SPS COMMERCE INC
Form 10-Q
May 05, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended: March 31, 2011

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 001-34702

SPS COMMERCE, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**41-2015127**
(State or Other Jurisdiction of Incorporation or Organization)	***(I.R.S. Employer Identification No.)***

333 South Seventh Street, Suite 1000, Minneapolis, MN 55402

(Address of Principal Executive Offices, Including Zip Code)

(612) 435-9400

(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 þ No o

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 (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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 o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

The number of shares of the registrant s common stock, par value $0.001 per share, outstanding at April 29, 2011 was 11,897,171 shares.

SPS COMMERCE, INC.
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SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

This Quarterly Report on Form 10-Q contains forward-looking statements regarding us, our business prospects and our results of operations that are subject to certain risks and uncertainties posed by many factors and events that could cause our actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those described under the heading *Risk Factors* included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the Commission that advise interested parties of the risks and factors that may affect our business.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SPS COMMERCE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited; in thousands, except share amounts

	March 31, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 40,447	$ 40,473
Accounts receivable, less allowance for doubtful accounts of $200 and $209	6,356	5,574
Deferred costs, current	4,887	4,720
Prepaid expenses and other current assets	1,234	874
Total current assets	52,924	51,641
PROPERTY AND EQUIPMENT, net	2,826	2,760
GOODWILL	1,166	1,166
INTANGIBLE ASSETS, net	290	290
OTHER ASSETS		
Deferred costs, net of current portion	2,031	1,943
Other non-current assets	80	80
	$ 59,317	$ 57,880
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Capital lease obligations, current	$	$ 122
Accounts payable	1,579	998
Accrued compensation and benefits	3,362	3,577
Accrued expenses and other current liabilities	944	807
Deferred revenue, current	3,549	3,585
Total current liabilities	9,434	9,089
OTHER LIABILITIES		
Deferred revenue, less current portion	5,302	5,002
Other non-current liabilities	244	281
Total liabilities	14,980	14,372
STOCKHOLDERS EQUITY		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; 0 shares issued and outstanding		

Common stock, $0.001 par value; 55,000,000 shares authorized; 11,881,688 and 11,849,572 shares issued and outstanding, respectively	12	12
Additional paid-in capital	106,601	106,264
Accumulated deficit	(62,276)	(62,768)
Total stockholders equity	44,337	43,508
	$ 59,317	$ 57,880

The accompanying notes are an integral part of these consolidated financial statements.

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SPS COMMERCE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; in thousands, except per share amounts)

	Three Months Ended March 31,	
	2011	**2010**
Revenues	$ 12,649	$ 10,243
Cost of revenues	3,321	2,981
Gross profit	9,328	7,262
Operating expenses		
Sales and marketing	5,126	3,507
Research and development	1,240	1,043
General and administrative	2,455	1,665
Total operating expenses	8,821	6,215
Income from operations	507	1,047
Other income (expense)		
Interest expense		(45)
Interest income	32	
Other expense	(18)	(18)
Total other income (expense), net	14	(63)
Income before income taxes	521	984
Income tax expense	(29)	(65)
Net income	$ 492	$ 919
Net income per share		
Basic	$ 0.04	$ 2.81
Diluted	$ 0.04	$ 0.10
Weighted average common shares used to compute net income per share		
Basic	11,864	327
Diluted	12,698	9,525

The accompanying notes are an integral part of these consolidated financial statements.

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SPS COMMERCE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in thousands)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Cash flows from operating activities		
Net income	$ 492	$ 919
Reconciliation of net income to net cash provided by operating activities		
Depreciation and amortization	422	340
Provision for doubtful accounts	55	102
Stock-based compensation	312	51
Change in carrying value of preferred stock warrants		27
Other		2
Changes in assets and liabilities		
Accounts receivable	(837)	(460)
Prepaid expenses and other current assets	(360)	(573)
Deferred costs	(255)	(235)
Accounts payable	581	(137)
Deferred revenue	264	319
Accrued compensation and benefits	(215)	(338)
Accrued expenses and other current liabilities	101	237
Net cash provided by operating activities	560	254
Cash flows from investing activities		
Purchases of property and equipment	(488)	(130)
Net cash used in investing activities	(488)	(130)
Cash flows from financing activities		
Borrowings on line of credit		4,450
Payments on line of credit		(4,350)
Payments on equipment loans		(138)
Payments of capital lease obligations	(122)	(21)
Net proceeds from exercise of options to purchase common stock	24	
Net cash used in financing activities	(98)	(59)
Net increase (decrease) in cash and cash equivalents	(26)	65
Cash and cash equivalents at beginning of period	40,473	5,931
Cash and cash equivalents at end of period	$ 40,447	$ 5,996

