ELLIE MAE INC
Form 10-Q
November 06, 2014

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 September 30, 2014

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: 001-35140

ELLIE MAE, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	94-3288780 (I.R.S. Employer Identification No.)
4155 Hopyard Road, Suite 200 Pleasanton, California	94588
(Address of principal executive offices)	(Zip Code)

(925) 227-7000
(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 (§ 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 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 “small reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Indicate the number of shares outstanding of each of the registrant’s classes of common stock as of the latest practicable date:

As of October 31, 2014:

Class	Number of Shares
Common Stock, $0.0001 par value	28,744,899

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ITEM 1—CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Ellie Mae, Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except share and per share amounts)

	September 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$43,859	$33,462
Short-term investments	42,093	46,325
Accounts receivable, net of allowances for doubtful accounts of $80 and $81 as of September 30, 2014 and December 31, 2013, respectively	17,868	12,024
Prepaid expenses and other current assets	5,681	6,473
Total current assets	109,501	98,284
Property and equipment, net	23,122	12,751
Long-term investments	66,239	56,285
Other intangible assets, net	7,126	5,089
Goodwill	52,460	51,051
Deposits and other assets	5,878	5,112
Total assets	$264,326	$228,572
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$4,734	$3,783
Accrued and other current liabilities	12,253	10,224
Acquisition holdback, net of discount	521	1,965
Deferred revenue	4,690	4,752
Total current liabilities	22,198	20,724
Leases payable, net of current portion	521	175
Other long-term liabilities	1,714	777
Total liabilities	24,433	21,676
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock, $0.0001 par value per share; 140,000,000 authorized shares, 28,589,869 and 27,624,025 shares issued and outstanding as of September 30, 2014 and December 31, 2013, respectively	3	3
Additional paid-in capital	235,850	212,043
Accumulated other comprehensive loss	(37)	(34)
Retained earnings (accumulated deficit)	4,077	(5,116)
Total stockholders' equity	239,893	206,896
Total liabilities and stockholders' equity	$264,326	$228,572

See accompanying notes to these condensed consolidated financial statements (unaudited).

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Ellie Mae, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(in thousands, except share and per share amounts)

	Three Months ended September 30,		Nine Months ended September 30,	
	2014	2013	2014	2013
Revenues	$42,798	$33,006	$114,960	$98,131
Cost of revenues	11,669	8,332	31,445	24,550
Gross profit	31,129	24,674	83,515	73,581
Operating expenses:				
Sales and marketing	6,521	5,163	19,067	15,233
Research and development	6,456	6,573	19,348	18,651
General and administrative	9,556	7,547	28,100	23,108
Total operating expenses	22,533	19,283	66,515	56,992
Income from operations	8,596	5,391	17,000	16,589
Other income, net	134	83	343	355
Income before income taxes	8,730	5,474	17,343	16,944
Income tax provision	4,675	2,114	8,150	5,986
Net income	$4,055	$3,360	$9,193	$10,958
Net income per share of common stock:				
Basic	$0.14	$0.13	$0.33	$0.41
Diluted	$0.14	$0.12	$0.31	$0.39
Weighted average common shares used in computing net income per share of common stock:				
Basic	28,007,770	26,681,974	27,657,217	26,407,572
Diluted	29,661,211	28,623,092	29,332,162	28,330,521
Net income	$4,055	$3,360	$9,193	$10,958
Other comprehensive income, net of taxes:				
Unrealized gain (loss) on investments	(75)	137	(3)	13
Comprehensive income	$3,980	$3,497	$9,190	$10,971

See accompanying notes to these condensed consolidated financial statements (unaudited).

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Ellie Mae, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in thousands)

	Nine Months ended September 30, 2014	Nine Months ended September 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$9,193	$10,958
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,815	3,515
Provision for uncollectible accounts receivable	12	81
Amortization of other intangible assets	1,575	1,081
Amortization of discount related to acquisition holdback	36	93
Stock-based compensation	10,816	10,894
Excess tax benefit from exercise of stock options	(5,306)	(6,187)
Deferred income taxes	(37)	(679)
Amortization of investment premium	972	1,232
Changes in operating assets and liabilities:		
Accounts receivable	(5,856)	(1,605)
Prepaid expenses and other current assets	580	1,800
Deposits and other assets	(632)	(1,195)
Accounts payable	1,172	(849)
Accrued, other current and other liabilities	8,494	2,564
Deferred revenue	(54)	(725)
Net cash provided by operating activities	24,780	20,978
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property and equipment	(12,839)	(5,034)
Purchases of investments	(49,662)	(91,297)
Maturities of investments	42,965	44,971
Acquisitions	(6,500)	(3,000)
Net cash used in investing activities	(26,036)	(54,360)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of capital lease obligations	(987)	(509)
Proceeds from issuance of common stock under employee stock plans	8,002	5,342
Tax payments related to shares withheld for vested restricted stock units	(668)	(101)
Excess tax benefit from exercise of stock options	5,306	6,187
Net cash provided by financing activities	11,653	10,919
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	10,397	(22,463)
CASH AND CASH EQUIVALENTS, Beginning of period	33,462	44,114
CASH AND CASH EQUIVALENTS, End of period	$43,859	$21,651
Supplemental disclosure of cash flow information:		
Cash paid for interest	$41	$241
Cash paid for income taxes	$43	$3,324
Supplemental disclosure of non-cash investing and financing activities:		
Fixed asset purchases not yet paid	$664	$522
Stock-based compensation capitalized to property and equipment	$350	$91
Acquisition of property and equipment under capital leases	$1,269	$1,336

