PEGASYSTEMS INC
Form 10-Q
May 06, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

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	**04-2787865**
(State or other jurisdiction of	***(IRS Employer***
incorporation or organization)	***Identification No.)***
One Rogers Street Cambridge, MA	**02142-1209**
(Address of principal executive offices)	***(Zip Code)***

(617) 374-9600

(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨	Smaller reporting company ¨
		(Do not check if smaller reporting company)	

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

There were 37,936,149 shares of the Registrant s common stock, $.01 par value per share, outstanding on April 25, 2013

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PEGASYSTEMS INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	As of March 31, 2013	As of December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 123,731	$ 77,525
Marketable securities	57,124	45,460
Total cash, cash equivalents, and marketable securities	180,855	122,985
Trade accounts receivable, net of allowance of $1,134 and $963	70,513	134,066
Deferred income taxes	10,252	10,202
Income taxes receivable	4,774	6,261
Other current assets	5,735	5,496
Total current assets	272,129	279,010
Property and equipment, net	29,747	30,827
Long-term deferred income taxes	49,163	49,292
Long-term other assets	1,618	1,680
Intangible assets, net	55,455	58,232
Goodwill	20,451	20,451
Total assets	$ 428,563	$ 439,492
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,233	3,330
Accrued expenses	15,267	15,534
Accrued compensation and related expenses	18,848	40,715
Deferred revenue	104,608	95,546
Total current liabilities	140,956	155,125
Income taxes payable	13,707	13,551
Long-term deferred revenue	16,029	18,719
Other long-term liabilities	16,482	15,618
Total liabilities	187,174	203,013
Commitments and contingencies		
Stockholders equity:		
Preferred stock, 1,000 shares authorized; no shares issued and outstanding		
Common stock, 100,000 shares authorized; 37,951 shares and 37,945 shares issued and outstanding	380	379
Additional paid-in capital	137,591	138,576
Retained earnings	102,276	94,349
Accumulated other comprehensive income	1,142	3,175
Total stockholders equity	241,389	236,479

Total liabilities and stockholders equity	$	428,563	$	439,492

See notes to unaudited condensed consolidated financial statements.

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PEGASYSTEMS INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Revenue:		
Software license	$ 43,209	$ 35,943
Maintenance	36,322	30,845
Professional services	36,715	44,379
Total revenue	116,246	111,167
Cost of revenue:		
Cost of software license	1,583	1,599
Cost of maintenance	3,735	3,609
Cost of professional services	32,335	36,326
Total cost of revenue	37,653	41,534
Gross profit	78,593	69,633
Operating expenses:		
Selling and marketing	39,270	38,395
Research and development	19,576	19,004
General and administrative	6,796	6,315
Total operating expenses	65,642	63,714
Income from operations	12,951	5,919
Foreign currency transaction (loss) gain	(1,890)	740
Interest income, net	118	111
Other income (expense), net	839	(839)
Income before provision for income taxes	12,018	5,931
Provision for income taxes	2,949	1,874
Net income	$ 9,069	$ 4,057
Earnings per share:		
Basic	$ 0.24	$ 0.11
Diluted	$ 0.23	$ 0.10
Weighted-average number of common shares outstanding		
Basic	37,947	37,756
Diluted	38,788	38,889
Cash dividends declared per share	$ 0.03	$ 0.03

See notes to unaudited condensed consolidated financial statements.

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PEGASYSTEMS INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Three Months Ended March 31,	
	2013	**2012**
(in thousands)		
Net income	$ 9,069	$ 4,057
Other comprehensive income (loss), net of tax:		
Unrealized gain on securities	37	72
Foreign currency translation adjustments	(2,070)	1,274
Total other comprehensive (loss) income	(2,033)	1,346
Comprehensive income	$ 7,036	$ 5,403

See notes to unaudited condensed consolidated financial statements.

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PEGASYSTEMS INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Operating activities:		
Net income	$ 9,069	$ 4,057
Adjustment to reconcile net income to cash provided by (used in) operating activities:		
Excess tax benefits from exercise or vesting of equity awards	(725)	(1,622)
Deferred income taxes	56	214
Depreciation and amortization	4,727	4,686
Stock-based compensation expense	3,432	2,852
Foreign currency transaction loss	219	395
Other non-cash items	1,241	1,713
Change in operating assets and liabilities:		
Trade accounts receivable	63,200	(8,130)
Income taxes receivable and other current assets	1,604	(156)
Accounts payable and accrued expenses	(23,799)	(25,861)
Deferred revenue	6,811	4,696
Other long-term assets and liabilities	211	(618)
Cash provided by (used in) operating activities	66,046	(17,774)
Investing activities:		
Purchase of marketable securities	(15,779)	(10,479)
Matured and called marketable securities	3,750	6,780
Investment in property and equipment	(1,195)	(4,267)
Cash used in investing activities	(13,224)	(7,966)
Financing activities:		
Issuance of common stock for share-based compensation plans	271	293
Excess tax benefits from exercise or vesting of equity awards	725	1,622
Dividend payments to shareholders		(1,132)
Common stock repurchases for tax withholdings for net settlement of equity awards	(1,611)	(2,072)
Common stock repurchases under share repurchase programs	(3,512)	(814)
Cash used in financing activities	(4,127)	(2,103)
Effect of exchange rate on cash and cash equivalents	(2,489)	963
Net increase (decrease) in cash and cash equivalents	46,206	(26,880)
Cash and cash equivalents, beginning of period	77,525	60,353
Cash and cash equivalents, end of period	$ 123,731	$ 33,473

