

AGILYSYS INC  
Form 10-Q  
February 07, 2014  
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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 December 31, 2013

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 0-5734

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

Ohio  
(State or other jurisdiction of  
incorporation or organization)

34-0907152  
(I.R.S. Employer  
Identification No.)

425 Walnut Street, Suite 1800,  
Cincinnati, Ohio  
(Address of principal executive offices)

45202  
(ZIP Code)

(770) 810-7800  
(Registrant's telephone number, including area code)

N/A  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

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

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

The number of Common Shares of the registrant outstanding as of January 31, 2014 was 22,480,849.

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## AGILYSYS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share data)

|  | December 31,<br>2013 | March 31,<br>2013 |
|--|----------------------|-------------------|
| <b>ASSETS</b>  |                      |                   |
| Current assets:  |                      |                   |
| Cash and cash equivalents  | \$96,357             | \$82,931          |
| Accounts receivable, net of allowances of \$971 and \$786, respectively  | 24,459               | 17,892            |
| Inventories  | 2,408                | 1,709             |
| Prepaid expenses   | 3,103                | 3,167             |
| Other current assets   | 1,649                | 671               |
| Assets of discontinued operations, current   | —                    | 40,007            |
| Total current assets   | 127,976              | 146,377           |
| Property and equipment, net  | 13,850               | 13,855            |
| Goodwill   | 17,747               | 14,128            |
| Intangible assets, net   | 10,947               | 11,283            |
| Software development costs, net  | 13,613               | 5,596             |
| Other non-current assets   | 3,626                | 4,179             |
| Assets of discontinued operations, non-current   | —                    | 2,162             |
| Total assets   | \$187,759            | \$197,580         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                      |                   |
| Current liabilities:   |                      |                   |
| Accounts payable   | \$11,341             | \$10,427          |
| Deferred revenue   | 19,958               | 20,461            |
| Accrued liabilities  | 12,180               | 12,938            |
| Capital lease obligations, current   | 43                   | 58                |
| Liabilities of discontinued operations, current  | —                    | 30,372            |
| Total current liabilities  | 43,522               | 74,256            |
| Deferred income taxes, non-current   | 3,904                | 4,002             |
| Capital lease obligations, non-current   | 38                   | 28                |
| Other non-current liabilities  | 6,204                | 4,640             |
| Liabilities of discontinued operations, non-current  | —                    | 798               |
| Commitments and contingencies (see Note 9)   |                      |                   |
| Shareholders' equity:  |                      |                   |
| Common shares, without par value, at \$0.30 stated value; 80,000,000 shares authorized; 31,606,831 shares issued; and 22,426,958 and 22,145,915 shares outstanding at December 31, 2013 and March 31, 2013, respectively | 9,482                | 9,482             |
| Treasury shares, 9,179,873 and 9,460,916 at December 31, 2013 and March 31, 2013, respectively   | (2,756               | ) (2,838          |
| Capital in excess of stated value  | (13,452              | ) (14,267         |
| Retained earnings  | 141,684              | 122,578           |
| Accumulated other comprehensive loss   | (867                 | ) (1,099          |
| Total shareholders' equity   | 134,091              | 113,856           |

|  |           |           |
|--|-----------|-----------|
| Total liabilities and shareholders' equity | \$187,759 | \$197,580 |
|--|-----------|-----------|

See accompanying notes to condensed consolidated financial statements.

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AGILYSYS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (Unaudited)

| (In thousands, except per share data)                    | Three months ended |            | Nine months ended |            |   |
|--|--------------------|------------|-------------------|------------|---|
|  | December 31,       |            | December 31,      |            |   |
|  | 2013               | 2012       | 2013              | 2012       |   |
| Net revenue:   |                    |            |                   |            |   |
| Products   | \$8,693            | \$12,467   | \$26,294          | \$26,757   |   |
| Support, maintenance and subscription services           | 13,607             | 12,245     | 39,945            | 37,147     |   |
| Professional services                                    | 3,707              | 3,478      | 10,847            | 10,907     |   |
| Total net revenue  | 26,007             | 28,190     | 77,086            | 74,811     |   |
| Cost of goods sold:                                      |                    |            |                   |            |   |
| Products   | 4,663              | 8,135      | 12,443            | 15,555     |   |
| Support, maintenance and subscription services           | 3,129              | 2,561      | 8,061             | 7,987      |   |
| Professional services                                    | 2,508              | 2,144      | 7,320             | 7,002      |   |
| Total net cost of goods sold                             | 10,300             | 12,840     | 27,824            | 30,544     |   |
| Gross profit   | 15,707             | 15,350     | 49,262            | 44,267     |   |
|  | 60.4               | % 54.5     | % 63.9            | % 59.2     | % |
| Operating expenses:                                      |                    |            |                   |            |   |
| Product development                                      | 6,074              | 6,260      | 19,555            | 17,965     |   |
| Sales and marketing                                      | 3,400              | 3,667      | 11,014            | 10,798     |   |
| General and administrative                               | 5,981              | 5,852      | 16,051            | 16,379     |   |
| Depreciation of fixed assets                             | 584                | 508        | 1,592             | 1,639      |   |
| Amortization of intangibles                              | 2,365              | 806        | 3,953             | 2,478      |   |
| Asset impairments and related charges                    | 309                | —          | 327               | 208        |   |
| Restructuring, severance and other charges               | 206                | (31)       | 822               | 1,524      |   |
| Operating loss   | (3,212)            | ) (1,712)  | ) (4,052)         | ) (6,724)  | ) |
| Other (income) expenses:                                 |                    |            |                   |            |   |
| Interest income  | (19)               | ) —        | (52)              | ) (8)      | ) |
| Interest expense   | 44                 | (13)       | ) 150             | 231        |   |
| Other (income) expense, net                              | (5)                | ) 217      | (45)              | ) 201      |   |
| Loss before income taxes                                 | (3,232)            | ) (1,916)  | ) (4,105)         | ) (7,148)  | ) |
| Income tax benefit                                       | (1,154)            | ) (813)    | ) (1,760)         | ) (1,975)  | ) |
| Loss from continuing operations                          | (2,078)            | ) (1,103)  | ) (2,345)         | ) (5,173)  | ) |
| (Loss) income from discontinued operations, net of taxes | (584)              | ) 1,619    | 21,451            | 3,545      |   |
| Net (loss) income  | \$(2,662)          | ) \$516    | \$19,106          | \$(1,628)  | ) |
| Weighted average shares outstanding - basic and diluted  | 22,150             | 21,900     | 22,100            | 21,873     |   |
| Net (loss) income per share - basic and diluted:         |                    |            |                   |            |   |
| Loss from continuing operations                          | \$(0.09)           | ) \$(0.05) | ) \$(0.11)        | ) \$(0.24) | ) |
| (Loss) income from discontinued operations               | (0.03)             | ) 0.07     | 0.97              | 0.17       |   |
| Net (loss) income per share                              | \$(0.12)           | ) \$0.02   | \$0.86            | \$(0.07)   | ) |

See accompanying notes to condensed consolidated financial statements.



