CSG SYSTEMS INTERNATIONAL INC
Form 10-Q
November 03, 2017

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 September 30, 2017

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 0-27512

CSG SYSTEMS INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	47-0783182
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9555 Maroon Circle

Englewood, Colorado 80112

(Address of principal executive offices, including zip code)

(303) 200-2000

(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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 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 NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	(Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth 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

Shares of common stock outstanding at October 31, 2017: 33,523,452

CSG SYSTEMS INTERNATIONAL, INC.

FORM 10-Q for the Quarter Ended September 30, 2017

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CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED

(in thousands, except per share amounts)

	September 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 142,751	$ 126,351
Short-term investments	115,796	150,147
Total cash, cash equivalents and short-term investments	258,547	276,498
Trade accounts receivable:		
Billed, net of allowance of $2,456 and $3,080	201,837	208,930
Unbilled	34,688	30,828
Income taxes receivable	9,560	11,931
Other current assets	35,034	31,751
Total current assets	539,666	559,938
Non-current assets:		
Property and equipment, net of depreciation of $128,669 and $122,866	37,822	33,116
Software, net of amortization of $106,539 and $99,316	27,014	30,427
Goodwill	210,023	201,094
Client contracts, net of amortization of $93,871 and $96,723	36,797	40,675
Deferred income taxes	14,251	14,218
Other assets	9,799	12,411
Total non-current assets	335,706	331,941
Total assets	$ 875,372	$ 891,879
LIABILITIES, CURRENT PORTION OF LONG-TERM DEBT CONVERSION OBLIGATION AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt, net of unamortized discounts of zero and $296	$ 20,625	$ 49,426
Client deposits	29,061	33,916
Trade accounts payable	31,686	35,118
Accrued employee compensation	60,346	65,341
Deferred revenue	53,597	45,064
Income taxes payable	613	822
Other current liabilities	15,168	22,342
Total current liabilities	211,096	252,029
Non-current liabilities:		
Long-term debt, net of unamortized discounts of $19,462 and $23,007	313,663	326,993
Deferred revenue	11,550	6,694
Income taxes payable	2,445	2,245
Deferred income taxes	98	99
Other non-current liabilities	11,668	12,618
Total non-current liabilities	339,424	348,649
Total liabilities	550,520	600,678
Current portion of long-term debt conversion obligation	-	39,841
Stockholders' equity:		
Preferred stock, par value $.01 per share; 10,000 shares authorized; zero shares issued and outstanding	-	-

Common stock, par value $.01 per share; 100,000 shares authorized; 33,575 and 32,261 shares outstanding	689	672
Common stock warrants; zero and 1,426 warrants vested; 1,425 and 2,851 issued	-	16,007
Additional paid-in capital	422,919	391,209
Treasury stock, at cost; 33,959 and 34,919 shares	(809,748)	(826,002)
Accumulated other comprehensive income (loss):		
Unrealized loss on short-term investments, net of tax	(5)	(159)
Cumulative foreign currency translation adjustments	(30,040)	(45,213)
Accumulated earnings	741,037	714,846
Total stockholders' equity	324,852	251,360
Total liabilities, current portion of long-term debt conversion obligation and stockholders' equity	$ 875,372	$ 891,879

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

CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME - UNAUDITED

(in thousands, except per share amounts)

	Quarter Ended		Nine Months Ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Revenues:				
Cloud and related solutions	$164,789	$ 151,217	$481,445	$ 451,023
Software and services	15,726	18,634	46,680	58,964
Maintenance	18,680	19,460	56,253	55,802
Total revenues	199,195	189,311	584,378	565,789
Cost of revenues (exclusive of depreciation, shown separately below):				
Cloud and related solutions	79,856	70,150	233,194	206,578
Software and services	9,725	12,230	31,404	37,057
Maintenance	10,136	11,040	30,487	32,051
Total cost of revenues	99,717	93,420	295,085	275,686
Other operating expenses:				
Research and development	30,324	23,572	85,103	71,479
Selling, general and administrative	35,816	32,508	109,981	101,539
Depreciation	3,344	3,398	9,975	10,423
Restructuring and reorganization charges	1,618	(185)	4,597	(601)
Total operating expenses	170,819	152,713	504,741	458,526
Operating income	28,376	36,598	79,637	107,263
Other income (expense):				
Interest expense	(4,186)	(4,398)	(12,638)	(11,876)
Amortization of original issue discount	(634)	(1,062)	(2,147)	(3,856)
Interest and investment income, net	800	707	2,310	1,698
Loss on repurchase of convertible notes	-	(332)	-	(8,651)
Other, net	(970)	(1,354)	(1,123)	(4,040)
Total other	(4,990)	(6,439)	(13,598)	(26,725)
Income before income taxes	23,386	30,159	66,039	80,538
Income tax provision	(8,806)	(12,265)	(19,641)	(30,303)
Net income	$14,580	$ 17,894	$46,398	$ 50,235
Weighted-average shares outstanding:				
Basic	32,561	31,063	32,383	30,922
Diluted	32,901	32,639	32,825	33,041
Earnings per common share:				
Basic	$0.45	$ 0.58	$1.43	$ 1.62
Diluted	0.44	0.55	1.41	1.52