See accompanying notes to these condensed consolidated financial statements (unaudited).

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Ellie Mae, Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1—Description of Business

Ellie Mae, Inc. (“Ellie Mae,” “the Company,” “we,” “our” or “us”) is a leading provider of innovative on-demand software solutions and services for the residential mortgage industry in the United States. The Company’s end-to-end Encompass mortgage management solution provides one system of record that allows banks, credit unions and mortgage lenders to originate and fund mortgages and improve compliance, loan quality and efficiency.

NOTE 2—Basis of Presentation and Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2013, which was filed with the SEC on March 13, 2014 (“2013 Form 10-K”). The condensed consolidated balance sheet as of December 31, 2013, included herein, was derived from the audited financial statements as of that date but does not include all disclosures, including notes required by GAAP.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial positions, results of operations and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year 2014 or any future period.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Certain reclassifications have been made to prior period amounts to conform to current period presentation. Such reclassifications have no effect on revenues, income from operations or net income as previously reported.

Use of Estimates

The preparation of condensed consolidated 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 period. Actual results could differ from those estimates.

Significant Accounting Policies

Our significant accounting policies are described in Note 2 of the Notes to Consolidated Financial Statements in our 2013 Form 10-K. There have been no significant changes to these policies.

Other Income, Net

Other income, net consisted of the following:

	Three Months ended September 30,		Nine Months ended September 30,	
	2014	2013	2014	2013
	(in thousands)			
Interest income	$146	$113	$412	$528
Net realized loss on investments	—	—	(7)	(60)
Interest expense	(12)	(30)	(62)	(113)
Total other income, net	$134	$83	$343	$355

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Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes certain changes in equity that are excluded from net income, specifically unrealized gains (losses) on available-for-sale investments. Except for net realized loss on investments which was not significant, there were no reclassifications out of accumulated other comprehensive income that affected net income during the three and nine months ended September 30, 2014 and 2013.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 also requires significantly expanded disclosures about revenue recognition. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. We are currently evaluating the impact that adoption will have on our consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern (“ASU 2014-15”), which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. ASU 2014-15 requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date of issuance of the entity’s financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is “substantial doubt about the entity’s ability to continue as a going concern.” ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter; early adoption is permitted. We do not believe that adoption of ASU 2014-15 will have a material impact on our consolidated financial statements.

NOTE 3—Net Income Per Share of Common Stock

Net income per share of common stock is calculated by dividing net income by the weighted average shares of common stock outstanding during the period. Diluted net income per share of common stock is calculated by dividing net income by the weighted average shares of common stock outstanding and potential shares of common stock during the period. Potential shares of common stock include shares attributable to the assumed exercise of stock options, restricted stock unit awards (“RSUs”), performance share awards (“Performance Awards”) and Employee Stock Purchase Plan (“ESPP”) shares using the treasury stock method, if dilutive.

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The components of net income per share of common stock were as follows:

	Three Months ended September 30,		Nine Months ended September 30,	
	2014	2013	2014	2013
	(in thousands, except share and per share amounts)			
Net income	$4,055	$3,360	$9,193	$10,958
Basic shares:				
Weighted average common shares outstanding	28,007,770	26,681,974	27,657,217	26,407,572
Diluted shares:				
Weighted average shares used to compute basic net income per share	28,007,770	26,681,974	27,657,217	26,407,572
Effect of potentially dilutive securities:				
Employee stock options, RSUs, Performance Awards and ESPP shares	1,653,441	1,941,118	1,674,945	1,922,949
Weighted average shares used to compute diluted net income per share	29,661,211	28,623,092	29,332,162	28,330,521
Net income per share:				
Basic	$0.14	$0.13	$0.33	$0.41
Diluted	$0.14	$0.12	$0.31	$0.39

The following potential common shares were excluded from the computation of diluted net income per share, as their effect would have been anti-dilutive:

	Three Months ended September 30,		Nine Months ended September 30,	
	2014	2013	2014	2013
Employee stock options and awards	840,161	826,879	914,197	681,394

Performance Awards are included in the diluted shares outstanding for each period if the established performance criteria have been met at the end of the respective periods. However, if none of the required performance criteria have been met for such awards, we include the number of shares that would be issuable if the end of the reporting period were the end of the contingency period. Accordingly, in addition to the employee stock options and awards noted above, 106,250 and 124,300 shares underlying Performance Awards have been excluded from the dilutive shares outstanding for each of the three and nine months ended September 30, 2014 and 2013, respectively.

NOTE 4—Financial Instruments and Fair Value Measurements

Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are classified and disclosed in one of the following three categories:

Level 1 — Valuations based on quoted prices in active markets for identical assets or liabilities.

Level 2 — Valuations based on other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Valuations based on inputs that are generally unobservable and typically reflect management’s estimates of assumptions that market participants would use in pricing the assets or liabilities.

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The following tables set forth by level within the fair value hierarchy the Company's financial assets that were accounted for at fair value on a recurring basis, according to the valuation techniques the Company used to determine their values:

	Fair value at	Fair value measurements using inputs considered as		
	September 30, 2014	Level 1	Level 2	Level 3
	(in thousands)			
Money market funds	$3,177	$3,177	$—	$—
Certificates of deposit	14,369	—	14,369	—
Corporate notes and obligations	29,463	—	29,463	—
Municipal obligations	3,418	—	3,418	—
U.S. government and government agency obligations	61,082	16,946	44,136	—
	$111,509	$20,123	$91,386	$—

	Fair value at	Fair value measurements using inputs considered as		
	December 31, 2013	Level 1	Level 2	Level 3
	(in thousands)			
Money market funds	$16,431	$16,431	$—	$—
Certificates of deposit	14,920	—	14,920	—
Corporate notes and obligations	26,774	—	26,774	—
Municipal obligations	3,830	—	3,830	—
U.S. government and government agency obligations	60,018	11,428	48,590	—
	$121,973	$27,859	$94,114	$—

Financial instruments include cash, cash equivalents and investments including investment-grade interest-bearing securities such as money market accounts, certificates of deposit, commercial paper, corporate bonds, municipal and government agency obligations and guaranteed obligations of the U.S. government. We classify our money market funds and U.S. government obligations as Level 1 instruments due to the use of observable market prices for identical securities that are traded in active markets.

When the Company uses observable market prices for identical securities that are traded in less active markets, the Company classifies its marketable financial instruments as Level 2. When observable market prices for identical securities are not available, the Company prices its marketable financial instruments using non-binding market consensus prices that are corroborated with observable market data; quoted market prices for similar instruments; or pricing models with all significant inputs derived from or corroborated with observable market data. Non-binding market consensus prices are based on the proprietary valuation models of pricing providers. These valuation models incorporate a number of inputs, including non-binding and binding broker quotes; observable market prices for identical or similar securities; and the internal assumptions of pricing providers or brokers that use observable market inputs and, to a lesser degree, unobservable market inputs. The Company corroborates non-binding market consensus prices with observable market data as such data exists.

At September 30, 2014 and December 31, 2013, the Company did not have any assets or liabilities that were valued using Level 3 inputs. For the three and nine months ended September 30, 2014 and 2013, there were no transfers of financial instruments among Level 1, Level 2 or Level 3 classifications.

For the three and nine months ended September 30, 2014 the Company recognized interest income from financial instruments of $0.1 million and $0.4 million, respectively. For the three and nine months ended September 30, 2013 the Company recognized interest income from financial instruments of $0.1 million and $0.5 million, respectively.

Gross realized gains and gross realized losses from the sale of investments were not significant during the three and nine months ended September 30, 2014 and 2013.

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The carrying amounts, gross unrealized gains and losses and estimated fair value of cash and cash equivalents and both short and long-term investments consisted of the following:

	September 30, 2014			
	Amortized cost	Unrealized gains	Unrealized losses	Carrying or fair value
	(in thousands)			
Cash and cash equivalents:				
Cash	$40,682	$—	$—	$40,682
Money market funds	3,177	—	—	3,177
	$43,859	$—	$—	$43,859
Investments:				
Corporate notes and obligations	$29,472	$16	$(25)	$29,463
Certificates of deposit	14,372	12	(15)	14,369
Municipal obligations	3,410	8	—	3,418
U.S. government and government agency obligations	61,115	29	(62)	61,082
	$108,369	$65	$(102)	$108,332

	December 31, 2013			
	Amortized cost	Unrealized gains	Unrealized losses	Carrying or fair value
	(in thousands)			
Cash and cash equivalents:				
Cash	$14,092			