CLAYTON HOLDINGS INC
Form 10-Q
August 08, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2007

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 000-51846

CLAYTON HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-2660764**
(State of incorporation)	(I.R.S. Employer Identification No.)
2 Corporate Drive, Shelton, CT	**06484**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(203) 926-5600**

(Former Name, Former Address and Former Fiscal year, if changed since last report)

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

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

21,111,969 shares of Common Stock, par value $0.01 per share, outstanding as of July 31, 2007.

CLAYTON HOLDINGS, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CLAYTON HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2007 (unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,361,458	$ 22,881,553
Restricted cash		11,738,871
Accounts receivable, net of allowance for doubtful accounts of $325,697 and $191,569 as of June 30, 2007 and December 31, 2006, respectively	29,441,713	37,452,008
Unbilled receivables	16,417,133	14,950,591
Prepaid expenses and other current assets	2,852,020	3,251,642
Prepaid income taxes	5,390,678	1,790,828
Deferred tax assets	605,198	571,835
Assets of discontinued operations		5,014,936
Total current assets	71,068,200	97,652,264
Property and equipment, net	18,880,496	19,621,749
Goodwill	70,008,616	69,843,468
Intangible assets, net	71,820,124	74,293,680
Other assets, net	1,466,528	1,501,430
Total assets	$ 233,243,964	$ 262,912,591
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Long term debt and capital lease obligations, current portion	$ 742,975	$ 928,633
Accounts payable and accrued expenses	14,745,339	22,831,882
Servicer escrow liability		11,738,871
Liabilities of discontinued operations		18,880
Total current liabilities	15,488,314	35,518,266
Long-term debt and capital lease obligations, net of current portion	54,030,528	64,423,566
Deferred tax liabilities	3,500,141	4,088,816
Deferred revenue	283,031	203,729
Deferred rent	1,676,349	949,165
Other long-term liabilities	2,136,506	
Total liabilities	77,114,869	105,183,542
Commitments and contingencies		
Stockholders equity:		
Common stock, par value $0.01 per share, 150,000,000 shares authorized and 21,105,813 and 20,688,556 shares issued and outstanding as of June 30, 2007 and December 31, 2006, respectively	211,059	206,886
Additional paid-in capital	144,048,866	141,255,632
Retained earnings	11,829,708	16,266,531
Accumulated other comprehensive income, net of tax	39,462	
Total stockholders equity	156,129,095	157,729,049
Total liabilities and stockholder equity	$ 233,243,964	$ 262,912,591

The accompanying notes are an integral part of these statements.

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CLAYTON HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	For the three months ended June 30, 2007	For the three months ended June 30, 2006	For the six months ended June 30, 2007	For the six months ended June 30, 2006
Revenue	$ 43,153,459	$ 59,897,052	$ 96,505,624	$ 113,841,981
Cost of services:				
Compensation expense	20,205,613	29,098,804	45,925,806	57,609,954
Travel and related expenses	3,546,523	6,753,220	9,090,073	13,879,788
Other direct costs	1,534,270	3,035,020	4,011,630	5,368,432
Total cost of services	25,286,406	38,887,044	59,027,509	76,858,174
Gross profit	17,867,053	21,010,008	37,478,115	36,983,807
Operating expenses:				
Salaries and benefits	5,524,916	5,087,032	11,196,490	10,115,422
Other selling, general and administrative expenses	5,596,633	4,539,709	11,029,791	9,163,235
Depreciation and amortization	2,432,600	1,864,260	4,487,608	3,365,728
Amortization of intangibles	2,571,240	2,541,870	5,068,985	5,083,722
Total operating expenses	16,125,389	14,032,871	31,782,874	27,728,107
Income from operations	1,741,664	6,977,137	5,695,241	9,255,700
Interest expense, net	1,022,070	1,659,653	2,214,012	4,724,235
Loss from extinguishment of debt	45,289		90,332	746,002
Income from continuing operations before income taxes	674,305	5,317,484	3,390,897	3,785,463
Income tax expense	207,143	2,103,274	1,294,302	1,459,267
Income from continuing operations	467,162	3,214,210	2,096,595	2,326,196
Loss from discontinued operations:				
Loss from operations (net of income tax benefit of $221,251, $624,749, $810,058 and $761,719, respectively)	(434,918)	(862,752)	(1,402,994)	(1,051,897)
Loss on disposal (net of income tax benefit of $131,653 and $1,922,724, respectively)	(385,718)		(3,330,424)	
Net (loss) income	$ (353,474)	$ 2,351,458	$ (2,636,823)	$ 1,274,299
Basic income (loss) per share:				
Continuing operations	$ 0.02	$ 0.15	$ 0.10	$ 0.14
Discontinued operations	(0.04)	(0.04)	(0.23)	(0.06)
Total	$ (0.02)	$ 0.11	$ (0.13)	$ 0.08
Diluted income (loss) per share:				
Continuing operations	$ 0.02	$ 0.15	$ 0.10	$ 0.13
Discontinued operations	(0.04)	(0.04)	(0.23)	(0.06)
Total	$ (0.02)	$ 0.11	$ (0.13)	$ 0.07
Weighted average shares outstanding:				

Basic	20,926,048	20,522,449	20,860,989	16,373,676
Diluted	21,513,975	21,522,106	21,574,185	17,302,704

The accompanying notes are an integral part of these statements.

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CLAYTON HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(unaudited)

	Common Stock Number of shares	Value	Additional paid in capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance, January 1, 2007	20,688,556	$ 206,886	$ 141,255,632	$	$ 16,266,531	$ 157,729,049
Adjustment for the cumulative effect as of January 1, 2007 on prior years of the adoption of FIN 48 (Note 9)					(1,800,000)	(1,800,000)
Stock based compensation	156,350	1,564	639,047			640,611
Exercise of stock options	260,907	2,609	911,291			913,900
Tax benefit of options exercised			1,242,896			1,242,896
Other comprehensive income				39,462		39,462
Net loss for the six months ended June 30, 2007					(2,636,823)	(2,636,823)
Balance, June 30, 2007	21,105,813	$ 211,059	$ 144,048,866	$ 39,462	$ 11,829,708	$ 156,129,095

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(unaudited)

	For the three months ended June 30, 2007	2006	For the six months ended June 30, 2007	2006
Net (loss) income	$ (353,474)	$ 2,351,458	$ (2,636,823)	$ 1,274,299
Foreign currency translation adjustments, net of tax	39,462		39,462	
Total comprehesive (loss) income	$ (314,012)	$ 2,351,458	$ (2,597,361)	$ 1,274,299

The accompanying notes are an integral part of these statements.

CLAYTON HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	For the six months ended June 30, 2007	2006
Cash flows from operating activities:		
Net (loss) income	$ (2,636,823)	$ 1,274,299
Add: Loss on disposal of discontinued operations	3,330,424	
Loss from discontinued operations	1,402,994	1,051,897
Adjustments to reconcile net (loss) income to net cash provided by operating activities		
Depreciation and amortization	4,487,608	3,365,728
Amortization of intangibles	5,068,985	5,083,722
Amortization of debt issuance cost	132,983	187,488
Adoption of FIN 48	336,506	
Loss from extinguishment of debt	90,332	746,002
Stock based compensation	640,611	853,314
Deferred income taxes	(733,390)	67,977
Loss (gain) on sale of fixed assets	30,004	(2,095)
Provision for doubtful accounts	545,945	208,962
Changes in operating assets and liabilities, net of business combinations:		
Accounts receivable	6,878,927	(264,142)
Unbilled receivables	(1,465,760)	(1,797,642)
Prepaid expenses and other current assets	380,846	907,728
Prepaid income taxes	(755,752)	753,095
Due to an affiliated entity		23,434
Other assets, net	(129,107)	(89,253)
Accounts payable and accrued expenses	(9,729,571)	(2,157,492)
Deferred revenue	(91,373)	(605,882)
Deferred rent	727,184	12,120
Net cash provided by operating activities	8,511,573	9,619,260
Cash flows from investing activities:		
Proceeds from sale of fixed assets	23,968	35,000
Capital expenditures	(3,999,677)	(5,349,916)
Acquisition of businesses	(2,959,829)	(6,120,010)
Cash held in escrow from acquisition of businesses inclusive of interest earned		(603,247)
Net cash used in investing activities	(6,935,538)	(12,038,173)
Cash flows from financing activities:		
Proceeds from revolving credit facility		7,400,000
Repayments of revolving credit facility		(7,400,000)
Repayments of capital lease obligations	(77,423)	(69,657)
Repayment of term loan	(10,312,810)	(70,200,501)
Deferred charges related to the issuance of debt	(59,305)	(124,158)
Proceeds from issuance of common stock upon initial public offering		146,625,000
Underwriting commisssions and offering expenses		(14,795,756)
Redemption of convertible preferred stock		(52,764,950)
Excess tax benefits from share-based payment arrangements	1,242,896	
Proceeds from the exercise of stock options	913,900	26,000
Net cash (used in) provided by financing activities	(8,292,742)	8,695,978
Cash flows from discontinued operations (revised - see Note 3):		
Operating cash flows	382,814	(2,171,314)

Investing cash flows			(81,576	)
Financing cash flows	(188,463	)	(77,559	)
	194,351		(2,330,449	)
Effect of exchange rate changes on cash and cash equivalents	2,261			
Net increase (decrease) in cash and cash equivalents	(6,520,095	)	3,946,616	
Cash and cash equivalents at the beginning of the period	22,881,553		7,208,875	
Cash and cash equivalents at the end of the period	$ 16,361,458		$ 11,155,491	

The accompanying notes are an integral part of these statements.

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	For the six months ended June 30, 2007	2006
Supplementary disclosures of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 451,941	$ 661,418
Interest	$ 2,524,707	$ 4,209,919
Other noncash investing and financing activities:		
Assets acquired under capital lease	$	$ 220,279
Liabilities assumed from acquisitions	$ 964,049	$ 1,013,143

The accompanying notes are an integral part of these statements.

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CLAYTON HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1 Organization, Description of Business and Basis of Presentation

Clayton Holdings, Inc. (collectively with its wholly owned subsidiaries, the Company) was formed on March 31, 2005 as a Delaware corporation. The Company was formed to combine two companies which were under common control, GRP Holdings, Inc. (GRP), a Delaware corporation, and TMHC Holdings, Inc. (TMHC), a Delaware corporation. GRP was formed to acquire Clayton Services, Inc. (CSI) and First Madison Services, Inc. (FMS) from unrelated parties on August 2, 2004. TMHC was formed to acquire Clayton Fixed Income Services Inc., formerly known as The Murrayhill Company (CFIS), from an unrelated party on May 24, 2004.

The Company provides a full suite of outsourced services, information-based analytics and specialty consulting for buyers and sellers of, and investors in, mortgage-related loans and securities and other debt instruments. The Company s services include (i) transaction management, which consists of due diligence, conduit support services, professional staffing services, and compliance products and services, (ii) credit risk management and securities surveillance and (iii) special servicing. The Company uses proprietary technology and processes to provide these services across the lifecycle of a loan, from loan origination, aggregation and securities issuance to the surveillance and administration of loans and securities. The Company provides a majority of its services to participants in the non-agency segment of the mortgage-backed securities, or MBS, market and the non-conforming mortgage loan market.

Basis of Presentation

The accompanying condensed consolidated financial statements are unaudited. In the opinion of management, all adjustments, consisting of only normal recurring adjustments considered necessary for a fair presentation, have been included. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (US GAAP) have been condensed or omitted. It is suggested that these unaudited condensed consolidated financial statements be read in conjunction with the consolidated financial statements, accounting policies and notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006, which includes audited financial statements. Results for the interim periods are not necessarily indicative of results for the full year.

