loan) for $6.0 million. The Term Loan bears interest at a floating rate equal to the U.S. Prime Rate plus 1.0% and is secured by substantially all of our assets, including a pledge, subject to certain limitations with respect to stock of foreign subsidiaries, of the stock of the existing and future direct subsidiaries of the Company. Interest accrues and is payable monthly. We are required to repay the Term Loan in 36 equal monthly installments, which commenced on January 1, 2017. The Term Loan matures on January 1, 2020.

Both in the Lumata Facility and the Term Loan (collectively, Loans), require us to maintain a minimum current ratio, a specified ratio of Total Liabilities to EBITDA and a minimum fixed charge coverage ratio, as defined in the Term Loan. The Loans also include negative covenants that place restrictions on our ability to, among other things: incur additional indebtedness; create liens or other encumbrances on assets; make loans, enter into letters of credit, guarantees, investments and acquisitions; sell or otherwise dispose of assets; cause or permit a change of control; merge or consolidate with another entity; make negative pledges; enter into affiliate transactions; limits the amount of cash distributions to our stockholders; and change the nature of our business materially. Outstanding amounts under the Loans may be accelerated by East West Bank upon the occurrence and continuance of certain events of default, including without limitation: payment defaults, breach of covenants beyond applicable grace periods, breach of representations and warranties, bankruptcy and insolvency defaults, and the occurrence of a material adverse effect (as defined). Acceleration is automatic upon the occurrence of certain bankruptcy and insolvency defaults.

The Loans and related obligations, including interest payments, covenants and restrictions, could have important consequences, including the following:

- reserving cash in order to satisfy the obligations relating to the Loans could adversely affect the amount or timing of investments to grow our business, impairing our ability to invest in and successfully grow our business;

- the Loans could limit our ability to obtain additional financing on satisfactory terms to fund our working capital

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- requirements, capital expenditures, acquisitions, debt obligations and other general corporate requirements;

- the Loans may increase our vulnerability to general economic downturns, competition and industry conditions and we may be unable to take advantage of opportunities that our leverage prevents us from exploiting, placing us at a disadvantage to our competitors that are less leveraged; and,

- the Loans impose restrictions on the manner in which we conduct our business, including restrictions on our ability to pay dividends, incur additional debt and sell assets.

The obligations under the Loans could have an adverse effect on our business, financial condition, operating results or cash flows. In addition, our failure to comply with the covenants under the Loans could result in an event of default and acceleration of the outstanding balance, which could significantly harm our business and cause our stock price to decline. We did not comply with the fixed charge ratio covenant for the quarter ended December 31, 2018. We received a waiver of the non-compliance from East West Bank and we are negotiating new quarterly ratios for 2019. We may fail to meet the covenant requirements in future periods and may be unable to obtain additional waivers or modifications.

We recently completed a number of acquisitions in support of our new strategy based on recurring managed services. Acquisitions present many risks and we cannot guarantee that we will realize the financial and strategic goals that were contemplated at the time of a transaction.

We have recently entered into acquisitions that we believe have accelerated and will continue to accelerate our pivot to the customer acquisition and customer value management (CVM) domains. We expect to continue making acquisitions or entering into strategic alliances as part of our long-term business strategy. We cannot be sure that these transactions will ultimately enhance our products or strengthen our competitive position. These transactions involve significant challenges and risks: they may not advance our business strategy, we may not get a satisfactory return on our investment, we may have difficulty integrating operations, new technologies, products and employees, and they may distract management and employees from our other businesses. The success of these transactions will depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones. It may take longer than expected to realize the full benefits from these transactions, such as increased revenue, enhanced efficiencies, or increased market share, or the benefits may ultimately be smaller than we expected.

Furthermore, we may fail to identify or assess the magnitude of certain liabilities, shortcomings or other circumstances prior to acquiring a company or technology, which could result in regulatory exposure, unfavorable accounting treatment, unexpected increases in taxes due, a loss of anticipated tax benefits or other adverse effects on our business, operating results or financial condition. In addition, future acquisitions could result in dilutive issuances of equity securities, impact employee stock options, reduce our cash available for operations and increase our debt. All of these factors associated with acquisitions could result in unexpected litigation from employees and stockholders. The occurrence of any of these risks could have a material adverse effect on our business, results of operations, financial condition or cash flows, particularly in the case of a large acquisition or several concurrent acquisitions.

An impairment of the carrying value of goodwill or other indefinite-lived intangible assets could negatively affect our consolidated operating results.

Goodwill is the excess of acquisition cost of an acquired entity over the fair value of the identifiable net assets acquired. Goodwill is not amortized but tested for impairment annually or whenever indicators of impairment exist. These indicators may include an other than temporary decline in our market capitalization that is calculated as our common stock s market price multiplied by the number of shares of common stock outstanding, a significant change in the business climate, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business or other factors. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to the reporting unit, and determination of the fair value of the reporting unit. In 2018, the Company adopted ASU 2017-04, Intangibles Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment, which simplifies the subsequent measurement of goodwill by eliminating the second step from the quantitative goodwill impairment test. Under this guidance, annual or interim goodwill impairment testing will be performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge will then be recognized for the amount by which the carrying amount exceeds the reporting unit s fair value, not to exceed the carrying value of goodwill.

Fair value determinations require considerable judgment and are sensitive to changes in underlying assumptions, estimates and market factors. Estimating the fair value of our business and indefinite-lived intangible assets requires us to make assumptions and estimates regarding our future plans, as well as industry and economic conditions. These assumptions and estimates include projected

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revenues and income growth rates, terminal growth rates, competitive and consumer trends, market-based discount rates, and other market factors. If current expectations of future growth rates are not met or market factors outside of our control, such as discount rates, change significantly, then goodwill or intangible assets might become impaired in the future. As goodwill and intangible assets associated with recently acquired businesses are recorded on the balance sheet at their estimated acquisition date fair values, those amounts are more susceptible to an impairment risk if business operating results or macroeconomic conditions deteriorate. Additionally, recently impaired intangible assets can also be more susceptible to future impairment as they are recorded on the balance sheet at their recently estimated fair values. An impairment of the carrying value of goodwill or other indefinite-lived intangible assets could negatively affect our operating results or net worth.

We depend on a limited number of significant customers for a substantial portion of our revenue, and the loss of one or more of these customers, or a delay in a large order, could adversely affect our business.

We earn a significant portion of our revenue from a small number of customers in the communications industry. The loss of any significant customer, delays in delivery or acceptance of any of our products by a customer, delays in performing services for a customer, or delays in collection of customer receivables could harm our business and operating results to a greater degree than other companies with a broader customer base.

Customers budgetary constraints and internal acceptance reviews may cause potential clients to delay or forego a purchase, making it difficult for us to forecast the timing and size of our contracts. In addition, our sales opportunities in any given quarter and year typically include a few high value opportunities. The delay or failure to close one or more large orders could have a material adverse effect on our results of operations and financial condition and cause our results to vary significantly from quarter to quarter and year to year.

Our managed services offerings and our cloud strategy, or Software as a Service (SaaS), may not be successful.

We offer some of our products as a managed service or a SaaS implementation and we intend to offer more of our solutions in this manner in the future. Even as we transition more of our business software-as-a-service business model and managed services, the license-based proprietary software model generates a substantial portion of our software revenue. While we believe the demand for managed services and cloud-based solutions is strong, there are no guarantees that we will be able to compete effectively, generate significant revenues or maintain profitability. Whether we are successful in providing our solutions as managed services or solutions as cloud solutions depends on our execution in a number of areas, including continuing to innovate and bring to market compelling managed services and cloud-based offerings and ensuring that our services meet the reliability expectations of our customers and maintain the security of customer data. Our managed and cloud-based services strategies also may fail to achieve success if other companies offering managed services and cloud-based solutions experience data loss, security breaches or service reliability issues that cause consumers to become less willing to accept managed services and cloud-based solutions in general.

Our products are complex and have a lengthy implementation process; unanticipated difficulties or delays in obtaining customer acceptance could result in higher costs and delayed payments.

Implementing our solutions can be a relatively complex and lengthy process since we typically customize these solutions for each customer s unique environment. Often our customers also require rapid deployment of our software solutions, resulting in pressure on us to meet demanding delivery and implementation schedules. Inability to meet these demanding schedules, or quality issues resulting from accelerated delivery schedules, may result in customer dissatisfaction and/or damage our reputation, which could materially harm our business.

The majority of our existing contracts provide for acceptance testing by the customer, which can be a lengthy process. Unanticipated difficulties or delays in the customer acceptance process could result in higher costs, delayed payments, and deferral of revenue recognition. In addition, if our software contains defects or we otherwise fail to satisfy acceptance criteria within prescribed times, the customer may be entitled to liquidated damages, to cancel its contract and receive a refund of all or a portion of amounts paid or to seek other monetary damages. These could exceed related contract revenue and result in a future charge to earnings. Any failure or delay in achieving final acceptance of our software and services could harm our business, financial condition, results of operations and cash flows.

We face risks associated with doing business through local partners.

In some countries, because of local customs and regulations or for language reasons, we do business through local partners who resell our products and services, with or without value-added services. This can cause delays in closing contracts because of the increased complexity of having another party involved in negotiations. In addition, where the local partner provides additional software, hardware and/or services to the end-user, our products and services may only be a small portion of the total solution. As a result, conditions surrounding acceptance and payments owed to us may be impacted by factors that are out of our control. Resellers may also delay paying us even when they have been paid by the end-user. We have in the past experienced delays in closing contracts through partners and collecting from resellers and this situation may arise again in the future, negatively impacting our cash flows. Doing business through local partners may also increase our risks under anti-bribery regulations, discussed below.

The success of our business depends on continued growth in the wireless services industry and demand for connected devices, and other usage of mobile data.

Our primary market, wireless telecommunications, is fairly mature and saturated, which may result in lower budgets and margins for our solutions and services. The future success of our business depends upon continued new subscriber growth, consumer adoption of new types of connected devices like IoT and consequently mobile operator demand for next generation software solutions and services. If there is a slowdown in subscriber growth in the wireless services industry or the demand for connected devices and usage of mobile data were to stabilize or decline, our business and results of operations may be adversely affected.

