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, 2015

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 incorporation or organization)	**(IRS Employer 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	¨ (Do not check if smaller reporting company)	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 76,543,705 shares of the Registrant s common stock, $.01 par value per share, outstanding on April 24, 2015.

Table of Contents

PEGASYSTEMS INC.

Index to Form 10-Q

Table of Contents

PEGASYSTEMS INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	As of March 31, 2015	As of December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 127,480	$ 114,585
Marketable securities	97,877	96,631
Total cash, cash equivalents, and marketable securities	225,357	211,216
Trade accounts receivable, net of allowance of $1,664 and $1,540	150,902	154,844
Deferred income taxes	12,950	12,974
Income taxes receivable	5,623	4,502
Other current assets	13,277	9,544
Total current assets	408,109	393,080
Property and equipment, net	31,135	30,156
Long-term deferred income taxes	69,208	69,258
Long-term other assets	3,087	2,783
Intangible assets, net	42,487	45,664
Goodwill	46,777	46,860
Total assets	$ 600,803	$ 587,801
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 6,408	$ 4,752
Accrued expenses	35,136	42,958
Accrued compensation and related expenses	30,642	47,250
Deferred revenue	170,476	134,672
Total current liabilities	242,662	229,632
Income taxes payable	24,825	24,896
Long-term deferred revenue	18,499	20,859
Other long-term liabilities	17,000	17,709
Total liabilities	302,986	293,096
Stockholders equity:		
Preferred stock, 1,000 shares authorized; no shares issued and outstanding		
	766	764

Common stock, 200,000 shares authorized; 76,563 shares and 76,357 shares issued and outstanding		
Additional paid-in capital	143,976	141,495
Retained earnings	156,692	153,058
Accumulated other comprehensive loss	(3,617)	(612)
Total stockholders equity	297,817	294,705
Total liabilities and stockholders equity	$ 600,803	$ 587,801

See notes to unaudited condensed consolidated financial statements.

Table of Contents

PEGASYSTEMS INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
Revenue:		
Software license	$ 57,975	$ 52,614
Maintenance	48,752	44,881
Services	47,191	42,969
Total revenue	153,918	140,464
Cost of revenue:		
Software license	1,076	1,579
Maintenance	5,180	4,664
Services	43,803	39,670
Total cost of revenue	50,059	45,913
Gross profit	103,859	94,551
Operating expenses:		
Selling and marketing	55,735	45,807
Research and development	29,844	24,609
General and administrative	6,345	9,302
Acquisition-related	26	206
Total operating expenses	91,950	79,924
Income from operations	11,909	14,627
Foreign currency transaction (loss) gain	(2,962)	322
Interest income, net	313	124
Other expense, net		(532)
Income before provision for income taxes	9,260	14,541
Provision for income taxes	3,325	4,776
Net income	$ 5,935	$ 9,765
Earnings per share:		
Basic	$ 0.08	$ 0.13

Diluted	$	0.08	$	0.12
Weighted-average number of common shares outstanding:				
Basic		76,401		76,298
Diluted		78,592		78,661
Cash dividends declared per share	$	0.03	$	0.015

See notes to unaudited condensed consolidated financial statements.

Table of Contents

PEGASYSTEMS INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Three Months Ended March 31,	
	2015	**2014**
Net income	$ 5,935	$ 9,765
Other comprehensive (loss) income:		
Unrealized gain on securities, net of tax	91	31
Foreign currency translation adjustments	(3,096)	385
Total other comprehensive (loss) income, net	(3,005)	416
Comprehensive income	$ 2,930	$ 10,181

See notes to unaudited condensed consolidated financial statements.

5

Table of Contents

PEGASYSTEMS INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
Operating activities:		
Net income	$ 5,935	$ 9,765
Adjustments to reconcile net income to cash provided by operating activities:		
Excess tax benefits from exercise or vesting of equity awards	(822)	(971)
Deferred income taxes	(3)	44
Depreciation and amortization	5,624	5,846
Stock-based compensation expense	6,269	3,295
Foreign currency transaction loss (gain)	2,962	(322)
Other non-cash items	161	222
Change in operating assets and liabilities:		
Trade accounts receivable	(299)	57,291
Income taxes receivable and other current assets	(4,403)	1,629
Accounts payable and accrued expenses	(21,621)	(21,587)
Deferred revenue	33,919	18,337
Other long-term assets and liabilities	(201)	(691)
Cash provided by operating activities	27,521	72,858
Investing activities:		
Purchases of marketable securities	(18,120)	(11,630)
Proceeds from maturities and called marketable securities	16,549	11,021
Payments for acquisitions	(535)	(793)
Investment in property and equipment	(3,275)	(1,228)
Cash used in investing activities	(5,381)	(2,630)
Financing activities:		
Issuance of common stock for share-based compensation plans	146	22
Excess tax benefits from exercise or vesting of equity awards	822	971
Dividend payments to shareholders	(2,294)	(1,145)
Common stock repurchases for tax withholdings for net settlement of equity awards	(2,584)	(1,805)
Common stock repurchases under share repurchase programs	(2,427)	(4,630)
Cash used in financing activities	(6,337)	(6,587)
Effect of exchange rates on cash and cash equivalents	(2,908)	458