Initial Public Offering of Common Stock

On March 29, 2006, the Company sold 8,625,000 shares, inclusive of an over-allotment option of 1,125,000 shares, of its common stock in an initial public offering (IPO) of common stock at a price to the public of $17.00 per share, for net proceeds of approximately $131,800,000 after deducting the underwriting discount and approximately $4,500,000 of offering expenses. The Company used approximately $130,200,000 of the proceeds to pay down indebtedness and to redeem all outstanding shares of redeemable preferred stock, which were issued upon the conversion of the Company s convertible preferred stock. The Company used the remaining approximately $1,600,000 for general corporate purposes. After giving effect to this offering, the Company had 20,516,306 shares of common stock outstanding.

All share information has been adjusted to reflect a 1-for-4 reverse stock split of common stock and class B common stock, which was consummated on March 1, 2006.

Note 2 Summary of Significant Accounting Policies

Significant accounting policies followed by the Company, as summarized below, are in conformity with US GAAP.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company. All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities in the financial statements and accompanying notes. Some of these accounting policies require the application of significant judgment by management in the selection of appropriate assumptions for determining these estimates. By their nature, these judgments are subject to an inherent degree of uncertainty; therefore, the Company cannot give assurance that actual results will not differ significantly from estimated results. Management bases these judgments on the Company s historical experience, management s forecasts and other available information, as appropriate. The most significant estimates reflected in the financial statements include deferred tax assets and liabilities, income tax accruals, valuation allowance for accounts receivable, unbilled receivables, asset impairments, the valuation of stock options and the valuation of intangible assets and assessments of their useful lives, and related party transactions. Actual results could differ from estimated amounts. The Company also makes estimates in determining other ordinary accruals.

Segment Reporting

The Company has three reportable segments which are operated and managed as strategic business units: Transaction Management, Special Servicing and Surveillance. For more information concerning these business segments, see Note 14.

Accounts Receivable and Allowance for Doubtful Accounts

The Company s accounts receivable are due from customers in the normal course of business. Credit decisions are made based on an evaluation of a customers financial condition. Accounts receivable are generally due within 30 days. Interest is not charged on delinquent payments.

The Company makes estimates to determine the amount of the allowance for doubtful accounts necessary to reduce accounts receivable and unbilled receivables to their expected net realizable value. The Company estimates the amount of the required allowance by reviewing the status of significant past-due receivables and by analyzing historical bad debt trends and realization adjustments to revenue. Actual collection experience has not varied significantly from estimates, due primarily to credit policies, the controls and procedures designed to estimate realization adjustments to revenue and a lack of concentrations of accounts receivable. Accounts receivable balances are not collateralized.

Deferred Financing Costs

The Company amortizes the costs that it incurs to obtain debt financing over the terms of the underlying obligations using the effective interest method for the portion of the costs associated with term loan debt and using the straight line method for the portion of the costs associated with the revolving credit facility. The amortization of deferred financing costs is included in interest expense. Unamortized deferred financing costs are included in other assets, net in the accompanying condensed consolidated balance sheets. On February 5, 2007 and on May 4, 2007, the Company repaid $5,000,000 of its outstanding term loan balance on each date and wrote off a proportionate share of the unamortized deferred financing costs associated with the term loan. There were no penalties associated with this repayment. In addition, as a result of the Company s IPO (see Note 1) on March 29, 2006, the Company repaid $70,000,000 of principal on its $150,000,000 term loan and wrote off a proportionate share of the unamortized deferred financing costs associated with the term loan. Losses on extinguishment of $90,332 and $746,002 reflecting these write-offs are reflected in the statements of operations for the six months ended June 30, 2007 and 2006, respectively. Unamortized deferred financing costs at June 30, 2007 and December 31, 2006 were $1,123,714 and $1,287,694, respectively, and are included on the accompanying consolidated balance sheets in other assets, net.

Escrow and Fiduciary Funds

The Company maintains segregated bank accounts in trust for the benefit of clients for payments on mortgage loans serviced for clients. The Company also maintains bank accounts for the benefit of borrowers property tax and hazard insurance premium payments that are escrowed by borrowers. These bank accounts totaled $22,626,421 at June 30, 2007, and have been excluded from the Company s assets and liabilities effective January 1, 2007, because the Company does not have title to or use of the funds. The Company believes this treatment is preferential because it more accurately represents the operations and cash position of the Company.

At December 31, 2006, the Company maintained a restricted cash balance of $11,738,871. This balance represented funds received in connection with certain loan servicing functions the Company performs for a customer. Such funds are received throughout the month and remitted to the customer on a monthly basis. The balance on hand is included in servicer escrow liability in the accompanying condensed consolidated balance sheet at December 31, 2006.

Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, the service has been performed, the fee is fixed and determinable, and collection of the resulting receivable is reasonably assured.

The Company derives most of its revenues from professional service activities. Revenues consisting of billed fees and pass-through expenses are recorded as work is performed and expenses are incurred. Revenues also include expenses billed to clients, which includes travel and other out-of-pocket expenses, and other reimbursable expenses. Based on aggregate volume of all travel expenses incurred for both corporate purposes and client service activities, the Company is eligible to receive certain retroactive volume discounts from several of its travel providers. Such amounts are accrued as earned, are netted against travel and related expenses and historically have not been material. For the three months ended June 30, 2007 and 2006, pass-through expenses included in revenues were $3,546,523 and $6,753,220, respectively. For the six months ended June 30, 2007 and 2006, pass-through expenses included in revenues were $9,090,073 and $13,879,788, respectively.

The Company records provisions for fee adjustments and discretionary pricing adjustments as a reduction of revenues. Revenues recognized, but not yet billed to clients, have been recorded as unbilled receivables in the accompanying condensed consolidated balance sheets.

Cost of Services

Direct cost of operations consists primarily of employee compensation and related payroll benefits, the cost of billable labor assigned to revenue-generating activities as well as corresponding travel and related expenses incurred in providing such services to clients. Direct cost of operations does not include an allocation of overhead costs.

Income Taxes

The Company recognizes deferred income tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred income tax liabilities and assets are determined based on the difference between the financial statement and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The Company recognizes deferred tax assets if it is more likely than not that the assets will be realized in future years and a valuation allowance on the deferred tax assets if they are deemed to be impaired.

The Company adopted FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007 (see Note 9).

Stock-based Compensation

The Company adopted the fair value measurement provisions of SFAS No. 123(R), Share-Based Payment, using the prospective method under which the Company recognizes the compensation expense of a stock-based award to an employee over the vesting period based on the fair value of the award on the grant date consistent with the method described in Note 13.

Concentration of Credit Risk and Significant Customers

At June 30, 2007, 21.8% and 20.4% of the Company s billed and unbilled receivables were related to its two largest clients, respectively. At December 31, 2006, 23.1% and 29.2% of the Company s billed and unbilled receivables, respectively, were related to its two largest clients.

For the three months ended June 30, 2007 and 2006, revenue from the Company s largest two clients accounted for an aggregate of 18.8% and 27.4% of total revenue, respectively. Revenue from one client exceeded 10% of revenue for the three months ended June 30, 2007. Revenue from two clients exceeded 10% of revenue for the three months ended June 30, 2006. This revenue is primarily associated with the Transaction Management segment.

For the six months ended June 30, 2007 and 2006, revenue from the Company s largest two clients accounted for an aggregate of 20.0% and 26.5% of total revenue, respectively. Revenue from one client exceeded 10% of revenue for the six months ended June 30, 2007. Revenue from two clients exceeded 10% of revenue for the six months ended June 30, 2006. This revenue is primarily associated with the Transaction Management segment.

Earnings Per Share

Basic earnings per share is computed by dividing net (loss) income by the weighted-average number of shares of common stock and common stock equivalents outstanding during the period. Diluted earnings per share gives effect to dilutive options, restricted stock awards and units, and other potential common stock outstanding during the period. At June 30, 2007, outstanding options to purchase 52,500 and 37,500 common shares had exercise prices in excess of the average market price of common shares for the three and six month periods ended June 30, 2007. At June 30, 2006, outstanding options to purchase 28,000 and 130,000 common shares had exercise prices in excess of the average market price of common shares for the three and six month periods ended June 30, 2006. These options were not included in the computation of diluted earnings per share for the respective periods because the effect would be antidilutive.

At June 30, 2007, 156,350 shares of restricted stock are excluded from basic weighted average shares of common stock outstanding and included in dilutive shares of common stock using the treasury stock method. Such shares will be included in basic weighted average shares of common stock outstanding when they are no longer contingent upon the satisfaction of all specified conditions. In addition, at June 30, 2007, 15,476 deferred stock units issued under the Company s Non-Employee Directors Compensation Plan have not been included in the diluted earnings per share calculation because their inclusion would have had an antidilutive effect.

The following table presents a reconciliation of the numerators and denominators of basic and diluted earnings per share for the three and six months ended June 30, 2007 and 2006:

	For the three months ended June 30, 2007		For the three months ended June 30, 2006	
	Basic	Diluted	Basic	Diluted
Income from continuing operations	$ 467,162	$ 467,162	$ 3,214,210	$ 3,214,210
Loss from discontinued operations	(820,636)	(820,636)	(862,752)	(862,752)
Net (loss) income	$ (353,474)	$ (353,474)	$ 2,351,458	$ 2,351,458
Weighted average number of common shares outstanding	20,926,048	20,926,048	20,522,449	20,522,449
Effect of dilutive shares		587,927		999,657
Total weighted average number of common shares outstanding	20,926,048	21,513,975	20,522,449	21,522,106
Income per share from continuing operations	$ 0.02	$ 0.02	$ 0.15	$ 0.15
Loss per share from discontinued operations	(0.04)	(0.04)	(0.04)	(0.04)
Net (loss) income per share	$ (0.02)	$ (0.02)	$ 0.11	$ 0.11

	For the six months ended June 30, 2007		For the six months ended June 30, 2006	
	Basic	Diluted	Basic	Diluted
Income from continuing operations	$ 2,096,595	$ 2,096,595	$ 2,326,196	$ 2,326,196
Loss from discontinued operations	(4,733,418)	(4,733,418)	(1,051,897)	(1,051,897)
Net (loss) income	$ (2,636,823)	$ (2,636,823)	$ 1,274,299	$ 1,274,299
Weighted average number of common shares outstanding	20,860,989	20,860,989	16,373,676	16,373,676
Effect of dilutive shares		713,196		929,028
Total weighted average number of common shares outstanding	20,860,989	21,574,185	16,373,676	17,302,704
Income per share from continuing operations	$ 0.10	$ 0.10	$ 0.14	$ 0.13
Loss per share from discontinued operations	(0.23)	(0.23)	(0.06)	(0.06)
Net (loss) income per share	$ (0.13)	$ (0.13)	$ 0.08	$ 0.07

Adoption of New Accounting Pronouncements

The Company adopted FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007 (see Note 9).

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 establishes a common definition for fair value to be applied to US GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS No. 157 on its consolidated financial position and results of operations.

Foreign Currency Translation

The functional currency for Clayton s foreign operations is the local currency. The Company translates income statement amounts at average exchange rates for the period, and assets and liabilities are translated at end-of-period exchange rates. These translation adjustments are recorded in Accumulated Other Comprehensive Income, a separate component of Stockholders Equity, in the Company s consolidated balance sheets. Exchange gains and losses on intercompany foreign currency transactions of a long-term nature are reported in Accumulated Other Comprehensive Income. Other exchange gains and losses are reported in income.