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AGILYSYS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
 (Unaudited)

| (In thousands)                                      | Three months ended |           | Nine months ended |             |
|---|--------------------|-----------|-------------------|-------------|
|   | December 31,       |           | December 31,      |             |
|   | 2013               | 2012      | 2013              | 2012        |
| Net (loss) income                                   | \$ (2,662 )        | \$ 516    | \$ 19,106         | \$ (1,628 ) |
| Other comprehensive (loss) income, net of tax:      |                    |           |                   |             |
| Unrealized foreign currency translation adjustments | 48                 | (826 )    | 232               | (777 )      |
| Unrealized loss on sale of securities               | —                  | —         | —                 | (4 )        |
| Total comprehensive (loss) income                   | \$ (2,614 )        | \$ (310 ) | \$ 19,338         | \$ (2,409 ) |

See accompanying notes to condensed consolidated financial statements.



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AGILYSYS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)

| (In thousands)  | Nine months ended    |            |
|---|----------------------|------------|
|   | December 31,<br>2013 | 2012       |
| Operating activities  |                      |            |
| Net income (loss)   | \$19,106             | \$(1,628 ) |
| Less: Income from discontinued operations   | 21,451               | 3,545      |
| Loss from continuing operations   | (2,345 )             | (5,173 )   |
| Adjustments to reconcile loss from continuing operations to net cash used in operating activities |                      |            |
| Restructuring, severance and other charges  | 822                  | 1,524      |
| Payments for restructuring, severance and other charges   | (1,530 )             | (6,306 )   |
| Payments for legal settlements  | (87 )                | —          |
| Asset impairments and related charges   | 327                  | 208        |
| Depreciation  | 1,592                | 1,639      |
| Amortization  | 4,053                | 3,223      |
| Share-based compensation  | 1,543                | 1,006      |
| Excess tax benefit from equity awards   | (209 )               | —          |
| Changes in operating assets and liabilities:  |                      |            |
| Accounts receivable   | (6,158 )             | (4,300 )   |
| Inventories   | (598 )               | (111 )     |
| Prepaid expense   | (747 )               | 3          |
| Accounts payable  | 577                  | 4,687      |
| Deferred revenue  | (1,379 )             | (6,105 )   |
| Accrued liabilities   | (1,451 )             | (6,208 )   |
| Income taxes payable  | (2,118 )             | (2,225 )   |
| Other changes, net  | 205                  | (29 )      |
| Net cash used in operating activities from continuing operations                                  | (7,503 )             | (18,167 )  |
| Net cash (used in) provided by operating activities from discontinued operations                  | (1,018 )             | 779        |
| Net cash used in operating activities   | (8,521 )             | (17,388 )  |
| Investing activities  |                      |            |
| Proceeds from sale of RSG   | 36,024               | —          |
| Cash paid for acquisition, net  | (1,801 )             | —          |
| Capital expenditures  | (3,235 )             | (1,530 )   |
| Capitalized software development costs  | (8,247 )             | (1,767 )   |
| Proceeds from sale of marketable securities   | —                    | 4,347      |
| Additional investments in corporate-owned life insurance policies                                 | (87 )                | (85 )      |
| Net cash provided by investing activities from continuing operations                              | 22,654               | 965        |
| Net cash used in investing activities from discontinued operations                                | (117 )               | (754 )     |
| Net cash provided by investing activities   | 22,537               | 211        |
| Financing activities  |                      |            |
| Repurchase of common shares to satisfy employee tax withholding                                   | (729 )               | (148 )     |
| Exercise of employee stock options  | 64                   | 67         |
| Excess tax benefit from equity awards   | 209                  | —          |
| Principal payments under long-term obligations  | (53 )                | (257 )     |
| Net cash used in financing activities from continuing operations                                  | (509 )               | (338 )     |

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|  |          |   |          |   |
|--|----------|---|----------|---|
| Net cash used in financing activities from discontinued operations | (80      | ) | (288     | ) |
| Net cash used in financing activities                              | (589     | ) | (626     | ) |
| Effect of exchange rate changes on cash                            | (1       | ) | 54       |   |
| Cash flows provided by (used in) continuing operations             | 14,641   |   | (17,486  | ) |
| Cash flows used in discontinued operations                         | (1,215   | ) | (263     | ) |
| Net increase (decrease) in cash and cash equivalents               | 13,426   |   | (17,749  | ) |
| Cash and cash equivalents at beginning of period                   | 82,931   |   | 97,587   |   |
| Cash and cash equivalents at end of period                         | \$96,357 |   | \$79,838 |   |

See accompanying notes to condensed consolidated financial statements.

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AGILYSYS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Table amounts in thousands, except per share data)

1. Nature of Operations and Financial Statement Presentation

Nature of Operations

Agilysys is a leading developer and marketer of proprietary enterprise software, services and solutions to the hospitality industry. The company specializes in market-leading point-of-sale, property management, inventory & procurement and mobile & wireless solutions that are designed to streamline operations, improve efficiency and enhance the guest experience. Agilysys serves casinos, resorts, hotels, foodservice venues, stadiums and cruise lines. Agilysys operates extensively throughout North America, Europe and Asia, with corporate services located in Alpharetta, GA, EMEA headquarters in Cheshire, UK, and APAC offices in Singapore, Hong Kong and Malaysia.

Following the divestiture of the Technology Solutions Group in August 2011 and the Retail Solutions Group (RSG) in July 2013, Agilysys operates as one operating segment and as a pure play software-driven solutions provider to the hospitality industry. The sale of RSG represented a disposal of a component of an entity. As such, the operating results of RSG have been reported as a component of discontinued operations in the Condensed Consolidated Financial Statements for the periods presented (see Note 4).

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include our accounts consolidated with our wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Our fiscal year ends on March 31st. References to a particular year refer to the fiscal year ending in March of that year. For example, fiscal 2014 refers to the fiscal year ending March 31, 2014.

Our unaudited interim financial statements are prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information, the instructions to the Quarterly Report on Form 10-Q (Quarterly Report) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and Rule 10-01 of Regulation S-X under the Exchange Act. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations relating to interim financial statements.

The Condensed Consolidated Balance Sheet as of December 31, 2013, as well as the Condensed Consolidated Statements of Operations and the Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended December 31, 2013 and 2012, and the Condensed Consolidated Statements of Cash Flow for the nine months ended December 31, 2013 and 2012, are unaudited. However, these financial statements have been prepared on the same basis as those in the audited annual financial statements. In the opinion of management, all adjustments of a recurring nature necessary to fairly present the results of operations, financial position, and cash flows have been made. Further, we have evaluated all significant events occurring subsequent to the date of the Condensed Consolidated Financial Statements and through the filing of this Quarterly Report.