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

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CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME - UNAUDITED

(in thousands)

	Quarter Ended		Nine Months Ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Net income	$14,580	$ 17,894	$46,398	$ 50,235
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	5,609	(1,393)	15,173	(10,433)
Unrealized holding gains (losses) on short-term investments arising during period	7	(566)	154	91
Other comprehensive income (loss), net of tax	5,616	(1,959)	15,327	(10,342)
Total comprehensive income, net of tax	$20,196	$ 15,935	$61,725	$ 39,893

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

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CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

(in thousands)

	Nine Months Ended September 30, 2017	September 30, 2016
Cash flows from operating activities:		
Net income	$46,398	$ 50,235
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation	9,975	10,423
Amortization	21,670	19,921
Amortization of original issue discount	2,147	3,856
Asset impairment	2,135	-
Gain on short-term investments and other	(76)	(23)
Loss on repurchase of convertible notes	-	8,651
Gain on disposition of business operations	-	(6,611)
Deferred income taxes	1,487	(2,159)
Excess tax benefit of stock-based compensation awards	-	(4,622)
Stock-based compensation	16,659	17,273
Changes in operating assets and liabilities:		
Trade accounts receivable, net	7,567	(16,275)
Other current and non-current assets	(1,788)	199
Income taxes payable/receivable	1,715	(2,750)
Trade accounts payable and accrued liabilities	(16,007)	(23,628)
Deferred revenue	10,940	5,016
Net cash provided by operating activities	102,822	59,506
Cash flows from investing activities:		
Purchases of property and equipment	(23,370)	(11,542)
Purchases of short-term investments	(116,203)	(122,736)
Proceeds from sale/maturity of short-term investments	150,768	107,816
Acquisition of and investments in client contracts	(10,082)	(6,038)
Proceeds from the disposition of business operations	-	8,850
Net cash provided by (used in) investing activities	1,113	(23,650)
Cash flows from financing activities:		
Proceeds from issuance of common stock	1,259	1,120
Payment of cash dividends	(20,405)	(18,325)
Repurchase of common stock	(24,764)	(22,455)
Proceeds from long-term debt	-	230,000
Payments on long-term debt	(11,250)	(5,625)
Repurchase of convertible notes	-	(215,657)
Settlement of convertible notes	(34,771)	-
Payments of deferred financing costs	-	(6,744)
Excess tax benefit of stock-based compensation awards	-	4,622
Net cash used in financing activities	(89,931)	(33,064)

Effect of exchange rate fluctuations on cash	2,396	4,798
Net increase in cash and cash equivalents	16,400	7,590
Cash and cash equivalents, beginning of period	126,351	132,631
Cash and cash equivalents, end of period	$142,751	$ 140,221
Supplemental disclosures of cash flow information:		
Cash paid during the period for-		
Interest	$13,638	$ 11,165
Income taxes	16,407	35,260

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

CSG SYSTEMS INTERNATIONAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. GENERAL

We have prepared the accompanying unaudited condensed consolidated financial statements as of September 30, 2017 and December 31, 2016, and for the quarters and nine months ended September 30, 2017 and 2016, in accordance with accounting principles generally accepted in the United States of America ("U.S.") ("GAAP") for interim financial information, and pursuant to the instructions to Form 10-Q and the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of our management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of our financial position and operating results have been included. The unaudited Condensed Consolidated Financial Statements (the "Financial Statements") should be read in conjunction with the Consolidated Financial Statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), contained in our Annual Report on Form 10-K for the year ended December 31, 2016 (our "2016 10-K"), filed with the SEC. The results of operations for the quarter and nine months ended September 30, 2017 are not necessarily indicative of the expected results for the entire year ending December 31, 2017.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates in Preparation of Financial Statements. The preparation of the accompanying 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 our Financial Statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Cash and Cash Equivalents. We consider all highly liquid investments with original maturities of three months or less at the date of the purchase to be cash equivalents. As of September 30, 2017 and December 31, 2016, our cash equivalents consist primarily of institutional money market funds, commercial paper, and time deposits held at major banks.

As of September 30, 2017 and December 31, 2016, we had $2.8 million and $4.3 million, respectively, of restricted cash that serves to collateralize outstanding letters of credit. This restricted cash is included in cash and cash equivalents in our Condensed Consolidated Balance Sheets ("Balance Sheets" or "Balance Sheet").