Reclassifications

Certain reclassifications have been made to prior periods financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

Note 3 Recent Transactions

Acquisition of Euro Risk Management Limited, Bristol

On April 10, 2007, the Company completed the acquisition of Euro Risk Management Limited, Bristol, (subsequently renamed Clayton Euro Risk (CER)) a credit and risk consultancy operating in the United Kingdom, Italy and Holland for an aggregate purchase price of $2,959,829. Dependant on the exchange rate at the time of payment, the purchase price may be increased by up to an additional $2,500,000 based on future earnings. This acquisition was not presented on a pro forma basis because it was not deemed to be material.

The purchase price was allocated as follows:

Accounts receivable	$	1,193,508
Goodwill		163,298
Intangible assets customer relationships		2,368,689
Intangible assets noncompetition agreement		198,383
Liabilities assumed		(964,049)
	$	2,959,829

Asset Purchase from M R Network I, Ltd.

On February 3, 2006, the Company entered into an asset purchase agreement through a subsidiary pursuant to which the subsidiary acquired substantially all of the assets and assumed certain liabilities of M R Network I, Ltd. (formerly d/b/a Mortgage Resource Network and thereafter d/b/a Clayton Lender Solutions, Inc. (CLS)) for an aggregate purchase price of $5,344,970. This acquisition was not presented on a pro forma basis because it was not deemed to be material.

The purchase price was allocated as follows:

Accounts receivable	$	952,943
Prepaid expenses		19,030
Property and equipment		957,792
Goodwill		3,558,177
Intangible assets customer relationships		771,000
Intangible assets noncompetition agreement		74,000
Deposit		25,986
Liabilities assumed		(1,013,958)
	$	5,344,970

Discontinued Operations

On March 28, 2007, the Company s Board of Directors approved the recommendation of management that it discontinue the operations of CLS. The pre-tax charge recorded during the first quarter of 2007 in connection with the CLS shutdown was $4,735,777 ($2,944,706, after tax) and consisted of a pre-tax non-cash impairment charge related to the impairment of goodwill, intangible assets and property and equipment. During the second quarter of 2007, the Company recorded a $517,371 pre-tax ($385,718, after tax) adjustment to the previously estimated loss on disposal which consisted of facility closure costs and the write off of property and equipment. CLS ceased operations on June 30, 2007.

In accordance with SFAS No. 144, any component of the Company s business that is disposed of or is classified as held for sale that has operations and cash flows clearly distinguishable from operations, and for financial reporting purposes, and that will be eliminated from the ongoing operations, should be classified as discontinued operations. Accordingly, the Company has classified the results of operations of CLS as discontinued operations in the consolidated statement of operations and has restated prior periods.

Summarized financial information for CLS (discontinued operations) is set forth below:

	For the Three Months Ended June 30, 2007	2006	For the Six Months Ended June 30, 2007	2006
Revenue	$ 196,228	$ 1,906,982	$ 739,626	$ 3,189,665
Operating loss	(647,440)	(1,458,117)	(2,171,496)	(1,778,534)
Income tax benefit	221,251	624,749	810,058	761,719
Net loss	(434,918)	(862,752)	(1,402,994)	(1,051,897)
Loss on disposal, net of tax	(385,718)		(3,330,424)	

	December 31, 2006
Net property and equipment	$ 743,117
Goodwill	3,558,177
Other intangibles	713,642
Total assets of discontinued operations	$ 5,014,936

At December 31, 2006, liabilities of discontinued operations represent deferred rent.

Note 4 Cash, Cash Equivalents and Restricted Cash

At June 30, 2007 and December 31, 2006, the Company maintained cash and cash equivalent balances in excess of $100,000 at two separate financial institutions. Accounts at these institutions are insured by the Federal Deposit Insurance Corporation up to $100,000. At June 30, 2007 and December 31, 2006, the cash balances exceeded $100,000 by $17,455,479 and $31,862,444, respectively, including restricted cash at December 31, 2006.

Note 5 Property and Equipment, net

Property and equipment, net consists of the following:

	June 30, 2007	December 31, 2006
Computer and office equipment	$ 11,299,483	$ 10,013,262
Software	18,035,158	17,461,869
Furniture and fixtures	3,304,040	3,105,350
Leasehold improvements	2,501,011	1,814,635
Website	280,317	280,317
Automobiles	108,883	112,336
	35,528,892	32,787,769
Less accumulated depreciation and amortization	17,914,157	13,748,487
	17,614,735	19,039,282
Construction in progress	1,016,292	65,925
Software under development	249,469	516,542
	$ 18,880,496	$ 19,621,749

Included in software at June 30, 2007 and December 31, 2006, is $10,585,417 and $10,383,256, respectively, of internally developed software placed in service. Software under development represents other internally developed software that has not yet been placed in service.

For the three months ended June 30, 2007 and 2006 depreciation and amortization expense charged to operations was $2,432,600 and $1,864,260, respectively. For the six months ended June 30, 2007 and 2006 depreciation and amortization expense charged to operations was $4,487,608 and $3,365,728, respectively.

Note 6 Goodwill and Other Intangible Assets

As of June 30, 2007 and December 31, 2006, intangible assets not subject to amortization consisted of goodwill of $70,008,615 and $69,843,468, respectively, and trade names and trademarks of $15,504,917.

At June 30, 2007, the Company s intangible assets with identifiable useful lives, which continue to be amortized, consisted of the following:

	Gross carrying amount	Accumulated amortization	Net
Customer relationships			
Transaction management and advisory	$ 38,795,522	$ 5,958,036	$ 32,837,486
Staffing services	4,300,000	1,254,167	3,045,833
Portfolio management	10,008,599	3,059,075	6,949,524
Client backlog	2,146,200	1,332,721	813,479
Technology	26,842,900	15,772,876	11,070,024
Noncompetition agreements	3,695,580	2,105,504	1,590,076
Patent	20,452	11,667	8,785
	$ 85,809,253	$ 29,494,046	$ 56,315,207

At December 31, 2006, the Company s intangible assets with identifiable useful lives, which continue to be amortized, consisted of the following:

	Gross carrying amount	Accumulated amortization	Net
Customer relationships			
Transaction management and advisory	$ 36,400,000	$ 4,887,037	$ 31,512,963
Staffing services	4,300,000	1,039,167	3,260,833
Portfolio management	10,008,599	2,548,308	7,460,291
Client backlog	2,146,200	1,118,101	1,028,099
Technology	26,842,900	13,088,586	13,754,314
Noncompetition agreements	3,494,950	1,734,880	1,760,070
Patent	20,452	8,259	12,193
	$ 83,213,101	$ 24,424,338	$ 58,788,763

In connection with the CLS shutdown, in March 2007 the Company recorded an impairment charge of $4,735,777 to reflect the write-off of goodwill and intangible assets.

In December 2006, the Company recorded an impairment charge of $279,458 to reflect the write-off of certain customer relationships associated with portfolio management.

Amortization expense for the three months ended June 30, 2007 and 2006 was $2,571,240 and $2,541,870, respectively. Amortization expense for the six months ended June 30, 2007 and 2006 was $5,068,985 and $5,083,722, respectively.

Note 7 Revolving Credit Facility, Long-Term Debt and Capital Lease Obligations

Long-term debt and capital lease obligations consist of the following:

	June 30, 2007	December 31, 2006
Term loans	$ 54,286,188	$ 64,598,998
Capital lease obligations	487,315	753,201
Total long-term debt	54,773,503	65,352,199
Less current portion	742,975	928,633
Long-term debt, net of current portion	$ 54,030,528	$ 64,423,566

Credit Agreement

On December 8, 2005 the Company entered into a credit agreement (the Credit Agreement) with a financial institution. The Credit Agreement provided the Company with a $150,000,000 term loan, all of which was funded at closing, and a $40,000,000 revolving credit facility, none of which was funded at closing. Subject to the agreement of the lenders to increase their commitments, the Company had the option to borrow up to an additional $10,000,000 under the revolving credit facility, for an aggregate revolving credit facility of $50,000,000. On January 11, 2006 and April 28, 2006, the Company exercised its option and amended the Credit Agreement to increase the revolving credit facility by $5,000,000 on each date, such that the Company had an aggregate revolving credit facility of $50,000,000 as of, and subsequent to, April 28, 2006.

After the Company s initial public offering was completed on March 29, 2006 the Company repaid $70,000,000 of the $150,000,000 outstanding term loan balance without incurring any prepayment penalty. In addition, $7,400,000 which was outstanding under the revolving credit facility was repaid. In both February 2007 and May 2007, the Company prepaid $5,000,000 outstanding under the term loan.

The Credit Agreement terminates on December 8, 2011. Principal repayments on the term loan of $137,433 are required on a quarterly basis for each quarter through 2010, and the remaining principal balance at the end of 2010 is repayable in equal quarterly installments during 2011. This facility can be used to fund acquisitions requiring cash, as well as to fund short-term liquidity needs. Liquidity needs occasionally arise as a result of differences in the timing between collecting accounts receivable and making disbursements to support operations.

The Credit Agreement is collateralized by substantially all of the assets of the Company. The Credit Agreement contains covenants which, among other matters, require the Company to maintain certain interest coverage, fixed charge and total leverage ratios. These covenants became effective on March 31, 2006. The Company is in compliance with these covenants as of June 30, 2007. In addition, the Credit Agreement places limitations on total annual capital expenditures, indebtedness, liens, dividends and distributions, asset sales, transactions with affiliates, acquisitions and conduct of business, all as defined in the agreement. The Credit Agreement also contains provisions for an increased rate of interest during periods of default.

On March 15, 2007, the terms of the Credit Agreement were amended. The amendment lowered the interest rate on borrowings under the Credit Agreement to the applicable London interbank offered rate (LIBOR) plus 1.75%, or Prime Rate plus 0.75%, at the Company s option. Prior to the amendment, loans under the Credit Agreement bore interest at LIBOR plus 3.00% or Prime rate plus 2.00%, at the Company s option. In addition, the Company is required to pay a commitment fee of 0.5% based on the calculation of the excess of the revolving credit loan commitment over the revolving outstanding balance as defined in the Credit Agreement.

At June 30, 2007 and December 31, 2006, the revolving credit facility had no outstanding balance and there was an outstanding balance of $54,286,188 and $64,598,998, respectively, under the term loan with an interest rate of 7.07% and 8.55%, respectively.

On July 27, 2007 the Company repaid $5,000,000 outstanding under the term loan.

Capitalized Lease Obligations

At June 30, 2007, the Company leased $707,123 of equipment under agreements accounted for as capital leases with accumulated depreciation of $355,961. The obligations for the equipment require the Company to make monthly payments through March 2011, with implicit interest rates from 7.06% to 19.06%.

At December 31, 2006, the Company leased $1,068,087 of equipment under agreements accounted for as capital leases with accumulated depreciation of $311,169. The obligations for the equipment require the Company to make monthly payments through August 2011, with implicit interest rates from 7.06% to 19.06%.