These unaudited interim financial statements should be read together with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2013, filed with the Securities and Exchange Commission (SEC) on June 14, 2013.



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### 2. Summary of Significant Accounting Policies

A detailed description of our significant accounting policies can be found in the audited financial statements for the fiscal year ended March 31, 2013, included in our Annual Report on Form 10-K. Except as described below, there have been no material changes to our significant accounting policies and estimates from those disclosed therein.

**Change in Accounting Estimate.** In October 2013, we initiated an internal enterprise resource planning (ERP) system replacement project and determined that amortization for our existing ERP system should be accelerated. As a result, we recorded approximately \$1.6 million of additional amortization expense in connection with this acceleration within "Amortization of intangibles" in the Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2013, respectively. This change also impacted the basic and diluted loss per share by \$0.07 in each of the three and nine months ended December 31, 2013. The existing ERP system will be fully amortized as of May 31, 2014.

**Asset Impairments.** During the third quarter of fiscal 2014, in connection with the ERP system replacement project, we determined that certain internal use developed software would not be continued. As a result, we impaired the entire asset and \$0.3 million was recorded as an impairment charge. During fiscal 2013, we recorded \$0.2 million of additional impairment charges from the fiscal 2012 impairment of certain developed technologies.

**Changes to Prior Period Presentation.** In the first quarter of fiscal 2014, as a result of increased visibility into our services organization, certain costs previously classified in product development expenses were recorded in cost of goods sold to more properly reflect the nature of these expenses. The portion of these expenses that was erroneously recorded in previous periods was immaterial to the overall financial statements. Prior period presentation has been modified to conform to the current presentation.

#### Adopted and Recently Issued Accounting Pronouncements.

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. ASU 2013-11 clarifies guidance and eliminates diversity in practice on the presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. This new guidance is effective on a prospective basis for fiscal years and interim reporting periods within those years, beginning after December 15, 2013. We are currently evaluating the impact that the adoption of ASU 2013-11 will have on our consolidated financial statements or related disclosures.

In July 2012, the FASB issued ASU No. 2012-02, Intangibles-Goodwill and Other-Testing Indefinite-Lived Intangible Assets for Impairment, to allow entities to use a qualitative approach to test indefinite-lived intangible assets for impairment. ASU 2012-02 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value. If it is concluded that this is the case, it is then necessary to perform the currently prescribed quantitative impairment test by comparing the fair value of the indefinite-lived intangible asset with its carrying value. Otherwise, the quantitative impairment test is not required. This guidance is effective for fiscal years beginning after September 15, 2012 and early adoption is permitted. We adopted this guidance as of April 1, 2013, and it did not have a material impact on our consolidated financial statements or related disclosures.

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, which amends certain provisions in ASC 220 Comprehensive Income. These provisions require the disclosure of significant amounts that are reclassified out of other comprehensive income into net income in its entirety during the reporting period. These provisions are effective for fiscal and interim periods beginning after December 15, 2012. We adopted this guidance as of April 1, 2013, and it did not have a material impact on our consolidated financial statements or related disclosures.

In March 2013, FASB issued ASU No. 2013-05, Foreign Currency Matters: Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity, an amendment which allows an entity to release cumulative translation adjustment into net

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income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. This is effective for fiscal years and interim reporting periods beginning after December 15, 2013, with early adoption permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements or related disclosures.

Management continually evaluates the potential impact, if any, of all recent accounting pronouncements on our consolidated financial statements or related disclosures and, if significant, makes the appropriate disclosures required by such new accounting pronouncements.

### 3. Acquisitions

On June 10, 2013, Agilysys purchased certain assets and assumed certain liabilities of TimeManagement Corporation (TMC), a privately-owned Minneapolis-based technology provider with solutions that streamline workforce management environments for hospitality operators. This technology based acquisition is consistent with the core value we provide to the industry and integrates with our point-of-sale, inventory and procurement systems, including InfoGenesis™ point of sale system and Eatec® inventory and procurement solution. The purchase consideration consisted of \$1.8 million in cash paid and \$1.8 million of contingent consideration. The fair value of the contingent consideration was estimated to be \$1.8 million at the date of acquisition and is expected to be paid out over the next six years and payments could vary based on actual revenue during that time. The fair value of the contingent consideration was determined by calculating the probability-weighted earn-out payments based on the assessment of the likelihood that certain milestones would be achieved. The acquisition was funded with cash on hand. Management concluded that this acquisition was not a material acquisition under the provisions of ASC 805, Business Combinations. The operations of the purchased business have been included in our Condensed Consolidated Financial Statements from the date of acquisition and did not have a material impact on our condensed consolidated financial statements or related disclosures.

The following is a summary of the estimated fair values of the assets acquired and liabilities assumed from the acquisition:

(In thousands)

|   |         |
|---|---------|
| Current assets                          | \$327   |
| Property and equipment                  | 88      |
| Goodwill                                | 3,444   |
| Developed technology                    | 605     |
| Total assets acquired                   | 4,464   |
| Total liabilities assumed (all current) | 914     |
| Net assets acquired                     | \$3,550 |

The goodwill of approximately \$3.4 million arising from the acquisition consists largely of synergies and economies of scale expected from combining the operations of Agilysys and TMC. The goodwill from this acquisition is deductible for tax purposes over a period of 15 years.

The following is a summary of the intangible asset acquired and the weighted-average useful life over which it will be amortized.

|                      | Purchased assets | Weighted-average useful life |
|----------------------|------------------|------------------------------|
| Developed technology | \$605            | 5 years                      |

#### 4. Discontinued Operations

##### Sale of Assets of RSG - Fiscal 2014

In July 2013, we completed the sale of our RSG business to Kyrus Solutions, Inc. (Kyrus), an affiliate of Clearlake Capital Group, L.P., for total consideration of approximately \$37.6 million in cash, including a working capital adjustment of \$3.1 million. Upon the close of the transaction, the aggregate purchase price was reduced by fees of approximately \$1.6 million for transaction related costs, resulting in net proceeds received of approximately \$36.0 million. In addition to the purchase agreement, we entered into a transition services agreement (TSA) with Kyrus, under which we provided certain transitional administrative and support services to Kyrus through January 31, 2014.