The success of our business also depends on our ability to renew our support and managed services offerings. The quality of our support and managed services offerings is important to our customers. If we fail to meet our service level obligations under our agreements, we could incur penalties and could lose customers.

Providing a high level of support for our solutions is critical to our business. Our customers expect us to resolve issues relating to the use of our solutions and if we are unable to meet or exceed the expectations of our customers, we could experience loss of customers and difficulty attracting new customers. In addition, we have service level agreements with many of our customers under which we guarantee specified levels of service availability and service credits for failing to achieve our agreed service levels, which could result in higher than expected costs, decreased revenues and decreased operating margins. Any of the above results would likely have a material adverse impact on our business, revenue, results of operations, financial condition and reputation.

Compliance with changing European privacy laws could require us to incur significant costs and failure to comply could give rise to liabilities. Disclosure and misuse of personal data could result in liability and harm our reputation.

During the course of providing our products and services we may collect names, addresses, telephone numbers and other personally identifiable information, or PII . This may subject us to complex regulatory requirements related to data collection and risks of improper use or disclosure. In addition, we have offices and clients in the EU where new more stringent regulations, known as the General Data Protection Regulations or GDPR, took effect in May 2018. The GDPR imposes significant new obligations and compliance with these obligations depends in part on how particular regulators apply and interpret them. If we fail to comply with the GDPR, or if regulators assert we have failed to comply with the GDPR, it may lead to regulatory enforcement actions, which can result in monetary penalties of up to 4% of worldwide revenue, private lawsuits, or reputational damage.

We strive to limit the amount of PII we collect and/or store and we have implemented steps designed to protect against unauthorized access to such information but because of the inherent risks and complexities involved in protecting this information, particularly if we store such information in a cloud implementation Despite our efforts to improve our security controls, it is possible our security controls over personal data, our training of employees and vendors on data security, and other practices we follow may not prevent the improper disclosure of customer or user data we store and manage. In addition, third party vendors that we engage to perform services for us may unintentionally release PII or otherwise fail to comply with applicable laws and regulations. We may also experience hesitancy, reluctance or refusal by European or multi-national customers to continue to use our services due to the potential risk exposure that these customers might face as a result of the current data protection obligations imposed on them by certain data protection authorities. These customers may require us to accept increased liability, decide not to do business with us or may require that their personal data remains in certain locations. We will incur additional costs if we are required to implement special operational processes and store data in jurisdictions not of our choosing. Any failure by us to comply with laws and regulations regulating privacy, data security, or consumer protection could result in damage claims from our customers, lost or restricted business, actions or fines brought against us or levied by governmental entities or others and could adversely affect our business and harm our reputation.

Cyber-attacks and security vulnerabilities could lead to reduced revenue, increased costs, liability claims, or harm to our competitive position.

The security of our products and services is important in our customers decisions to purchase or use our products or services. Increased sophistication and activities of perpetrators of cyber-attacks have resulted in an increase in information security risks in recent years. Hackers develop and deploy viruses, worms, and other malicious software programs that attack products and services and gain access to networks and data centers. A substantial portion of our software development and customer support is provided from our India facility, which may be subject to increased risk of cyber-attacks, power loss, telecommunications failure, terrorist attacks and similar events. If we were to experience difficulties maintaining existing systems or implementing new systems, we could

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incur significant losses due to disruptions in our operations. Additionally, these systems contain valuable proprietary and confidential information and may contain personal data of our customers subscribers. A security breach could result in disruptions of our internal systems and business applications, impairment of our ability to provide services to our customers, product development delays, harm to our competitive position from the compromise of confidential business information, or subject us to liability under laws that protect personal data. Although we believe that we have robust information security procedures and other safeguards in place, many of our services do not have fully redundant systems or a formal business continuity or disaster recovery plan, and we may not have adequate business interruption insurance to compensate us for losses that occur from a system outage. As cyber threats continue to evolve, we may be required to expend additional resources to continue to enhance our information security measures and/or to investigate and remediate any information security vulnerabilities. Any of these consequences would adversely affect our revenue and margins.

System security risks, data protection breaches, cyberattacks and systems integration issues could disrupt our internal operations or IT services provided to customers, and any such disruption could reduce our revenue, increase our expenses, damage our reputation and adversely affect our stock price.

As a technology services business, we are exposed to attacks from criminals, nation state actors and activist hackers (collectively, malicious parties) who may be able to circumvent or bypass our cyber security measures and misappropriate, maliciously alter or destroy our confidential information or that of third parties, create system disruptions or cause shutdowns. Malicious parties also may be able to develop and deploy viruses, worms, ransomware and other malicious software programs that attack our products or otherwise exploit any security vulnerabilities of our products. Threats to our own IT infrastructure can also affect our customers. Customers using our cloud-based services rely on the security of our infrastructure, including hardware and other elements provided by third parties, to ensure the reliability of our services and the protection of their data. Sophisticated hardware and operating system software and applications that we procure from third parties may contain defects in design or manufacture, including flaws that could unexpectedly interfere with the operation of the system. The costs to us to eliminate or alleviate cyber or other security problems, including bugs, viruses, worms, malicious software programs and other security vulnerabilities, could be significant and could reduce our operating margins. Our efforts to address these problems may not be successful and could result in interruptions, delays, cessation of service and loss of existing or potential customers that may impede our sales, manufacturing, distribution or other critical functions.

We manage and store various proprietary information and sensitive or confidential data relating to our business. In addition, our business may process, store and transmit data relevant to our clients, including commercially sensitive and personally identifiable information, including the personal information of European citizens covered by the GDPR. Breaches of our cyber or physical security measures or the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or sensitive or confidential data about us, our clients or their customers, including the potential loss or disclosure of such information or data, could expose us, our customer or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability for us, damage our brand and reputation or otherwise harm our business. We also could lose existing or potential customers or incur significant expenses in connection with our customers system failures or any actual or perceived security vulnerabilities in our products and services. In addition, the cost and operational consequences of implementing further data protection measures could be significant.

Portions of our IT infrastructure also may experience interruptions, delays or cessations of service or produce errors in connection with systems integration or migration work that takes place from time to time. We may not be successful in implementing new systems and transitioning data, which could cause business disruptions and be more expensive, time-consuming, disruptive and resource intensive. Such disruptions could adversely impact our ability to fulfill orders and respond to customer requests and interrupt other processes. Delayed sales, lower margins or lost customers resulting from these disruptions could reduce our revenue, increase our expenses, damage our reputation and adversely affect our stock price.

We are a relatively small company with a limited number of products and staff. Sales fluctuations and employee turnover may adversely affect our business.

We are a relatively small company. Consequently, compared to larger companies, sales fluctuations have a greater impact on our revenue and profitability on a quarter-to-quarter and year-to-year basis and a delayed contract could cause our operating results to vary significantly from quarter to quarter and year-to-year. In addition, as a small company we have limited staff and are heavily reliant on certain key personnel to operate our business. If a key employee were to leave the company, it could have a material impact on our business and results of operations as we might not have sufficient depth in our staffing to fill the role that was previously being performed. A delay in filling the vacated position could put a strain on existing personnel or result in a failure to satisfy our contractual obligations or to effectively implement our internal controls, and materially harm our business.

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Our periodic workforce restructurings can be disruptive.

We have in the past restructured our workforce in response to management changes, acquisitions, product changes, performance issues or other considerations. These types of restructurings have resulted in increased restructuring costs and temporary reduced productivity while our staff adjusted to new roles and responsibilities. We may choose to implement additional restructuring in the future. There is no certainty that we will achieve the expected cost savings or other benefits of these restructurings or do so within the expected timeframe. As a result, our business revenues and other results of operations could be negatively affected.

Because our quarterly and annual operating results are difficult to predict and may fluctuate, the market price for our stock may be volatile.

Our operating results have fluctuated significantly in the past and may continue to fluctuate significantly in the future from quarter-to-quarter and year-to-year. These quarterly and annual fluctuations may result from a number of factors, including:

- the size of new contracts, rate of progress under our contracts and when we are able to recognize the related revenue;
- foreign exchange fluctuations;
- budgeting cycles of our customers;
- changes in the terms and rates related to the renewal of support agreements;
- the mix of products and services sold;
- the timing of delivery of software and hardware by third parties;
- level and timing of operating expenses and capital investments;
- impairment in the value of our long-lived assets;

- changes in our strategy; and,
- general economic conditions.

As a result, quarter-to-quarter and year-to-year comparisons of operating results are not necessarily meaningful, nor do they indicate what our future performance will be. Furthermore, we base our operating expenses and capital investment budgets on expected sales and revenue and many of our expenses, such as lease expenses, expenses associated with our debt and personnel costs, are relatively fixed in the short term. Variations in the rate and timing of conversion of our sales prospects into actual revenue could cause us to plan or budget inaccurately and we may be unable to adjust spending quickly enough to compensate for an unexpected shortfall in revenue. Any significant shortfall in anticipated levels of demand for our products and services could adversely affect our business, financial condition, results of operations and cash flows and the market price of our common stock.

The markets for our service activation and number management products are mature and the markets for our next generation loyalty and customer lifecycle management software and services are evolving. The industry in which we compete is subject to rapid technological change and if we do not adapt to rapid technological change, we could lose customers or market share.

Our industry is characterized by rapid technological change, evolving industry standards, changes in carrier requirements and preferences and frequent new service offerings. The introduction of products that incorporate new technologies and the emergence of new industry standards can make existing products obsolete and unmarketable. To compete successfully, we must continue to design, develop and sell new products and enhancements to existing products that provide higher levels of performance and reliability, take advantage of technological advancements and changes in industry standards and respond to new customer requirements. Developing new products and services is complex and time-consuming and investment in new technologies is speculative. It can require long development and testing periods. Significant delays in new releases or significant problems in creating new products or services could adversely affect our revenue. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new offerings or upgrades, unfavorably affecting revenue. We may not achieve significant revenue from new products and services for several years, if at all. New products and services may not be profitable, and even if they

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are profitable, operating margins for some new products and businesses will not be as high as the margins we have experienced historically.