Note 8 Preferred Stock

On March 29, 2006, the Company completed its initial public offering of common stock, resulting in the conversion of the Series A Convertible Preferred Stock into 2,206,308 shares of common stock, par value $0.01 per share, and 8,825,241 shares of Series A Redeemable Preferred Stock, and the conversion of 24,185,493 shares of Series B Convertible Preferred Stock into 6,046,371 shares of common stock, par value $0.01 per share, and 24,185,493 shares of Series B Redeemable Preferred Stock. A portion of the proceeds from the initial public offering was used to redeem all shares of the Series A Redeemable Preferred Stock and Series B Redeemable Preferred Stock for $52,764,950, and all of the Series A and Series B Redeemable Preferred Stock were immediately retired. The difference between the liquidation preference amount of the convertible preferred stock and the redemption amount of the redeemable preferred stock was allocated to the common stock resulting from the conversion and credited to additional paid-in capital.

Note 9 Income Taxes

On January 1, 2007, the Company adopted FIN 48. As a result of the implementation of FIN 48, the Company recognized an increase of $1,800,000 in the liability for unrecognized tax benefits, which was accounted for as a decrease to the January 1, 2007 balance of retained earnings. As of the date of adoption and after the impact of recognizing the increase in liability noted above, the Company s unrecognized tax benefits totaled $1,943,000, all of which would impact the effective income tax rate if recognized. Within the next twelve months, it is not expected that there will be any material changes to this balance.

The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits within its operations in income tax expense. In conjunction with the adoption of FIN 48, the Company recognized approximately $64,000 for the payment of interest and penalties at January 1, 2007 which is included as a component of the $1,800,000 unrecognized tax benefit noted above. There were no significant changes to these amounts during the six months ended June 30, 2007.

The Company and its subsidiaries file income tax returns in the United States Federal jurisdiction and in various state and foreign jurisdictions. With few exceptions, the Company is subject to U.S. Federal, and to state and local income tax examinations for the tax years 2004 through 2006 and is subject to foreign income tax examinations for the period ended December 31, 2006.

Note 10 Commitments and Contingencies

Operating Leases

The Company leases its office facilities and certain equipment under operating lease arrangements expiring on various dates through 2017, unless terminated earlier. Such leases include fixed or minimum payments plus, in some cases, scheduled base rent increases over the term of the lease and additional rents based on the Consumer Price Index. Certain leases provide for monthly payments of real estate taxes, insurance and other operating expenses applicable to the property.

For the three months ended June 30, 2007 and 2006, rent expense was approximately $1,226,234 and $928,066, respectively. For the six months ended June 30, 2007 and 2006, rent expense was approximately $2,456,336 and $1,840,137, respectively.

Litigation

In the normal course of business, the Company is subject to various legal proceedings and claims, the resolution of which, in management s opinion, will not have a material adverse effect on the financial position or the results of operations of the Company.

Note 11 Common Stock

Prior to the initial public offering, the Company s outstanding capital stock consisted of: (i) 3,281,607 shares of common stock, par value $0.01 per share; (ii) 357,020 shares of Class B common stock, par value $0.01 per share; (iii) 8,825,241 shares of Series A Convertible Preferred Stock, par value $0.01 per share; and (iv) 24,185,493 shares of Series B Convertible Preferred Stock, par value $0.01 per share.

In connection with, and upon the completion of, the initial public offering on March 29, 2006, 8,825,241 shares of Series A Convertible Preferred Stock were converted into 2,206,308 shares of common stock and 8,825,241 shares of Series A Redeemable Preferred Stock, and 24,185,493 shares of Series B Convertible Preferred Stock were converted into 6,046,371 shares of common stock and 24,185,493 shares of Series B Redeemable Preferred Stock.

Upon the consummation of the initial public offering, all outstanding shares of Class B common stock were converted into 357,020 shares of common stock, par value $0.01 per share, and each share of Class B common stock was retired.

Inclusive of an over-allotment option of 1,125,000 shares of its common stock, the Company sold 8,625,000 shares of common stock in its initial public offering at a price to the public of $17.00 per share, for net proceeds of approximately $131,800,000 after deducting the underwriting discount and approximately $4,500,000 of offering expenses. After giving effect to this offering and the conversion transactions described above, the Company had 20,516,306 shares of common stock outstanding as of March 29, 2006.

On March 29, 2006, in connection with the Company s initial public offering, the Fourth Amended and Restated Certificate of Incorporation, which was adopted by the stockholders prior to the initial public offering, was filed with the State of Delaware. The Company s Certificate of Incorporation was amended to change the authorized capital stock of the Company from an aggregate of 160,000,000 shares, consisting of (a) 69,673,021 shares of preferred stock, par value $0.01 per share, consisting of Series A Convertible Preferred Stock, Series B Convertible Preferred Stock, Series A Redeemable Preferred Stock and Series B Redeemable Preferred Stock, (b) 80,326,979 shares of common stock, consisting of common stock and Class B common stock, and (c) 10,000,000 shares of undesignated preferred stock to a total of 160,000,000 shares of capital stock consisting of (i) 150,000,000 shares of common stock, par value $0.01 per share, and (ii) 10,000,000 shares of undesignated preferred stock, par value $0.01 per share.

All share information has been adjusted to reflect a 1-for-4 reverse stock split of common stock and Class B common stock, which was consummated on March 1, 2006.

At June 30, 2007, the Company had 150,000,000 shares of common stock authorized, of which 21,105,813 and 20,688,556 were issued and outstanding at June 30, 2007 and December 31, 2006, respectively.

Note 12 Related Party Transactions

On March 29, 2006 the Company paid $52,764,950 from proceeds from its IPO to redeem from investment funds affiliated with TA Associates and other preferred stockholders, including Brian L. Libman, a director of the Company, all of the shares of redeemable preferred stock outstanding immediately following the conversion of Series A Convertible Preferred Stock and Series B Convertible Preferred Stock.

The Company s chief executive officer, who was appointed in April 2005, has served on the Board of Directors of another public company since 1995 and is currently the chairman of this entity s audit committee. This unrelated entity acquires and originates non-conforming residential and commercial loans. The Company has provided due diligence and professional staffing services to this entity. The Company received no revenues from this entity for the three and six months ended June 30, 2007 or 2006.

The Company has contracts to perform services for portfolios managed by a stockholder. Revenues generated from the contracts for the three months ended June 30, 2007 and 2006 were approximately $35,191 and $163,926, respectively. Revenues generated from the contracts for the six months ended June 30, 2007 and 2006 were approximately $95,165 and $313,723, respectively. Accounts receivable from this party at June 30, 2007 and December 31, 2006, were $29,859 and $141,056, respectively. Certain of these contracts were cancelled effective December 31, 2006.

Note 13 Stock Plans

On January 26, 2006, the Company s Board of Directors approved the adoption of the Company s 2006 Stock Option and Incentive Plan (2006 Option Plan), and the 2006 Option Plan was subsequently approved by stockholders on March 8, 2006. The 2006 Option Plan permits grants of incentive stock options, non-qualified stock options, stock appreciation rights, deferred stock awards, restricted stock awards, unrestricted stock awards and dividend equivalent rights. The Company reserved 1,814,130 shares of common stock for issuance of awards under the 2006 Option Plan, subject to adjustment for any stock split, dividend or other change in the Company s capitalization. Generally, shares that are forfeited or cancelled from awards under the 2006 Option Plan will be available for future grants. Stock options granted under the 2006 Option Plan have a maximum term of ten years from the date of grant and incentive stock option awards have an exercise price of no less than the fair market value of the common stock on the date of grant, which will be on the last day of the month of the award. The options generally vest over a period of four years, with 25% of each grant vesting after one year and the remaining shares vesting monthly over the following three years. The Company issues new shares upon the exercise of stock options. Cash received upon the exercise of options for the six months ended June 30, 2007 and 2006 was $913,900 and $26,000, respectively.

Changes in options outstanding during the six months ended June 30, 2007 are as follows:

	Number of Shares	**Weighted Average Exercise Price**
Options outstanding, January 1, 2007	1,470,774	$ 6.33
Granted	15,000	16.38
Exercised	260,907	3.48
Forfeited	88,644	9.63
Expired	3,290	7.64
Options outstanding, June 30, 2007	1,132,933	$ 6.86
Weighted average fair value of options granted for the six months ended June 30, 2007		$ 6.72
Options available for future grant at June 30, 2007		1,624,630

The intrinsic value of options exercised during the six months ended June 30, 2007 was approximately $4,200,000.

Changes in unvested restricted stock outstanding during the six months ended June 30, 2007 are as follows:

	Number of Shares	Weighted Average Grant Date Fair Value	Aggregate Fair Value at June 30, 2007
Unvested shares outstanding, January 1, 2007		$	$
Granted	165,000	18.48	1,879,350
Vested			
Cancelled or forfeited	8,650	18.48	
Unvested shares outstanding, June 30, 2007	156,350	$ 18.48	$ 1,780,827

The Company recorded compensation expense of approximately $151,000 and $277,000 related to restricted stock for the three and six months ended June 30, 2007, respectively. In addition, the Company will recognize approximately $2,600,000 of expense related to these grants over the remaining vesting period of such shares of 3.6 years.

During the six months ended June 30, 2007, the Company granted 15,476 deferred stock awards to members of its Board of Directors under the Company s Non-Employee Directors Deferred Compensation Plan. The Company recorded compensation expense of approximately $47,000 and $57,000 related to these awards for the three and six months ended June 30, 2007. In addition, the Company will recognize approximately $212,000 of expense related to these grants over the remaining vesting period of such awards.

The following table summarizes information about stock options at June 30, 2007:

June 30, 2007

	Options Outstanding			Options Exercisable		
Exercise Price	**Number Outstanding**	**Remaining Contractual Life (yrs.)**	**Aggregate Intrinsic Value as of June 30, 2007**	**Number Exercisable**	**Weighted Average Exercise Price**	**Aggregate Intrinsic Value as of June 30, 2007**
$ 0.98-0.98	147,524	7.41	$ 1,536,380	122,707	$ 0.98	$ 1,277,925
4.00-6.00	606,816	7.73	3,438,313	518,990	5.70	2,952,866
6.36-6.80	189,093	8.22	886,002	105,373	6.72	492,150
12.34-17.00	152,000	8.99		37,067	14.54	
18.46-21.38	37,500	9.27		4,009	20.97	
	1,132,933	7.99	$ 5,860,695	788,146	5.59	$ 4,722,941

The weighted average contractual life of options exercisable at June 30, 2007 was 7.80 years.

The weighted average fair value of options granted during the six months ended June 30, 2006 was $5.87. The aggregate intrinsic value of options outstanding and exercisable at June 30, 2006 was approximately $12,236,000 and $7,668,000, respectively.

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123(R), Accounting for Stock Based Compensation which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires an issuer to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This eliminates the exception to account for such awards using the intrinsic method previously allowable under Accounting Principles Board (APB) Opinion No. 25. In March 2005, the SEC released Staff Accounting Bulletin (SAB) 107, Share-Based Payment, which expresses views of the SEC staff about the application of SFAS No. 123(R). SFAS No. 123(R) became effective for annual reporting periods beginning on or after June 15, 2005. The Company previously adopted the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, for all awards granted to employees. On January 1, 2006 the Company adopted SFAS No. 123(R) and it did not have a material impact on the Company s financial statements.

The Company completed its initial public offering on March 29, 2006. According to the provisions of incentive stock option agreements between the Company and its employees, the vesting term for certain options outstanding as of the date of the IPO accelerated by either one year or twenty percent, varying in accordance with the terms of the employee s specific incentive stock option agreement. In addition, 130,208 of performance based options became immediately vested. Therefore, on March 29, 2006 the Company recognized $611,696 of additional compensation expense from this accelerated vesting.