##### Components of Results of Discontinued Operations

For the three and nine months ended December 31, 2013 and 2012, the income from discontinued operations was comprised of the following:

| (In thousands)                             | Three months ended<br>December 31, |           | Nine months ended<br>December 31, |          |
|--|------------------------------------|-----------|-----------------------------------|----------|
|  | 2013                               | 2012      | 2013                              | 2012     |
| Discontinued operations:                   |                                    |           |                                   |          |
| Net revenue                                | \$—                                | \$39,258  | \$24,315                          | \$99,035 |
| Income from operations of RSG              | —                                  | 2,451     | 895                               | 5,451    |
| Gain on sale of RSG                        | —                                  | —         | 23,135                            | —        |
| Income on sale of RSG                      | —                                  | 2,451     | 24,030                            | 5,451    |
| Income tax expense                         | 584                                | 832       | 2,579                             | 1,906    |
| (Loss) income from discontinued operations | \$(584                             | ) \$1,619 | \$21,451                          | \$3,545  |

Income tax expense recorded during the three months ended December 31, 2014 is due to intra-period tax allocation rules associated with discontinued operations.

#### 5. Restructuring Charges

We recognize restructuring charges when a plan that materially changes the scope of our business or the manner in which that business is conducted is adopted and communicated to the impacted parties, and the expenses have been incurred or are reasonably estimable.

##### Fiscal 2014 Restructuring Activity

In the first quarter of fiscal 2014, we announced restructuring actions to better align corporate functions and to reduce operating costs, following the sale of RSG. These restructuring activities are expected to be completed in fiscal 2014. We recorded \$0.7 million in restructuring charges during the first nine months of fiscal 2014, comprised of severance and other employee related benefits. We expect to incur minimal additional restructuring charges during the remainder of fiscal 2014 for the fiscal 2014 restructuring activity.

##### Fiscal 2012 Restructuring Activity

In fiscal 2012, we took steps to realign services and costs, including the relocation of our corporate services from Solon, Ohio to Alpharetta, Georgia. Since 2012, as previously disclosed, we have recorded \$12.1 million in restructuring charges related to the fiscal 2012 restructuring activity. As of December 31, 2013, there was no further liability for fiscal 2012 restructuring activity.





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## Fiscal 2009 Restructuring Activity

During fiscal 2009, we took steps to realign our cost and management structure. Since 2009, as previously disclosed, we have incurred charges totaling approximately \$19.0 million related to the fiscal 2009 restructuring activity. As of December 31, 2013, there was no further liability fiscal 2009 restructuring activity.

Following is a reconciliation of the beginning and ending balances of the restructuring liability:

| (In thousands)                  | Balance at<br>March 31,<br>2013 | Provision | Payments   | Balance at<br>December 31,<br>2013 |
|---------------------------------|---------------------------------|-----------|------------|------------------------------------|
| Fiscal 2014 Restructuring Plan: |                                 |           |            |                                    |
| Severance and employment costs  | \$—                             | \$686     | \$(510 )   | \$176                              |
| Fiscal 2012 Restructuring Plan: |                                 |           |            |                                    |
| Severance and employment costs  | 348                             | —         | (348 )     | —                                  |
| Fiscal 2009 Restructuring Plan: |                                 |           |            |                                    |
| Facilities costs                | 236                             | 32        | (268 )     | —                                  |
| Total restructuring costs       | \$584                           | \$718     | \$(1,126 ) | \$176                              |

All of the remaining severance and employment costs will be paid in fiscal 2014.

## 6. Intangible Assets and Software Development Costs

The following table summarizes our intangible assets and software development costs:

| (In thousands)                      | December 31, 2013           |                             |                           | March 31, 2013              |                             |                           |
|-------------------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|                                     | Gross<br>carrying<br>amount | Accumulated<br>amortization | Net<br>carrying<br>amount | Gross<br>carrying<br>amount | Accumulated<br>amortization | Net<br>carrying<br>amount |
| Amortized intangible assets:        |                             |                             |                           |                             |                             |                           |
| Customer relationships              | \$10,775                    | \$(9,855 )                  | \$920                     | \$10,775                    | \$(9,179 )                  | \$1,596                   |
| Non-competition agreements          | 2,700                       | (2,408 )                    | 292                       | 2,700                       | (2,213 )                    | 487                       |
| Developed technology                | 10,660                      | (10,125 )                   | 535                       | 10,055                      | (10,055 )                   | —                         |
| Patented technology                 | 80                          | (80 )                       | —                         | 80                          | (80 )                       | —                         |
|                                     | 24,215                      | (22,468 )                   | 1,747                     | 23,610                      | (21,527 )                   | 2,083                     |
| Unamortized intangible assets:      |                             |                             |                           |                             |                             |                           |
| Trade names                         | 10,100                      | N/A                         | 10,100                    | 10,100                      | N/A                         | 10,100                    |
| Accumulated impairment              | (900 )                      | N/A                         | (900 )                    | (900 )                      | N/A                         | (900 )                    |
|                                     | 9,200                       | N/A                         | 9,200                     | 9,200                       | N/A                         | 9,200                     |
| Total intangible assets             | \$33,415                    | \$(22,468 )                 | \$10,947                  | \$32,810                    | \$(21,527 )                 | \$11,283                  |
| Software development costs          | \$12,447                    | \$(88 )                     | \$12,359                  | \$9,493                     | \$—                         | \$9,493                   |
| Project expenditures not yet in use | 10,747                      | —                           | 10,747                    | 5,596                       | —                           | 5,596                     |
| Accumulated impairment              | (9,493 )                    | N/A                         | (9,493 )                  | (9,493 )                    | N/A                         | (9,493 )                  |
| Total software development costs    | \$13,701                    | \$(88 )                     | \$13,613                  | \$5,596                     | \$—                         | \$5,596                   |

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The following table summarizes our remaining estimated amortization expense relating to in service intangible assets and software development costs.

| (In thousands)               | Estimated<br>Amortization<br>Expense |
|------------------------------|--------------------------------------|
| Fiscal year ending March 31, |                                      |
| Remainder of fiscal 2014     | \$468                                |
| 2015                         | 1,634                                |
| 2016                         | 712                                  |
| 2017                         | 712                                  |
| 2018                         | 712                                  |
| 2019                         | 375                                  |
| Total                        | \$4,613                              |

Amortization expense relating to intangible assets was \$0.3 million and \$0.5 million for the three months ended December 31, 2013, and 2012, respectively, and \$0.9 million and \$1.6 million for the nine months ended December 31, 2013 and 2012, respectively. Amortization expense relating to software development costs was \$0.1 million for the three and nine months ended December 31, 2013. Amortization expense for acquired and internally developed intangibles that are related to revenue generating products is included in Products cost of goods sold.

Capitalized software development costs that are internally developed are carried on our balance sheet at net realizable value, net of accumulated amortization. We capitalized approximately \$4.3 million and \$1.5 million during the three months ended December 31, 2013 and 2012, respectively, and \$10.0 million and \$3.1 million during the nine months ended December 31, 2013 and 2012, respectively.