If we are unable to properly supervise our software development staff in India, or if political or other uncertainties interfere, we may be unable to satisfactorily perform our customer contracts.

In 2004, we formed Evolving Systems India, a wholly owned subsidiary of Evolving Systems, Inc. and as a result of our 2015 acquisition of SSM, we acquired two additional Indian subsidiaries. We have experienced a high level of turnover with our Indian development staff as a result of strong competition for technology-based personnel in India. In addition, salary levels in India are steadily increasing, reducing the competitive advantages associated with offshore labor. If we are unable to effectively manage our India-based development staff and/or we continue to experience high levels of staff turnover, we may fail to provide quality software in a timely fashion. Furthermore, political changes and uncertainties in India could negatively impact the business climate there. As a result, we may be unable to satisfactorily perform under our contracts and our business, financial condition and results of operations could be materially harmed.

Changes or challenges to the regulations of the communication industry could hurt the market for our products and services.

Our customers may require, or we may find it necessary or advisable, to modify our products or services to address actual or anticipated changes in regulations affecting our customers. This could increase our costs, delay adoption of our products and increase our sales cycle, which could materially harm our business, financial condition, results of operations, and cash flows. We are also subject to numerous regulatory requirements of foreign jurisdictions, which are often complex and changing. Any failure to comply with such regulations could, likewise, materially harm our business, financial condition, results of operations and cash flows.

Consolidation in the communications industry may impact our financial performance.

The global communications industry has experienced and continues to experience significant consolidation. These consolidations have caused us to lose customers and may result in fewer potential customers. In addition, combining companies often re-evaluate their solutions and their capital expenditures, choosing to consolidate with one solution; there is no guarantee our solution will be selected in this process. As our customers become larger, they generally have longer sales cycles and stronger purchasing power, which can result in delays in securing contracts and pressure to reduce our prices. All of these factors can have a negative impact on our financial performance, particularly in any fiscal quarter.

Many of our products and services are sold on a fixed-price basis. If we incur budget overruns this may reduce our profitability.

A large portion of our revenue currently is, and historically has been, derived from fixed-price contracts and we expect this will continue. These contracts specify certain obligations and deliverables we must meet regardless of the actual costs we incur. Projects done on a fixed-price basis are subject to budget overruns. On occasion, we have experienced budget overruns, resulting in lower than anticipated margins. We may incur similar budget overruns in the future, including overruns that result in losses on these contracts. If we incur budget overruns, our margins may be harmed, thereby affecting our overall profitability.

The communications industry is highly competitive and if our products do not satisfy customer demand for performance or price, our customers could purchase products and services from our competitors.

Our primary markets are intensely competitive, and we face continuous demand to release new products, new features and product enhancements, to improve product performance and to reduce prices. Our competitors include many large domestic and international companies who have substantially greater resources, larger installed customer bases and longer-standing relationships with customers. In addition, some companies who would not typically compete with us, such as network equipment manufacturers, offer next generation solutions that address some of the benefits provided by our solutions.

Our customers are not precluded from competing with us and also may offer competitive products or services. Many telecommunications companies have large internal development organizations, which develop software solutions and provide services similar to the products and services we provide.

We believe that our ability to compete successfully depends on numerous factors, including the quality and price of our products and services compared to those of our competitors, the emergence of new industry standards and technical innovations and our ability to respond to those changes. Some of these factors are within our control, and others are not. A variety of potential actions by our competitors, including price reductions or increased marketing and promotion, accelerated introduction of new or enhanced products, or cooperative relationships among competitors and their strategic partners, could negatively impact the sale of our products and services. We may have to reduce the prices we charge for our products and services, resulting in lower revenue and operating margins. We may not be able to compete successfully or to properly identify and address the demands of new markets. This is particularly true in new markets where standards are not yet established. Our failure to adapt to emerging market demands, respond to regulatory and technological changes or compete successfully with existing and new competitors would materially harm our business, financial condition, results of operations and cash flows.

Our business depends largely on our ability to attract and retain talented employees.

Attracting and retaining talented employees is key to our success. The market for skilled workers in our industry is very competitive. We may not be able to retain personnel or to hire additional personnel on a timely basis, if at all. Because of the complexity of our software solutions, a significant time lag exists between the hiring date of technical and sales personnel and the time when they become fully productive. We have at times experienced high employee turnover and difficulty in recruiting and retaining technical personnel. Our failure to retain personnel or to hire qualified personnel on a timely basis could adversely affect our business by impacting our ability to develop new products, to complete our projects and secure new contracts.

Our solutions are complex and may have errors that are not detected until deployment. Resolving warranty and product liability claims could be expensive and could negatively affect our reputation and profitability.

The provisions of our agreements with customers are designed to limit our exposure to potential liability for damages arising out of the use of, or defects in, our products. We cannot guarantee that these limitations will be effective. Although we carry errors and omissions insurance, to the extent that any successful product liability claim is not covered by our errors and omissions insurance or exceeds the coverage under our policy, we may be required to incur legal fees and pay for a claim. This could be expensive, particularly since our software solutions may be used in critical business applications. On occasion, we also engage subcontractors to provide deliverables under customer contracts; we could be required to indemnify customers for work performed by our subcontractors. We may not be able to recover these damages from a subcontractor. Defending against a product liability claim, regardless of its merits, could be expensive and require the time and attention of key management personnel, either of which could materially harm our business, financial condition and results of operations. In addition, our business reputation could be harmed by product liability claims, regardless of their merit or the eventual outcome of these claims.

Our measures to protect our intellectual property may not be adequate.

Our success and ability to compete are dependent to a significant degree on our proprietary technology. Protecting our global intellectual property rights is difficult. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. We have 9 patents in the U.S. on elements of our DSA and mobile broadband enablement products and patents pending in other countries on elements of our DSA and Intelligent M2M Controller (IMC) products. In addition, we have registered or filed for registration of certain of our trademarks. Our patent portfolio is relatively small and given the cost of obtaining additional patent protection, we may choose not to patent certain inventions that later become important. There is also the possibility that our means of protecting our proprietary rights may not be adequate; a third party may copy or otherwise obtain and use our products or technology without authorization or may develop similar technology independently or design around our patents. In addition, the laws of some foreign countries may not adequately protect our proprietary rights.

Source code, the detailed program commands for our software programs, is critical to our business. While we take steps to limit access to our source code and to protect it as a trade secret, we may not be able to protect our source code from copying if there is an unauthorized disclosure. Trade secret protection for that source code could be jeopardized, making it easier for third parties to develop competing products.

If our intellectual property protection proves inadequate, we may lose our competitive advantage and our future financial results may suffer.

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Third parties may claim we are infringing their intellectual property rights, or that we have not complied with their license requirements and we may incur significant expenses in resolving these claims.

It is possible that our business activities may infringe upon the proprietary rights of others, or that other parties may assert infringement claims against us. Those claims may involve patent holding companies or other adverse patent owners who have no relevant product revenue of their own, and against whom our own patents may provide little or no deterrence. We could incur substantial costs in defending against any infringement claim and we could be required to develop non-infringing technology, obtain licenses, or cease selling the applications that contain the infringing intellectual property. Adverse publicity related to any intellectual property litigation also could harm the sale of our products and damage our competitive position.

Certain software we develop, or use, may include so called open source software made available under a license which may impose obligations on us in the event we distribute derivative works based on the open source software. Certain licenses impose obligations that could require us to make source code for a derivative work available to the public or license the derivative work under a particular type of open source software license, rather than the license terms we customarily use to protect our software.

There is little or no legal precedent for interpreting the terms of certain of these open source licenses, including the terms addressing the extent to which software incorporating open source software may be considered a derivative work subject to these licenses. We believe we have complied with our obligations under the various applicable open source licenses. However, if the owner of any open source software were to successfully establish that we had not complied with the terms of an open source license for a particular product that includes such open source software, we may be forced to release the source code for that derivative work to the public or cease distribution of that work.

Our performance may be adversely affected by economic and political conditions in the United Kingdom where we do business.

Our performance has been in the past and may continue in the future to be impacted by economic and political conditions in the United Kingdom where we do business. Economic and financial uncertainties in our international markets, including uncertainties surrounding the United Kingdom s impending withdrawal from the European Union (commonly referred to as Brexit) and changes to major international trade arrangements, could negatively impact our operations and sales. Brexit may result in greater regulatory complexity surrounding the services we provide to our customers from our UK resources and financial results could be negatively impacted.

Disruptions from terrorist activities, geopolitical conditions or military actions may disrupt our business.

The continued threat of terrorism and acts of war may cause significant disruption to commerce throughout the world. Abrupt political changes and armed conflict pose a risk of economic disruption in affected countries, which may increase our operating costs and add uncertainty to the timing and budget for technology investment decisions by our customers. Our business and results of operations could be materially and adversely affected to the extent that such disruptions result in delays or cancellations of customer orders, delays in collecting cash, a general decrease in corporate spending on information technology, or our inability to effectively market, manufacture or ship our products. We are unable to predict whether war, political unrest and the threat of terrorism will result in any long-term commercial disruptions or if such activities will have any long-term material adverse effect on our business, results of operations, financial condition or cash flows.

Our international operations subject us to potential liability under anti-corruption laws and regulations.

Our international business operations are subject to the Foreign Corrupt Practices Act (FCPA), which generally prohibits U.S. companies and their intermediaries from paying or offering anything of value to foreign government officials for the purpose of obtaining or keeping business, or otherwise receiving discretionary favorable treatment of any kind. To the extent we do business through Evolving Systems UK, we are also subject to the U.K. Bribery Act of 2010. In addition, many countries in which we do business have their own anti-bribery rules and regulations. Under these regulations, we may be held liable for actions taken by our local partners and agents, even if such parties act without our knowledge. Any determination that we have violated the FCPA or the Bribery Act of 2010 (whether directly or through acts of others, intentionally or through inadvertence) or other anti-bribery legislation could result in sanctions that could have a material adverse effect on our business. While we have procedures and controls in place to monitor compliance, situations outside of our control may arise that could put us in violation of anti-bribery legislation inadvertently and thus negatively impact our business.