The ongoing effect on consolidated results of operations of financial condition will be dependent upon future stock based compensation awards granted. The Company utilizes the Black-Scholes option valuation method to calculate the fair market value of the options using assumptions in effect on the date of the grant, as follows:

	Six Months Ended June 30, 2007		June 30, 2006	
Expected life (in years)	7.0		6.5 7.5	
Risk-free interest rate	4.5	%	4.7 5.1	%
Volatility	28	%	25	%
Dividend	0	%	0	%

For the three months ended June 30, 2007 and 2006 the Company recognized expenses related to the stock option grants summarized above over the vesting period of such options of approximately $143,000 and $138,000, respectively. For the six months ended June 30, 2007 and 2006 the Company recognized expenses related to stock option grants of approximately $307,000 and $853,000, respectively. In addition, the Company will recognize approximately $1,200,000 of expense related to these grants over the remaining vesting period of such options. This expense is expected to be recognized over a weighted-average period of 2.5 years.

Note 14 Segment Information

Reportable Segments

The Company has organized its business portfolio into three reportable segments to reflect its business strategy. The Company measures and evaluates its reportable segments based on segment operating income. The Company generally accounts for intersegment transactions at cost. Segment operating income is equal to gross profit less direct selling, general and administrative expenses. The Company s segments and their principal activities consist of the following:

Transaction Management

The transaction management segment provides a full range of outsourced transaction management services to clients, including:

- due diligence services - assisting loan buyers and sellers in making decisions on how they price portfolios and manage risk;

- conduit support services - providing the technology and systems required to manage key aspects of a buyer s loan acquisition pipeline, including overall process management, due diligence, fulfillment, funding and integration with third-party service providers;

- compliance products and services - providing proprietary compliance testing engine through the High Cost Analyzer suite to market participants including loan originators;

- professional staffing services providing access to qualified independent mortgage loan professionals to clients to augment their staffs on both a long- and short-term basis; and

- consulting services providing advice to clients on issues related to business process improvement, risk management, regulatory compliance, and technology enablement.

Special Servicing

The special servicing segment provides comprehensive loan management for defaulted and delinquent loans and reverse mortgages, collection management, oversight and reporting, foreclosure and bankruptcy administration, eviction and real estate owned disposition oversight.

Surveillance

The surveillance segment provides credit risk management and surveillance services consisting of the oversight and monitoring of predominantly residential non-agency MBS to MBS underwriters, issuers and investors.

The following tables provide operating financial information for the Company s three reportable segments:

	For the Three Months Ended June 30, 2007			
	Transaction Management	**Special Servicing**	**Surveillance**	**Total Segments**
Revenue	$ 28,086,147	$ 2,434,438	$ 12,632,874	$ 43,153,459
Depreciation and amortization	3,437,515	429,044	1,137,281	5,003,840
Segment operating income	6,484,503	504,774	7,722,152	14,711,429
Capital expenditures	123,263		12,143	135,406

	For the Three Months Ended June 30, 2006			
	Transaction Management	**Special Servicing**	**Surveillance**	**Total Segments**
Revenue	$ 48,238,610	$ 3,408,328	$ 8,250,114	$ 59,897,052
Depreciation and amortization	3,436,560	324,165	645,405	4,406,130
Segment operating income	11,415,371	1,815,546	4,785,501	18,016,418
Capital expenditures	2,075,359	95,000	52,514	2,222,873

	For the Six Months Ended June 30, 2007			
	Transaction Management	**Special Servicing**	**Surveillance**	**Total Segments**
Revenue	$ 67,963,126	$ 4,179,908	$ 24,362,590	$ 96,505,624
Depreciation and amortization	6,637,396	826,746	2,092,451	9,556,593
Segment operating income	16,773,260	88,914	14,469,247	31,331,421
Capital expenditures	2,803,017	12,526	14,567	2,830,110

	For the Six Months Ended June 30, 2006 Transaction Management		Special Servicing		Surveillance		Total Segments	
Revenue	$	91,778,873	$	6,318,797	$	15,744,311	$	113,841,981
Depreciation and amortization	6,601,257		619,942		1,228,251		8,449,450	
Segment operating income	18,863,885		3,297,715		9,106,684		31,268,284	
Capital expenditures	3,713,466		187,842		155,936		4,057,244	

The following tables are reconciliations of certain segment items to the total consolidated amount:

	For the Three Months Ended June 30, 2007		2006		For the Six Months Ended June 30, 2007		2006	
Segment Operating Income:								
Total consolidated segment operating income	$	14,711,429	$	$ 18,016,418	$	31,331,421	31,268,284	
Direct selling, general and administrative expenses	3,155,624		2,993,590		6,146,694		5,715,523	
Consolidated reported gross profit	$	17,867,053	$	21,010,008	$	37,478,115	$	36,983,807

	For the Three Months Ended June 30, 2007		2006		For the Six Months Ended June 30, 2007		2006	
Capital Expenditures:								
Total segment capital expenditures	$	135,406	$	2,222,873	$	2,830,110	$	4,057,244
General assets	1,029,304		171,463		1,169,567		1,292,672	
Consolidated capital expenditures	$	1,164,710	$	2,394,336	$	3,999,677	$	5,349,916

Note 15 Subsequent Event

On July 27, 2007, the Company prepaid $5,000,000 of its outstanding term loan balance. There were no penalties associated with this payment. At June 30, 2007, the $5,000,000 used to make this payment was included in cash and cash equivalents in the accompanying condensed consolidated balance sheet.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements and Projections

This Quarterly Report on Form 10-Q contains forward looking statements. Forward looking statements relate to future events or our future financial performance. We generally identify forward looking statements by terminology such as may, will, should, expects, plans, anticipates, could, intends, target, projects, contemplates, believes, estimates, predicts, potential or continue or the negative of these terms or other similar words. These statements are only predictions. We have based these forward looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, results of operations and financial condition. The outcome of the events described in these forward looking statements is subject to risks, uncertainties and other factors described in Management s Discussion and Analysis of Financial Condition and Results of Operations, elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2006. Accordingly, you should not rely upon forward looking statements as predictions of future events. We cannot assure you that the events and circumstances reflected in the forward looking statements will be achieved or occur, and actual results could differ materially from those projected in the forward looking statements. The forward looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

Overview

We provide a full suite of outsourced services, mortgage-related analytics and specialized consulting services for buyers and sellers of, and investors in, mortgage-related loans and securitizations. Our services include transaction management, which consists of due diligence and mortgage processing services for buyers of mortgage loans (conduit support services), professional staffing services, and compliance products and services, oversight and reporting on mortgage-backed securities (credit risk management and surveillance), and specialized loan servicing (special servicing) and consulting services. We provide a majority of our services to participants in the non-agency mortgage-backed securities, or MBS, market and the non-conforming mortgage loan market. We believe that several factors support the demand for our services, including:

- the desire for outsourced services by capital markets firms and other major mortgage loan market participants;
- the increased complexities and requirements of federal, state and local regulations applicable to the mortgage loan industry; and,
- investors growing demand for operational risk assessment and loan performance data.

Our revenue is also driven by non-agency MBS issuance and the aggregate number of non-conforming mortgage loan originations. Changes in the volume of non-agency MBS issuances and non-conforming mortgage loan originations may impact the number of loans for which we perform our services, leading to a corresponding change in gross revenue. We are increasingly utilizing our centralized underwriting facilities to perform our services which should reduce the amount of per loan travel expenses.

We believe the volume of non-agency MBS securitizations and non-conforming mortgage loan originations will be lower in 2007 than in 2006. We do not expect that these markets will experience significant growth in the short term, but they could experience moderate growth over the long term. We believe there will be continued demand for new loan products and increased home ownership driven in part by first-time homeowners, minorities and immigrants. We face a number of risks in our industry and the market for our services is highly competitive. Our business is driven in part by the MBS market, the mortgage lending industry and the housing market, each of which is highly sensitive to trends in the general economy, including interest rates, perceived and actual economic conditions, taxation policies, availability of credit, employment levels, more strict underwriting guidelines in effect at a given time and wage and salary levels. Adverse changes in any of these trends, the recent downturn in the non-prime mortgage loan market, including the failure of additional non-prime lenders, the failure of hedge funds that invest in mortgage-backed securities, additional downgrades of mortgage-backed securities by the major rating agencies, or a decline in the sale of both new and existing homes or in home values, could lessen the demand for mortgage loans, which could result over time in a reduced demand for our services and diminish our revenue. A material reduction in the number of loans available for securitization may cause our clients to engage us for fewer services, which could have an adverse effect on our business and results of operations. Moreover, the majority of our business is generated through our largest 20 clients. The loss of one or more of these clients could adversely affect our business and results of operations. Lastly, we are dependent on our independent loan review specialists to perform our services. Our business could suffer if we are unable to recruit and retain additional qualified independent loan review specialists.

Basis of Presentation

We were formed as a Delaware corporation in March 2005, following the combination of the holding companies of each of Clayton Services and its subsidiaries, including FMS and CFIS. Prior to the combination, each holding company was controlled by investment funds affiliated with TA Associates. In accordance with US GAAP relating to companies under common control prior to their combination, the financial statements of the previously separate companies under common control are restated on a combined basis from the dates of their respective acquisitions by the controlling entity. Accordingly, for accounting purposes, the date of our inception was May 24, 2004, the date that investment funds affiliated with TA Associates acquired CFIS, the first of the combined entities that were brought under common control.

Critical Accounting Policies

Basis of Presentation

Our condensed consolidated financial statements are unaudited. In our opinion, all adjustments, consisting of only normal recurring adjustments considered necessary for a fair presentation, have been included. Certain information and footnote disclosures normally included in financial statements prepared in accordance with US GAAP have been condensed or omitted. It is suggested that these unaudited condensed consolidated financial statements be read in conjunction with the consolidated financial statements, accounting policies and notes included in our Annual Report on Form 10-K for the year ended December 31, 2006, which includes audited financial statements. Results for the interim periods are not necessarily indicative of results for the full year.

In preparing our financial statements in conformity with US GAAP, we have to make estimates and assumptions about future events that affect the amounts of reported assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities in the financial statements and accompanying notes. Some of our accounting policies require the application of significant judgment by management in the selection of appropriate assumptions for determining these estimates. By their nature, these judgments are subject to an inherent degree of uncertainty; therefore, we cannot assure you that actual results will not differ significantly from estimated results. We base these judgments on our historical experience, management s forecasts and other available information, as appropriate.

Our most critical accounting policies, which reflect significant management estimates and judgment in determining reported amounts in the consolidated financial statements are as follows:

Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, the service has been performed, the fee is fixed and determinable, and collection of the resulting receivable is reasonably assured.

We derive most of our revenue from professional service activities. Revenue consisting of billed fees and pass-through expenses is recorded as work is performed and expenses are incurred. Revenue also includes expenses billed to clients, which include travel and other out-of-pocket expenses, and other reimbursable expenses.

We record provisions for fee adjustments and discretionary pricing adjustments as a reduction of revenue. Revenue recognized, but not yet billed to clients, has been recorded as unbilled receivables in the Company s consolidated balance sheets.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123(R), Accounting for Stock Based Compensation which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. On January 1, 2006 we adopted SFAS No. 123(R) and it did not have a material impact on our financial statements.

According to the provisions of our incentive stock option agreements, the vesting term for certain options outstanding as of the date of our IPO accelerated by either one year or twenty percent, varying in accordance with the terms of the employee s specific incentive stock option agreement. In addition, 130,208 of performance based options became immediately vested. As a result, on March 29, 2006, we recognized $611,696 of additional compensation expense from this accelerated vesting.