The accompanying notes are an integral part of these consolidated financial statements.

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SPS COMMERCE, INC.
Notes to Condensed Consolidated Financial Statements (Unaudited)
NOTE A General

Business Description

We are a leading provider of on-demand supply chain management solutions, providing integration, collaboration, connectivity, visibility and data analytics to thousands of customers worldwide. We provide our solutions through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other customers manage and fulfill orders. We deliver our solutions to our customers over the Internet using a Software-as-a-Service model and derive the majority of our revenues from thousands of monthly recurring subscriptions from businesses that utilize our solutions.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these condensed consolidated financial statements do not include all of the information and footnotes required by GAAP. We have included all normal recurring adjustments considered necessary to give a fair statement of our financial position, results of operations and cash flows for the interim periods shown. Operating results for these interim periods are not necessarily indicative of the results to be expected for the full year. The December 31, 2010 balance sheet data was derived from our audited financial statements at that date. For further information, refer to the consolidated financial statements and accompanying notes for the year ended December 31, 2010 included in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 3, 2011.

Use of Estimates

Preparing financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Significant Accounting Policies

During the three months ended March 31, 2011, there were no material changes in our significant accounting policies. See Note A to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011 for additional information regarding our significant accounting policies.

Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-13, Revenue Recognition (ASC Topic 605), *Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force.* This guidance modifies the fair value requirements of ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements,* by allowing the use of the best estimate of selling price in addition to Vendor Specific Objective Evidence and third-party evidence (or TPE) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when Vendor Specific Objective Evidence or TPE of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted.

In October 2009, the FASB issued ASU No. 2009-14, Software (ASC Topic 985), *Certain Revenue Arrangements That Include Software Elements, a consensus of the FASB Emerging Issues Task Force.* This guidance modifies the scope of ASC subtopic 965-605, *Software-Revenue Recognition,* to exclude from its requirements (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionality.

ASU No. 2009-13 and ASU No. 2009-14 both require expanded qualitative and quantitative disclosures and are effective for fiscal years beginning on or after June 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (ASC Topic 820), *Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 enhances the disclosure requirements to include transfers in and out of Level 1 and 2 and the associated reasons, which was effective for fiscal years beginning on or after December 15, 2009. ASU No. 2010-06 also requires the disclosure of a disaggregated gross reconciliation of Level 3 fair value measurements, which is effective for fiscal years beginning on or after December 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In July 2010, the FASB issued ASU No. 2010-20, Receivables (ASC Topic 310), *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU No. 2010-20 enhances the disclosure requirements about the credit quality and related allowance for credit losses of financing receivables. We will be required to disclose the nature of the inherent risk of receivables, the methodology and analytics that support that assessment, and support any changes to the allowance for doubtful accounts. We will also be required to provide a rollforward of the allowance and disclose the accounts receivable on a disaggregated basis. This update is effective for fiscal years beginning on or after December 15, 2010. We have adopted this update and it did not have a material impact on our financial statements.

NOTE B Financial Statement Components

Intangible Assets

Intangible assets included the following (in thousands):

	March 31, 2011			December 31, 2010		
	Carrying Amount	Accumulated Amortization	Net	Carrying Amount	Accumulated Amortization	Net
Subscriber relationships	$ 1,930	$ (1,930)	$	$ 1,930	$ (1,930)	$
Covenants not-to-compete	580	(290)	290	580	(290)	290
	$ 2,510	$ (2,220)	$ 290	$ 2,510	$ (2,220)	$ 290

There was no amortization expense for intangible assets for the three months ended March 31, 2011 or the three months ended March 31, 2010.

