

PEGASYSTEMS INC
Form 10-Q
May 21, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2007

or

☐ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _____ to _____

Commission File Number: 1-11859

PEGASYSTEMS INC.

(Exact name of Registrant as specified in its charter)

Massachusetts
(State or other jurisdiction of

incorporation or organization)

04-2787865
(IRS Employer

Identification No.)

101 Main Street Cambridge, MA
(Address of principal executive offices)

02142-1590
(Zip Code)

(617) 374-9600

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(Registrant's telephone number including area code)

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

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

There were 35,382,878 shares of the Registrant's common stock, \$.01 par value per share, outstanding on May 7, 2007.

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Table of Contents**PEGASYSTEMS INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)**

(in thousands, except share-related data)

	March 31, 2007	December 31, 2006
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 24,218	\$ 26,008
Short-term investments	108,546	101,750
Total cash and short-term investments	132,764	127,758
Trade accounts receivable, net of allowance for doubtful accounts of \$365 in 2007 and 2006 .	34,718	31,985
Short-term license installments	17,047	21,790
Other current assets	7,285	9,065
Total current assets	191,814	190,598
Long-term license installments, net of unearned interest income	13,742	17,458
Equipment and improvements, net of accumulated depreciation and amortization	2,884	2,453
Computer software for internal use, net of accumulated amortization	924	1,054
Long-term deferred tax assets and other assets	6,035	99
Goodwill	2,346	2,346
Total assets	\$ 217,745	\$ 214,008
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Current liabilities:		
Accrued payroll related expenses	\$ 7,717	\$ 11,770
Accounts payable and accrued expenses	12,266	14,474
Deferred revenue	20,971	17,062
Current portion of capital lease obligation	36	63
Total current liabilities	40,990	43,369
Long-term deferred income taxes		2,344
Income taxes payable and other long-term liabilities	11,165	2,137
Total liabilities	52,155	47,850
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value, 1,000,000 shares authorized; no shares issued and outstanding		
Common stock, \$.01 par value, 70,000,000 shares authorized; 35,367,873 and 35,308,978 shares issued and outstanding at March 31, 2007 and December 31, 2006, respectively	354	353
Additional paid-in capital	118,824	118,027
Stock warrants	94	94
Retained earnings	45,018	46,549
Accumulated other comprehensive income (loss):		
Net unrealized loss on investments available-for-sale	(214)	(343)
Foreign currency translation adjustments	1,514	1,478

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Total stockholders' equity	165,590	166,158
Total liabilities and stockholders' equity	\$ 217,745	\$ 214,008

See notes to unaudited condensed consolidated financial statements.

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(in thousands, except per share amounts)

	Three months ended	
	March 31, 2007	2006
Revenue:		
Software license	\$ 12,084	\$ 6,998
Services	25,405	22,201
Total revenue	37,489	29,199
Cost of revenue:		
Cost of software license		31
Cost of services	15,564	14,087
Total cost of revenue	15,564	14,118
Gross profit	21,925	15,081
Operating expenses:		
Research and development	6,185	5,402
Selling and marketing	11,769	9,810
General and administrative	4,215	2,637
Total operating expenses	22,169	17,849
Loss from operations	(244)	(2,768)
Installment receivable interest income	276	447
Other interest income, net	1,545	1,115
Other income (expense), net	(20)	245
Income (loss) before provision (benefit) for income taxes	1,557	(961)
Provision (benefit) for income taxes	537	(50)
Net income (loss)	\$ 1,020	\$ (911)
Earnings (loss) per share, basic and diluted	\$ 0.03	\$ (0.03)
Weighted average number of common shares outstanding, basic	35,349	35,572
Weighted average number of common shares outstanding, diluted	37,614	35,572

See notes to unaudited condensed consolidated financial statements.

Table of Contents**PEGASYSTEMS INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)****(in thousands)**