We granted options to purchase 15,000 shares in the six months ended June 30, 2007 with an average exercise price of $16.38 per share.

On January 30, 2007, we granted 165,000 shares of restricted stock at the closing stock price on that day of $18.48 per share.

During the six months ended June 30, 2007, we granted 15,476 deferred stock units to members of our Board of Directors under the Non-Employee Directors Deferred Compensation Plan.

Valuation of Long-lived Assets Excluding Goodwill

We evaluate all of our long-lived assets, including intangible assets other than goodwill and fixed assets, periodically for impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-lived Assets (SFAS No. 144). SFAS No. 144 requires that long-lived assets be evaluated for impairment when events or changes in facts and circumstances indicate that their carrying value may not be recoverable. If events or circumstances indicate that the carrying value of an asset may not be recoverable, we assess the recoverability of identified intangible assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. The amount of impairment will be measured as the difference between the carrying value and the fair value of the impaired asset. An impairment will be recorded as an operating expense in the period of the impairment and as a reduction in the carrying value of that asset.

Accounts Receivable

We are required to estimate the collectibility of accounts receivable. A considerable amount of judgment is required in assessing the likelihood of realization of receivables. Relevant assessment factors include the creditworthiness of the customer, our prior collection history with the customer and related aging of past due balances. Specific accounts receivable are evaluated when we believe a customer may not be able to meet its financial obligations due to a deterioration of its financial condition or its credit ratings. The allowance requirements are based on the best facts available and are re-evaluated and adjusted on a regular basis and as additional information is received.

Intangible Assets

Intangible assets consist of customer relationships, technology, trade name and trademarks, non-competition agreements and excess of cost over fair value of net assets acquired, or goodwill. Customer relationships are the value of the specifically acquired customer relationships. Technology is the value of recreating the completed technology infrastructure. Trade name and trademarks are the value inherent in the recognition of Clayton and the other names that we use. The value of the non-competition agreements are an appraisal of potential lost revenues that would arise from an individual initiating a competing enterprise.

Except for goodwill, trade names and trademarks, all intangible assets are stated at cost less accumulated amortization. The costs attributable to the identified intangibles were based on a number of significant assumptions as determined by us and our independent appraisal expert. Identifiable intangible assets with finite lives are amortized under the straight-line method over their applicable estimated useful lives.

We adopted SFAS No. 142 Goodwill and Other Intangible Assets (SFAS No. 142), which provides, among other things, that goodwill and intangibles with indefinite lives are no longer amortized but are reviewed for impairment at least annually (beginning with the first anniversary of the acquisition date). Annual impairment tests were conducted for Clayton Services and CFIS in 2007 and there was no impairment to goodwill or intangibles with indefinite lives of either entity.

On March 28, 2007, our Board of Directors approved the recommendation of management that it discontinue the operations of CLS. As a result, we recorded an impairment charge of $4,735,777 in connection with the CLS shutdown to reflect the write-off of goodwill, intangible assets and property and equipment.

In December 2006, we recorded an impairment charge of $279,458 to reflect the write-off of certain customer relationships associated with portfolio management.

Income Taxes

Our effective tax rate is based on pre-tax income, statutory tax rates and tax planning strategies. Significant management judgment is required in determining the effective tax rate and in evaluating our tax position.

Our accompanying Condensed Consolidated Balance Sheets include certain deferred tax assets resulting from deductible temporary differences, which are expected to reduce future taxable income. These assets are based on management s estimate of realizability based upon forecasted taxable income. Realizability of these assets is reassessed at the end of each reporting period based upon our forecast of future taxable income and available tax planning strategies, and may result in the recording of a valuation reserve. Failure to achieve forecasted taxable income could affect the ultimate realization of certain deferred tax assets.

The Company adopted FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007 (see Note 9).

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors and our Audit Committee has reviewed our disclosures relating to them.

Revenue

We generate a majority of our revenue by providing professional outsourced services across the lifecycle of a mortgage loan.

Our transaction management services are provided under time-and-materials or per file billing arrangements. Under time-and-materials arrangements, we bill our clients on an hourly basis with travel and other reimbursable expenses passed through and recognized as revenue. Under per file billing arrangements, we bill our clients for each file reviewed with travel and other reimbursable expenses passed through separately or included in the per file rate. Revenues consisting of billed fees and pass-through expenses, which include travel and other reimbursable expenses, are recorded as work is performed and expenses are incurred. Revenues recognized, but not yet billed to clients, have been recorded as unbilled receivables in our consolidated balance sheets. For the three months ended June 30, 2007 and 2006, transaction management revenue accounted for 65.1% and 80.5%, respectively, of total revenue. For the six months ended June 30, 2007 and 2006, transaction management revenue accounted for 70.4% and 80.6%, respectively, of total revenue.

Our surveillance and special servicing services provide a revenue stream which is generally recurring in nature. In a typical MBS transaction for which we provide surveillance services, we are engaged by the trustee of an MBS issuance to provide our services over the life of the trust and are paid monthly directly from the cash flow of the trust. A majority of our surveillance revenue is based upon a negotiated rate multiplied by the outstanding principal balance of the underlying mortgage loans in the MBS issuance. These fees are recognized each month as services are rendered. Our special servicing activities are conducted under annual or multi-year contracts for which we typically receive revenue on a per loan per month basis as well as incentive fees. For the three months ended June 30, 2007 and 2006, surveillance and special servicing services revenue accounted for 34.9% and 19.5%, respectively, of total revenue. For the six months ended June 30, 2007 and 2006, surveillance and special servicing services revenue accounted for 29.6% and 19.4%, respectively, of total revenue.

For the three months ended June 30, 2007 and 2006, revenue from our largest two clients accounted for an aggregate of 18.8% and 27.4% of total revenue, respectively. Revenue from one client exceeded 10% of revenue for the three months ended June 30, 2007. Revenue from two clients exceeded 10% of revenue for the three months ended June 30, 2006. This revenue is primarily associated with the Transaction Management segment.

For the six months ended June 30, 2007 and 2006, revenue from our largest two clients accounted for an aggregate of 20.0% and 26.5% of total revenue, respectively. Revenue from one client exceeded 10% of revenue for the six months ended June 30, 2007. Revenue from two clients exceeded 10% of revenue for the six months ended June 30, 2006. This revenue is primarily associated with the Transaction Management segment.

Cost of Services

Compensation Expense

Compensation expense consists primarily of compensation for independent loan review specialists and employees directly involved in the delivery of our services, which include our client service managers who manage our engagements. Compensation expense also includes payroll related benefits for our direct employees. The professionals we retain from a professional employment organization, including our independent loan review specialists, do not receive any employee benefits from us and are only compensated for actual hours worked. Our direct cost of operations does not include an allocation of overhead costs.

Travel and Related Expenses

Travel and related expenses consist of expenses incurred in enabling employees and independent loan review specialists to travel to clients   sites and are comprised of airfare, hotel and car rental expenses. A majority of these expenses is either directly billed to clients or included in the per file rates charged. As such, these expenses are directly or indirectly included in our revenue.

Other Direct Costs

Other direct costs include the cost of third party mortgage loan services (primarily collateral appraisal fees), outside support for our compliance services used in connection with our loan reviews, independent loan review specialist training and miscellaneous non-billable transaction costs.

Operating Expenses

Operating expenses primarily consist of corporate overhead costs not directly associated with a specific transaction or contract, such as salaries and benefits, marketing and administrative expenses, professional fees and depreciation and amortization expenses.

In connection with becoming a public company, we have incurred significant additional operating expenses such as increased audit fees, professional fees, directors and officers   insurance costs, compensation for our board of directors, and expenses related to hiring additional personnel and expanding our administrative functions. Many of these expenses either were not incurred or were incurred at a lower level by us as a private company.

Salaries and Benefits

Salaries and benefits consist of employee compensation for those employees who are not directly billable to a particular assignment including costs of administrative, finance, human resources, technology, marketing, business development and executive personnel.

Other Selling, General and Administrative Expenses

Other selling, general and administrative expenses consist of costs such as rent and utilities, marketing, advertising and promotion expenses, non-reimbursable travel and entertainment, information technology, insurance, education, training and hiring expenses other than for independent loan review specialists and professional fees consisting of legal, accounting and other consulting fees in connection with the ongoing operation of our business including audit and Sarbanes-Oxley Act of 2002 compliance.

Depreciation and Amortization

We incur depreciation and amortization expenses for costs related to the capitalization of property and equipment and software developed for internal use on a straight-line basis over the estimated useful lives of the assets, which range from three to seven years. Leasehold improvements and assets under capital lease are amortized over the shorter of the estimated useful life of the asset or the lease term.

Treatment of Goodwill and Amortization of Intangibles

We also incur amortization expenses for costs related to the capitalization of identifiable intangible assets including customer relationships, technology and non-competition agreements.

We account for acquisitions of companies in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* (SFAS No. 141). We allocate purchase price to tangible assets, intangible assets, and liabilities based on fair values with the excess of purchase price amount being allocated to goodwill. The allocation of the purchase price to these intangible assets is based on a number of significant assumptions as determined by us and in the case of material acquisitions our independent appraisal expert, including evaluations of the future income producing capabilities of these assets and related future expected cash flows. We also make estimates about the useful lives of the acquired intangible assets. Should different conditions result in the determination that the value of the goodwill and acquired intangible assets has been impaired, we could incur write-downs of goodwill or intangible assets, or changes in the estimation of useful lives of those intangible assets. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), goodwill is not amortized, but is subject to annual impairment testing which is discussed in greater detail below.

In accordance with SFAS No. 142, goodwill is subject to annual impairment tests or on a more frequent basis if events or conditions indicate that goodwill may be impaired. Goodwill is tested for impairment at a level of reporting referred to as a reporting unit. The first step of our annual test is to compare the fair value of our shares to the carrying value of our net assets of the reporting unit. If we determine that our carrying value exceeds our fair value, we would conduct a second step to the goodwill impairment test. The second step compares the implied fair value of the goodwill (determined as the excess fair value over the fair value assigned to our other assets and liabilities) to the carrying amount of goodwill. When the carrying amount of goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized.

We evaluate all of our long-lived assets, including intangible assets other than goodwill and fixed assets, periodically for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* (SFAS No. 144). SFAS No. 144 requires that long-lived assets be evaluated for impairment when events or changes in facts and circumstances indicate that their carrying value may not be recoverable. If events or circumstances indicate that the carrying value of an asset may not be recoverable, the amount of impairment will be measured as the difference between the carrying value and the fair value of the impaired asset. An impairment will be recorded as an operating expense in the period of the impairment and as a reduction in the carrying value of that asset.

In connection with the CLS shutdown, in March 2007 the Company recorded an impairment charge of $4,735,777 to reflect the write-off of goodwill and intangible assets. In December 2006, the Company recorded an impairment charge of $279,458 to reflect the write-off of certain customer relationships associated with portfolio management.

Net Interest Expense

Net interest expense consists of interest paid on our debt net of interest received on our cash balances.

Interest expense for the three and six months ended June 30, 2007 and 2006 primarily consisted of interest on our term loan and amortization of debt issuance costs related to the term loan and revolving line of credit. Interest expense for the three and six months ended June 30, 2006 also included interest on our revolving line of credit. Our term loan had a balance at December 31, 2006 of $64,598,998, and $54,286,188 at June 30, 2007. Our term loan had a balance of $150,000,000 at December 31, 2005, and $79,799,499 at June 30, 2006.