Short-term Investments and Other Financial Instruments. Our financial instruments as of September 30, 2017 and December 31, 2016 include cash and cash equivalents, short-term investments, accounts receivable, accounts payable, and debt. Because of their short maturities, the carrying amounts of cash equivalents, accounts receivable, and accounts payable approximate their fair value.

Our short-term investments and certain of our cash equivalents are considered "available-for-sale" and are reported at fair value in our Balance Sheets, with unrealized gains and losses, net of the related income tax effect, excluded from earnings and reported in a separate component of stockholders' equity. Realized and unrealized gains and losses were not material in any period presented.

Primarily all short-term investments held by us as of September 30, 2017 and December 31, 2016 have contractual maturities of less than two years from the time of acquisition. Our short-term investments as of September 30, 2017 and December 31, 2016 consisted almost entirely of fixed income securities. Proceeds from the sale/maturity of short-term investments for the nine months ended September 30, 2017 and 2016 were $150.8 million and $107.8 million, respectively.

The following table represents the fair value hierarchy based upon three levels of inputs, of which Levels 1 and 2 are considered observable and Level 3 is unobservable, for our financial assets and liabilities measured at fair value (in thousands):

	September 30, 2017			December 31, 2016		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets:						
Cash equivalents:						
Money market funds	$3,790	$—	$3,790	$6,531	$—	$6,531
Commercial paper	—	18,138	18,138	—	24,826	24,826
Short-term investments:						
Corporate debt securities	—	92,749	92,749	—	109,140	109,140
U.S. government agency bonds	—	8,905	8,905	—	26,513	26,513
Asset-backed securities	—	14,142	14,142	—	14,494	14,494
Total	$3,790	$133,934	$137,724	$6,531	$174,973	$181,504

Valuation inputs used to measure the fair values of our money market funds and corporate equity securities were derived from quoted market prices. The fair values of all other financial instruments are based upon pricing provided by third-party pricing services. These prices were derived from observable market inputs.

We have chosen not to measure our debt at fair value, with changes recognized in earnings each reporting period. The following table indicates the carrying value (par value for convertible debt) and estimated fair value of our debt as of the indicated periods (in thousands):

	September 30, 2017		December 31, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Credit agreement (carrying value including current maturities)	$123,750	$123,750	$135,000	$135,000
2010 Convertible debt (par value)	—	—	34,722	74,795
2016 Convertible debt (par value)	230,000	247,538	230,000	258,175

The fair value for our credit agreement was estimated using a discounted cash flow methodology, while the fair value for our convertible debt was estimated based upon quoted market prices or recent sales activity, both of which are considered Level 2 inputs. See Note 4 for additional discussion regarding our convertible debt.

Accounting Pronouncements Adopted. In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718). This ASU simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. The methods of adoption for this ASU vary by amendment. We adopted this ASU in the first quarter of 2017, prospectively applying the guidance related to the recognition of excess tax benefits and tax deficiencies in the income statement and the presentation of excess tax benefits on the statement of cash flows. See Note 6 for further discussion of the impact of adopting this ASU.

Accounting Pronouncement Issued But Not Yet Effective. The FASB has issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). In August 2015, the FASB issued ASU 2015-14 Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date which deferred the effective date of ASU 2014-09 for one year. In December 2016, the FASB issued ASU 2016-20 Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers. Collectively, this ASU is a single comprehensive model which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. Under the new guidance, revenue is recognized when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The accounting guidance is effective for annual and interim reporting periods in fiscal years beginning after December 15, 2017. Early adoption is permitted. An entity may choose to adopt this ASU either retrospectively or through a cumulative effect adjustment as of the start of the first period for which it applies the standard.

We are currently evaluating the impact this ASU will have to our accounting policies, business processes and potential differences in the timing and/or method of revenue recognition for our customer contracts. In conjunction with this evaluation, we are updating our policies to align with the new accounting guidance as well as evaluating our significant customer contracts to determine if the guidance will materially impact our existing portfolio of customer contracts. In addition, we will review new contracts entered into up until the adoption of the ASU. Based upon our initial evaluations, the adoption of this guidance is not expected to have a material impact on our Financial Statements. We currently intend to adopt the ASU in the first quarter of 2018, utilizing the cumulative effect approach.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This ASU requires lessees to recognize a lease liability and a right-to-use asset for all leases, including operating leases, with a term greater than twelve months on its balance sheet. This ASU is effective in annual and interim periods in fiscal years beginning after December 15, 2018, with early adoption permitted, and requires a modified retrospective transition method. We are currently in the process of evaluating the impact this ASU will have on our Financial Statements. Based on our initial evaluations, we believe the adoption of this standard will have a material impact on our consolidated balance sheet.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) Intra-Entity Transfers of Assets Other Than Inventory. This ASU requires entities to recognize at the transaction date the income tax consequences of intercompany asset transfers. This ASU is effective in annual and interim periods in fiscal years beginning after December 15, 2017, with early adoption permitted, and requires a modified retrospective transition method. We are currently in the process of evaluating the impact that this ASU will have on our Financial Statements.