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In order to operate internationally and comply with local government regulations and customer requirements, we maintain bank accounts at non-U.S. banks located in Asian and African countries and in local currencies. Certain countries such as India and Nigeria require that we pay withholding taxes should we transfer our cash from a non-U.S. bank account to our U.S. bank accounts.

As of December 31, 2018, of our $6.7 million cash balance, $1.3 million is on deposit in the U.S., the U.S. dollar equivalents of $2.8 million is on deposit in the U.K. and Europe, $1.5 million is on deposit in India and $1.1 million is on deposit in Nigeria. Should we choose to transfer cash out of our bank accounts in India and Nigeria, we may be required to pay the local tax authorities a withholding tax ranging from 10% to 20% of the amount transferred. Local regulations may make a transfer may take longer to execute than transfers from our U.S., U.K. and European bank accounts and the withholding tax we pay may not be refundable. The longer execution times and the withholding taxes means we may be subject to delays in executing our operations and our available cash is reduced by the withholding taxes.

As a result of operating as a smaller public company, our management is required to devote a substantial amount of time to comply with regulatory matters; our relatively small staff can make compliance challenging.

Because our common stock is publicly traded, we are subject to certain rules and regulations of federal, state and financial market exchange entities charged with the protection of investors and the oversight of companies whose securities are publicly traded. These entities, including the Public Company Accounting Oversight Board, the SEC and NASDAQ, have issued requirements and regulations and continue to adopt additional regulations and requirements in response to laws enacted by Congress. Establishment of effective internal controls is further complicated because we are a relatively small company with global operations, and multiple locations and IT systems. Our management and other personnel have and will continue to devote a substantial amount of time to these compliance initiatives.

Our stock price could become more volatile and your investment could lose value.

All of the factors discussed in this section, as well as general economic and market conditions, could affect our stock price. A significant drop in our stock price could also expose us to the risk of securities class actions lawsuits, which could result in substantial costs and divert management s attention and resources, which could adversely affect our business.

The input method of accounting used for most of our projects can result in overstated or understated profits or losses.

Our services and managed services revenue under fixed-price services contracts is accounted for using the input method of accounting. Under this method, we recognize revenue and profits for each fixed-price service project-based efforts or inputs toward satisfying a performance obligation, which is a promise in a contract to transfer a distinct service to the customer. The input method requires us to estimate the total performance obligation and to allocate the transaction price of a contract to each distinct performance obligation. Our failure to accurately estimate these often-subjective factors could result in overstated or understated revenue, profits or losses.

Changes in, or interpretations of, accounting principles or tax rules and regulations, could adversely affect our results of operations.

We prepare our consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP). It is possible that future requirements could change our current application of GAAP, resulting in a material adverse impact on our financial positions or results of operations. In addition, our future effective tax rates could be unfavorably affected by changes in tax laws or the interpretation of tax laws or by changes in the valuation of our deferred tax assets and liabilities. We regularly assess our implementation of applicable accounting principles and the adequacy of our provision for income taxes, but we are a relatively small company and our business is complex; the final determination of any tax authority, upon examination of our income tax returns, could have an adverse effect on our operating results and financial position.

Sales of large blocks of our stock may result in the reduction in the market price of our stock and make it more difficult to raise funds in the future.

If our stockholders sell substantial amounts of our common stock in the public market, the market price of our common stock could fall. The perception among investors that such sales will occur could also produce this effect. We currently have several stockholders who own large percentages of our stock. To the extent we continue to have one or more stockholders who own a large percentage of our stock and those stockholders chose to liquidate their holdings, it may have a dramatic impact on the market price of our stock. These factors also could make it more difficult to raise funds through future offerings of common stock.

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Certain provisions of our charter documents, employment arrangements and Delaware law may discourage, delay or prevent an acquisition of us, even if an acquisition would be beneficial to our stockholders, and may prevent attempts by our stockholders to replace or remove our current management.

Provisions of our amended and restated certificate of incorporation and bylaws, as well as provisions of Delaware law, could make it difficult for a third party to acquire us, even if doing so would benefit our stockholders. In addition, these provisions, which make it more difficult for stockholders to replace members of our board of directors, may frustrate or prevent attempts by our stockholders to replace or remove our current management because our board of directors is responsible for appointing the members of our management team. These provisions include the following:

- our stockholders cannot take action by written consent;
- we have advance notice requirements for nominations for election to the Board of Directors or for proposing matters that can be acted upon at stockholder meetings;
- our stockholders can only remove directors without cause by supermajority vote; and,
- our stockholders can only amend our bylaws or certain Board of Directors-related provisions of our amended and restated certificate of incorporation by a supermajority vote.

In addition, we are subject to the anti-takeover provisions of Section 203 of Delaware General Corporation Law, which prohibit us from engaging in a business combination with an interested stockholder for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in the prescribed manner. The application of Section 203 and certain provisions of our restated certificate of incorporation may have the effect of delaying or preventing changes in control of our management, which could adversely affect the market price of our common stock by discouraging or preventing takeover attempts that might result in the payment of a premium price to our stockholders.

Certain of our named executive officers have entered into agreements with us that contain a change in control provision. These agreements generally provide for acceleration on vesting of stock awards. The acceleration of vesting of stock awards upon a change in control may be viewed as an anti-takeover measure and may have the effect of discouraging a merger proposal, tender offer or other attempt to gain control of us.

Our Stock Incentive Plans provide for acceleration of vesting of stock awards under certain changes in control. As noted above, the acceleration on vesting of stock awards upon a change in control may be viewed as an anti-takeover measure.

All of the above factors could adversely affect the market price of our common stock by discouraging or preventing takeover attempts that might result in the payment of a premium price to our stockholders.

We suspended our dividends in 2016 and we may not pay dividends in the future.

In June 2016, our Board of Directors suspended our quarterly dividends. Any decision to pay dividends in the future and the amount of any dividend we may declare will depend on general business conditions, the impact of such payment on our financial condition and other factors our Board of Directors may consider to be relevant. In addition, our Loans limit our ability to pay dividends by establishing a maximum amount that can be paid per quarter and prohibiting payment of dividends when an event of default has occurred. If we elect to pay future dividends, this could reduce our cash reserves to levels that may be inadequate to fund expansions to our business plan or unanticipated contingent liabilities.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

We lease office space at various locations which are shown below.

Location	Square Footage	Lease Expiration
Englewood, Colorado	400	month-to-month
New York, New York	391	01/31/20
Durham, North Carolina	1,453	08/31/20
London, England	376	09/30/19
Bangalore, India	12,429	08/18/23
Kolkata, India	5,638	07/31/20
Delhi, India	322	03/09/20
Johannesburg, South Africa	130	03/31/19
Kuala Lumpur, Malaysia	1,042	07/14/19
Mexico City, Mexico	89	02/28/19
Grenoble, France	3,767	03/21/21
Cluj-Napoca, Romania	7,793	12/31/22
Madrid, Spain	215	month-to-month

We believe that our facilities are adequate for our current and near-term needs, and that we will be able to locate additional facilities as needed.

ITEM 3. LEGAL PROCEEDINGS

We are involved in various legal matters arising in the normal course of business. Losses, including estimated costs to defend, are recorded for these matters to the extent they were probable of loss and the amount of loss could be reasonably estimated. We do not believe that any such matters, either individually or in the aggregate, will have a material impact on our results of operations and financial position.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq Capital Market under the symbol EVOL.

As of April 3, 2019, there were approximately 79 holders of record of our common stock.

Dividends

Our Loans limit our ability to pay dividends by establishing a maximum amount that can be paid per quarter and prohibiting payment of dividends when an event of default has occurred. Payment of future dividends can also affect our business as this could reduce our cash reserves to levels that may be inadequate to fund expansions to our business plan or unanticipated contingent liabilities. Any decision to declare dividends in the future and the amount of any dividend we may declare will depend on general business conditions, the impact of such payment on our financial condition and other factors our Board of Directors may consider to be relevant.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current expectations, estimates, and projections about Evolving Systems industry, management s beliefs, and certain assumptions made by management. Forward-looking statements include our expectations regarding product, services, and customer support revenue; our expectations associated with Evolving Systems India, Evolving Systems U.K., Evolving Systems NC Evolving Systems BLS LTD, Lumata UK LTD, Lumata France SAS, Lumata Deutschland GmbH, and Lumata Spain SL and short- and long-term cash needs. In some cases, words such as anticipates , expects , intends , plans , believes or estimates and variations of these words and similar expressions are intended to identify forward-looking statements. The following discussion should be read in conjunction with, and is qualified in its entirety by, the consolidated financial statements and the notes thereto included elsewhere in this Annual Report on Form 10-K. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth in this section and in Item 1A - Risk Factors.

OVERVIEW

Evolving Systems, Inc. is a provider of real-time digital engagement solutions and services to the wireless carrier and consumer financial services markets. We operate a managed services business model through which we maintain long-standing relationships with many of the largest wireless companies worldwide. The Company s portfolio includes market-leading solutions and services for real-time analytics, customer acquisition and activation, customer value management and loyalty for the telecom industry promoting partnerships into retail and financial services. The Company has moved from selling technology to offering business solutions. The value proposition likewise has moved away from cost savings to a focus on revenue increases for the carrier and our business model has moved from classic capital expenditure license and services to operating expense models based on managed services with performance fees.

In July 2017, we completed our acquisition of BLS, a company headquartered in Newbury, United Kingdom that specializes in data-driven customer value management and customer engagement solutions that have been implemented in over 20 mobile operators in Europe, Africa, Asia-Pacific and the Caribbean. BLS solutions can turn customer data into actionable insights and personalized contextual offers. Customer engagement occurs through in-bound and out-bound offers and is further extended through a suite of loyalty and retention solutions.

In September 2017, we completed the acquisition of four business operating units of the Lumata Entities . The Lumata Entities are a leading global provider of real-time, next generation loyalty and customer lifecycle management software and services that help businesses gain value from their customer data for relevant and contextual insights and actions of value to both customers and enterprises. Lumata s customers include wireless carriers Orange, Telefonica and other Tier-1 and emerging wireless carriers in Europe, Asia, the Middle East, Africa, the Caribbean and Central and South America.