Loss from Extinguishment of Debt

Due to the prepayment of $10,000,000 on our term loan during the six months ended June 30, 2007, we wrote-off a portion of the debt issuance costs on the term loan and recognized a loss from extinguishment of debt of $45,043 during the first quarter of 2007 and $45,289 during the second quarter of 2007.

On March 29, 2006, following our initial public offering, we repaid $70,000,000 of the outstanding balance on our $150,000,000 term loan and the entire $7,400,000 outstanding balance on our revolving line of credit. Due to the prepayment of $70,000,000 on our term loan, we wrote-off a portion of the debt issuance costs on the term loan and recognized a loss from extinguishment of debt of $746,002 in the first quarter of 2006.

Results of Operations

Comparison of Three Month Periods Ended June 30, 2007 and 2006

Revenue

Our consolidated revenue was $43.2 million for the three months ended June 30, 2007, a decrease of $16.7 million or 27.8%, compared to revenue of $59.9 million for the three months ended June 30, 2006. The decrease was primarily due to reduced due diligence, conduit, special servicing and staffing services revenues, partially offset by an increase in surveillance revenue and the acquisition of Risk Management, Limited (subsequently renamed Clayton Euro Risk (CER)). Our total revenue per loan increased by 38.2%, as our non-loan related surveillance and consulting businesses increased as a percentage of overall revenues. The number of loans serviced during the six months ended June 30, 2007 decreased by 47.9% as compared to fiscal 2006, due to significant reductions in the number of loans serviced in our due diligence and conduit businesses, due to the weak subprime market during the quarter. Revenues per loan in our core due diligence business increased by 4.4% due to an increase in non-loan related special due diligence projects involving distressed lenders and a decrease in the prevalence of other file reviews, in which we verify a limited number of data points in a loan file.

Transaction Management

Transaction management revenue was $28.1 million for the three months ended June 30, 2007, a decrease of $20.1 million or 41.7%, compared to revenue of $48.2 million for the three months ended June 30, 2006. The decrease was primarily due to a 47.9% reduction in loans serviced, due to the weak subprime market during the quarter. This decrease was partially offset by the 4.4% increase in due diligence revenues per loan.

Special Servicing

Special servicing revenue was $2.5 million for the three months ended June 30, 2007, a decrease of $0.9 million or 26.5%, compared to revenue of $3.4 million for the three months ended June 30, 2006. The decrease was primarily due to the termination of a tax lien servicing contract during the three months ended September 30, 2006 and reduced incentive and monthly fees from our non-performing loan servicing contracts.

Surveillance

Surveillance revenue was $12.6 million for the three months ended June 30, 2007, an increase of $4.3 million or 51.8%, compared to revenue of $8.3 million for the three months ended June 30, 2006. The increase was primarily due to an increase in our putback review business and an increase in the value of assets monitored.

Cost of Services

Our cost of services was $25.3 million for the three months ended June 30, 2007, a decrease of $13.6 million or 35.0%, compared to cost of services of $38.9 million for the three months ended June 30, 2006. This decrease was attributable to the specific factors discussed below.

Compensation Expense. Compensation expense was $20.2 million for the three months ended June 30, 2007, a decrease of $8.9 million or 30.6%, compared to compensation expense of $29.1 million for the three months ended June 30, 2006. The decrease was primarily due to a reduction in variable contractor expense in our due diligence and conduit businesses due to reduced loan volumes and, to a lesser extent, reduced training, fixed payroll and staffing services contractor expenses.

Travel and Related Expenses. Travel and related expenses were $3.6 million for the three months ended June 30, 2007, a decrease of $3.2 million or 47.1%, compared to travel and related expenses of $6.8 million for the three months ended June 30, 2006. The decrease was primarily due to reduced field due diligence loan volumes and staffing services engagements. Travel expenses per loan increased by 0.8%.

Other Direct Costs. Other direct costs were $1.5 million for the three months ended June 30, 2007, a decrease of $1.5 million or 50.0%, compared to other direct costs of $3.0 million for the three months ended June 30, 2006. The decrease was primarily due to reduced third-party appraisal vendor fees due to reduced due diligence volumes.

Operating Expenses

Operating expenses were $16.1 million for the three months ended June 30, 2007, an increase of $2.1 million or 15.0%, compared to operating expenses of $14.0 million for the three months ended June 30, 2006. This increase was attributable to the specific factors discussed below.

Salaries and Benefits. Salaries and benefits were $5.5 million for the three months ended June 30, 2007, an increase of $0.4 million or 7.8%, compared to salaries and benefits of $5.1 million for the three months ended June 30, 2006. This increase was primarily due to an increase in information technology compensation expense, severance expense and stock-based compensation related to restricted stock grants in the first quarter. These increases were partially offset by reduced bonus expense due to the weaker financial results.

Other Selling, General and Administrative Expenses. Other selling, general and administrative expenses were $5.6 million for the three months ended June 30, 2007, an increase of $1.1 million or 24.4%, as compared to selling, general and administrative expenses of $4.5 million for the three months ended June 30, 2006. This increase was due to higher occupancy expenses, due to the relocation of the Tampa centralized underwriting operations to a new facility, and increased bad debt, telecommunications and professional fee expenses, partially offset by reduced recruiting expenses.

Depreciation and Amortization. Depreciation and amortization was $2.4 million for the three months ended June 30, 2007, an increase of $0.5 million or 26.3%, compared to depreciation and amortization of $1.9 million for the three months ended June 30, 2006. This increase was primarily due to depreciation recorded on additional property and equipment and software developed for internal use.

Amortization of Intangibles. Amortization of intangibles was $2.6 million for the three months ended June 30, 2007, an increase of $0.1 million or 4.0 %, compared to depreciation and amortization of $2.5 million for the three months ended June 30, 2006. This increase was primarily due to the amortization of intangible assets acquired in connection with the acquisition of CER.

Interest Expense, net

Interest expense, net was $1.0 million for the three months ended June 30, 2007, a decrease of $0.7 million or 41.2%, compared to interest expense, net of $1.7 million for the three months ended June 30, 2006. This decrease was due to reduced borrowings on our term loan and a reduction of the interest rate on our term loan. *See Liquidity and Capital Resources.*

Loss from Extinguishment of Debt

For the three months ended June 30, 2007, we recognized a loss from extinguishment of debt of $0.05 million due to the write-off of debt issuance costs as a result of a $5.0 million prepayment during this period. *See Liquidity and Capital Resources.*

Income Taxes

Income taxes for the three months ended June 30, 2007 were $0.2 million, a decrease of $1.9 million, compared to $2.1 million for the three months ended June 30, 2006. This decrease was primarily due to changes in taxable income and our effective tax rate.

Discontinued Operations

On March 28, 2007, we committed to discontinue the operations of CLS. Results for the three months ended June 30, 2007 include a pre-tax loss on disposal of a $0.4 million, relating to facility closure costs and the write-off of property and equipment. CLS operating results for the three months ended June 30, 2007 included revenue of $0.2 million, an operating loss of $0.6 million, a pre-tax loss of $0.6 million, an income tax benefit of $0.2 million and a net loss of $0.4 million. CLS operating results for the three months ended June 30, 2006 included revenue of $1.9 million, an operating loss of $1.5 million, a pre-tax loss of $1.5 million, an income tax benefit of $0.6 million and a net loss of $0.9 million.

Comparison of Six Month Periods Ended June 30, 2007 and 2006

Revenue

Our consolidated revenue was $96.5 million for the six months ended June 30, 2007, a decrease of $17.3 million or 15.2%, compared to revenue of $113.8 million for the six months ended June 30, 2006. The decrease was primarily due to reduced due diligence, conduit, special servicing and staffing services revenues, partially offset by an increase in surveillance revenue and the acquisition of CER. Our total revenue per loan increased by 15.0%, as revenues from our non-loan related surveillance and consulting businesses increased as a percentage of overall revenues. The number of loans serviced during the three months ended June 30, 2007 decreased by 26.3% as compared to fiscal 2006, due to significant reductions in the number of loans serviced in our due diligence and conduit businesses, due to the weak subprime market during the period. Revenues per loan in our core due diligence business decreased by 1.6% as an increase in the percentage of loans serviced in our centralized underwriting facility offset an increase in non-loan related special due diligence projects involving distressed lenders.

Transaction Management

Transaction management revenue was $67.9 million for the six months ended June 30, 2007, a decrease of $23.9 million or 26.0%, compared to revenue of $91.8 million for the six months ended June 30, 2006. The decrease was primarily due to a 26.3% reduction in loans serviced, due to the weak subprime market during the period.

Special Servicing

Special servicing revenue was $4.2 million for the six months ended June 30, 2007, a decrease of $2.1 million or 33.3%, compared to revenue of $6.3 million for the six months ended June 30, 2006. The decrease was primarily due to the termination of a tax lien servicing contract during the three months ended September 30, 2006, and reduced incentive and monthly fees from our non-performing loan servicing contracts.

Surveillance

Surveillance revenue was $24.4 million for the six months ended June 30, 2007, an increase of $8.7 million or 55.4%, compared to revenue of $15.7 million for the six months ended June 30, 2006. The increase was primarily due to an increase in the value of assets monitored and an increase in our putback review business.

Cost of Services

Our cost of services was $59.0 million for the six months ended June 30, 2007, a decrease of $17.9 million or 23.3%, compared to cost of services of $76.9 million for the six months ended June 30, 2006. This decrease was attributable to the specific factors discussed below.

Compensation Expense. Compensation expense was $45.9 million for the six months ended June 30, 2007, a decrease of $11.7 million or 20.3%, compared to compensation expense of $57.6 million for the six months ended June 30, 2006. The decrease was primarily due to a reduction in variable contractor expense in our due diligence and conduit businesses due to reduced loan volumes and, to a lesser extent, reduced training, fixed payroll and staffing services contractor expenses.

Travel and Related Expenses. Travel and related expenses were $9.1 million for the six months ended June 30, 2007, a decrease of $4.8 million or 34.5%, compared to travel and related expenses of $13.9 million for the six months ended June 30, 2006. The decrease was primarily due to reduced field due diligence loan volumes and staffing services engagements. Travel expenses per loan decreased by 11.2% due to an increase in the percentage of loans serviced in our centralized underwriting facility.

Other Direct Costs. Other direct costs were $4.0 million for the six months ended June 30, 2007, a decrease of $1.4 million or 25.9%, compared to other direct costs of $5.4 million for the six months ended June 30, 2006. The decrease was primarily due to reduced third-party appraisal vendor fees due to reduced due diligence volumes.

Operating Expenses

Operating expenses were $31.8 million for the six months ended June 30, 2007, an increase of $4.1 million or 14.8%, compared to operating expenses of $27.7 million for the six months ended June 30, 2006. This increase was attributable to the specific factors discussed below.

Salaries and Benefits. Salaries and benefits were $11.2 million for the six months ended June 30, 2007, an increase of $1.1 million or 10.9%, compared to salaries and benefits of $10.1 million for the six months ended June 30, 2006. This increase was primarily due to an increase in information technology, executive and accounting compensation expense, partially offset by reduced bonus expense due to the weaker financial results and reduced stock-based compensation expense, as the six months ended June 30, 2006 included expense related to the acceleration of vesting of stock options following the company s IPO.

Other Selling, General and Administrative Expenses. Other selling, general and administrative expenses were $11.0 million for the six months ended June 30, 2007, an increase of $1.9 million or 20.9%, as compared to selling, general and administrative expenses of $9.1 million for the six months ended June 30, 2006. This increase was due to higher occupancy expenses, due to the relocation of the Tampa centralized underwriting operations to a new facility, and increased bad debt, telecommunications, insurance and professional fee expenses, partially offset by reduced recruiting expenses.