See notes to unaudited condensed consolidated financial statements.

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PEGASYSTEMS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. ACCOUNTING POLICIES

Basis of Presentation

Pegasystems Inc. (together with its subsidiaries, the Company) has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the U.S. 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 (U.S.) 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, 2012.

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 2013.

2. MARKETABLE SECURITIES

(in thousands)	March 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Municipal bonds	$ 35,961	57	(9)	$ 36,009
Corporate bonds	19,804	73	(12)	19,865
Certificates of deposit	1,253		(3)	1,250
	$ 57,018	130	(24)	$ 57,124

(in thousands)	December 31, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Municipal bonds	$ 30,488	48	(10)	$ 30,526
Corporate bonds	14,853	83	(2)	14,934
	$ 45,341	131	(12)	$ 45,460

The Company considers debt securities with maturities of three months or less from the purchase date to be cash equivalents. Interest is recorded when earned. All of the Company s investments are classified as available-for-sale and are carried at fair value with unrealized gains and losses recorded as a component of accumulated other comprehensive income, net of related income taxes.

As of March 31, 2013, remaining maturities of marketable debt securities ranged from June 2013 to July 2015, with a weighted-average remaining maturity of approximately 12 months.

3. DERIVATIVE INSTRUMENTS

The Company uses foreign currency forward contracts to manage its exposure to changes in foreign currency exchange rates associated with its foreign currency denominated accounts receivable, intercompany payables and cash. The U.S. operating company invoices most of its foreign customers in foreign currencies, which results in cash and receivables held at the end of the reporting period denominated in these foreign currencies. Since the U.S. operating company s functional currency is the U.S. dollar, the Company recognizes a foreign currency transaction gain or (loss) on the foreign currency denominated cash and accounts receivable held by the U.S. operating company in its consolidated statements of operations when there are changes in the foreign currency exchange rates versus the U.S. dollar. The Company is primarily exposed to changes in the value of the Euro and British pound relative to the U.S. dollar. The foreign currency forward contracts utilized by the Company are not designated as hedging instruments and as a result, the Company records the fair value of these contracts at the end of each reporting period in its consolidated balance sheet as other current assets for unrealized gains and accrued expenses for unrealized losses, with any fluctuations in the value of these contracts recognized in other income (expense), net, in its consolidated statement of operations. However, the fluctuations in the value of these foreign currency forward contracts partially offset the gains and losses from the remeasurement or settlement of the foreign currency denominated accounts receivable, intercompany payables, and cash held by the U.S. operating company, thus partly mitigating the volatility. Generally, the Company enters into foreign currency forward contracts with terms not greater than 90 days.

During the first quarter of 2013, the Company entered into and settled foreign currency forward contracts to sell 16 million and £19 million and receive $50.8 million. During the first quarter of 2012, the Company entered into and settled foreign currency forward contracts to sell 11.0 million and £12.0 million and receive $32.8 million. As of March 31, 2013 and December 31, 2012, the Company did not have any foreign currency forward contracts outstanding. During the first quarter of 2013 and 2012, the change in the fair value of the Company s foreign currency forward contracts recorded in other income (expense), net, was a gain of $0.8 million and a loss of $0.8 million, respectively.

4. FAIR VALUE MEASUREMENTS

Assets Measured at Fair Value on a Recurring Basis

Fair value is an exit price, representing the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants based on assumptions that market participants would use in pricing an asset or liability. As a basis for classifying the fair value measurements, a three-tier fair value hierarchy, which classifies the fair value measurements based on the inputs used in measuring fair value, was established as follows: (Level 1) observable inputs such as quoted prices in active markets for identical assets or liabilities; (Level 2) significant other observable inputs that are observable either directly or indirectly; and (Level 3) significant unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company records its marketable securities at fair value.

The Company s investments classified within Level 1 of the fair value hierarchy are valued using quoted market prices. The Company s investments classified within Level 2 of the fair value hierarchy are valued based on matrix pricing compiled by third party pricing vendors, using observable market inputs such as interest rates, yield curves, and credit risk. The Company does not have any investments classified within Level 3 of the fair value hierarchy.