RECENT DEVELOPMENTS

We reported a net loss of $14.8 million and net income of $2.5 million for the years ended December 31, 2018 and 2017, respectively.

In 2018, the Company adopted ASU 2017-04, Intangibles Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment, which simplifies the subsequent measurement of goodwill by eliminating the second step from the quantitative goodwill impairment test. Under this guidance, annual or interim goodwill impairment testing will be performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge will then be recognized for the amount by which the carrying amount exceeds the reporting unit s fair value, not to exceed the carrying value of goodwill. Due to a sustained decline in the market capitalization of our common stock during the fourth quarter of 2018, we performed an interim goodwill impairment test in accordance with the provisions of ASU 2017-04.The outcome of this goodwill impairment test resulted in a charge for the impairment of goodwill of $17.8 million, which was recorded in the consolidated financial statements for the year ended December 31, 2018. Management considered that, along with other possible factors affecting the assessment of the Company s reporting unit for the purposes of performing a goodwill impairment assessment, including management assumptions about expected future revenue forecasts and discount rates, changes in the overall economy, trends in the stock price, estimated control premium and other operating conditions.

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We have operations in foreign countries where the local currency is used to prepare the consolidated financial statements which are translated into our reporting currency, U.S. dollars. Changes in the exchange rates between these currencies and our reporting currency are partially responsible for some of the changes from period to period in our financial statement amounts. The majority of the changes in 2018 and 2017 are a result of the U.S. dollar strengthening on average versus the British Pound Sterling. The chart below summarizes what the effects on our revenue and expenses would be on a constant currency basis. The constant currency basis assumes that the exchange rate was constant for the periods presented (in thousands):

		For the Years Ended December 31, 2018 vs. 2017
Changes in:		
Revenue	$	435
Costs of revenue and operating expenses		(3,187)
Loss from operations	$	(2,752)

The net effect of our foreign currency translations for the year ended December 31, 2018 was a $0.4 million increase in revenue and a $3.2 million decrease in operating expenses versus the year ended December 31, 2017 due to a stronger U.S. dollar on average during the year 2017.

RESULTS OF OPERATIONS

The following table presents our consolidated statements of operations in comparative format:

	For the Years Ended December 31, 2018	2017	Change	% Change
		(in thousands)		
REVENUE				
License fees	$ 1,433	$ 3,438	$ (2,005)	(58)%
Services	29,203	25,374	3,829	15%
Total revenue	30,636	28,812	1,824	6%
COSTS OF REVENUE AND OPERATING EXPENSES				
Costs of revenue, excluding depreciation and amortization	10,349	8,680	1,669	19%
Sales and marketing	6,592	5,214	1,378	26%
General and administrative	6,677	6,065	612	10%
Product development	4,170	2,042	2,128	104%
Depreciation	121	250	(129)	(52)%
Amortization	970	860	110	13%
Restructuring		286	(286)	(100)%
Goodwill impairment loss	17,760		17,760	100%
Total costs of revenue and operating expenses	46,639	23,397	23,242	99%
(Loss) income from operations	(16,003)	5,415	(21,418)	(396)%
Other income (expense)				
Interest income	65	1	64	6,400%
Interest expense	(478)	(365)	(113)	31%

Other income		393		23		370	1,609%
Foreign currency exchange income (loss)		810		(1,137)		1,947	(171)%
Other income (expense), net		790		(1,478)		2,268	(153)%
(Loss) income from operations before income taxes		(15,213)		3,937		(19,150)	(486)%
Income tax (benefit) expense		(426)		1,421		(1,847)	(130)%
Net (loss) income	$	(14,787)	$	2,516	$	(17,303)	(688)%

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The following table presents our consolidated statements of operations reflected as a percentage of total revenue:

	For the Years Ended December 31, 2018	2017
REVENUE		
License fees	5%	12%
Services	95%	88%
Total revenue	100%	100%
COSTS OF REVENUE AND OPERATING EXPENSES		
Costs of revenue, excluding depreciation and amortization	34%	30%
Sales and marketing	22%	18%
General and administrative	22%	21%
Product development	14%	7%
Depreciation	0%	1%
Amortization	3%	3%
Restructuring	0%	1%
Goodwill impairment loss	58%	0%
Total costs of revenue and operating expenses	153%	81%
(Loss) income from operations	(53)%	19%
Other income (expense)		
Interest income	0%	0%
Interest expense	(2)%	(1)%
Other income	1%	0%
Foreign currency exchange income (loss)	3%	(4)%
Other income (expense), net	2%	(5)%
(Loss) income from operations before income taxes	(51)%	14%
Income tax (benefit) expense	(1)%	5%
Net (loss) income	(50)%	9%

Revenue

Revenue is comprised of license fees and services. License fees represent the fees we receive from the licensing of our software products. Services revenue are directly related to the delivery of the licensed product as well as integration services, managed services, SaaS services, time and materials work and customer support services. Customer support services include annual support fees, recurring maintenance fees, minor product upgrades and warranty fees. Warranty fees are typically deferred and recognized over the warranty period.

License Fees

License fees revenue decreased 58%, or $2.0 million to $1.4 million for the year ended December 31, 2018 compared to $3.4 million for the year ended December 31, 2017. The decrease is related to a $0.6 million decline in one-time licensing fees from prior year related to the BLS acquisition and the remaining $1.4 million from our historical products as the Company continues to transition to a managed services model and more reliable recurring revenue.

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Services

Services revenue increased 15%, or $3.8 million, to $29.2 million for the year ended December 31, 2018 from $25.4 million for the year ended December 31, 2017. The increase is related to $5.3 million in service revenue from the acquired companies offset by a decline in our services revenues related to historical relationships of $1.5 million due to fewer new implementations and pricing pressures.

Costs of Revenue, excluding depreciation and amortization

Costs of revenue, excluding depreciation and amortization, consist primarily of personnel costs and other direct costs associated with these personnel, facilities costs, costs of third-party software and partner commissions. Costs of revenue includes product development expenses related to software features requested in advance of their scheduled availability which are funded by customers as part of a managed service offering. Costs of revenue, excluding depreciation and amortization increased $1.7 million, or 19%, to $10.4 million for the year ended December 31, 2018 from $8.7 million for the year ended December 31, 2017. The increase in costs of revenue is primarily attributable to higher service project hours from projects related to the Acquired Companies of $2.5 million partially offset by lower service project hours from existing client relationships. This has allowed for experienced resources to work on internal projects and product development. As a percentage of revenue, costs of revenue, excluding depreciation and amortization, increased to 34% for the year December 31, 2018 from 30% for the year ended December 31, 2017. The increase as a percentage of revenue is primarily due to the increased hours and resource costs from the Acquired Companies on projects generating lower margins.

Sales and Marketing

Sales and marketing expenses primarily consist of compensation costs, including incentive compensation and commissions, travel expenses, advertising, marketing and facilities expenses. Sales and marketing expenses increased 26%, or $1.4 million, to $6.6 million for the year ended December 31, 2018 from $5.2 million for the year ended December 31, 2017. The increase in expenses is attributable to $1.3 million in costs from the acquired companies and $0.1 million in additional staff. As a percentage of total revenue, sales and marketing expenses for the year ended December 31, 2018 increased to 22% from 18% for the year ended December 31, 2017. The increase in sales and marketing expenses as a percentage of revenue is primarily due to the aforementioned higher costs.

General and Administrative

General and administrative expenses consist principally of employee-related costs for the following departments: finance, human resources, and certain executive management; facilities costs; and professional and legal fees. General and administrative expenses increased 10%, or $0.6 million, to $6.7 million for the year ended December 31, 2018 from $6.1 million for the year ended December 31, 2017. The increase in costs was related to $0.1 million in costs related to the Acquired Companies, $0.5 million in legal costs related to finalizing a matter regarding our September 2015 SSM acquisition, and $0.3 million in professional fees related to audits and preparations of routine regulatory filings in connection with the addition of the Acquired Companies. This was partially offset by the reduction of $0.3 million in legal and other costs related to closing of acquisitions and bank loans in 2017. As a percentage of total revenue, general and administrative expenses increased to 22% for the year ended December 31, 2018 from 21% for the year ended December 31, 2017. The increase in general and administrative expenses as a percentage of revenue is primarily due to the aforementioned higher costs.

Product Development

Product development expenses consist primarily of labor-related costs. Product development expenses increased 104%, or $2.1 million, to $4.1 million for the year ended December 31, 2018 from $2.0 million for the year ended December 31, 2017. The increase is primarily related to $1.5 million in additional costs from the Acquired Companies and additional product development hours costing $0.6 million by existing staff, as we utilize the larger technical staff for development work to build and enhance our product offerings. As a percentage of total revenue, product development expenses increased to 14% for the year ended December 31, 2018 from 7% for the year ended December 31, 2017. The increase in product development expenses as a percentage of revenue is primarily due to the aforementioned higher costs.

Depreciation

Depreciation expense consists of depreciation of long-lived property and equipment. Depreciation expenses decreased 52%, or $0.1 million, to $0.1 million for the year ended December 31, 2018 from $0.2 million for the year ended December 31, 2017. The decrease of expense was due to older assets becoming fully depreciated in the prior year. As a percentage of revenue, depreciation expense decreased to less than 1% for the year ended December 31, 2018 from 1% for the year ended December 31, 2017.

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Amortization

Amortization expense consists of amortization of identifiable intangibles related to our acquisitions of Evolving Systems Labs, Evolving Systems NC, EVOL BLS, and the Lumata Entities. Amortization expense increased 13%, or $0.1 million, to $1.0 million for the year ended December 31, 2018 from $0.9 million for the year ended December 31, 2017. The increase in amortization expense was due to the having a full year in 2018 of amortization expense of the intangible assets relating to the acquisition of EVOL BLS on July 3, 2017 and the Lumata Entities on September 4, 2017. This was partially offset by a reduction in amortization expense related to intangibles acquired in the formation of Evolving Systems NC reaching the end of life of those assets during 2018. As a percentage of revenue, amortization expense remained 3% for the year ended December 31, 2018 and 2017.