3. LONG-LIVED ASSETS

Goodwill. The changes in the carrying amount of goodwill for the nine months ended September 30, 2017, were as follows (in thousands):

January 1, 2017 balance	$201,094
Adjustments related to prior acquisitions	(45)
Effects of changes in foreign currency exchange rates	8,974
September 30, 2017 balance	$210,023

Other Intangible Assets. Our intangible assets subject to ongoing amortization consist primarily of client contracts and software. As of September 30, 2017 and December 31, 2016, the carrying values of these assets were as follows (in thousands):

	September 30, 2017			December 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Client contracts	$130,668	$ (93,871)	$36,797	$137,398	$ (96,723)	$40,675
Software	133,553	(106,539)	27,014	129,743	(99,316)	30,427
Total	$264,221	$ (200,410)	$63,811	$267,141	$ (196,039)	$71,102

The total amortization expense related to intangible assets for the third quarters of 2017 and 2016 were $6.7 million and $6.3 million, respectively, and for the nine months ended September 30, 2017 and 2016 were $20.0 million and $18.2 million, respectively. Based on the September 30, 2017 net carrying value of our intangible assets, the estimated total amortization expense for each of the five succeeding fiscal years ending December 31 are: 2017 – $27.0 million; 2018 – $23.2 million; 2019 – $16.1 million; 2020 – $8.3 million; and 2021 – $3.8 million.

4. DEBT

Our long-term debt, as of September 30, 2017 and December 31, 2016, was as follows (in thousands):

	September 30, 2017	December 31, 2016
Credit Agreement:		
Term loan, due February 2020, interest at adjusted LIBOR plus 1.75% (combined rate of 3.08% at September 30, 2017)	$ 123,750	$ 135,000
Less - deferred financing costs	(2,572)	(3,489)

Term loan, net of unamortized discounts	121,178	131,511
$200 million revolving loan facility, due February 2020, interest at adjusted LIBOR plus applicable margin	—	—
Convertible Notes:		
2016 Convertible Notes – Senior convertible notes; due March 15, 2036; cash interest at 4.25%	230,000	230,000
Less – unamortized original issue discount	(12,130)	(14,005)
Less – deferred financing costs	(4,760)	(5,513)
2016 Convertible Notes, net of unamortized discounts	213,110	210,482
2010 Convertible Notes – Senior subordinated convertible notes; due March 1, 2017; cash interest at 3.0%	—	34,722
Less – unamortized original issue discount	—	(272)
Less – deferred financing costs	—	(24)
2010 Convertible Notes, net of unamortized discounts	—	34,426
Total debt, net of unamortized discounts	334,288	376,419
Current portion of long-term debt, net of unamortized discounts	(20,625)	(49,426)
Long-term debt, net of unamortized discounts	$ 313,663	$ 326,993

Credit Agreement

During the nine months ended September 30, 2017, we made $11.3 million of principal repayments on our $150 million aggregate principal five-year term loan (the “2015 Term Loan”). As of September 30, 2017, our interest rate on the 2015 Term Loan is 3.08% (adjusted LIBOR plus 1.75% per annum), effective through December 29, 2017, and our commitment fee on the unused $200 million aggregate principal five-year revolving loan facility (the “2015 Revolver”) is 0.25%. As of September 30, 2017, we had no borrowing outstanding on our 2015 Revolver and had the entire $200.0 million available to us.

Convertible Notes

2016 Convertible Notes. Upon conversion of the 2016 Convertible Notes, we will settle our conversion obligation by paying or delivering, as the case may be, cash, shares of our common stock, or a combination thereof, at our election. It is our current intent and policy to settle our conversion obligations as follows: (i) pay cash for 100% of the par value of the 2016 Convertible Notes that are converted; and (ii) to the extent the value of our conversion obligation exceeds the par value, we can satisfy the remaining conversion obligation in our common stock, cash or a combination thereof.

The 2016 Convertible Notes will be convertible at the option of the note holders upon the satisfaction of specified conditions and during certain periods. During the period from, and including, December 15, 2021 to the close of business on the business day immediately preceding March 15, 2022 and on or after December 15, 2035, holders may convert all or any portion of their 2016 Convertible Notes at the conversion rate then in effect at any time regardless of these conditions.