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## 7. Additional Balance Sheet Information

Additional information related to the Condensed Consolidated Balance Sheets is as follows:

| (In thousands)                                   | December 31,<br>2013 | March 31,<br>2013 |
|--|----------------------|-------------------|
| Other non-current assets:                        |                      |                   |
| Corporate owned life insurance policies          | \$2,285              | \$3,673           |
| Long-term prepaids                               | 848                  | —                 |
| Other  | 493                  | 506               |
| Total  | \$3,626              | \$4,179           |
| Accrued liabilities:                             |                      |                   |
| Salaries, wages, and related benefits            | \$5,903              | \$6,916           |
| Other taxes payable                              | 1,031                | 1,035             |
| Accrued legal settlements                        | 1,601                | 1,664             |
| Restructuring liabilities                        | 176                  | 584               |
| Professional fees                                | 566                  | 701               |
| License fees                                     | 554                  | —                 |
| Income taxes payable                             | 879                  | 631               |
| Deferred rent - current                          | 432                  | 362               |
| Contingent consideration - current               | 180                  | —                 |
| Other  | 858                  | 1,045             |
| Total  | \$12,180             | \$12,938          |
| Other non-current liabilities:                   |                      |                   |
| Income taxes payable and uncertain tax positions | \$2,464              | \$2,469           |
| Deferred rent - non-current                      | 1,729                | 1,976             |
| Contingent consideration - non-current           | 1,570                | —                 |
| Other  | 441                  | 195               |
| Total  | \$6,204              | \$4,640           |

## 8. Income Taxes

The following table compares our income tax benefit and effective tax rates for the three and nine months ended December 31, 2013 and 2012:

| (Dollars in thousands) | Three months ended<br>December 31, |          | Nine months ended<br>December 31, |            |   |
|------------------------|------------------------------------|----------|-----------------------------------|------------|---|
|                        | 2013                               | 2012     | 2013                              | 2012       |   |
| Income tax benefit     | \$(1,154                           | ) \$(813 | ) \$(1,760                        | ) \$(1,975 | ) |
| Effective tax rate     | 35.7                               | %42.4    | % 42.9                            | %27.6      | % |

For the three and nine months ended December 31, 2013, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations. Other items affecting the rate include a decrease in unrecognized tax benefits attributable to the expiration of statute of limitations, recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance, and other U.S. permanent book to tax differences.

For the three and nine months ended December 31, 2012, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations. Other items affecting the rate include recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation

allowance, and other U.S. permanent book to tax differences

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Because of our losses in prior periods, we have recorded a valuation allowance offsetting substantially all of our deferred tax assets. The amount of the valuation allowance, however, could be reduced in the near term. The exact timing and the portion of the valuation allowance released are subject to change based on the level of profitability that we are able to achieve for the remainder of fiscal 2014 and our visibility into future period results. We expect that any release of the valuation allowance will be recorded as an income tax benefit or an adjustment to paid-in capital at the time of release, significantly increasing our reported net income. Our recorded tax rate may increase in subsequent periods following a significant release of the valuation allowance and our net income may be reduced in periods following the release. Any valuation allowance release will not affect the amount of cash paid for income taxes.

#### 9. Commitments and Contingencies

Agilysys is the subject of various threatened or pending legal actions and contingencies in the normal course of conducting its business. We provide for costs related to these matters when a loss is probable and the amount can be reasonably estimated. The effect of the outcome of these matters on our future results of operations and liquidity cannot be predicted because any such effect depends on future results of operations and the amount or timing of the resolution of such matters. While it is not possible to predict with certainty, management believes that the ultimate resolution of such individual or aggregated matters will not have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

On April 6, 2012, Ameranth, Inc. filed a complaint against us for patent infringement in the United States District Court for the Southern District of California. The complaint alleges, among other things, that point-of-sale and property management and other hospitality information technology products, software, components and/or systems sold by us infringe three patents owned by Ameranth purporting to cover generation and synchronization of menus, including restaurant menus, event tickets, and other products across fixed, wireless and/or internet platforms as well as synchronization of hospitality information and hospitality software applications across fixed, wireless and internet platforms. The complaint seeks monetary damages, injunctive relief, costs and attorneys fees. At this time, we are not able to predict the outcome of this lawsuit, or any possible monetary exposure associated with the lawsuit. However, we dispute the allegations of wrongdoing and are vigorously defending ourselves in this matter.

On July 9, 2012, a putative class action lawsuit was filed against us in the United States District Court for the Northern District of California alleging violations of federal and state wage and hour laws, rules and regulations pertaining primarily to pay for missed meals and rest periods and failure to reimburse business expenses. On January 9, 2014, the court issued its preliminary approval of a settlement of the lawsuit pursuant to which we would pay a gross settlement in the amount of approximately \$1.5 million. This amount was accrued at March 31, 2013 and remains recorded within "Accrued liabilities" on our Consolidated Balance Sheets. The final approval hearing for the settlement has been set for May 20, 2014.

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## 10. Earnings (Loss) per Share

The following data shows the amounts used in computing (loss) earnings per share and the effect on income and the weighted average number of shares of dilutive potential common shares.

| (In thousands, except per share data)  | Three months ended<br>December 31, |            | Nine months ended<br>December 31, |            |
|--|------------------------------------|------------|-----------------------------------|------------|
|  | 2013                               | 2012       | 2013                              | 2012       |
| Numerator:   |                                    |            |                                   |            |
| Loss from continuing operations  | \$(2,078                           | ) \$(1,103 | ) \$(2,345                        | ) \$(5,173 |
| (Loss) income from discontinued operations                                   | (584                               | ) 1,619    | 21,451                            | 3,545      |
| Net (loss) income  | \$(2,662                           | ) \$516    | \$19,106                          | \$(1,628   |
| Denominator:   |                                    |            |                                   |            |
| Weighted average shares outstanding - basic and diluted                      | 22,150                             | 21,900     | 22,100                            | 21,873     |
| Earnings (loss) per share - basic and diluted:                               |                                    |            |                                   |            |
| Loss from continuing operations  | \$(0.09                            | ) \$(0.05  | ) \$(0.11                         | ) \$(0.24  |
| (Loss) income from discontinued operations                                   | (0.03                              | ) 0.07     | 0.97                              | 0.17       |
| Net (loss) income per share  | \$(0.12                            | ) \$0.02   | \$0.86                            | \$(0.07    |
| Anti-dilutive stock options, SSARs, restricted shares and performance shares | 1,850                              | 2,383      | 2,014                             | 2,400      |

Basic earnings (loss) per share is computed as net income available to common shareholders divided by the weighted average basic shares outstanding. The outstanding shares used to calculate the weighted average basic shares excludes 270,333 and 236,919 of restricted shares and performance shares at December 31, 2013 and 2012, respectively, as these shares were issued but were not vested and, therefore, not considered outstanding for purposes of computing basic earnings per share at the balance sheet dates.