Restructuring

Restructuring expense includes the costs associated with a reduction in workforce due to the consolidation of duplicative functions and alignment of staff with ongoing business activity as a result of the acquisition of EVOL BLS and the Lumata Entities in third quarter of 2017. Restructuring decreased 100%, or $0.3 million, to $0.0 million for the year ended December 31, 2018 from $0.3 million for the year ended December 31, 2017. As a percentage of revenue, restructuring expense decreased to 0% for the year ended December 31, 2018 from 1% for the year ended December 31, 2017. The decrease of restructuring expense as a percentage of total revenue is related to their being no restructuring in 2018.

Goodwill Impairment Loss

During the quarter ended December 31, 2018, our market capitalization declined to a level that was less than the net book value of our stockholders   equity. We performed a goodwill impairment analysis as of December 31, 2018. As a result of the decline in the market capitalization (triggering event) and the associated impairment analysis, the Company recorded an impairment loss on goodwill of $17.8 million. We had no goodwill impairment loss for the year ended December 31, 2017.

Interest Expense

Interest expense includes the amortization of debt issuance costs and interest expense from our term loans. Interest expense for the year ended December 31, 2018 increased 31%, or $0.1 million, to $0.5 million as compared to $0.4 million for the year ended December 31, 2017. The increase is related to having a full year of the term loan borrowings used to acquire the Lumata Entities.

Other Income (Expense)

For the year ended December 31, 2018, we had $0.8 million in other income, net, which consisted of: (1) when we acquired Telespree on October 24, 2013, we agreed to make a final cash payment on October 24, 2014 of $0.5 million. This payment was subject to reduction for certain claims and we notified the seller s representative that we were asserting claims against the final cash payment and the contractually agreed time period has lapsed. Accordingly, we eliminated the liability as of June 30, 2018 and recognized $0.5 million gain in other income; (2) at the end of the second quarter we agreed to a Mutual Release and Settlement Agreement and a Contribution Agreement (the SSM Agreements) with certain parties related to our September 30, 2015 acquisition of SSM. The SSM Agreements settled a dispute with a former SSM contractor, of which $0.1 million was on the Company s behalf and recorded as other expense; (3) When we acquired EVOL BLS on July 3, 2017, we agreed to make up to three annual cash payments equal to 50% of the EVOL BLS revenue in excess of $4.8 million for the 12-month periods ending July 3, 2018, 2019 and 2020. The Company also agreed to guarantee the EVOL BLS obligations under the Purchase Agreement. As of June 30, 2018, EVOL BLS has exceeded their projected revenues and we estimated the total annual cash payments for the three 12-month periods to be $0.8 million, which is a $0.4 million increase. We recognized $0.4 million in interest expense as a result of our increased obligation, and (4) $0.4 million in other income from eliminating certain allowances, unearned revenue and accrued liabilities that primarily came from the BLS and Lumata entities at the time of our acquisition. Foreign currency exchange income resulted from transactions denominated in a currency other than the functional currency of the respective subsidiary increased 171%, or $1.9 million, to a $0.8 million gain for the year ended December 31, 2018 compared to a $1.1 million loss for the year ended December 31, 2017. The income was generated primarily through the re-measurement of certain non-functional currency denominated financial assets and liabilities of our foreign subsidiaries.

For the year ended December 31, 2017, we had $1.5 million in other expense, net.

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Income Tax Expense

We recorded a net income tax benefit of $0.4 million for the year ended December 31, 2018 and net income tax expense of $1.4 million for the year ended December 31, 2017. The net expense for the year ended December 31, 2018 consisted of current income tax expense of $0.5 million and a deferred tax benefit of $0.9 million. The current tax expense consists of income tax primarily from our U.S. and U.K. based operations. The deferred tax benefit primarily consists of benefits from establishing deferred tax assets of $0.5 million for our foreign tax credit (FTC) carryforwards, $0.2 million for net operating losses from certain U.K. subsidiaries that are expected to be used by another U.K. subsidiary and $0.2 million decrease in net deferred tax liabilities. The net expense during the year ended December 31, 2017 consisted of current income tax expense of $1.9 million and a deferred tax benefit of $0.5 million. The current tax expense consists of income tax from our U.S., U.K., France and India based operations and unrecoverable foreign withholding taxes in the U.K. The deferred tax benefit was related primarily to the increase of certain net deferred tax assets and amortization of stock options and the intangible assets related to the acquisition of Evolving Systems NC, Inc. in September 2015. Refer to Note 6, Income Taxes, of our Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K for more information regarding the foreign tax credit.

We use a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. As of December 31, 2018, and 2017, we had no liability for unrecognized tax benefits. We do not believe there will be any material changes to our unrecognized tax positions over the next twelve months.

FINANCIAL CONDITION

Our working capital position decreased 10%, or $0.9 million to $8.1 million at December 31, 2018 from $9.0 million at December 31, 2017. The decrease in working capital is related to decrease in cash, contract receivables, unbilled work in progress, prepaids and other assets along with an increase in current notes payable and partially offset by the decreases in accounts payable, accrued liabilities and unearned revenue along with the payment of a contingent earn-out and release of Telespree liability.

LIQUIDITY AND CAPITAL RESOURCES

We have historically financed operations through cash flows from operations as well as debt and equity transactions. At December 31, 2018, our principal sources of liquidity were $6.7 million in cash and cash equivalents and $7.8 million in contract receivables, net of allowances. Our anticipated uses of cash in the future will be to fund the expansion of our business through both organic growth as well as possible acquisition activities, the expansion of our customer base internationally, and term loan payments. Other uses of cash may include capital expenditures and technology expansion.

During 2017, in connection with the Acquisition, EVOL Holdings entered into a Term Loan Facility Agreement, a Debenture and a Subordination Deed with East West Bank as lender in the amount of $4.7 million. We used the full amount of the Lumata Facility to fund the acquisition. The Lumata Facility requires the Company to make monthly principal payments of approximately $131,400 commencing July 31, 2018 and interest at the greater of (a) 3.5% or (b) the variable rate of interest that appears in the Wall Street Journal on a monthly measurement date, plus in either case 1.5%. The Lumata Facility is secured by substantially all of the assets of the Company. The unpaid balance of the Lumata Facility is due on August 16, 2021.

On February 29, 2016, we retired the Revolving Facility and we entered into a term loan agreement with East West Bank (Term Loan) for $6.0 million. The Term Loan bears interest at a floating rate equal to the U.S. Prime Rate plus 1.0% and is secured by substantially all of the Company s assets, including a pledge, subject to certain limitations with respect to stock of foreign subsidiaries, of the stock of the existing and future direct subsidiaries of the Company. Interest accrues and is payable monthly. We are required to repay the Term Loan in 36 equal monthly installments, commencing on January 1, 2017. We were required to use the $6 million Term Loan proceeds, plus $4.0 million from our cash reserves, to pay off the Revolving Facility. The Term Loan matures on January 1, 2020.

Both the Lumata Facility and the Term Loan (collectively, Loans) include negative covenants that place restrictions on the Company s ability to, among other things: incur additional indebtedness; create liens or other encumbrances on assets; make loans, enter into letters of credit, guarantees, investments and acquisitions; sell or otherwise dispose of assets; cause or permit a change of control; merge or consolidate with another entity; make negative pledges; enter into affiliate transactions; limits the amount of cash distributions to our shareholders; and change the nature of our business materially. We must also maintain a minimum current ratio, a specified ratio of Total Liabilities to EBITDA and a minimum fixed charge coverage ratio, as defined in the Term Loan. As of December 31, 2018, our fixed charge coverage ratio was 0.81, which failed to meet the minimum required 1.25 fixed charge coverage ratio. On March 29, 2019, we received a letter from East West Bank that waived the violation and are currently negotiating modifications to the minimum required fixed charge ratio for the four quarters of the fiscal year ending December 31, 2019.

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Net cash provided by operating activities for the year ended December 31, 2018 and 2017 was $2.6 million and $3.5 million, respectively. Cash provided by operating activities for the year ended December 31, 2018 was primarily due to a net loss of $14.8 million offset by non-cash goodwill impairment loss of $17.8 million, and net decrease in operating assets and liabilities of $0.4 million.

The cash provided by operating activities for the year ended December 31, 2017 was primarily due to increase in contract receivables related to the acquisitions and additional expenses related to the acquisitions as well as a decrease in accounts payable and current liabilities.

Net cash used in investing activities was $0.2 million and $6.0 million for the years ended December 31, 2018 and 2017, respectively. Cash used in investing activities for the year ended December 31, 2018 was due to the purchase of property and equipment. Cash used in investing activities for the year ended December 31, 2017 was primarily due to the acquisition of the Acquired Companies of $5.9 million. Refer to Note 2, Acquisition, of our Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K for more information regarding the acquisitions.

Net cash (used in) provided by financing activities was ($3.2) million and $2.7 million for the years ended December 31, 2018 and 2017, respectively. The cash used in 2018 financing activities was for principal payments on our term loans and payment of contingent earn-out. The cash provided by our 2017 financing activities was primarily related to the proceeds from the Lumata Facility entered into August 2017 to acquire the Lumata Entities offset by the principal payments on our term loan and the payment for second year debt issuance costs.

We believe that our current cash and cash equivalents, together with anticipated cash flow from operations will be sufficient to meet our working capital, debt extinguishment and capital expenditure requirements for at least the next twelve months as of the date this Form 10-K was filed. In making this assessment, we considered the following:

- Our cash and cash equivalents balance at December 31, 2018 of $6.7 million;
- Our working capital balance of $8.1 million; and,
- Our ability to historically generate positive operating cash flows.