As a result of us increasing our quarterly dividend in March 2017 (see Note 9), the previous conversion rate for the 2016 Convertible Notes of 17.4753 shares of our common stock per $1,000 principal amount of the 2016 Convertible Notes, which is equivalent to an initial conversion price of approximately $57.22 per share of our common stock, has been adjusted to 17.4809 shares of our common stock per $1,000 principal amount of the 2016 Convertible Notes, which is equivalent to an initial conversion price of approximately $57.21 per share of our common stock.

Holders may require CSG to repurchase the 2016 Convertible Notes for cash on each of March 15, 2022, March 15, 2026, and March 15, 2031, or upon the occurrence of a fundamental change (as defined in the 2016 Convertible Notes Indenture) in each case at a purchase price equal to the principal amount thereof plus accrued and unpaid interest.

We may not redeem the 2016 Convertible Notes prior to March 20, 2020. On or after March 20, 2020, we may redeem for cash all or part of the 2016 Convertible Notes if the last reported sale price of our common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading day period (including the last trading day of such period) ending on, and including, the trading day immediately preceding the date on which CSG provides notice of redemption. On or after March 15, 2022, we may redeem for cash all or part of the 2016 Convertible Notes regardless of the sales price condition described in the preceding sentence. In each case, the redemption price will equal the principal amount of the 2016 Convertible Notes to be redeemed, plus accrued and unpaid interest.

As of September 30, 2017, none of the conversion features have been achieved, and thus, the 2016 Convertible Notes are not convertible by the holders.

2010 Convertible Notes.   In March 2017, we settled our conversion obligation for the 2010 Convertible Notes as follows: (i) we paid cash of $34.8 million for the remaining par value of the 2010 Convertible Notes; and (ii) delivered 694,240 shares of our common shares from treasury stock, to settle the $28.8 million value of the conversion obligation in excess of the par value. See Note 9 for discussion of our equity transactions.

5. RESTRUCTURING AND REORGANIZATION CHARGES

During the third quarters of 2017 and 2016, we recorded restructuring and reorganization charges of $1.6 million and ($0.2) million, respectively, and for the nine months ended September 30, 2017 and 2016, we recorded restructuring and reorganization charges of $4.6 million and ($0.6) million, respectively.

Our restructuring activities during the nine months ended September 30, 2017 are primarily made up of the following:

- We reduced our workforce by approximately 20 employees as a result of organizational changes made to pursue global opportunities and efficiencies. As a result, we incurred restructuring charges related to involuntary terminations of $2.1 million.

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- We impaired a long-term receivable related to the disposition of a business resulting in additional restructuring charges of $1.9 million.

The activity in the business restructuring and reorganization reserves during the nine months ended September 30, 2017 was as follows:

	Termination Benefits	Facilities Abandonment	Disposition of Business Operations	Other	Total
January 1, 2017 balance	$ 2,414	$ 1,332	$ —	$—	$3,746
Charged to expense during period	2,084	897	1,904	(288)	4,597
Cash payments	(3,100)	(652)	—	—	(3,752)
Adjustment for asset impairment	—	(231)	(1,904)	—	(2,135)
Other	(466)	(141)	—	288	(319)
September 30, 2017 balance	$ 932	$ 1,205	$ -	$-	$2,137

6. INCOME TAXES

The effective income tax rates for the third quarters and nine months ended September 30, 2017 and 2016 were as follows:

Quarter Ended September 30, 2017	Quarter Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
38 %	41 %	30 %	38 %

The lower rate for the nine months ended September 30, 2017 reflects an approximately $5 million net benefit received in the first quarter of 2017 resulting from Comcast's exercise of 1.4 million vested stock warrants in January 2017, discussed below in Note 9. The stock warrants appreciated in value since their vesting, which resulted in an income tax benefit to us when exercised. Additionally, as discussed in Note 2, we adopted ASU 2016-09, Compensation – Stock Compensation (Topic 718) in the first quarter of 2017. This ASU requires a change in the recognition of excess tax benefits and tax deficiencies, related to share-based payment transactions, which were recorded in equity, and now are recorded discrete to the quarter incurred as a component of income tax expense in the income statement. Under the guidance of this ASU, we recognized an income tax benefit of approximately $1 million and approximately $2 million, respectively, for the third quarter and nine months ended September 30, 2017. It is expected to provide an approximately $2 million benefit for the full year. For the full-year 2017 we are currently estimating an effective income tax rate of approximately 33%.

7. COMMITMENTS, GUARANTEES AND CONTINGENCIES

Warranties. We generally warrant that our solutions and related offerings will conform to published specifications, or to specifications provided in an individual client arrangement, as applicable. The typical warranty period is 90 days from the date of acceptance of the solution or offering. For certain service offerings we provide a limited warranty for the duration of the services provided. We generally warrant that services will be performed in a professional and workmanlike manner. The typical remedy for breach of warranty is to correct or replace any defective deliverable, and if not possible or practical, we will accept the return of the defective deliverable and refund the amount paid under the client arrangement that is allocable to the defective deliverable. Our contracts also generally contain limitation of damages provisions in an effort to reduce our exposure to monetary damages arising from breach of warranty claims. Historically, we have incurred minimal warranty costs, and as a result, do not maintain a warranty reserve.