Net increase in cash and cash equivalents	12,895	64,099
Cash and cash equivalents, beginning of period	114,585	80,231
Cash and cash equivalents, end of period	$ 127,480	$ 144,330

See notes to unaudited condensed consolidated financial statements.

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, 2014.

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 2015.

2. NEW ACCOUNTING PRONOUNCEMENTS

Revenue from Contracts with Customers: In May 2014, the Financial Accounting Standard Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606) . This ASU amends the guidance for revenue recognition to replace numerous, industry-specific requirements, and converges areas under this topic with those of the International Financial Reporting Standards. This ASU implements a five-step process for customer contract revenue recognition that focuses on transfer of control, as opposed to transfer of risk and rewards. This ASU also requires enhanced disclosures regarding the nature, amount, timing, and uncertainty of revenues and cash flows from contracts with customers. Other major provisions include ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The amendments in this ASU are effective for reporting periods beginning after December 15, 2016, and early adoption is not permitted. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. On April 1, 2015, the FASB voted to propose a delay in the effective date of this ASU for reporting periods beginning after December 15, 2017, with early adoption permitted as of the original effective date. As a result, the proposed new effective date for the Company will be January 1, 2018. Management is currently assessing the impact the adoption of this ASU will have on the Company s consolidated financial statements.

Table of Contents

3. MARKETABLE SECURITIES

(in thousands)	March 31, 2015			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Municipal bonds	$ 28,130	$ 39	$ (12)	$ 28,157
Corporate bonds	64,864	47	(35)	64,876
Certificates of deposit	4,839	6	(1)	4,844
	$ 97,833	$ 92	$ (48)	$ 97,877

(in thousands)	December 31, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Municipal bonds	$ 27,820	$ 52	$ (17)	$ 27,855
Corporate bonds	65,487	5	(144)	65,348
Certificates of deposit	3,428	2	(2)	3,428
	$ 96,735	$ 59	$ (163)	$ 96,631

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, 2015, remaining maturities of marketable debt securities ranged from April 2015 to May 2017, with a weighted-average remaining maturity of approximately 14 months.

4. DERIVATIVE INSTRUMENTS

The Company has historically used foreign currency forward contracts (forward contracts) to manage its exposure to changes in foreign currency exchange rates associated with its foreign currency denominated accounts receivable, cash and intercompany payables. The U.S. operating company invoices most of its foreign clients in foreign currencies, which results in cash and receivables held at the end of the reporting period denominated in those 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, intercompany payables, 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 has been primarily exposed to the fluctuation in the British pound, Euro, Australian dollar, and Indian rupee relative to the U.S. dollar.

The 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 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.

Effective in the second quarter of 2015, the Company intends to restructure its transactions with its non-North American clients who will begin transacting with Pegasystems Limited, a U.K. subsidiary of the Company, which has the British pound as its functional currency. This reorganization could result in foreign currency transaction gains or (losses) on cash, intercompany payables, and accounts receivable held by the U.K. subsidiary in currencies other than the British pound. As a result, the Company expects its exposure to fluctuations in primarily the Euro and Australian dollar relative to the U.S. dollar to decrease, and its exposure from these currencies relative to the British pound to increase.

The Company is in the process of reassessing its hedging strategy and has not entered into any forward contracts since February 2014. The Company intends to fully or partially hedge its exposures relative to both the U.S. dollar and the British pound under its revised strategy, once implemented. As of March 31, 2015 and December 31, 2014, the Company did not have any forward contracts outstanding.

Table of Contents

The Company entered into forward contracts with notional values as follows:

	Notional Amount Three Months Ended March 31,	
Foreign currency (in thousands)	**2015**	**2014**
Euro		21,900
British pound	£	£ 26,500
Australian dollar	A$	A$ 12,900
Indian rupee	Rs	Rs 204,000

The total change in the fair value of the Company s forward contracts recorded in other expense, net, was as follows:

	Change in Fair Value in USD Three Months Ended March 31,	
(in thousands)	**2015**	**2014**
Loss included in other expense, net	$	$ (532)

5. 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 ac