We are exposed to foreign currency rate risks which impact the carrying amount of our foreign subsidiaries and our consolidated equity, as well as our consolidated cash position due to translation adjustments. For the years ended December 31, 2018 and 2017, the effect of exchange rate changes resulted in a less than $0.1 million decrease and a $0.2 million decrease to consolidated cash, respectively. We do not currently hedge our foreign currency exposure, but we closely monitor the rate changes and may hedge our exposures in the future.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have a material current effect, or that are reasonably likely to have a material future effect, on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Contractual Obligations and Commercial Commitments

The following summarizes our significant contractual obligations as of December 31, 2018 (in thousands):

	Payments due by period					
	Total	2019	2020	2021	2022	Thereafter
Operating Leases	$ 1,470	$ 509	$ 357	$ 253	$ 252	$ 99
Term Loans	5,938	3,573	1,577	788		
Total Commitments	$ 7,048	$ 4,082	$ 1,934	$ 1,041	$ 252	$ 99

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CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are disclosed in Note 1 of our Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K. The following discussion addresses our most critical accounting policies, which are those that are both important to the portrayal of our financial condition and results of operations and that require significant judgment or use of complex estimates.

Business Combinations

We account for business combinations in accordance with the acquisition method. The acquisition method of accounting requires that assets acquired, and liabilities assumed be recorded at their fair values on the date of a business acquisition. The excess of the purchase price over the fair value of assets acquired is recognized as goodwill. Certain adjustments to the assessed fair values of the assets and liabilities made subsequent to the acquisition date, but within the measurement period, which is up to one year, are recorded as adjustments to goodwill. Any adjustments subsequent to the measurement period are recorded in income. Our consolidated financial statements and results of operations reflect an acquired business from the completion date of an acquisition.

The judgments that we make in determining the estimated fair value assigned to each class of assets acquired and liabilities assumed, as well as asset lives, can materially impact net income in periods following a business combination. We generally use either the income, cost or market approach to aid in our conclusions of such fair values and asset lives. The income approach presumes that the value of an asset can be estimated by the net economic benefit to be received over the life of the asset, discounted to present value. The cost approach presumes that an investor would pay no more for an asset than its replacement or reproduction cost. The market approach estimates value based on what other participants in the market have paid for reasonably similar assets. Although each valuation approach is considered in valuing the assets acquired, the approach ultimately selected is based on the characteristics of the asset and the availability of information.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, at the date of the consolidated financial statements, as well as the reported amounts of revenue and expenses during the reporting period. We made estimates with respect to revenue recognition for progress toward completion and direct profit or loss on contracts, allowance for doubtful accounts, income tax valuation allowance, fair values of long-lived assets, valuation of intangible assets and goodwill, useful lives for property, equipment and intangible assets, business combinations, capitalization of internal software development costs and fair value of stock-based compensation amounts. Actual results could differ from these estimates.

Foreign Currency

Our functional currency is the U.S. dollar. The functional currency of our foreign operations, generally, is the respective local currency for each foreign subsidiary. Assets and liabilities of foreign operations denominated in local currencies are translated at the spot rate in effect at the applicable reporting date. Our consolidated statements of income are translated at the weighted average rate of exchange during the applicable period. The resulting unrealized cumulative translation adjustment is recorded as a component of accumulated other comprehensive income (loss) in stockholders equity. Realized and unrealized transaction gains and losses generated by transactions denominated in a currency different from the functional currency of the applicable entity are recorded in other income (loss) in the period in which they occur.

Goodwill

Goodwill is the excess of acquisition cost of an acquired entity over the fair value of the identifiable net assets acquired. Goodwill is not amortized but tested for impairment annually or whenever indicators of impairment exist. These indicators may include an other than temporary decline in our market capitalization that is calculated as our common stock s market price multiplied by the number of shares of common stock outstanding, a significant change in the business climate, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business or other factors. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to the reporting unit, and determination of the fair value of the reporting unit. In 2018, the Company adopted ASU 2017-04, Intangibles Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment, which simplifies the subsequent measurement of goodwill by eliminating the second step from the quantitative goodwill impairment test. Under this guidance, annual or interim goodwill impairment testing will be performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge will then be recognized for the amount by which the carrying amount exceeds the reporting unit s fair value, not to exceed the carrying value of goodwill.

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Intangible Assets

Amortizable intangible assets consist primarily of purchased software and licenses, customer relationships, trademarks and tradenames, non-competition and purchased software acquired in conjunction with our purchase of Telespree Communications (Evolving Systems Labs, Inc.), Evolving Systems NC, Inc., EVOL BLS and the Lumata Entities. These assets are amortized using the straight-line method over their estimated lives.

We assess the impairment of identifiable intangibles if events or changes in circumstances indicate that the carrying value of the asset may not be recoverable.

If we determine that the carrying value of intangibles and/or long-lived assets may not be recoverable, we compare the estimated undiscounted cash flows expected to result from the use of the asset and its eventual disposition to the asset s carrying amount. If an amortizable intangible or long-lived asset is not deemed to be recoverable, we recognize an impairment loss representing the excess of the asset s carrying value over its estimated fair value.

Fair Value Measurements

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Inputs that are generally unobservable and typically reflect management s estimate of assumptions that market participants would use in pricing the asset or liability.

Revenue Recognition

Effective January 1, 2018, we adopted Financial Accounting Standards Board (FASB) Topic 606, Revenue from Contacts with Customers (ASC 606). ASC 606 was applied using the modified retrospective method. Accordingly, comparative periods have not been adjusted and continue to be reported under FASB ASC Topic 605, Revenue Recognition (ASC 605). There was no cumulative effect of the initial application to be recognized as an adjustment to opening retained earnings at January 1, 2018 as the adoption did not have a material impact on the Company s results of operations or financial condition.

The majority of our license fees and services revenue is generated from fixed-price contracts, this provides for licenses to our software products and services that customize such software to meet our customers needs. In most instances, customization services are determined to be essential to the functionality of the delivered software. Under ASC 606, revenue is recognized when our customer obtains control of promised goods or services in an amount that reflects the consideration we expect to receive in exchange for those goods or services. We measure revenue based on consideration specified in a contract with a customer and exclude any sales incentives. Furthermore, we recognize revenue when we satisfy a performance obligation by transferring control over the service to our customer.

A performance obligation is a promise in a contract to transfer a distinct service to the customer. The transaction price of a contract is allocated to each distinct performance obligation and recognized as revenue when or as the customer receives the benefit of the performance obligation. Our customers typically receive the benefit of our services as they are performed. Substantially all customer contracts provide that we are compensated for services performed to date. Losses on fixed-price projects are recorded when identified. Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by us from a customer, are excluded from revenue.

Nature of goods and services

The following is a description of our products and services from which we generate revenue, as well as the nature, timing of satisfaction of performance obligations, and significant payment terms for each:

i. License Revenue

License fees represent the fees we receive from the licensing of our software products. In most instances, customization services are determined to be essential to the functionality of the delivered software. The license along with the customization services are transferred to our customers over time. In arrangements where the services are not essential to the functionality of the delivered software, we recognize license revenue when the license agreement has been approved and the software has been delivered. We can identify each party s rights, payment terms, and commercial substance of the content. Where applicable, we identify multiple performance obligations and record as revenue as the performance obligations are fulfilled based on their estimated allocated value. The selection of the method to measure progress towards completion requires judgment and is based on the extent of progress towards completion of the performance obligation.

ii. Customer Support Revenue

Customer support services includes annual support fees, recurring maintenance fees, warranty support fees and minor product upgrades. The warranty support fees represent a separate performance obligation that is provided for up to a year with initial license purchase. The Company allocates the contract transaction price related to warranty support fees based on pricing consistent with what we would offer to other market participants. Upon the conclusion of the warranty period, the customer can choose to continue to receive support and maintenance services via our customer support offerings. We recognize revenue from our support ratably over the service contract period.

iii. Services Revenue

We recognize revenue from fixed-price service contracts using the input method of accounting. Under the input method, revenue is recognized revenue on the basis of an entity s efforts or inputs toward satisfying a performance obligation. We recognize revenue from professional services provided pursuant to time-and-materials based contracts and training services as the services are performed, as that is when our performance obligation to our customers under such arrangements is fulfilled.

iv. Managed Services

We recognize revenue from our managed services contracts primarily over the service contract period. On occasion, our managed services contracts will contain a specified number of hours to work over the term of the contract. Revenue for this type of managed service contract is recognized using the input method of accounting, as previously described.

Contract balances

Contract receivables are recorded at the invoiced amount and do not bear interest. Credit is extended based on the evaluation of a customer s financial condition and collateral is not required. Unbilled work-in-progress is revenue which has been earned but not invoiced. The contract assets are transferred to the receivables when invoiced.

The contract liabilities primarily relate to unearned revenue. Amounts billed in advance of performance obligations being satisfied are booked as unearned revenue.

Transaction price allocated to the remaining performance obligations

Remaining performance obligations represent the transaction price of firm orders for which work has not been performed as of the period end date and excludes unexercised contract options and potential orders under ordering-type contracts (e.g., indefinite-delivery, indefinite-quantity). As of December 31, 2018, the aggregate amount of the transaction price allocated to remaining performance obligations with lives greater than one-year totals $1.5 million. The Company expects approximately 80% of remaining performance obligations to be recognized into revenue within the next twelve months, with the remaining 20% recognized thereafter.

We apply the practical expedient in paragraph ASC 606-10-50-14 and do not disclose information about remaining performance obligations that have original expected durations of one-year or less. We apply the transition practical expedient in paragraph ASC 606-10-65-1(f)(3) and do not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when we expect to recognize that amount as revenue. Additionally, applying the practical expedient in paragraph ASC 340-40-25-4, the Company recognizes the incremental costs of obtaining contracts (i.e., commissions) as an expense when incurred if the amortization period of the assets that the Company otherwise would have recognized is one-year or less.

Allowance for Doubtful Accounts

We make judgments related to our ability to collect outstanding accounts receivable and unbilled work-in-progress. We provide allowances for receivables when their collection becomes doubtful by recording an expense. We determine the allowance based on our assessment of the realization of receivables using historical information and current economic trends, including assessing the probability of collection from customers. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments owed to us, an increase in the allowance for doubtful accounts would be required. We evaluate the adequacy of the allowance regularly and make adjustments accordingly. Adjustments to the allowance for doubtful accounts could materially affect our results of operations.

Stock-based Compensation

We account for stock-based compensation by applying a fair-value-based measurement method to account for share-based payment transactions with employees and directors. We record compensation costs associated with the vesting of unvested options on a straight-line basis over the vesting period. Stock-based compensation is a non-cash expense because we settle these obligations by issuing shares of our common stock instead of settling such obligations with cash payments. We use the Black-Scholes model to estimate the fair value of each option grant on the date of grant. This model requires the use of estimates for expected term of the options and expected volatility of the price of our common stock.