Product and Services Indemnifications. Our arrangements with our clients generally include an indemnification provision that will indemnify and defend a client in actions brought against the client that claim our products and/or services infringe upon a copyright, trade secret, or valid patent. Historically, we have not incurred any significant costs related to such indemnification claims, and as a result, do not maintain a reserve for such exposure.

Claims for Company Non-performance. Our arrangements with our clients typically cap our liability for breach to a specified amount of the direct damages incurred by the client resulting from the breach. From time-to-time, these arrangements may also include provisions for possible liquidated damages or other financial remedies for our non-performance, or in the case of certain of our outsourced customer care and billing solutions, provisions for damages related to service level performance requirements. The service level performance requirements typically relate to system availability and timeliness of service delivery. As of September 30, 2017, we believe we have adequate reserves, based on our historical experience, to cover any reasonably anticipated exposure as a result of our nonperformance for any past or current arrangements with our clients.

Indemnifications Related to Officers and the Board of Directors. We have agreed to indemnify members of our Board of Directors (the “Board”) and certain of our officers if they are named or threatened to be named as a party to any proceeding by reason of the fact that they acted in such capacity. We maintain directors’ and officers’ (D&O) insurance coverage to protect against such losses. We have not historically incurred any losses related to these types of indemnifications, and are not aware of any pending or threatened actions or claims against any officer or member of our Board. As a result, we have not recorded any liabilities related to such indemnifications as of September 30, 2017. In addition, as a result of the insurance policy coverage, we believe these indemnification agreements are not significant to our results of operations.

Legal Proceedings. From time-to-time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. We are not presently a party to any material pending or threatened legal proceedings.

8. EARNINGS PER COMMON SHARE

Basic and diluted earnings per common share (“EPS”) amounts are presented on the face of the accompanying Income Statements.

No reconciliation of the basic and diluted EPS numerators is necessary as net income is used as the numerators for all periods presented. The reconciliation of the basic and diluted EPS denominators related to the common shares is included in the following table (in thousands):

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Basic weighted-average common shares	32,561	31,063	32,383	30,922
Dilutive effect of restricted common stock	340	525	442	620
Dilutive effect of 2010 Convertible Notes	-	706	-	1,171
Dilutive effect of Stock Warrants	-	345	-	328
Diluted weighted-average common shares	32,901	32,639	32,825	33,041

The Convertible Notes have a dilutive effect only in those quarterly periods in which our average stock price exceeds the current effective conversion price. The 2010 Convertible Notes were settled in March 2017 (see Note 4).

The Stock Warrants have a dilutive effect only in those quarterly periods in which our average stock price exceeds the exercise price of $26.68 per warrant (under the treasury stock method), and are not subject to performance vesting conditions. All the vested Stock Warrants were exercised in January 2017 (see Note 9).

Potentially dilutive common shares related to non-participating unvested restricted stock excluded from the computation of diluted EPS, as the effect was antidilutive, were not material in any period presented.

9. STOCKHOLDERS’ EQUITY AND EQUITY COMPENSATION PLANS

Stock Repurchase Program. We currently have a stock repurchase program, approved by our Board, authorizing us to repurchase our common stock from time-to-time as market and business conditions warrant (the “Stock Repurchase Program”). During the nine months ended September 30, 2017 and 2016 we repurchased 0.4 million shares of our common stock for $15.6 million (weighted-average price of $40.54 per share) and 0.3 million shares of our common stock for $9.5 million (weighted-average price of $36.07 per share), respectively, under a SEC Rule 10b5-1 Plan.

As of September 30, 2017, the total remaining number of shares available for repurchase under the Stock Repurchase Program totaled 6.4 million shares.

Stock Repurchases for Tax Withholdings. In addition to the above mentioned stock repurchases, during the nine months ended September 30, 2017 and 2016, we repurchased and then cancelled 0.2 million shares of common stock for $9.4 million and 0.3 million shares of common stock for $13.0 million, respectively, in connection with minimum tax withholding requirements resulting from the vesting of restricted common stock under our stock incentive plans.

Cash Dividends. During the third quarter of 2017, the Board approved a quarterly cash dividend of $0.1975 per share of common stock, totaling $6.7 million. During the third quarter of 2016, the Board approved a quarterly cash dividend of $0.185 per share of common stock, totaling $6.0 million. Dividends declared for the nine months ended September 30, 2017 and 2016 totaled $20.0 million and $18.0 million, respectively.