Diluted earnings (loss) per share includes the effect of all potentially dilutive securities on earnings per share. We have stock options, stock-settled appreciation rights ("SSARs") and unvested restricted shares that are potentially dilutive securities. When a loss is reported, the denominator of diluted earnings per share cannot be adjusted for the dilutive impact of share-based compensation awards because doing so would be anti-dilutive. In addition, when a loss from continuing operations is reported, adjusting the denominator of diluted earnings per share would also be anti-dilutive to the loss per share, even if the entity has net income after adjusting for a discontinued operation. Therefore, for all periods presented, basic weighted-average shares outstanding were used in calculating the diluted net loss per share.

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## 11. Share-based Compensation

We may grant non-qualified stock options, incentive stock options, stock-settled stock appreciation rights, restricted shares, and restricted share units for up to 3.0 million common shares under our 2011 Stock Incentive Plan (“the 2011 Plan”). The maximum number of shares subject to stock options or SSARs that may be granted to an individual in a calendar year is 800,000 shares, and the maximum number of shares subject to restricted shares or restricted share units that may be granted to an individual in a calendar year is 400,000 shares. The maximum aggregate number of restricted shares or restricted share units that may be granted under the 2011 Plan is 1.0 million.

We have a shareholder-approved 2006 Stock Incentive Plan (the “2006 Plan”), as well as, a 2000 Stock Option Plan for Outside Directors and a 2000 Stock Incentive Plan that still have vested awards outstanding. Awards are no longer being granted from these incentive plans.

We may distribute authorized but unissued shares or treasury shares to satisfy share option and appreciation right exercises or restricted share and performance share awards.

We record compensation expense related to stock options, stock-settled stock appreciation rights, restricted shares, and performance shares granted to certain employees and non-employee directors based on the fair value of the awards on the grant date. The fair value of restricted share and performance share awards is based on the closing price of our common shares on the grant date. The fair value of stock option and stock-settled appreciation right awards is estimated on the grant date using the Black-Scholes-Merton option pricing model, which includes assumptions regarding the risk-free interest rate, dividend yield, life of the award, and the volatility of our common shares.

The following table summarizes the share-based compensation expense for options, SSARs, restricted and performance awards included in the Condensed Consolidated Statements of Operations:

| (In thousands)                         | Three months ended |       | Nine months ended |         |
|--|--------------------|-------|-------------------|---------|
|  | December 31,       |       | December 31,      |         |
|  | 2013               | 2012  | 2013              | 2012    |
| Product development                    | \$194              | \$114 | \$551             | \$287   |
| Sales and marketing                    | 46                 | 24    | 106               | 52      |
| General and administrative             | 411                | 301   | 886               | 667     |
| Total share-based compensation expense | \$651              | \$439 | \$1,543           | \$1,006 |



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## Stock Options

The following table summarizes the activity during the nine months ended December 31, 2013 for stock options awarded under the 2006 Plan:

|  | Number<br>of<br>Options | Weighted-<br>Average<br>Exercise<br>Price<br><br>(per share) | Remaining<br>Contractual<br>Term<br><br>(in years) | Aggregate<br>Intrinsic<br>Value |
|--|-------------------------|--|--|---------------------------------|
| (In thousands, except share and per share data)  |                         |  |  |                                 |
| Outstanding at April 1, 2013                     | 1,318,000               | \$ 14.07   |  |                                 |
| Granted  | —                       | —  |  |                                 |
| Exercised  | (107,000 )              | 6.64   |  |                                 |
| Cancelled/expired                                | (45,000 )               | 20.02  |  |                                 |
| Outstanding and exercisable at December 31, 2013 | 1,166,000               | \$ 14.52   | 1.6  | \$ 179                          |

A total of 42,870 shares, net of 52,712 shares withheld to cover the applicable exercise price of the award and 11,419 shares withheld to cover the employee's minimum applicable income taxes, were issued from treasury shares to settle stock options exercised during the first nine months of fiscal 2014.

## Stock-Settled Stock Appreciation Rights

Stock-Settled Appreciation Rights (SSARs) are rights granted to an employee to receive value equal to the difference in the price of our common shares on the date of the grant and on the date of exercise. This value is settled in common shares of Agilysys.

The following table summarizes the activity during the nine months ended December 31, 2013 for SSARs awarded under the 2011 and the 2006 Plan:

|   | Number<br>of Rights | Weighted-<br>Average<br>Exercise<br>Price<br><br>(per right) | Remaining<br>Contractual<br>Term<br><br>(in years) | Aggregate<br>Intrinsic<br>Value |
|---|---------------------|--|--|---------------------------------|
| (In thousands, except share and per share data) |                     |  |  |                                 |
| Outstanding at April 1, 2013                    | 683,119             | \$ 7.27  |  |                                 |
| Granted   | 119,120             | 12.36  |  |                                 |
| Exercised                                       | (292,576 )          | 6.84   |  |                                 |
| Forfeited                                       | (131,132 )          | 8.67   |  |                                 |
| Expired   | (1,849 )            | 6.76   |  |                                 |
| Outstanding at December 31, 2013                | 376,682             | \$ 8.72  | 5.4  | \$ 1,958                        |
| Exercisable at December 31, 2013                | 124,696             | \$ 7.54  | 4.7  | \$ 796                          |

As of December 31, 2013, total unrecognized stock based compensation expense related to non-vested SSARs was \$0.8 million, which is expected to be recognized over a weighted-average vesting period of 1.7 years.

A total of 96,299 shares, net of 44,809 shares withheld to cover the employee's minimum applicable income taxes, were issued from treasury shares to settle SSARs exercised during the nine months ended December 31, 2013. The shares withheld were returned to treasury shares.

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## Restricted Shares

We granted shares to certain of our Directors, executives and key employees under the 2011 Plan, the vesting of which is service-based. The following table summarizes the activity during the nine months ended December 31, 2013 for restricted shares awarded under the 2011 Plan:

|                                  | Number<br>of Shares | Weighted-<br>Average<br>Grant-<br>Date Fair<br>Value<br>(per share) |
|----------------------------------|---------------------|---|
| Outstanding at April 1, 2013     | 122,039             | \$7.99  |
| Granted                          | 188,513             | 12.31   |
| Vested                           | (11,308             | ) 12.38   |
| Forfeited                        | (46,639             | ) 9.89  |
| Outstanding at December 31, 2013 | 252,605             | \$10.67   |

The weighted-average grant date fair value of the restricted shares is determined based upon the closing price of our common shares on the grant date. As of December 31, 2013, total unrecognized stock based compensation expense related to non-vested restricted stock was \$1.5 million, which is expected to be recognized over a weighted-average vesting period of 1.9 years.

