

PEGASYSTEMS INC
Form 10-Q
August 08, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2018

OR

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 1-11859

PEGASYSTEMS INC.

(Exact name of Registrant as specified in its charter)

Massachusetts

04-2787865
(IRS Employer Identification No.)

(State or other jurisdiction of incorporation or organization)

One Rogers Street, Cambridge, MA
(Address of principal executive offices)

02142-1209
(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 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 No

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

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

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

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 78,645,411 shares of the Registrant's common stock, \$0.01 par value per share, outstanding on August 1, 2018.

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Table of Contents**PART I - FINANCIAL INFORMATION****ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
PEGASYSTEMS INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS ⁽¹⁾****(in thousands)**

	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 144,291	\$ 162,279
Marketable securities	99,292	61,469
Total cash, cash equivalents, and marketable securities	243,583	223,748
Accounts receivable	141,384	222,735
Unbilled receivables	151,354	158,898
Other current assets	63,864	41,135
Total current assets	600,185	646,516
Long-term unbilled receivables	169,330	160,708
Goodwill	72,911	72,952
Other long-term assets	130,614	131,391
Total assets	\$ 973,040	\$ 1,011,567
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	\$ 14,411	\$ 17,370
Accrued expenses	44,882	45,508
Accrued compensation and related expenses	48,691	66,040
Deferred revenue	163,525	166,297
Total current liabilities	271,509	295,215
Deferred income tax liabilities	38,208	38,463
Other long-term liabilities	24,151	23,652
Total liabilities	333,868	357,330
Stockholders equity:		
Preferred stock, 1,000 shares authorized; no shares issued and outstanding		
Common stock, 200,000 shares authorized; 78,748 and 78,081 shares issued and outstanding at		
June 30, 2018 and December 31, 2017, respectively	787	781

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Additional paid-in capital	141,400	152,097
Retained earnings	506,769	508,051
Accumulated other comprehensive loss	(9,784)	(6,692)
Total stockholders' equity	639,172	654,237
Total liabilities and stockholders' equity	\$ 973,040	\$ 1,011,567

(1) On January 1, 2018 the Company adopted the ASC 606 revenue recognition standard and has adjusted prior periods to conform. See Note 2. New Accounting Pronouncements for additional information.
See notes to unaudited condensed consolidated financial statements.

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue				
Software license	\$ 44,784	\$ 51,150	\$ 132,557	\$ 178,158
Maintenance	65,906	59,424	130,431	118,137
Services	86,089	76,022	168,973	146,610
Total revenue	196,779	186,596	431,961	442,905
Cost of revenue				
Software license	1,262	1,250	2,517	2,550
Maintenance	5,874	7,011	11,956	14,229
Services	66,681	59,614	134,958	119,186
Total cost of revenue	73,817	67,875	149,431	135,965
Gross profit	122,962	118,721	282,530	306,940
Operating expenses				
Selling and marketing	93,972	75,200	182,355	144,881
Research and development	41,972	39,762	88,757	80,058
General and administrative	10,181	12,706	26,645	25,041
Total operating expenses	146,125	127,668	297,757	249,980
(Loss)/income from operations	(23,163)	(8,947)	(15,227)	56,960
Foreign currency transaction gain/(loss)	1,244	(2,242)	159	(1,497)
Interest income, net	629	202	1,393	407
Other income, net		566	363	287
(Loss)/income before (benefit) from income taxes	(21,290)	(10,421)	(13,312)	56,157
(Benefit) from income taxes	(10,881)	(14,123)	(15,103)	(508)
Net (loss)/income	\$ (10,409)	\$ 3,702	\$ 1,791	\$ 56,665
(Loss)/earnings per share				
Basic	\$ (0.13)	\$ 0.05	\$ 0.02	\$ 0.74
Diluted	\$ (0.13)	\$ 0.04	\$ 0.02	\$ 0.69

Weighted-average number of common shares outstanding

Basic		78,635		77,313		78,436		77,039
Diluted		78,635		82,945		83,247		82,412
Cash dividends declared per share	\$	0.03	\$	0.03	\$	0.06	\$	0.06

(1) On January 1, 2018 the Company adopted the ASC 606 revenue recognition standard and has adjusted prior periods to conform. See Note 2. New Accounting Pronouncements for additional information.

See notes to unaudited condensed consolidated financial statements.

Table of Contents**PEGASYSTEMS INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE
(LOSS)/INCOME⁽¹⁾****(in thousands)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net (loss)/income	\$ (10,409)	\$ 3,702	\$ 1,791	\$ 56,665
Other comprehensive (loss)/income, net of tax				
Unrealized gain/(loss) on available-for-sale marketable securities, net of tax	73	(1)	(115)	126
Foreign currency translation adjustments	(7,414)	4,043	(2,977)	6,272
Total other comprehensive (loss)/income, net of tax	(7,341)	4,042	(3,092)	6,398
Comprehensive (loss)/income	\$ (17,750)	\$ 7,744	\$ (1,301)	\$ 63,063

⁽¹⁾ On January 1, 2018 the Company adopted the ASC 606 revenue recognition standard and has adjusted prior periods to conform. See Note 2. New Accounting Pronouncements for additional information.
See notes to unaudited condensed consolidated financial statements.

Table of Contents**PEGASYSTEMS INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS ⁽¹⁾****(in thousands)**

	Six Months Ended June 30,	
	2018	2017
Operating activities:		
Net income	\$ 1,791	\$ 56,665
Adjustments to reconcile net income to cash provided by operating activities:		
Change in operating assets and liabilities, net	30,158	(14,874)
Stock-based compensation expense	31,165	26,440
Depreciation and amortization of intangible assets	12,474	12,356
Other non-cash	(156)	5,182
Cash provided by operating activities	75,432	85,769
Investing activities:		
Purchases of investments	(51,395)	(16,656)
Proceeds from maturities and called investments	11,546	20,824
Other	(6,520)	(5,327)
Cash used in investing activities	(46,369)	(1,159)
Financing activities:		
Dividend payments to shareholders	(4,702)	(4,613)
Common stock repurchases	(41,123)	(30,247)
Cash used in financing activities	(45,825)	(34,860)
Effect of exchange rates on cash and cash equivalents	(1,226)	1,282
Net (decrease)/increase in cash and cash equivalents	(17,988)	51,032
Cash and cash equivalents, beginning of period	162,279	70,594
Cash and cash equivalents, end of period	\$ 144,291	\$ 121,626

⁽¹⁾ On January 1, 2018 the Company adopted the ASC 606 revenue recognition standard and has adjusted prior periods to conform. See Note 2. New Accounting Pronouncements for additional information.
See notes to unaudited condensed consolidated financial statements.

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PEGASYSTEMS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. 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, 2017.

On January 1, 2018 the Company adopted Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606) using the full retrospective method which required each prior reporting period presented be adjusted to reflect the application of this ASU. See Note 2. New Accounting Pronouncements for additional information.

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 2018.

2. NEW ACCOUNTING PRONOUNCEMENTS

Financial Instruments

In June 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-13, Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which requires measurement and recognition of expected credit losses for financial assets measured at amortized cost, including accounts receivable, upon initial recognition of that financial asset using a forward-looking expected loss model, rather than an incurred loss model for credit losses. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses when the fair value is below the amortized cost of the asset, removing the concept of other-than-temporary impairments. The effective date for the Company will be January 1, 2020, with early adoption permitted. The Company is currently evaluating the effect this ASU will have on its consolidated financial statements and related disclosures.

Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires lessees to record most leases on their balance sheets, recognizing a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. The effective date