Warrants. In 2014, in conjunction with the execution of an amendment to our current agreement with Comcast Corporation ("Comcast"), we issued stock warrants (the "Warrant Agreement") for the right to purchase up to approximately 2.9 million shares of our common stock (the "Stock Warrants") as an additional incentive for Comcast to convert customer accounts onto our Advanced Convergent Platform based on various milestones. The Stock Warrants have a 10-year term and an exercise price of $26.68 per warrant.

Upon vesting, the Stock Warrants are recorded as a client incentive asset with the corresponding offset to stockholders' equity. The client incentive asset related to the Stock Warrants is amortized as a reduction in cloud and related solutions revenues over the remaining term of the Comcast amended agreement. As of September 30, 2017, we recorded a client incentive asset related to these Stock Warrants of $16.0 million and have amortized $7.8 million as a reduction in cloud and related solutions revenues. The remaining unvested Stock Warrants will be accounted for as client incentive assets in the period the performance conditions necessary for vesting have been met.

As of December 31, 2016, approximately 1.4 million Stock Warrants had vested. In January 2017, Comcast exercised approximately 1.4 million vested Stock Warrants, which we net share settled under the provisions of the Warrant Agreement (discussed further in Treasury Stock below). As of September 30, 2017, approximately 1.5 million Stock Warrants remain issued, none of which were vested.

Treasury Stock. In January 2017, we net share settled the exercise of 1.4 million vested Stock Warrants noted above by delivering 649,221 of our common shares from treasury stock, which had a fair value of $31.5 million. The carrying value of the shares of treasury stock delivered was $15.4 million (weighted-average price of $23.66 per share). The difference between the carrying amount of the treasury shares and the $16.0 million carrying amount of the common stock warrants was recorded as an adjustment to additional paid-in capital.

In March 2017, we net share settled the portion of the conversion obligation in excess of the par value related to our 2010 Convertible Notes by delivering 694,240 of our common shares from treasury stock. The carrying value of the shares of treasury stock delivered was $16.5 million (weighted average price of $23.71 per share). The difference between the carrying amount of the treasury shares and the $28.8 million carrying amount of the conversion obligation on the settlement date was recorded as an adjustment to additional paid-in capital.

Stock-Based Awards. A summary of our unvested restricted common stock activity during the quarter and nine months ended September 30, 2017 is as follows (shares in thousands):

	Quarter Ended September 30, 2017		Nine Months Ended September 30, 2017	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Unvested awards, beginning	1,391	$ 34.92	1,394	$ 31.26
Awards granted	67	37.96	542	39.30
Awards forfeited/cancelled	(16)	32.29	(36)	32.99
Awards vested	(231)	28.51	(689)	28.58
Unvested awards, ending	1,211	$ 36.34	1,211	$ 36.34

Included in the awards granted during the nine months ended September 30, 2017 are performance-based awards for 0.1 million restricted common stock shares issued to members of executive management and certain key employees, which vest in equal installments over three years upon meeting either pre-established financial performance objectives or pre-established total shareholder return objectives. The performance-based awards become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment.

All other restricted common stock shares granted during the quarter and nine months ended September 30, 2017 are time-based awards, which vest annually over four years with no restrictions other than the passage of time. Certain shares of the restricted common stock become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment.

We recorded stock-based compensation expense for the third quarters of 2017 and 2016 of $5.0 million and $5.2 million, respectively, and for the nine months ended September 30, 2017 and 2016 of $16.7 million and $17.3 million, respectively.

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

The information contained in this MD&A should be read in conjunction with the Financial Statements and Notes thereto included in this Form 10-Q and the audited consolidated financial statements and notes thereto in our 2016 10-K.

Forward-Looking Statements

This report contains a number of forward-looking statements relative to our future plans and our expectations concerning our business and the industries we serve. These forward-looking statements are based on assumptions about a number of important factors, and involve risks and uncertainties that could cause actual results to differ materially from estimates contained in the forward-looking statements. Some of the risks that are foreseen by management are outlined within Part II Item 1A. Risk Factors of this report and in Part I Item 1A. Risk Factors of our 2016 10-K. Readers are strongly encouraged to review those sections closely in conjunction with MD&A.

Company Overview

We are one of the world’s largest and most established providers of business support solutions, primarily serving the global communications industry. We have thirty-five years of expertise supporting communications service providers as their businesses have evolved from a single product offering to highly complex and competitive multi-product offerings, while also requiring increasingly differentiated, real-time, and personalized experiences for their customers.