## Performance Shares

The following table summarizes the activity during the nine months ended December 31, 2013 for performance shares awarded under the 2011 Plan:

|                                  | Number<br>of<br>Shares | Weighted-<br>Average<br>Grant-<br>Date Fair<br>Value<br>(per share) |
|----------------------------------|------------------------|---|
| Outstanding at April 1, 2013     | 17,728                 | \$8.64  |
| Granted                          | —                      | —   |
| Outstanding at December 31, 2013 | 17,728                 | \$8.64  |

The weighted-average grant date fair value of the performance shares is determined based upon the closing price of our common shares on the grant date and assumed that performance goals would be met at target. As of December 31, 2013, total unrecognized stock based compensation expense related to non-vested performance shares was \$0.1 million, which is expected to be recognized over a weighted-average vesting period of 0.4 years.

## 12. Fair Value Measurements

We estimate the fair value of financial instruments using available market information and generally accepted valuation methodologies. We assess the inputs used to measure fair value using a three-tier hierarchy. The hierarchy indicates the extent to which pricing inputs used in measuring fair value are observable in the market. Level 1 inputs include unadjusted quoted prices for identical assets or liabilities and are the most observable. Level 2 inputs include unadjusted quoted prices for similar assets and liabilities that are either directly or indirectly observable, or other

observable inputs such as interest rates, foreign currency exchange rates, commodity rates, and yield curves. Level 3 inputs are not observable in the market and include our own judgments about the assumptions market participants would use in pricing the asset or liability. The use of observable and unobservable inputs is reflected in the hierarchy assessment disclosed in the tables below.

There were no significant transfers between Levels 1, 2, and 3 during the nine months ended December 31, 2013.

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The following tables present information about our financial assets and liabilities measured at fair value on a recurring basis and indicate the fair value hierarchy of the valuation techniques utilized to determine such fair value:

|  | Fair value measurement used |  |  |  |
|--|-----------------------------|--|--|--|
|  | Recorded value as of        | Active markets for identical assets or liabilities | Quoted prices in similar instruments and observable inputs | Active markets for unobservable inputs |
| (In thousands)                               | December 31, 2013           | (Level 1)  | (Level 2)  | (Level 3)                              |
| Assets:                                      |                             |  |  |  |
| Commercial paper                             | \$19,990                    | \$—  | \$19,990   | \$—                                    |
| Corporate-owned life insurance — current     | 1,469                       | —  | —  | 1,469                                  |
| Corporate-owned life insurance — non-current | 2,285                       | —  | —  | 2,285                                  |
| Liabilities:                                 |                             |  |  |  |
| Contingent consideration — current           | 180                         | —  | —  | 180                                    |
| Contingent consideration — non-current       | 1,570                       | —  | —  | 1,570                                  |

|  | Fair value measurement used |  |  |  |
|--|-----------------------------|--|--|--|
|  | Recorded value as of        | Active markets for identical assets or liabilities | Quoted prices in similar instruments and observable inputs | Active markets for unobservable inputs |
| (In thousands)                               | March 31, 2013              | (Level 1)  | (Level 2)  | (Level 3)                              |
| Assets:                                      |                             |  |  |  |
| Corporate-owned life insurance — non-current | 3,673                       | —  | —  | 3,673                                  |

The fair value of the commercial paper was determined using a market approach, based on prices and other relevant information generated by market transactions involving similar assets, and therefore, is classified within Level 2 of the fair value hierarchy.

The recorded value of the corporate-owned life insurance policies is adjusted to the cash surrender value of the policies obtained from the third party life insurance providers, which are not observable in the market, and therefore, are classified within Level 3 of the fair value hierarchy. Changes in the cash surrender value of these policies are recorded within “Other expenses (income), net” in the Condensed Consolidated Statements of Operations.

The fair value of the contingent consideration was determined by calculating the probability-weighted earn-out payments based on the assessment of the likelihood that certain milestones would be achieved.

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The following table presents a summary of changes in the fair value of the Level 3 assets:

| (In thousands)   | Nine months ended    |         |
|--|----------------------|---------|
|  | December 31,<br>2013 | 2012    |
| Corporate-owned life insurance:                                |                      |         |
| Balance on April 1   | \$3,673              | \$3,458 |
| Unrealized gain relating to instruments held at reporting date | (6                   | ) 55    |
| Purchases, sales, issuances and settlements, net               | 87                   | 42      |
| Balance on December 31   | \$3,754              | \$3,555 |

The following tables present information about our financial and nonfinancial assets and liabilities measured at fair value on a nonrecurring basis and indicate the fair value hierarchy of the valuation techniques utilized to determine such fair value:

| (In thousands)   | Fair value measurement used |   |  |   |
|--|-----------------------------|---|--|---|
|  | Recorded<br>value as<br>of  | Active<br>markets<br>for<br>identical<br>assets or<br>liabilities | Quoted<br>prices in<br>similar<br>instruments<br>and<br>observable<br>inputs | Active<br>markets for<br>unobservable<br>inputs |
|  |                             |   |  |   |
| Assets:  |                             |   |  |   |
| Goodwill   | \$17,747                    | \$—   | \$—  | \$17,747  |
| Intangible assets  | 10,947                      | —   | —  | 10,947  |
| Liabilities:   |                             |   |  |   |
| Restructuring liabilities — current                      | 176                         | —   | —  | 176   |
| Other employee benefit plan obligations —<br>non-current | 195                         | —   | —  | 195   |

| (In thousands)  | Fair value measurement used |   |  |   |
|---|-----------------------------|---|--|---|
|   | Recorded<br>value as<br>of  | Active<br>markets<br>for<br>identical<br>assets or<br>liabilities | Quoted<br>prices in<br>similar<br>instruments<br>and<br>observable<br>inputs | Active<br>markets for<br>unobservable<br>inputs |
|   |                             |   |  |   |
| Assets:   |                             |   |  |   |
| Goodwill  | \$14,128                    | \$—   | \$—  | \$14,128  |
| Intangible assets   | 11,283                      | —   | —  | 11,283  |
| Liabilities:  |                             |   |  |   |
| Restructuring liabilities — current                       | 584                         | —   | —  | 584   |
| Other employee benefit plans obligations —<br>non-current | 195                         | —   | —  | 195   |

Goodwill represents the excess purchase price paid over the fair value of the net assets of acquired companies. Goodwill is subject to impairment testing at least annually or in interim periods if indicators of potential impairment exist, unless it is determined after a qualitative assessment that it is more likely than not that the fair value of the reporting unit is greater than its carrying amount. A qualitative assessment of our reporting units was used to determine that no further impairment analysis was required at March 31, 2013.