In March 2016, the FASB issued ASU 2016-09, Stock Compensation (Topic 718), which includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. The standard is effective for annual periods beginning after December 15, 2016. We adopted this ASU during the first quarter 2017. The key effects of the adoption on our financial statements include that the Company will now recognize windfall tax benefits as deferred tax assets instead of tracking the windfall pool and recording such benefits in equity. Additionally, we have elected to recognize forfeitures as they occur rather than estimating them at the time of grant.

Stock-based payments made to non-employees, including grants of stock options, are recognized in the statements of operations based on their estimated fair values. The fair value of these options will be re-measured on each reporting date until the options vest. The re-measured fair value will be recognized as compensation expense over the remaining vesting term of the options.

Income Taxes

We record deferred tax assets and liabilities for the estimated future tax effects of temporary differences between the tax bases of assets and liabilities and amounts reported in the accompanying consolidated balance sheets, as well as operating losses and tax credit carry-forwards. We measure deferred tax assets and liabilities using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. We reduce deferred tax assets by a valuation allowance if, based on available evidence, it is more likely than not that these benefits will not be realized.

We use a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more likely than not to be sustained upon examination by taxing authorities.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the ordinary course of business, we are exposed to certain market risks, including changes in foreign currency exchange rates and interest rates. Uncertainties that are either non-financial or non-quantifiable such as political, economic, tax, other regulatory or credit risks are not included in the following assessment of market risks.

Interest Rate Risks

Our cash balances are subject to interest rate fluctuations and as a result, interest income amounts may fluctuate from current levels. As of December 31, 2018, we had $5.9 million outstanding under our term loans, which under the loan agreements bear interest at variable rates. Refer to Note 5, Long-Term Debt, of our Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K for more information regarding the Term Loan. A 1% change in the interest rates on our Loans would change our interest expense by approximately $0.1 million.

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Foreign Currency Risk

We are exposed to fluctuations of the U.S. dollar (our functional currency) against the currencies of our operating subsidiaries. Any increase (decrease) in the value of the U.S. dollar against any foreign currency that is the functional currency of one of our operating subsidiaries will cause the parent company to experience unrealized foreign currency translation losses (gains) with respect to amounts already invested in such foreign currencies. In addition, we and our operating subsidiaries are exposed to foreign currency risk to the extent that we enter into transactions denominated in currencies other than our respective functional currencies, such as revenue and related accounts receivable (including intercompany amounts) that are denominated in a currency other than their own functional currency. Changes in exchange rates with respect to these items will result in unrealized (based upon period-end exchange rates) or realized foreign currency transaction gains and losses upon settlement of the transactions. In addition, we are exposed to foreign exchange rate fluctuations related to our operating subsidiaries monetary assets and liabilities and the financial results of foreign subsidiaries and affiliates when their respective financial statements are translated into U.S. dollars for inclusion in our consolidated financial statements. We record cumulative translation adjustments in accumulated other comprehensive income (loss) as a separate component of equity. As a result of foreign currency risk, we may experience economic loss and a negative impact on earnings and equity with respect to our holdings solely as a result of foreign currency exchange rate fluctuations.

The relationship between the British Pound Sterling, Indian rupee and the U.S. dollar, which is our functional currency, is shown below, per one U.S. dollar:

Spot rates:	**December 31, 2018**	**December 31, 2017**
British pound sterling	0.78524	0.74071
Euro	0.87440	0.83348
Indian rupee	69.78890	63.84000

Average rates:	**For the Years Ended December 31,**	
	2018	**2017**
British pound sterling	0.75005	0.77673
Euro	0.84746	0.88675
Indian rupee	68.39725	65.11189

At the present time, we do not hedge our foreign currency exposure or use derivative financial instruments that are designed to reduce our long-term exposure to foreign currency exchange risk. We continually monitor our foreign currency exchange risk and we may consider various options to reduce this risk in the future.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and

Stockholders of Evolving Systems, Inc.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Evolving Systems, Inc. (a Delaware corporation, the Company) as of December 31, 2018 and 2017, and the related consolidated statements of operations, comprehensive (loss) income, stockholders equity, and cash flows for each of the years in the two-year period ended December 31, 2018, and the related notes (collectively referred to as the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on the Company s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Friedman LLP

We have served as the Company s auditor since 2012
East Hanover, NJ
April 4, 2019

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EVOLVING SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	December 31, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,732	$ 7,562
Contract receivables, net of allowance for doubtful accounts of $771 and $970 at December 31, 2018 and December 31, 2017, respectively	7,757	10,151
Unbilled work-in-progress, net of allowance for doubtful accounts of $552 and $107 at December 31, 2018 and December 31, 2017, respectively	3,044	5,823
Prepaid and other current assets	1,351	1,633
Income taxes receivable	1,137	
Total current assets	20,021	25,169
Property and equipment, net	303	258
Amortizable intangible assets, net	4,550	5,613
Goodwill	6,738	25,216
Deferred income taxes, net	1,140	274
Total assets	$ 32,752	$ 56,530
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Term loans - current portion	$ 3,573	$ 2,805
Accounts payable and accrued liabilities	4,483	6,678
Contingent earn-out		396
Unearned revenue	3,911	5,397
Income taxes payable		899
Total current liabilities	11,967	16,175
Long-term liabilities:		
Term loans, net of current portion	2,365	5,942
Total liabilities	14,332	22,117
Commitments and contingencies (Note 11)		
Stockholders equity:		
Preferred stock, $0.001 par value; 2,000,000 shares authorized; no shares issued and outstanding as of December 31, 2018 and December 31, 2017, respectively		
Common stock, $0.001 par value; 40,000,000 shares authorized; 12,305,597 shares issued and 12,126,708 outstanding as of December 31, 2018 and 12,119,961 shares issued and 11,941,072 outstanding as of December 31, 2017	12	12
Additional paid-in capital	99,224	98,517
Treasury stock, 178,889 shares as of December 31, 2018 and December 31, 2017, at cost	(1,253)	(1,253)
Accumulated other comprehensive loss	(10,115)	(8,202)
Accumulated deficit	(69,448)	(54,661)
Total stockholders equity	18,420	34,413
Total liabilities and stockholders equity	$ 32,752	$ 56,530

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

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EVOLVING SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	For the Years Ended December 31, 2018	2017
REVENUE		
License fees	$ 1,433	$ 3,438
Services	29,203	25,374
Total revenue	30,636	28,812
COSTS OF REVENUE AND OPERATING EXPENSES		
Costs of revenue, excluding depreciation and amortization	10,349	8,680
Sales and marketing	6,592	5,214
General and administrative	6,677	6,065
Product development	4,170	2,042
Depreciation	121	250
Amortization	970	860
Restructuring		286
Goodwill impairment loss	17,760	
Total costs of revenue and operating expenses	46,639	23,397
(Loss) income from operations	(16,003)	5,415
Other income (expense)		
Interest income	65	1
Interest expense	(478)	(365)
Other income	393	23
Foreign currency exchange income (loss)	810	(1,137)
Other income (expense), net	790	(1,478)
(Loss) income from operations before income taxes	(15,213)	3,937
Income tax (benefit) expense	(426)	1,421
Net (loss) income	$ (14,787)	$ 2,516
Basic (loss) income per common share - net (loss) income	$ (1.22)	$ 0.21
Diluted (loss) income per common share - net (loss) income	$ (1.22)	$ 0.21
Weighted average basic shares outstanding	12,108	11,934
Weighted average diluted shares outstanding	12,108	11,981

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

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EVOLVING SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(in thousands)

[redacted]				
Net (loss) income	$	(14,787)	$	2,516
[redacted]				
Other comprehensive (loss) income				
[redacted]				
[redacted]				

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

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EVOLVING SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(in thousands, except per share data)

	Common Stock Shares	Common Stock Amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive loss	Accumulated deficit	Total stockholders equity
Balance at December 31, 2016	**11,907,391**	**$ 12**	**$ 97,744**	**$ (1,253)**	**$ (9,992)**	**$ (57,177)**	**$ 29,334**
Stock option exercises	32,904		30				30
Common stock issued pursuant to the Employee Stock Purchase Plan	777		2				2
Share-based compensation expense			742				742
Net income						2,516	2,516
Foreign currency translation income					1,790		1,790
Balance at December 31, 2017	**11,941,072**	**$ 12**	**$ 98,517**	**$ (1,253)**	**$ (8,202)**	**$ (54,661)**	**$ 34,413**
Stock option exercises	9,676		4				4
Common stock issued pursuant to the Employee Stock Purchase Plan	85		1				1
Restricted stock vested	175,875						
Share-based compensation expense			702				702
Net loss						(14,787)	(14,787)
Foreign currency translation loss					(1,913)		(1,913)
Balance at December 31, 2018	**12,126,708**	**$ 12**	**$ 99,224**	**$ (1,253)**	**$ (10,115)**	**$ (69,448)**	**$ 18,420**

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

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EVOLVING SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, except per share data)

	For the Years Ended December 31, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (14,787)	$ 2,516
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation	121	250
Amortization of intangible assets	970	860
Amortization of debt issuance costs	9	13
Share-based compensation expense	702	742
Change in fair value of contingent earn-out	413	(4)
Payment of contingent purchase consideration	(445)	
Unrealized foreign currency transaction (income) loss, net	(810)	1,136
Bad debt expense, net	431	861
Release of Telespree liability	(496)	
Provision for deferred income taxes	(946)	(491)
Goodwill impairment loss	17,760	
Change in operating assets and liabilities:		
Contract receivables	2,473	(2,971)
Unbilled work-in-progress	1,803	(1,032)
Prepaid and other assets	(25)	1,983
Accounts payable and accrued liabilities	(1,326)	(1,905)
Income taxes receivable	(2,036)	264
Unearned revenue	(1,244)	856
Other long-term obligations		380
Net cash provided by operating activities	2,567	3,458

CASH FLOWS FROM INVESTING ACTIVITIES: