

MODEL N, INC.
Form 10-Q
February 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 December 31, 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: 001-35840

Model N, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	77-0528806 (I.R.S. Employer Identification No.)
777 Mariners Island Boulevard, Suite 300 San Mateo, California	94404

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(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (650) 610-4600

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. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 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

As of January 26, 2018, the registrant had 29,483,120 shares of common stock, \$0.00015 par value per share, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)
MODEL N, INC.

Condensed Consolidated Balance Sheets

(in thousands, except per share data)

(Unaudited)

	As of December 31, 2017	As of September 30, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$48,324	\$57,558
Accounts receivable, net of allowance for doubtful accounts of \$43 as of December 31, 2017 and \$85 as of September 30, 2017	38,679	24,784
Prepaid expenses	2,800	3,733
Other current assets	1,202	1,013
Total current assets	91,005	87,088
Property and equipment, net	3,823	4,611
Goodwill	39,283	39,283
Intangible assets, net	38,738	40,156
Other assets	1,104	798
Total assets	\$173,953	\$171,936
Liabilities And Stockholders' Equity		
Current liabilities:		
Accounts payable	\$4,240	\$3,002
Accrued employee compensation	9,143	14,996
Accrued liabilities	4,028	4,979
Deferred revenue, current portion	57,135	49,186
Long term debt, current portion	4,831	4,753
Total current liabilities	79,377	76,916
Long term debt	52,610	52,452
Other long-term liabilities	1,266	1,307
Total liabilities	133,253	130,675
Commitments and contingencies		
Stockholders' equity:		
Common Stock, \$0.00015 par value; 200,000 shares authorized; 29,474 and 29,323 shares issued and outstanding at December 31, 2017 and September 30, 2017, respectively	4	4

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Preferred Stock, \$0.00015 par value; 5,000 shares authorized; no shares issued and outstanding	—	—
Additional paid-in capital	221,639	217,052
Accumulated other comprehensive loss	(393)	(502)
Accumulated deficit	(180,550)	(175,293)
Total stockholders' equity	40,700	41,261
Total liabilities and stockholders' equity	\$173,953	\$171,936

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

MODEL N, INC.

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

(Unaudited)

	Three Months Ended December	
	31,	
	2017	2016
Revenues:		
SaaS and maintenance	\$ 32,323	\$ 22,640
License and implementation	6,744	5,423
Total revenues	39,067	28,063
Cost of revenues:		
SaaS and maintenance	13,024	10,208
License and implementation	3,785	3,614
Total cost of revenues	16,809	13,822
Gross profit	22,258	14,241
Operating expenses:		
Research and development	9,068	5,975
Sales and marketing	8,492	8,734
General and administrative	8,731	7,185
Total operating expenses	26,291	21,894
Loss from operations	(4,033)	(7,653)
Interest expense (income), net	1,423	(33)
Other expenses (income), net	125	(154)
Loss before income taxes	(5,581)	(7,466)
(Benefit) provision for income taxes	(324)	134
Net loss	\$ (5,257)	\$ (7,600)
Net loss per share attributable to common stockholders:		
Basic and diluted	\$ (0.18)	\$ (0.27)
Weighted average number of shares used in computing net		
loss per share attributable to common stockholders:		
Basic and diluted	29,401	28,008

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

MODEL N, INC.

Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

(Unaudited)

	Three Months Ended December	
	31,	
	2017	2016
Net loss	\$ (5,257)	\$ (7,600)
Other comprehensive (loss) income, net		
Change in foreign currency translation adjustment	109	(114)
Total comprehensive loss	\$ (5,148)	\$ (7,714)

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

MODEL N, INC.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Three Months Ended December 31,	
	2017	2016
Cash flows from operating activities:		
Net loss	\$ (5,257)	\$ (7,600)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	2,265	1,094
Stock-based compensation	4,036	1,895
Amortization of debt discount and issuance cost	236	—
Other non-cash charges	(491)	49
Changes in assets and liabilities, net of acquisition:		
Accounts receivable	(13,846)	655
Prepaid expenses and other assets	363	843
Deferred cost of implementation services	191	701
Accounts payable	1,216	591
Accrued employee compensation	(5,896)	(898)
Other accrued and long-term liabilities	(703)	(1,298)
Deferred revenue	8,145	(4,261)
Net cash used in operating activities	(9,741)	(8,229)
Cash flows from investing activities:		
Purchases of property and equipment	(60)	(194)
Capitalization of software development costs	—	(275)
Cash held in escrow for acquisition	—	(5,000)
Net cash used in investing activities	(60)	(5,469)
Cash flows from financing activities:		
Proceeds from exercise of stock options	552	17
Net cash provided by financing activities	552	17
Effect of exchange rate changes on cash and cash equivalents	15	(22)
Net decrease in cash and cash equivalents	(9,234)	(13,703)
Cash and cash equivalents		
Beginning of period	57,558	66,149
End of period	\$ 48,324	\$ 52,446

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

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. The Company and Significant Accounting Policies and Estimates

Model N, Inc. (Company) was incorporated in Delaware on December 14, 1999. The Company is a provider of revenue management solutions for the life sciences and technology industries. The Company's solutions enable its customers to maximize revenues and reduce revenue compliance risk by transforming their revenue life cycle from a series of tactical, disjointed operations into a strategic end-to-end process, which enables them to manage the strategy and execution of pricing, contracting, incentives and rebates. The Company's corporate headquarters are located in San Mateo, California, with additional offices in the United States, India and Switzerland.

Fiscal Year

The Company's fiscal year ends on September 30. References to fiscal year 2018, for example, refer to the fiscal year ending September 30, 2018.

Basis for Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (U.S. 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 the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the fiscal year ended September 30, 2017. There have been no changes in the significant accounting policies from those that were disclosed in the audited consolidated financial statements for the fiscal year ended September 30, 2017 included in the Annual Report on Form 10-K.

In the opinion of management, the unaudited interim consolidated financial statements include all the normal recurring adjustments necessary to present fairly the condensed consolidated financial statements. The results of operations for the three months ended December 31, 2017 were not necessarily indicative of the operating results for the full fiscal year 2018 or any future periods.

The Company's condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated upon consolidation.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses during the reporting periods. Significant items subject to such estimates include revenue recognition, legal contingencies, income taxes, stock-based compensation, and valuation of goodwill and intangibles. These estimates and assumptions are based on management's best estimates and judgment. Management regularly evaluates its estimates and assumptions using

historical experience and other factors. However, actual results could differ significantly from these estimates.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued a new standard, Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, as amended, which will supersede nearly all existing revenue recognition guidance. Under ASU 2014-09, an entity is required to recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration received in exchange for those goods or services. ASU 2014-09 defines a five-step process in order to achieve this core principle, which may require the use of judgment and estimates, and also requires expanded qualitative and quantitative disclosures relating to the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, including significant judgments and estimates used.

The FASB has issued several amendments to the new standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. The amendments include ASU 2016-08, Revenue from Contracts with Customers

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Topic 606)—Principal versus Agent Considerations, which was issued in March 2016, and clarifies the implementation guidance for principal versus agent considerations in ASU 2014-09, and ASU 2016-10, Revenue from Contracts with Customers (Topic 606)—Identifying Performance Obligations and Licensing, which was issued in April 2016, and amends the guidance in ASU 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property.

The new standard permits adoption either by using (i) a full retrospective approach for all periods presented in the period of adoption or (ii) a modified retrospective approach with the cumulative effect of initially applying the new standard recognized at the date of initial application and providing certain additional disclosures. The new standard is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted for annual reporting periods beginning after December 15, 2016. The Company does not plan to early adopt, and accordingly, the Company will adopt the new standard effective October 1, 2018. The Company currently anticipates adopting the standard using the modified retrospective method.

The Company has identified, and is in the process of implementing, appropriate changes to its business processes, systems and controls to support recognition and disclosure under the new standard. Based on the Company's ongoing evaluation, the Company believes the impacts of this ASU will be primarily related to the capitalization and amortization of sales commissions, the timing of revenue recognition for certain sales contracts, and related disclosures. The Company expects that under this ASU it will now be required to capitalize sales commissions and amortize them over the period which the sales commissions are expected to benefit the Company. Sales commissions are currently expensed as incurred. In addition, there will be a change in relation to the timing of revenue recognition for certain sales contracts, due primarily to the removal of the current limitation on contingent revenue. These changes are being evaluated to determine the potential impact to the financial statements and disclosures. While the Company continues to assess the potential impacts of the new standard, including the areas described above, our preliminary conclusions may change.

In February 2016, the FASB issued ASU 2016-02, Lease (Topic 842), guidance on the recognition and measurement of leases. Under the new guidance, lessees are required to recognize a lease liability, which represents the discounted obligation to make future minimum lease payments, and a corresponding right-of-use asset on the balance sheet for most leases. The guidance retains the current accounting for lessors and does not make significant changes to the recognition, measurement, and presentation of expenses and cash flows by a lessee. Enhanced disclosures will also be required to give financial statement users the ability to assess the amount, timing and uncertainty of cash flows arising from leases. The guidance will require modified retrospective application at the beginning of October 1, 2019 for the Company, with optional practical expedients, but permits adoption in an earlier period. The Company is currently evaluating the impact this standard will have on its consolidated financial statements.

In March 2016, FASB issued ASU 2016-9, Compensation – Stock Compensation (Topic 718), which 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. For public companies, the guidance is effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted for all companies in any interim or annual period. Forfeitures can be estimated, as required today, or recognized when they occur. Estimates of forfeitures will still be required in certain circumstances, such as at the time of modification of an award or issuance of a replacement award

in a business combination. The Company adopted this guidance in the first quarter of fiscal year 2018 and has elected to continue to estimate its forfeiture rate. In the year of adoption, the ASU requires that the cumulative effect adjustment be recorded to retained earnings. Due to a full valuation allowance, there is no cumulative effect adjustment to record and the adoption of this guidance had no material impact on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flow (Topic 230), amended the existing accounting standards for the statement of cash flows. The amendments provide guidance on how companies present and classify certain cash receipts and cash payments in the statement of cash flows. The guidance becomes effective for the Company at the beginning of its first quarter of fiscal 2019. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact this standard will have on its consolidated financial statements, but does not believe this will have material impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Restricted Cash (Topic 230), clarifying the classification and presentation of restricted cash in the statement of cash flows. The standard requires that restricted cash and restricted cash equivalents are included in the cash and cash equivalent balance in the statement of cash flows. Further, reconciliation between the balance sheet and statement of cash flows is required when the balance sheet includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents. Therefore, transfers between these balances should no longer be presented as a cash flow activity. The guidance becomes effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with

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Notes to Condensed Consolidated Financial Statements

(Unaudited)

early adoption permitted. The Company does not plan to early adopt, and accordingly the Company will adopt the new standard effective October 1, 2018. The Company is currently evaluating the impact this standard will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combination (Topic 805): clarifying the definition of a business. The amendments in this guidance change the definition of a business to assist with evaluating when a set of transferred assets and activities is a business. The guidance becomes effective for the Company at the beginning of its first quarter of fiscal 2019. Early adoption is permitted. The Company is currently evaluating the impact this standard will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This new accounting standard update simplifies the measurement of goodwill by eliminating the Step two impairment test. Step two measures a goodwill impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. The new guidance requires a comparison of the Company's fair value of with carrying amount and the Company is required to recognize an impairment charge for the amount by which the carrying amount exceeds the fair value. Additionally, we should consider income tax effects from any tax deductible goodwill on the carrying amount when measuring the goodwill impairment loss, if applicable. The new guidance becomes effective for goodwill impairment tests in fiscal years beginning after December 15, 2019, though early adoption is permitted. The Company is currently evaluating the impact this standard will have on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718): providing clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. This ASU does not change the accounting for modifications but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions or award classification and would not be required if the changes are considered non-substantive. The amendments of this ASU are effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The Company is currently evaluating the impact of this standard, but does not believe this will have material impact on its consolidated financial statements.

2. Business Combination

Revitas Acquisition

On January 5, 2017, the Company completed the acquisition of 100% of the equity interests of Sapphire Stripe Holdings, Inc., the parent company of Revitas, Inc. ("Revitas"). Pursuant to the Agreement and Plan of Merger ("Merger Agreement"), the Company paid approximately \$52.8 million in cash and issued to the sellers two \$5.0 million promissory notes, one which will mature 18 months after the closing and the other which will mature 36 months after the closing. The Company acquired Revitas to, among other things, expand the Company's revenue management solutions for customers.

In connection with Revitas acquisition, the Company funded, in part, the cash portion of the purchase price with a five year term loan in the aggregate amount of \$50.0 million. See Note 5, "Debt", for additional information.

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Notes to Condensed Consolidated Financial Statements

(Unaudited)

Purchase Price Allocation

The total purchase price for Revitas was approximately \$61.5 million, which was comprised of \$52.8 million in cash and the fair value of the promissory note of \$8.6 million, see Note 5, "Debt", for additional details. The allocation of the purchase price is based on valuations derived from estimated fair value assessments and assumptions used by the Company. As of the acquisition date, the final allocation of the purchase price is as follows:

	Estimated Fair Value (in thousands)
Cash and cash equivalents	\$ 5,067
Accounts receivable	6,184
Prepaid expenses	1,067
Other current assets	47
Property, plant and equipment	1,506
Intangible assets	39,100
Goodwill	32,344
Other assets	25
Total assets acquired	85,340
Accounts payable	(1,352)
Accrued employee compensation	(3,983)
Accrued liabilities	(1,410)
Deferred revenue liability	(12,856)
Other liabilities	(4,256)
Total liabilities assumed	(23,857)
Net acquired assets	\$ 61,483

The following table presents certain information on the acquired identifiable assets:

Intangible assets	Fair value (in thousands)	Estimated useful lives (years)	Weighted-average estimated useful lives (years)
Developed technology	\$ 6,770	6	6
Customer relationship	32,180	10	10

Trade name	\$ 150	1	1
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The purchase accounting allocation resulted in an ascribed value to the acquired intangible assets of \$39.1 million and goodwill of \$32.3 million. The key factors attributable to the creation of goodwill by the transaction are synergies in skill-sets, return on future technology and customer development.

We do not expect the goodwill recognized as a part of the acquisition to be deductible for income tax purposes. See Note 4, "Goodwill" for additional information.

Unaudited Pro Forma Combined Consolidated Financial Information

The results of operations for Revitas and the estimated fair values of the assets acquired and liabilities assumed have been included in the Company's consolidated financial statements since the respective dates of acquisition.

The unaudited pro forma combined consolidated financial information is presented for illustrative purpose only and is not necessarily indicative of the result of operations that would have actually been reported had the acquisitions occurred on the above dates, nor is it necessarily indicative of the future results of operations of the combined company. The unaudited pro forma combined consolidated financial information reflects certain adjustments, such as amortization, interest expense, deferred tax valuation allowance and transaction related costs.

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Notes to Condensed Consolidated Financial Statements

(Unaudited)

The following unaudited pro forma combined consolidated financial information has been prepared by the Company using the acquisition method of accounting to give effect to the Revitas acquisition as if it had occurred on October 1, 2015. The following table sets forth the unaudited pro forma consolidated combined results of operations:

	Three Months Ended December 31, 2016 (in thousands, except per share data)	
Revenue	\$	37,121
Net loss		(10,910)
Net loss per shares-basic and diluted	\$	(0.39)

3. Consolidated Balance Sheet Components

Components of property and equipment, and intangible assets consisted of the following:

Property and Equipment

	As of December 31, 2017	As of September 30, 2017
	(in thousands)	
Computer software and equipment	\$10,211	\$10,274
Furniture and fixtures	1,257	1,284
Leasehold improvements	1,397	1,466
Software development costs	9,416	9,416
Total property and equipment	22,281	22,440
Less: Accumulated depreciation and amortization	(18,458)	(17,829)
Total property and equipment, net	\$3,823	\$4,611

Depreciation expense totaled \$0.8 million and \$0.7 million for the three months ended December 31, 2017 and 2016, respectively.

Intangible Assets

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	Estimated	As of December 31, 2017		
	Useful Life	Gross	Accumulated	Net
	(in Years)	Carrying	Amortization	Carrying
		Amount	Amount	Amount
		(in thousands)		
Intangible Assets:				
Developed technology	5-6	\$12,083	\$ (5,020)	\$ 7,063
Backlog	5	280	(230)	50
Customer relationships	3-10	36,599	(4,974)	31,625
Trade name	1	260	(260)	—
Total		\$49,222	\$ (10,484)	\$ 38,738

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	Estimated Useful Life (in Years)	As of September 30, 2017 Gross Carrying Amount (in thousands)	Accumulated Amortization (in thousands)	Net Carrying Amount
Intangible Assets:				
Developed technology	5-6	\$12,083	\$ (4,545)	\$ 7,538
Backlog	5	280	(215)	65
Non-competition agreement	3	100	(100)	—
Customer relationships	3-10	36,599	(4,084)	32,515
Trade name	1	260	(222)	38
Total		\$49,322	\$ (9,166)	\$ 40,156

The Company recorded amortization expense related to the acquired intangible assets of \$1.4 million and \$0.4 million for the three months ended December 31, 2017 and 2016, respectively.

Estimated future amortization expense for the intangible assets as of December 31, 2017 is as follows (in thousands):

2018 (remaining 9 months)	\$4,142
2019	5,466
2020	4,751
2021	4,686
2022 and thereafter	19,693
Total future amortization	\$38,738

4. Goodwill

The changes in the carrying amount of goodwill for the three months ended December 31, 2017 consisted of the following (in thousands):

Balance as at September 30, 2016	\$6,939
Add: Goodwill from acquisition of business	32,344
Balance as at September 30, 2017	\$39,283
Add: Goodwill from acquisition of business	—
Balance as at December 31, 2017	\$39,283

As a result of the acquisition of Revitas in the second quarter of fiscal 2017, the Company recognized goodwill of \$32.3 million. See Note 2, "Business Combination", for additional details.

5. Debt

Term Loan

In connection with the Revitas acquisition, on January 5, 2017, the Company entered into a Financing Agreement (Financing Agreement) by and among the Company, the Subsidiaries, as guarantors, Crystal Financial SPV, LLC and TC Lending, LLC (collectively, the “Lenders”), as administrative agent for the lenders, sole lead arranger, and collateral agent for the Lenders, pursuant to which the Lenders have extended term loan to the Company in an aggregate principle amount of \$50.0 million.

The term loan made pursuant to the Financing Agreement will bear interest at a rate of either (i) the Base Rate (as defined in the Financing Agreement) plus 9.25% or (ii) the LIBOR Rate (as defined in the Financing Agreement) plus 8.25%, as selected by the Company. The term loans mature on January 5, 2022. For the quarter ending December 31, 2017, the Company selected LIBOR Rate plus 8.25%. The Company must repay 0.625% of the aggregate principal amount of the term loans on the last business day of each fiscal quarter, beginning with the fiscal quarter ending March 31, 2019. The Company may voluntarily prepay the terms loans, subject to a 3% premium during the first 24 months and 1% premium after 24 months and prior to 36 months. Certain mandatory prepayments are required upon the sale of certain assets, the receipt of certain insurance or condemnation proceeds or extraordinary receipts, the

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

issuance of certain securities or debt, the occurrence of excess cash flows and the occurrence of certain restrictions on the business of the combined company or certain divestitures.

The Financing Agreement requires the Company and the subsidiaries to maintain certain financial covenants, including achieving certain levels of revenue from specified sources, as outlined in the agreement, and maintaining cash and cash-equivalents of \$20.0 million net of accounts payable in excess of \$0.5 million 90 days overdue. The Financing Agreement also contains certain non-financial covenants, including restricting our ability to dispose of assets, changing our organizational documents or amending our material agreements in a manner adverse to the lender, changing a method of accounting, merging with or acquiring other entities, incurring other indebtedness and making certain investments.

The Company was in compliance with all of the covenants described in the Financing Agreements as of December 31, 2017.

The subsidiary guarantors have jointly and severally guaranteed the payment in full of all obligations under the Financing Agreement. The Company and the subsidiary guarantors' obligations under the Financing Agreement are secured by substantially all of their assets and a pledge of certain of the Company and the subsidiaries' stock.

Promissory Notes

Also, in connection with the Revitas acquisition, the Company incurred \$10.0 million in debt in the form of two promissory notes with the sellers, one which will mature on July 5, 2018 and the other which will mature on January 5, 2020. These promissory notes bear interest at the rate of 3% per annum, and are subject to a right of set-off as partial security for the indemnification obligations of target's stockholders under the Merger Agreement. These promissory notes are subordinate to the term loan. The fair value of the promissory notes of \$8.6 million was determined based on a discounted future cash flow at 9.96% interest rate, which represents an arm's length interest rate.

As of December 31, 2017, the term loan and promissory notes consisted of the following:

	Amount (in thousands)
Principal	\$ 60,000
Unamortized debt discount and issuance costs	(2,559)
Net carrying amount	\$ 57,441

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The Company incurred approximately \$0.8 million in transaction costs in connection with the term loan in fiscal year 2017. These costs are included as part of the Company's debt. The effective interest rate for the term loan is 10.3%, the 18 month promissory note is 9.74% and the 36 month promissory note is 9.89%.

The future scheduled principal payments for the term loan and promissory notes as of December 31, 2017 were as follows (in thousands):

Fiscal Year	
2018 (remaining 9 months)	5,000
2019	937
2020	6,250
2021	1,250
2022	46,563
Total	\$60,000

6. Fair Value of Financial Instruments

The financial instruments of the Company consist primarily of cash and cash equivalents, accounts receivable, accounts payable, debt and certain accrued liabilities. The Company regularly reviews its financial instruments portfolio to identify and evaluate such instruments that have indications of possible impairment. When there is no readily available market data, fair value estimates are made

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

by the Company, which involves some level of management estimation and judgment and may not necessarily represent the amounts that could be realized in a current or future sale of these assets.

Fair value is defined as the exchange price that would be received for an asset or an exit price paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The current accounting guidance for fair value instruments defines a three-level valuation hierarchy for disclosures as follows:

Level 1—Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2—Input other than quoted prices included in Level 1 that are observable, unadjusted quoted prices in markets that are not active, or other inputs for similar assets and liabilities that are observable or can be corroborated by observable market data; and

Level 3—Unobservable inputs that are supported by little or no market activity, which requires the Company to develop its own models and involves some level of management estimation and judgment.

The Company's Level 1 assets consist of cash equivalent. These instruments are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets.

The table below sets forth the Company's cash equivalents as of December 31, 2017 and September 30, 2017, which are measured at fair value on a recurring basis by level within the fair value hierarchy. The assets are classified based on the lowest level of input that is significant to the fair value measurement.

	Level 1	Level 2	Level 3	Total
	(in thousands)			
As of December 31, 2017:				
Assets:				
Cash equivalents:	\$39,052	\$ —	\$ —	\$39,052
Total	\$39,052	\$ —	\$ —	\$39,052
As of September 30, 2017:				
Assets:				
Cash equivalents:	\$47,754	\$ —	\$ —	\$47,754
Total	\$47,754	\$ —	\$ —	\$47,754

The Company's cash equivalents as of December 31, 2017 and September 30, 2017 consisted of a money market funds with original maturity dates of less than three months from the date of their respective purchase. Cash equivalents are classified as Level 1. The fair value of the Company's money market funds approximated amortized cost and, as such,

there were no unrealized gains or losses on money market funds as of December 31, 2017 and September 30, 2017. The Company's financial instruments not measured at fair value on a recurring basis include cash, accounts receivable, accounts payable and accrued liabilities, and are reflected in the financial statements at cost and approximates their fair value due to their short-term nature. The term loan carrying value is approximately fair value since the term loan bears interest at rates that fluctuate with the changes in the Base Rate or the Libor Rate as selected by the Company. The promissory notes carrying values approximate their fair value as of December 31, 2017.

7. Stock-based Compensation

As of December 31, 2017, 4.5 million shares were available for future stock awards under the Company's equity plans and any additional releases resulting from an over-achievement relating to performance-based restricted stock units. There were no stock options granted during the three months ended December 31, 2017 and 2016, respectively.

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The following table summarizes the stock option activity and related information under all equity plans:

	Number of Shares (thousands)	Weighted Average Exercised Price	Weighted Average Remaining Contract Term (in Years)	Aggregate Intrinsic Value (in thousands)
Balance at September 30, 2017	453	\$ 7.71	3.53	\$ 3,281
Granted	—	—	—	
Exercised	(62)	8.97	—	
Forfeited	—	—	—	
Expired	—	—	—	
Balance at December 31, 2017	391	\$ 7.51	3.17	\$ 3,224
Options exercisable as of December 31, 2017	391	\$ 7.51	3.17	\$ 3,224
Options vested and expected to vest as of				
December 31, 2017	391	\$ 7.51	3.17	\$ 3,224

The following table summarizes the Company's restricted stock unit activity (including performance-based restricted stock units) under all equity award plans:

	Restricted Stock Units Outstanding (in thousands)	Weighted Average Grant Date Fair Value
Balance at September 30, 2017	2,917	\$ 12.55
Granted	65	14.55
Released	(89)	10.68
Forfeited	(138)	10.39
Balance at December 31, 2017	2,755	\$ 12.76

Stock-based Compensation

Stock-based compensation recorded in the statements of operations is as follows:

	Three Months Ended December	
	31,	2016
	2017	
	(in thousands)	
Cost of revenues:		
SaaS and maintenance	\$ 278	\$ 246
License and implementation	292	234
Total stock-based compensation in cost of revenue	570	480
Operating expenses:		
Research and development	657	404
Sales and marketing	871	553
General and administrative	1,938	458
Total stock-based compensation in operating expense	3,466	1,415
Total stock-based compensation	\$ 4,036	\$ 1,895

8. Income Taxes

On December 22, 2017, tax reform legislation known as the Tax Cuts and Jobs Act (the Tax Legislation) was enacted in the United States (U.S.). The Tax Legislation significantly revises the U.S. corporate income tax by, among other things, lowering the

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corporate income tax rate to 21%, implementing a modified territorial tax system and imposing a one-time repatriation tax on deemed repatriated earnings and profits of U.S.-owned foreign subsidiaries (the Toll Charge), and limiting the deductibility of certain expenses, such as interest expense. As a fiscal-year taxpayer, certain provisions of the Tax Legislation impact the Company in fiscal 2018, including the change in the corporate income tax rate and the Toll Charge, while other provisions will be effective starting at the beginning of fiscal 2019. The U.S. federal income tax rate reduction was effective as of January 1, 2018. Accordingly, the Company's federal statutory income tax rate for fiscal 2018 reflects a blended rate of approximately 24.3%.

On December 22, 2017, the SEC issued Staff Accounting Bulletin ("SAB 118"), which provides guidance on accounting for tax effects of the Tax Legislation. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Act for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Legislation is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate to be included in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provision of the tax laws that were in effect immediately before the enactment of the Tax Legislation. Given the amount and complexity of the changes in tax law resulting from the Tax Legislation, the Company has prepared an accounting estimate for the income tax effects of the Tax Legislation. This includes the amounts recorded to the Toll Charge, the re-measurement of deferred taxes and the change in the Company's indefinite reinvestment assertion. Further, the Company is in the process of analyzing the effects of new taxes due on certain foreign income and other provisions of the Tax Legislation.

The impact of the Tax Legislation may differ from this estimate, during the one-year measurement period due to, among other things, further refinement of the Company's calculations, changes in interpretations and assumptions the Company has made, guidance that may be issued and actions the Company may take as a result of the Tax Legislation. However, due to the availability of sufficient U.S. net operating losses as well as related valuation allowances, the Company does not anticipate the enactment of the Tax Legislations to have a material impact on the Company's financial statements other than disclosure items that will need to be disclosed in its year-end financial statements.

The Company anticipates that it will obtain the necessary information to complete the accounting requirements under ASC 740 before the end of its fiscal year. Currently, the Company has recognized an immaterial tax benefit resulting from the re-measurement of indefinitely-lived U.S. deferred tax liabilities at the reduced U.S. corporate tax rate and reduction of valuation allowance for certain deferred tax liabilities from acquisition activity that can now be used as a source of income.

The Company recorded an income tax (benefit) expense of \$(324,000) and \$134,000, representing effective income tax rates of (5.8)% and 1.8%, for the three months ended December 31, 2017 and 2016, respectively. The increase in income tax benefit is primarily due to discrete tax benefit recorded as a result reduction in deferred tax liabilities from the reduced corporate tax rate and valuation allowance release. This is in addition to a reversal of certain foreign unrecognized tax benefits. The Company's effective income-tax rates during these periods differ from the Company's blended federal statutory rate of 24.3%, primarily due to permanent differences for stock-based compensation and the impact of state income taxes and foreign tax rate differences. The Company realized no benefit for current period

losses due to maintaining a full valuation allowance against the U.S. and foreign net deferred tax assets.

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9. Net Loss per Share

The following table sets forth the computation of the Company's basic and diluted net loss per share attributable to common stockholders during the periods presented:

	Three Months Ended December 31,	
	2017	2016
	(in thousands, except per share data)	
Numerator:		
Basic and diluted:		
Net loss attributable to common stockholders	\$ (5,257)	\$ (7,600)
Denominator:		
Basic and diluted:		
Weighted Average Shares Used in Computing Net Loss per		
Share Attributable to Common Stockholders	29,401	28,008
Net Loss per Share Attributable to Common Stockholders:		
Basic and diluted	\$ (0.18)	\$ (0.27)

The following shares of common stock equivalents were excluded from the computation of diluted net loss per share attributable to common stockholders as the effect would have been anti-dilutive:

	Three Months Ended December 31,	
	2017	2016
	(in thousands)	
Stock options	208	542
Performance-based restricted stock units and restricted stock units	1,398	784

10. Litigation and Contingencies

Legal Proceedings

We are not currently a party to any pending material legal proceedings. From time to time, we may become involved in legal proceedings arising in the ordinary course of our business. Regardless of outcome, litigation can have an

adverse impact on us due to defense and settlement costs, diversion of management resources, negative publicity and reputational harm and other factors.

11. Geographic Information

The Company has one operating segment with one business activity—developing and monetizing revenue management solutions.

Revenues from External Customers

Revenues from customers outside of the United States were 13% and 9% of total revenues for the three months ended December 31, 2017 and 2016, respectively. However, no single jurisdiction outside of the United States represented more than 10% of total revenues.

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Long-Lived Assets

The following table sets forth the Company's property and equipment, net by geographic region:

	As of December 31, 2017	As of September 30, 2017
	(in thousands)	
United States	\$3,214	\$ 3,867
India	609	744
Total property and equipment, net	\$3,823	\$ 4,611

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Forward-Looking Statements

This report contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933, as amended (Securities Act) and the Securities Exchange Act of 1934, as amended (Exchange Act). All statements other than statements of historical facts are statements that could be deemed forward-looking statements. These statements are based on current expectations, estimates, forecasts and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as “anticipates,” “goals,” “plans,” “believes,” “seeks,” “estimates,” “continues,” “may,” “will,” variations of such words and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. You should not rely upon forward-looking statements as predictions of future events. The events and circumstances reflected in the forward-looking statements may not be achieved or occur. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Forward-looking statements are based only on our current expectations and projections and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below under “Part II, Item 1A. Risk Factors,” and elsewhere in this report. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

As used in this report, the terms “we,” “us,” “our,” and “the Company” mean Model N, Inc. and its subsidiaries unless the context indicates otherwise.

Overview

We are a leader in Revenue Management solutions for life science and technology companies. Driving mission-critical business processes such as configure, price and quote (CPQ), contract and rebate management, business intelligence, and regulatory compliance, our solutions transform the revenue lifecycle from a series of disjointed operations into a strategic end-to-end process. With deep industry expertise, we support the complex business needs of the world's leading brands in life sciences, technology and manufacturing across more than 100 countries.

Model N Revenue Cloud transforms the revenue lifecycle into a strategic, end-to-end process aligned across the enterprise. Our industry specific clouds – Revenue Cloud for Pharma, Revenue Cloud for Med Tech and Revenue Cloud for High Tech – offer a range of solutions from individual applications to complete suites. Deployments may vary from specific divisions or territories to enterprise-wide implementations. In addition to industry specific clouds, Revenue Cloud provides a broad set of cloud applications for a variety of industries.

Our solutions are delivered via four distinct cloud-based offerings:

• **Revenue Clouds for Pharma and Med Tech** – These Revenue Clouds help life science companies optimize revenue throughout the commercialization process and reduces revenue leakage, while adhering to government regulations.

- **Revenue Cloud for High Tech** – Revenue Cloud for High Tech enables customers to modernize their sales processes by adopting a strategic approach to manage the revenue lifecycle by planned revenue.

Revenue Cloud – a suite of software-as-a-service (SaaS) subscriptions designed to automate the Revenue Management lifecycle.

We derive revenues primarily from the sale of our cloud-based solutions and professional services, as well as maintenance and support and managed support services. We price our solutions based on a number of factors, including revenues under management and number of users. We also derive revenues from selling professional services related to past sales of perpetual licenses. Maintenance and support revenues are recognized ratably over the support period, which is typically one year. SaaS revenues for cloud-based solutions are derived from subscription fees from customers accessing our cloud-based solutions, as well as from associated implementation and professional services. The actual timing of revenue recognition may vary based on our customers' implementation requirements and availability of our services personnel.

We market and sell our solutions to customers in the life sciences and technology industries. While we have historically generated the substantial majority of our revenues from companies in the life sciences industry, we have also grown our base of technology customers and intend to continue to focus on increasing the revenues from customers in the technology industry. Our most

significant customers in any given period generally vary from period to period due to the timing in the delivery of our professional services and related revenue recognition.

For the three months ended December 31, 2017 and 2016, our total revenues were \$39.1 million and \$28.1 million, respectively, representing a year-over-year increase of approximately 39%, primarily due to the acquisition of Revitas in the second quarter of fiscal year 2017 and improvements in sales execution, which was partially offset by a decrease in our licensing and implementation revenues as we no longer sell perpetual licenses, as our business model continues to shift towards our cloud-based solutions.

Key Business Metric

In addition to the measures of financial performance presented in our Condensed Consolidated Financial Statements, we use adjusted EBITDA to evaluate and manage our business. We use this key metric internally to manage our business, and we believe it is useful for investors to compare key financial data from various periods. See “Adjusted EBITDA” below.

Key Components of Results of Operations

Revenues

Revenues are comprised of SaaS and maintenance revenues and license and implementation revenues.

SaaS and Maintenance

SaaS and maintenance revenues primarily include subscription and related professional fees from customers accessing our cloud-based solutions. Also included in SaaS and maintenance revenues are revenues related to maintenance and support, managed support services, training and customer-reimbursed expenses. The SaaS model is the primary way we sell to our customers in our vertical markets. Accordingly, we expect that SaaS and maintenance revenues for the fiscal year 2018 will be higher both in absolute dollars and as a percentage of total revenues than fiscal year 2017 as we continue to acquire new SaaS customers and expand our SaaS offerings within our existing customers.

License and Implementation

License and implementation revenues are generated from the sale of software licenses for our on-premise solutions and related professional services. We expect our license and implementation revenues for the fiscal year 2018 to be lower both in absolute dollars and as a percentage of total revenue from those recorded in the fiscal year ended on September 30, 2017, as we no longer sell perpetual licenses.

Cost of Revenues

SaaS and Maintenance

Cost of SaaS and maintenance revenues includes costs related to the implementation of our cloud-based solutions, maintenance and support for our on-premise solutions, managed support services, training and customer-reimbursed expenses. Cost of SaaS and maintenance revenues primarily consists of personnel-related costs including salary, bonus, stock-based compensation, royalty, facility expense, amortization, depreciation, reimbursable expenses, third-party contractors and cloud hosting costs. We believe that cost of SaaS and maintenance revenues will continue to increase in absolute dollars as we continue to sell more cloud-based products and subscriptions.

License and Implementation

Cost of license and implementation revenues includes costs related to the implementation of our on-premise solutions. Cost of license and implementation revenues primarily consists of personnel-related costs including salary, bonus, stock-based compensation, third-party contractors, and other-related expenses. Cost of license and implementation revenues may vary from period to period depending on a number of factors, including the amount of implementation services required to deploy our solutions and the level of involvement of third-party contractors providing implementation services.

Operating Expenses

Research and Development

Our research and development expenses consist primarily of personnel-related costs including salary, bonus, stock-based compensation and third-party contractors. Our software development costs for new software solutions and enhancements to existing software solutions are generally expensed as incurred. In the past, we capitalized development costs in connection with the development of new cloud-based services. We expect our research and development expenses to be relatively flat in fiscal year 2018 from fiscal year 2017.