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Depreciation and Amortization. Depreciation and amortization was $4.5 million for the six months ended June 30, 2007, an increase of $1.1 million or 32.4%, compared to depreciation and amortization of $3.4 million for the six months ended June 30, 2006. This increase was primarily due to depreciation recorded on additional property and equipment and software developed for internal use.

Amortization of Intangibles. Amortization of intangibles was $5.1 million for the six months ended June 30, 2007 and 2006.

Interest Expense, net

Interest expense, net was $2.2 million for the six months ended June 30, 2007, a decrease of $2.5 million or 53.2%, compared to interest expense, net of $4.7 million for the six months ended June 30, 2006. This decrease was due to reduced borrowings on our term loan and, to a lesser extent, reduced borrowings on our line of credit and a reduction of the interest rate on the term loan. *See Liquidity and Capital Resources.*

Loss from Extinguishment of Debt

For the six months ended June 30, 2007, we recognized a loss from extinguishment of debt of $0.1 million due to the write-off of debt issuance costs as a result of a $10.0 million prepayment on our term loan during this period. For the six months ended June 30, 2006, we recognized a loss from extinguishment of debt of $0.7 million due to the write-off of debt issuance costs as a result of a $70.0 million prepayment on our term loan following our initial public offering.
See Liquidity and Capital Resources.

Income Taxes

Income taxes for the six months ended June 30, 2007 were $1.3 million, a decrease of $0.2 million, compared to $1.5 million for the six months ended June 30, 2006. This increase was primarily due to changes in taxable income and our effective tax rate. Our effective tax rate for the first six months of 2007 was 38.2% as compared with 38.5% for the first six months of 2006.

Discontinued Operations

Results for the six months ended June 30, 2007 include a pre-tax loss on disposal of $5.2 million consisting of a non-cash pre-tax impairment charge of a $4.7 million relating to impairment of goodwill, intangible assets and property and equipment recognized in the first quarter of 2007, and facility closure costs and the write-off of property and equipment during the second quarter of 2007. CLS operating results for the six months ended June 30, 2007 included revenue of $0.7 million, an operating loss of $2.2 million, a pre-tax loss of $2.2 million, an income tax benefit of $0.8 million and a net loss of $1.4 million. CLS operating results for the six months ended June 30, 2006 included revenue of $3.2 million, an operating loss of $1.8 million, a pre-tax loss of $1.8 million an income tax benefit of $0.7 million and a net loss of $1.1 million.

Liquidity and Capital Resources

Historically, we have financed our growth from cash flow from operations and bank borrowings. We believe that funds generated from operations, together with existing cash and available borrowings under our Credit Agreement, will be sufficient to finance our current operations, planned capital expenditures and internal growth through at least the next twelve months. On March 29, 2006, we issued 8,625,000 shares of common stock, including 1,125,000 shares issued through the exercise of the underwriters over-allotment option, at a price of $17.00 per share through our initial public offering of common stock.

On March 1, 2006, we consummated a 1-for-4 reverse stock split of our common stock and class B common stock.

Immediately prior to the completion of the offering, the following transactions occurred:

- all of our 357,020 outstanding shares of class B common stock converted into 357,020 shares of common stock.

- our series A convertible preferred stock converted into 2,206,308 shares of common stock and 8,825,241 shares of series A redeemable preferred stock.

- our series B convertible preferred stock converted into 6,046,371 shares of common stock and 24,185,493 shares of series B redeemable preferred stock.

Our net proceeds of $131.8 million, net of $14.8 million of offering expenses and the underwriting discount, were used to:

- redeem $52.8 million of redeemable preferred stock that resulted from the conversion of our Series A convertible preferred stock and Series B convertible preferred stock immediately prior to the completion of the initial public offering.

- repay $70.0 million owed under the senior term loan portion of our credit facility.

- repay $7.4 million owed under the revolving credit portion of our credit facility.

- fund $1.6 million of working capital.

Our operating activities provided cash of $8.5 million and $9.6 million in the six months ended June 30, 2007 and 2006, respectively. Cash provided from operations is generated primarily from net income and the timing of accounts receivable collections and disbursements of accounts payable. Cash provided by operations for the six months ended June 30, 2007 was generated from a net loss of $2.6 million, which included a $3.3 million loss on disposal of discontinued operations and a $1.4 million loss from discontinued operations, and $10.8 million of non-cash charges and was negatively impacted by a net increase in operating assets of $4.4 million, primarily due to a decrease in accrued expenses. Cash provided by operations for the six months ended June 30, 2006 resulted from net income of $1.3 million, which included a $1.1 million loss from discontinued operations, and $10.2 million of non-cash charges and was negatively impacted by a net increase in operating assets of $2.9 million primarily due to an increase in accounts receivable and unbilled receivables and a decrease in deferred revenue. We believe cash flow from operations will be sufficient to finance our current operations for the next twelve months.

Our investing activities used cash of $6.9 million and $12.0 million in the six months ended June 30, 2007 and 2006, respectively. Cash used in investing activities in the six months ended June 30, 2007 primarily consisted of capital expenditures and the acquisition of CER. Cash used in investing activities in the six months ended June 30, 2006 primarily consisted of capital expenditures and the acquisition of CLS.

Our financing activities used cash of $8.3 million in the six months ended June 30, 2007 and provided cash of $8.7 million in the six months ended June 30, 2006. The principal use of cash from financing activities in the six months ended June 30, 2007 was the repayment of principal on the term loan, partially offset by proceeds from stock option exercises and excess tax benefits from share-based compensation arrangements. The principal sources of cash from financing activities in the six months ended June 30, 2006 were the proceeds from the initial public offering described above and, to a lesser extent, borrowings under our revolving credit agreement. This was partially offset by the redemption of preferred stock and repayments of outstanding debt under our credit facility described above.

Cash paid for interest expense was $2.5 million and $4.2 million in each of the six months ended June 30, 2007 and 2006, respectively. In the six months ended June 30, 2007 and 2006, the majority of interest expense was paid on borrowings outstanding under our term loan.

In July 2007, we prepaid $5.0 million outstanding under the term loan.

Credit Agreement

On December 8, 2005, we entered into a $190.0 million senior credit facility. The credit facility provided for a $150.0 million term loan, and a revolving credit facility of $40.0 million. The credit facility also provided us with an option, subject to the consent of the lenders, to increase the revolving credit facility by $10.0 million to an aggregate of $50.0 million. We exercised the option to increase our revolving credit facility by $5.0 million on each of January 11, 2006 and April 28, 2006, and as of June 30, 2007 we have an aggregate revolving credit facility of $50.0 million. Following our initial public offering in March 2006, we prepaid $70.0 million outstanding under the term loan and repaid $7.4 million

outstanding under the revolving credit facility. In February 2007, we prepaid $5.0 million outstanding under the term loan. An additional $5.0 million was repaid in May 2007, and another $5.0 million was repaid in July 2007.

The Credit Agreement terminates on December 8, 2011. Principal repayments on the term loan of $137,433 are required on a quarterly basis for each quarter through 2010, and the remaining principal balance at the end of 2010 is repayable in equal quarterly installments during 2011. This facility can be used to fund acquisitions requiring cash, as well as to fund short-term liquidity needs. Liquidity needs occasionally arise as a result of differences in the timing between collecting our accounts receivable and making disbursements to support our operations.

The Credit Agreement is collateralized by substantially all of our assets. The agreement contains covenants which, among other matters, require us to maintain certain interest coverage, fixed charge and total leverage ratios. As of June 30, 2007, we were in compliance with all debt covenants. In addition, the Credit Agreement places limitations on total annual capital expenditures, indebtedness, liens, dividends and distributions, asset sales, transactions with affiliates, acquisitions and conduct of business, all as defined in the agreement. The Credit Agreement also contains provisions for an increased interest rate during periods of default. We do not believe that these covenants will affect our ability to operate our business.

Loans under the Credit Agreement bear interest at the applicable LIBOR rate plus 1.75% or Prime Rate plus 0.75%, at our option. In addition, we are required to pay a commitment fee of 0.5% based on the calculation of the excess of the revolving credit loan commitment over the outstanding balance as defined in the Credit Agreement.

At June 30, 2007, there was an outstanding balance of $54.3 million under the term loan and no outstanding balance under the revolving credit facility.

Contractual Obligations

The following table describes our cash commitments, in thousands, to settle contractual obligations as of June 30, 2007.

	Total	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Term loans and loans payable	$ 54,286	$ 275	$ 1,099	$ 52,912	$
Capital lease obligations	487	111	274	102	
Operating lease obligations	15,132	1,930	5,181	2,682	5,339
Total	$ 69,905	$ 2,316	$ 6,554	$ 55,696	$ 5,339

As further discussed in Note 9, we adopted the provisions of FIN 48 on January 1, 2007. At June 30, 2007, we had approximately $1.9 million of unrecognized tax benefits which were not included in the Contractual Obligations table of our 2006 Form 10-K. Due to the inherent uncertainty of the underlying tax positions, it is not practical to assign the liability as of June 30, 2007 to any particular years in the table.

Interest payments due on the above amounts total $16,605.

Off-Balance-Sheet Arrangements

As of June 30, 2007, we did not have any significant off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K of the SEC.

Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>

During the six months ended June 30, 2007, there were no material changes in our market risk exposure. For a discussion of our market risk associated with interest rate risk and equity price risk as of December 31, 2006, see Risk Factors and Management s Discussion and Analysis of Financial Condition

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and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2006, which includes audited financial statements.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2007. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2007, our chief executive officer and chief financial officer concluded that, as of such date, the Company s disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the quarterly period ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may be party to various claims, suits and complaints. Currently, there are no such claims, suits or complaints that, in our opinion would have a material adverse effect on our business, results of operations and financial condition.

Item 1A. Risk Factors

Not applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Upon termination, during the three months ended June 30, 2007, employees forfeited 7,000 unvested shares of restricted stock, as detailed in the following table:

Period	Total Number of Shares Forfeited
April 1, 2007 April 30, 2007	1,500
May 1, 2007 May 31, 2007	1,500
June 1, 2007 June 30, 2007	4,000

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

On June 7, 2007, we held our Annual Meeting of Stockholders. At the meeting, the stockholders elected Brian L. Libman and Michael M. Sonderby to the Board of Directors, each to serve for a three-year term as a Class II Director. 19,955,640 votes were cast for Mr.Libman s election; 76,739 votes were cast to withhold authority for Mr. Libman. 19,955,140 votes were cast for Mr. Sonderby s election; 77,239 votes were cast to withhold authority for Mr. Sonderby. Also at the meeting, the stockholders ratified the appointment of Grant Thornton LLP as our independent registered public accounting firm for the current year. The votes cast to ratify Grant Thornton LLP s appointment were as follows: 19,994,804 shares voted for, 37,275 voted against and 300 shares abstained from voting.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

SIGNATURES

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

CLAYTON HOLDINGS, INC.

Date: August 8, 2007	By:	/s/ Frederick C. Herbst Frederick C. Herbst *Chief Financial Officer* (Duly Authorized Officer and Principal Financial Officer)

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EXHIBIT INDEX

Listed and indexed below are all Exhibits filed as part of this report.

Exhibit No.	**Description**
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Rule 13a-14(a)/15d-14(a), by Chief Executive Officer.
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Rule 13a-14(a)/15d-14(a), by Chief Financial Officer.
32.1*	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer and Chief Financial Officer.

* This Certification shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that Section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.