NOTE C Stock-Based Compensation

Our equity compensation plans provide for the grant of incentive and nonqualified stock options, as well as other stock-based awards, to employees, non-employee directors and other consultants who provide services to us. Stock options generally vest over three to four years and have a contractual term of ten years from the date of grant. At March 31, 2011, there were approximately 834,000 shares available for grant under approved equity compensation plans.

We recorded stock-based compensation expense of $312,000 and $51,000 for the three months ended March 31, 2011 and 2010, respectively. This expense was allocated as follows (in thousands):

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	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Cost of revenues	$ 46	$ 10
Operating expenses:		
Sales and marketing	89	17
Research and development	7	1
General and administrative	170	23
Total stock-based compensation expense	$ 312	$ 51

As of March 31, 2011, there was approximately $4.3 million of unrecognized stock-based compensation expense under our equity compensation plans, which is expected to be recognized on a straight line basis over a weighted average period of approximately two years.

Our stock option activity was as follows:

	Options (#)	Weighted Average Exercise Price ($/share)
Outstanding at December 31, 2010	1,549,344	$ 4.59
Granted	235,036	16.64
Exercised	(32,116)	0.78
Forfeited		
Outstanding at March 31, 2011	1,752,264	6.28

The weighted average fair value per share of options granted during 2011 was $8.00 and this was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

Weighted-average volatility	45.0%
Expected dividend yield	0%
Expected life (in years)	6.25
Weighted-average risk-free interest rate	3.05%

NOTE D Income Taxes

We recorded a provision for income taxes of $29,000 and $65,000 for the three months ended March 31, 2011 and 2010, respectively. We record our interim provision for income taxes based on our estimated annual effective tax rate for the year. Our provision for income taxes includes estimated federal alternative minimum taxes and state income taxes, as well as deferred tax expense resulting from the book and tax basis difference in goodwill from a prior asset acquisition.

As of December 31, 2010, we had net operating loss carryforwards of $49.9 million for U.S. federal tax purposes and $31.4 million for state tax purposes. These loss carryforwards expire between 2011 and 2029. Section 382 of the U.S. Internal Revenue Code generally imposes an annual limitation on the amount of net operating loss carryforwards that might be used to offset taxable income when a corporation has undergone significant changes in stock ownership. We have performed a Section 382 analysis for the time period from our inception through December 8, 2010. During this time period it was determined that we had six separate ownership changes under Section 382. We believe that approximately $17.6 million of federal losses and $7.0 million of state losses will expire unused due to Section 382 limitations. This limitation could be further restricted if ownership changes occur in future years. Our deferred tax asset is reported net of this limitation.

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Realization of our net operating loss carryforwards and other deferred tax temporary differences are contingent upon future taxable earnings. Our net deferred tax assets have been reduced fully by a valuation allowance, as realization is not considered to be likely based on an assessment of the history of losses and the likelihood of sufficient future taxable income. Our deferred tax liability relates to goodwill created in a prior asset acquisition which is deductible for tax purposes.

We are subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions. As of March 31, 2011, we are generally subject to U.S. federal and state tax examinations for all tax years prior to 2009 due to net operating loss carryforwards.

As of March 31, 2011, we do not have any unrecognized tax benefits. It is our practice to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. We do not expect any material changes in our unrecognized tax positions over the next 12 months.

NOTE E Net Income Per Share

Basic net income per share has been computed using the weighted average number of shares of common stock outstanding during each period. Diluted net income per share also includes the impact of our outstanding potential common shares, such as options, warrants and redeemable convertible preferred stock. Potential common shares that are anti-dilutive are excluded from the calculation of diluted net income per share.