Sales and Marketing

Our sales and marketing expenses consist primarily of personnel-related costs including salary, bonus, commissions, stock-based compensation, amortization of intangible, travel-related expenses and marketing programs. We expect our sales and marketing expenses to be slightly lower in fiscal year 2018 from fiscal 2017.

General and Administrative

Our general and administrative expenses consist primarily of personnel-related costs including salary, bonus, stock-based compensation, audit and legal fees as well as third-party contractors, facilities, costs associated with corporate transactions, and travel-related expenses. We expect our general and administrative expense to decrease in fiscal year 2018 from fiscal year 2017.

Results of Operations

The following tables set forth our consolidated results of operations for the periods presented and as a percentage of our total revenues for those periods. The period-to-period comparison of financial results is not necessarily indicative of financial results to be achieved in future periods.

	Three Months Ended December 31, 2017		2016	
	(in thousands)			
Consolidated Statements of Operations Data:				
Revenues:				
SaaS and maintenance	\$ 32,323		\$ 22,640	
License and implementation	6,744		5,423	
Total revenues	39,067		28,063	
Cost of Revenues:				
SaaS and maintenance	13,024		10,208	
License and implementation	3,785		3,614	
Total cost of revenues	16,809		13,822	
Gross profit	22,258		14,241	
Operating Expenses:				
Research and development	9,068		5,975	
Sales and marketing	8,492		8,734	
General and administrative	8,731		7,185	
Total operating expenses	26,291		21,894	
Loss from operations	(4,033))	(7,653))
Interest expense (income), net	1,423		(33))
Other expenses (income), net	125		(154))
Loss before income taxes	(5,581))	(7,466))
(Benefit) provision for income taxes	(324))	134)
Net loss	\$ (5,257))	\$ (7,600))

Comparison of the Three Months Ended December 31, 2017 and 2016

Revenues

	Three Months Ended December 31, 2017		2016		Change	
	Amount	% of Total Revenues	Amount	% of Total Revenues	(\$)	(%)
	(in thousands, except percentages)					
Revenue:						
SaaS and maintenance	\$32,323	83	% \$22,640	81	% \$9,683	43 %
License and implementation	6,744	17	5,423	19	1,321	24

Total revenues	\$39,067	100	%	\$28,063	100	%	\$11,004	39	%
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SaaS and Maintenance

SaaS and maintenance revenues increased by \$9.7 million, or 43%, to \$32.3 million for the three months ended December 31, 2017 from \$22.6 million for the three months ended December 31, 2016. As a percentage of total revenues, SaaS and maintenance revenues increased from 81% to 83%. The increase in our SaaS and maintenance revenues was primarily driven by an increase in our SaaS subscriptions and professional service of \$6.2 million, a \$2.9 million increase in our maintenance and support and managed support services revenues, and a \$0.6 million increase in our training and customer reimbursable expenses. These increases were in large part related to the revenue attributable from our acquisition of Revitas in the second quarter of fiscal 2017 and continued growth of our cloud-based solutions. We intend to focus on growing our recurring revenue from SaaS subscription and related implementation services in future periods.

License and Implementation

License and implementation revenues increased by \$1.3 million, or 24%, to \$6.7 million during the three months ended December 31, 2017 from \$5.4 million for the three months ended December 31, 2016. As a percentage of total revenue, license and implementation revenues decreased from 19% to 17%. The decrease in revenue as a percentage of total revenue was primarily due to no sales of perpetual licenses in fiscal 2018 and fewer sales of related implementation services as we shifted our business model towards cloud-based solutions and stopped selling perpetual licenses. The increase in revenue in absolute dollars was primarily due to the revenue attributable from the acquisition of Revitas in the second quarter of fiscal 2017.

Cost of Revenues

	Three Months Ended December 31, 2017		2016		Change	
	Amount (in thousands, except percentages)	% of Revenues	Amount	% of Revenues	(\$)	(%)
Cost of revenues						
SaaS and maintenance	\$13,024	40	% \$10,208	45	% \$2,816	28 %
License and implementation	3,785	56	3,614	67	171	5
Total cost of revenues	\$16,809	43	% \$13,822	49	% \$2,987	22 %

SaaS and Maintenance

Cost of SaaS and maintenance revenues increased by \$2.8 million, or 28%, to \$13.0 million during the three months ended December 31, 2017 from \$10.2 million for the three months ended December 31, 2016 due to the increase in the related revenue. As a percentage of SaaS and maintenance revenues, cost of SaaS and maintenance revenues decreased from 45% to 40% during the three months ended December 31, 2017, as we continued to improve gross margins due to increased efficiencies in our business and synergies related to our acquisition of Revitas in the second quarter of fiscal 2017, and as we continuously modernize our cloud platform.

License and Implementation

Cost of license and implementation revenues increased by \$0.2 million, or 5% , to \$3.8 million during the three months ended December 31, 2017 from \$3.6 million for the three months ended December 31, 2016, due to the increase to the related revenue. As a percentage of license and implementation revenues, cost of license and implementation revenues decreased from 67% to 56% during the three months ended December 31, 2017 due to the mix of professional services engagements with higher profit margins.

Operating Expenses

Three Months Ended December
31,

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	2017	2016	Change	
	(in thousands, except percentages)			
Operating expenses:				
Research and development	\$9,068	\$5,975	\$3,093	52 %
Sales and marketing	8,492	8,734	(242)	(3)
General and administrative	8,731	7,185	1,546	22
Total operating expenses	\$26,291	\$21,894		