	Three months ended	
	March 31,	
	2007	2006
Cash flows from operating activities:		
Net income (loss)	\$ 1,020	\$ (911)
Adjustment to reconcile net income (loss) to cash flows from operating activities:		
Stock option income tax benefits		(42)
Deferred income taxes	(259)	(351)
Depreciation, amortization, and other non cash items	553	611
Stock-based compensation expense	396	263
Change in operating assets and liabilities:		
Trade accounts receivable and license installments	5,726	1,289
Other current assets	1,754	534
Accounts payable and accrued expenses	(6,695)	(2,575)
Deferred revenue	3,909	3,988
Other long-term assets and liabilities	588	313
Cash flows from operating activities	6,992	3,119
Cash flows from investing activities:		
Purchase of investments	(25,189)	(21,608)
Maturing and called investments	17,820	14,900
Investment in software, equipment and improvements	(774)	(806)
Cash flows from investing activities	(8,143)	(7,514)
Cash flows from financing activities:		
Payments under capital lease obligation	(27)	(25)
Exercise of stock options	401	351
Tax benefit from vested stock options		42
Dividend payments to stockholders	(1,059)	
Repurchase of common stock		(311)
Cash flows from financing activities	(685)	57
Effect of exchange rate on cash and cash equivalents	46	40
Net decrease in cash and cash equivalents	(1,790)	(4,298)
Cash and cash equivalents, beginning of period	26,008	21,314
Cash and cash equivalents, end of period	\$ 24,218	\$ 17,016
Supplemental disclosures of cash flow information:		
Cash paid during the year to date period for:		
Interest	\$ 1	\$ 3
Income taxes	\$ 276	\$ 150

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Non-cash financing activity:

Dividends payable

See notes to unaudited condensed consolidated financial statements.

\$ 1,061 \$

Table of Contents**PEGASYSTEMS INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. BASIS OF PRESENTATION**

The Company has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements and should be read in conjunction with the Company's audited financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2006.

In the opinion of management, the Company has prepared the accompanying unaudited condensed consolidated financial statements on the same basis as its audited financial statements, and these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full year 2007.

2. SIGNIFICANT ACCOUNTING POLICIES***(a) Trade accounts receivable***

Trade accounts receivable balances, which consist of billed and unbilled amounts, were \$34.7 million and \$32.0 million at March 31, 2007 and December 31, 2006, respectively. The billed component of the total accounts receivable balance at March 31, 2007 was \$31.5 million compared to \$29.5 million at December 31, 2006. Trade accounts receivable includes \$3.2 million and \$2.5 million at March 31, 2007 and December 31, 2006, respectively, for services earned under time and material arrangements that had not been invoiced at the end of the period.

(b) Other current assets

Other current assets consist of the following:

(in thousands)	March 31, 2007	December 31, 2006
Deferred tax assets	\$ 2,929	\$ 2,962
Deferred cost of services	332	1,593
Interest receivable	1,314	1,776
Income tax receivable	1,334	1,331
Prepaid expense	606	842
Reimbursable expense	451	349
Sales tax receivable	319	212
Balance at the end of the period	\$ 7,285	\$ 9,065

(c) Stockholder's equity

On June 1, 2006, the Company's Board of Directors declared an ongoing quarterly cash dividend of \$0.03 per share. The dividend declared during the first quarter of 2007 was paid on April 16, 2007 to stockholders of record as of April 2, 2007. The Company paid in the aggregate approximately \$1.1 million in connection with this dividend. The accrued liability for this dividend is included in Accounts payable and accrued expenses on the Company's condensed consolidated balance sheet at March 31, 2007. The Company currently expects to continue to pay a quarterly cash dividend of \$0.03 per share to stockholders of record as of the first trading day of each quarter, subject to change by the Company's Board of Directors.

On June 1, 2006, the Company publicly announced that the Company's Board of Directors had approved a new \$10 million stock repurchase program beginning July 1, 2006 and ending June 30, 2007. Under the program, which may be suspended at any time without notice, the Company may repurchase shares of its common stock from time to time on the open market or in privately negotiated transactions. During the first quarter of 2007, the Company did not repurchase any shares. As of March 31, 2007, the Company had authorization remaining to

repurchase \$6.9 million of its common stock under the program.

Table of Contents**PEGASYSTEMS INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****(d) Earnings per share***

Basic earnings per share is computed based on the weighted average number of common shares outstanding during the period. Diluted earnings per share includes, to the extent inclusion of such shares would be dilutive to earnings per share, the effect of outstanding options and warrants, computed using the treasury stock method.

(in thousands, except per share amounts)	Three months ended	
	March 31, 2007	2006
<u>Basic</u>		
Net income (loss)	\$ 1,020	\$ (911)
Weighted average common shares outstanding	35,349	35,572
Earnings (loss) per share, basic	\$ 0.03	\$ (0.03)
<u>Diluted</u>		
Net income (loss)	\$ 1,020	\$ (911)
Weighted average common shares outstanding	35,349	35,572
Effect of assumed exercise of stock options and warrants	2,265	