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The fair value hierarchy of the Company s cash equivalents and marketable securities at fair value is as follows:

(in thousands)	March 31, 2013	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Fair Value Measurements at Reporting Date Using Significant Other Observable Inputs (Level 2)
Money market funds	$ 589	$ 589	$
Marketable securities:			
Municipal bonds	$ 36,009	$ 15,186	$ 20,823
Corporate bonds	19,865	19,865	
Certificate of deposits	1,250		1,250
Total marketable securities	$ 57,124	$ 35,051	$ 22,073

(in thousands)	December 31, 2012	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Fair Value Measurements at Reporting Date Using Significant Other Observable Inputs (Level 2)
Money market funds	$ 2,873	$ 2,873	$
Marketable securities:			
Municipal bonds	$ 30,526	$ 11,966	$ 18,560
Corporate bonds	14,934	14,934	
Total marketable securities	$ 45,460	$ 26,900	$ 18,560

Assets Measured at Fair Value on a Nonrecurring Basis

Assets not recorded at fair value on a recurring basis, such as property and equipment, and intangible assets, are recognized at fair value when they are impaired. During the first quarter of 2013 and 2012, the Company did not recognize any impairments on its assets measured at fair value on a nonrecurring basis.

5. TRADE ACCOUNTS RECEIVABLE, NET OF ALLOWANCE

(in thousands)	March 31, 2013	December 31, 2012
Trade accounts receivable	$ 58,278	$ 112,106

Unbilled trade accounts receivable	13,369	22,923
Total accounts receivable	71,647	135,029
Allowance for sales credit memos	(1,134)	(963)
	$ 70,513	$ 134,066

Unbilled trade accounts receivable relate to services earned under time and material arrangements, and maintenance and license arrangements that had not been invoiced as of March 31, 2013 and December 31, 2012, respectively.

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6. GOODWILL AND OTHER INTANGIBLE ASSETS

There were no changes in the carrying amount of goodwill during the first quarter of 2013.

Intangible assets are recorded at cost and are amortized using the straight-line method over their estimated useful life, which range from four to nine years.

(in thousands)	Cost	Accumulated Amortization	Net Book Value
As of March 31, 2013			
Customer related intangibles	$ 44,355	$ (14,374)	$ 29,981
Technology	43,446	(17,972)	25,474
Other intangibles	2,238	(2,238)	
Total	$ 90,039	$ (34,584)	$ 55,455

	Cost	Accumulated Amortization	Net Book Value
As of December 31, 2012			
Customer related intangibles	$ 44,355	$ (13,142)	$ 31,213
Technology	43,446	(16,431)	27,015
Other intangibles	2,238	(2,234)	4
Total	$ 90,039	$ (31,807)	$ 58,232

For the first quarter of 2013 and 2012, amortization of intangibles was reflected in the Company s unaudited condensed consolidated statements of operations as follows:

(in thousands)	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Cost of software license	$ 1,541	$ 1,568
Selling and marketing	1,232	1,232
General and administrative	4	5
Total amortization expense	$ 2,777	$ 2,805

Amortization of intangibles is estimated to be recorded over their remaining useful lives as follows:

(in thousands) As of March 31, 2013	Future estimated amortization expense
Remainder of 2013	$ 8,318
2014	9,489

2015		8,688
2016		8,688
2017		8,688
2018 & thereafter		11,584
	$	55,455

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7. ACCRUED EXPENSES

(in thousands)	March 31, 2013	December 31, 2012
Other taxes	$ 2,434	$ 2,711
Restructuring	333	441
Professional fees	1,524	1,157
Income taxes	821	1,167
Professional services partners fees	334	256
Short-term deferred rent	1,004	1,111
Self-insurance health and dental claims	1,043	1,707
Dividends payable	1,142	
Employee reimbursable expenses	1,708	879
Other	4,924	6,105
	$ 15,267	$ 15,534

8. DEFERRED REVENUE

(in thousands)	March 31, 2013	December 31, 2012
Software license	$ 17,358	$ 24,303
Maintenance	73,718	62,144
Professional services and other	13,532	9,099
Current deferred revenue	104,608	95,546
Software license	13,501	15,407
Maintenance and professional services	2,528	3,312
Long-term deferred revenue	16,029	18,719
	$ 120,637	$ 114,265

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9. ACCRUED RESTRUCTURING COSTS

Following the acquisition of Chordiant in 2010 and in connection with the Company s evaluation of its combined facilities, the Company eliminated space within one facility and recognized $1.6 million of restructuring expenses, representing future lease payments and demising costs, net of estimated sublease income for this space. The lease expires at the end of 2013.

A summary of the restructuring activity during the first quarter of 2013 is as follows:

(in thousands)	Facilities