The following table presents the components of the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2011	2010
Numerator:		
Net income	$ 492	$ 919
Denominator:		
Weighted average common shares outstanding, basic	11,864	327
Options and warrants to purchase common and preferred stock	834	1,104
Redeemable convertible preferred stock		8,094
Weighted average common shares outstanding, diluted	12,698	9,525
Net income per share:		
Basic	$ 0.04	$ 2.81
Diluted	$ 0.04	$ 0.10

The following outstanding options, warrants and redeemable convertible preferred stock were excluded from the computation of diluted net income per share for the periods indicated because they were anti-dilutive (in thousands):

	Three Months Ended March 31,	
	2011	2010
Options and warrants to purchase common and preferred stock	235	1
Redeemable convertible preferred stock		

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

Overview

We are a leading provider of on-demand supply chain management solutions, providing integration, collaboration, connectivity, visibility and data analytics to thousands of trading partners worldwide. We provide our solutions through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other trading partners manage and fulfill orders. We deliver our solutions to our customers over the Internet using a Software-as-a-Service model.

We plan to grow our business by further penetrating the supply chain management market, increasing revenues from our customers as their businesses grow, expanding our distribution channels, expanding our international presence and developing new solutions and applications. We also intend to selectively pursue acquisitions that will add customers, allow us to expand into new regions or industries or allow us to offer new functionalities.

Key Financial Terms and Metrics

We have several key financial terms and metrics, including annualized average recurring revenues per recurring revenue customer. During the three months ended March 31, 2011, there were no changes in the definitions of our key financial terms and metrics, which are discussed in more detail under the heading *Management s Discussion and Analysis of Financial Condition and Results of Operations* included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011.

To supplement our financial statements, we also provide investors with Adjusted EBITDA and non-GAAP net income per share, both of which are non-GAAP financial measures. We believe that these non-GAAP measures provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Our management uses these non-GAAP measures to compare the company s performance to that of prior periods for trend analyses and planning purposes. Adjusted EBITDA is also used for purposes of determining executive and senior management incentive compensation. These measures are also presented to our board of directors.

These non-GAAP measures should not be considered a substitute for, or superior to, financial measures calculated in accordance with generally accepted accounting principles in the United States. These non-GAAP financial measures exclude significant expenses and income that are required by GAAP to be recorded in the company s financial statements and are subject to inherent limitations. Investors should review the reconciliations of non-GAAP financial measures to the comparable GAAP financial measures that are included in this *Management s Discussion and Analysis of Financial Condition and Results of Operations.*

Critical Accounting Policies and Estimates

This discussion of our financial condition and results of operations is based upon our financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that we believe to be reasonable. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

We believe that of our significant accounting policies, the following accounting policies involve a greater degree of judgment, complexity and effect on materiality. A critical accounting policy is one that is both material to the presentation of our financial statements and requires us to make difficult, subjective or complex judgments for uncertain matters that could have a material effect on our financial condition and results of operations. Accordingly, we believe that our policies for revenue recognition, the allowance for doubtful accounts, income taxes, stock-based

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compensation and the valuation of goodwill are the most critical to aid in fully understanding and evaluating our financial condition and results of operations.

During the three months ended March 31, 2011, there were no significant changes in our critical accounting policies or estimates. See Note A to our financial statements included elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011 for additional information regarding our critical accounting policies, as well as a description of our other significant accounting policies.

Results of Operations

The following table presents our results of operations for the periods indicated (dollars in thousands):

	Three Months Ended March 31,					
	2011		2010		Change	
		% of revenue		% of revenue	$	%
Revenues	$ 12,649	100.0%	$ 10,243	100.0%	$ 2,406	23.5%
Cost of revenues	3,321	26.3	2,981	29.1	340	11.4
Gross profit	9,328	73.7	7,262	70.9	2,066	28.4
Operating expenses:						
Sales and marketing	5,126	40.5	3,507	34.2	1,619	46.2
Research and development	1,240	9.8	1,043	10.2	197	18.9
General and administrative	2,455	19.4	1,665	16.3	790	47.4
Total operating expenses	8,821	69.7	6,215	60.7	2,606	41.9
Income from operations	507	4.0	1,047	10.2	(540)	(51.6)
Other income (expense):						
Interest expense			(45)	(0.4)	45	(100.0)
Interest income	32	0.3			32	*
Other expense	(18)	(0.1)	(18)	(0.2)		
Total other income (expense), net	14	0.1	(63)	(0.6)	77	*
Income before income taxes	521	4.1	984	9.6	(463)	(47.1)
Income tax expense	(29)	(0.2)	(65)	(0.6)	36	(55.4)

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