Our proven experience and world-class solutions support the mission critical management of our clients’ revenue, customer interactions, and digital ecosystem as they advance their video, voice, data, content, and digital services to consumers. Over the years, we have focused our research and development (“R&D”) and acquisition investments on expanding our solution set to address the complex, transformative needs of service providers. Our broad and deep solutions help our clients be competitive in a dynamically evolving global business environment, respond to changing consumer demands, quickly launch new compelling product offerings, provide enhanced customer experiences through relevant and targeted interactions, and cost-effectively streamline and scale operations.

We generate approximately 70% of our revenues from the North American cable and satellite markets, approximately 20% of our revenues from wireline and wireless communication providers, and the remainder from a variety of other verticals, such as financial services, logistics, and transportation. Additionally, during the nine months ended September 30, 2017 we generated approximately 85% of our revenues from the Americas region, approximately 9% of our revenues from the Europe, Middle East and Africa region, and approximately 6% of our revenues from the Asia Pacific region.

We are a S&P Small Cap 600 company.

Management Overview of Quarterly Results

Third Quarter Highlights. A summary of our results of operations for the third quarter of 2017, when compared to the third quarter of 2016, is as follows (in thousands, except per share amounts and percentages):

	Quarter Ended	
	September 30, 2017	September 30, 2016
Revenues	$199,195	$ 189,311
Operating Results:		

Operating income	28,376	36,598
Operating income margin	14.2 %	19.3 %
Diluted EPS	$0.44	$ 0.55
Supplemental Data:		
Restructuring and reorganization charges	$1,618	$ (185)
Stock-based compensation (1)	4,700	5,364
Amortization of acquired intangible assets	1,758	2,116
Amortization of OID	634	1,062
Loss on repurchase of convertible notes	-	332

(1) Stock-based compensation included in the table above excludes amounts that have been recorded in restructuring and reorganization charges.

Revenues. Our revenues for the third quarter of 2017 were $199.2 million, a 5% increase when compared to revenues of $189.3 million for the third quarter of 2016. The year-over-year increase in revenues is primarily attributed to the growth of our cloud and related solutions revenues, resulting primarily from the higher revenues from our recurring managed services arrangements and the conversion of customer accounts onto our cloud solutions over the past year, which more than offset the lower software and services revenues generated during the quarter.

Operating Results. Operating income for the third quarter of 2017 was $28.4 million, or a 14.2% operating income margin percentage, compared to $36.6 million, or a 19.3% operating income margin percentage for the third quarter of 2016, with the decreases in operating income and operating income margin percentage reflective of the increase in planned investments aimed at generating future long-term growth in our business. These increased expenditures are primarily within the following areas of our business: (i) our R&D efforts; (ii) our go-to-market programs; and (iii) the operating environments for our cloud solutions (e.g., resiliency, security, and capacity).

Diluted EPS. Diluted EPS for the third quarter of 2017 was $0.44 compared to $0.55 for the third quarter of 2016, with the decrease mainly attributed to the lower operating results, discussed above.

Cash and Cash Flows. As of September 30, 2017, we had cash, cash equivalents and short-term investments of $258.5 million, as compared to $245.0 million as of June 30, 2017, and $276.5 million as of as of December 31, 2016. Our cash flows from operating activities for the quarter ended September 30, 2017 were $38.3 million. See the Liquidity section below for further discussion of our cash flows.

Significant Client Relationships

Charter/Time Warner. In connection with Charter Corporation Inc.'s ("Charter") acquisition of Time Warner Cable, Inc. ("Time Warner") in May 2016, the Time Warner Master Subscriber Management Agreement (the "Time Warner Agreement") was assigned to Charter. Our existing agreement with Charter ran through December 31, 2019. The Time Warner Agreement, which covered the Time Warner customer accounts serviced by CSG and now owned by Charter, was originally set to expire on March 31, 2017, but was extended for additional one-month periods through July 31, 2017, while the parties continued to finalize terms relating to a new long-term Charter Consolidated Master Subscriber Management System Agreement that would provide our products and services covering both Time Warner and Charter customer accounts under one master agreement.

On July 17, 2017, we entered into a new Consolidated CSG Master Subscriber Management System Agreement with Charter (the "New Agreement") which supersedes all previous agreements with Charter and Time Warner.

The key terms and conditions of the New Agreement are as follows:

- The New Agreement, effective August 1, 2017, extends our contractual relationship with Charter (an additional two years) and covers the Time Warner customer accounts serviced by CSG and now owned by Charter (an additional four-and-a-half years) through December 31, 2021. In addition, Charter has the option to extend the New Agreement for an additional one-year term.

- Consistent with the previous agreements, the fees generated under the New Agreement will be based primarily on monthly per unit charges for our cloud and related solutions, and other various ancillary services. Certain of the per-unit fees include volume-based pricing tiers, and are subject to annual inflationary price escalators.

- The New Agreement includes incentives for Charter to convert additional customer accounts onto our Advanced Convergent Platform (“ACP”) customer care and billing solution.