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Intangible assets are valued at their estimated fair value at time of acquisition. We evaluate the fair value of our definite-lived and indefinite-lived intangible assets on an annual basis, or in interim periods if indicators of potential impairment exist. The income approach using “the relief from royalty method” was used to value indefinite-lived intangible assets.

Restructuring liabilities primarily consist of one-time termination benefits to former employees and ongoing costs related to long-term operating lease obligations. The recorded value of the termination benefits to employees is adjusted to the expected remaining obligation each period based on the arrangements made with the former employees. The recorded value of the ongoing lease obligations is based on the remaining lease term and payment amount, net of sublease income plus interest, discounted to present value. Changes in subsequent periods resulting from revisions to either the timing or amount of estimated cash flows over the remaining future periods are measured using the credit-adjusted, risk-free rate that was used to measure the restructuring liabilities initially.

The inputs used to value our goodwill, intangible assets, capitalized software development, and restructuring liabilities are not observable in the market and therefore, these amounts are classified within Level 3 in the fair value hierarchy.

The following tables present a summary of changes in the fair value of the Level 3 assets and liabilities:

| Level 3 assets and liabilities<br>Nine months ended December 31, 2013 |          |                   |                          |  |                           |
|---|----------|-------------------|--------------------------|--|---------------------------|
| (In thousands)  | Goodwill | Intangible assets | Contingent consideration | Other employee benefit plans obligations | Restructuring liabilities |
| Balance at April 1, 2013  | \$14,128 | \$11,283          | \$—                      | \$195                                    | \$584                     |
| Foreign currency translation adjustments                              | 175      | —                 | —                        | —  | —                         |
| Amortization  | —        | (941              | ) —                      | —  | —                         |
| Provisions  | —        | —                 | —                        | —  | 718                       |
| Purchases   | 3,444    | 605               | —                        | —  | —                         |
| Activity, payments and other charges (net)                            | —        | —                 | 1,750                    | —  | (1,126                    |
| Balance at December 31, 2013  | \$17,747 | \$10,947          | 1,750                    | \$195                                    | \$176                     |

| Level 3 assets and liabilities<br>Nine months ended December 31, 2012 |          |                   |                  |  |                           |
|---|----------|-------------------|------------------|--|---------------------------|
| (In thousands)  | Goodwill | Intangible assets | SERP obligations | Other employee benefit plans obligations | Restructuring liabilities |
| Balance at April 1, 2012  | \$15,198 | \$13,190          | \$3,323          | \$195                                    | \$6,047                   |
| Foreign currency translation adjustments                              | (107     | ) —               | —                | —  | —                         |
| Amortization  | —        | (1,616            | ) —              | —  | —                         |
| Provisions  | —        | —                 | —                | —  | 1,182                     |
| Activity, payments and other charges (net)                            | —        | —                 | (3,323           | ) —                                      | (6,298                    |
| Balance at December 31, 2012  | \$15,091 | \$11,574          | \$—              | \$195                                    | \$931                     |

Unrealized losses related to goodwill represent fluctuations due to the movement of foreign currencies relative to the U.S. dollar and are recorded within “Accumulated other comprehensive (loss) income” in the Condensed Consolidated Balance Sheets.



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### Item 2. Managements' Discussion and Analysis of Financial Condition and Results of Operations

In "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"), management explains the general financial condition and results of operations for Agilysys and subsidiaries including:

- what factors affect our business;
- what our earnings and costs were;
- why those earnings and costs were different from the year before;
- where the earnings came from;
- how our financial condition was affected; and
- where the cash will come from to fund future operations.

The MD&A analyzes changes in specific line items in the Condensed Consolidated Statements of Operations and Condensed Consolidated Statements of Cash Flows and provides information that management believes is important to assessing and understanding our consolidated financial condition and results of operations. This Quarterly Report on Form 10-Q updates information included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2013, filed with the Securities and Exchange Commission (SEC). This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and related Notes that appear in Item 1 of this Quarterly Report as well as our Annual Report for the year ended March 31, 2013. Information provided in the MD&A may include forward-looking statements that involve risks and uncertainties. Many factors could cause actual results to be materially different from those contained in the forward-looking statements. See "Forward-Looking Information" on page 34 of this Quarterly Report and Item 1A "Risk Factors" in Part I of our Annual Report for the fiscal year ended March 31, 2013 for additional information concerning these items. Management believes that this information, discussion, and disclosure is important in making decisions about investing in Agilysys.

#### Overview

Agilysys is a leading developer and marketer of proprietary enterprise software, services and solutions to the hospitality industry. The company specializes in market-leading point-of-sale, property management, inventory & procurement and mobile & wireless solutions that are designed to streamline operations, improve efficiency and enhance the guest experience. Agilysys serves casinos, resorts, hotels, foodservice venues, stadiums and cruise lines. Agilysys operates extensively throughout North America, Europe and Asia, with corporate services located in Alpharetta, GA, EMEA headquarters in Cheshire, UK, and APAC offices in Singapore, Hong Kong and Malaysia.

Following the divestiture of the Retail Solutions Group (RSG) in July 2013, Agilysys operates as one operating segment and as a pure play software-driven solutions provider to the hospitality industry. Our top priority is increasing shareholder value by improving operating and financial performance and profitability growing the business through superior products and services. To that end, we expect to invest a certain portion of our cash on hand to develop and market new software products, to fund enhancements to existing software products, to expand our customer breadth, both geographically and vertically, and to make select accretive acquisitions that can compliment or integrate with existing products.

The primary objective of our ongoing strategic planning process is to create shareholder value by targeting accretive growth opportunities, by strengthening our competitive position within the highest value technology solutions we provide to the technology differentiated end markets we service. The plan builds on our existing strengths and targets industry leading growth and peer beating financial and operating results driven by new technology trends and market opportunities. Industry leading growth and peer beating financial and operational results will be achieved through tighter coupling and management of operating expenses of the business and sharpening the focus of our investments to concentrate on growth opportunities with the highest return by seeking the highest margin revenue opportunities in the

markets in which we compete.

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Our strategic plan specifically focuses on:

• Differentiated service excellence, with strong customer focus

• Customer driven development,

• Industry led innovation, capitalizing on our intellectual property and emerging technology trends.

• Enabling lasting connections with our customers by driving guest preference awareness and memorable, valued experiences which result in creating end-customer relationships for life.

Revenue - Defined

As required by the SEC, we separately present revenue earned as products revenue, support, maintenance and subscription services revenue or professional services revenue in our Condensed Consolidated Statements of Operations. In addition to the SEC requirements, we may, at times, also refer to revenue as defined below. The terminology, definitions, and applications of terms we use to describe our revenue may be different from those used by other companies and caution should be used when comparing these financial measures to those of other companies. We use the following terms to describe revenue:

Revenue - We present revenue net of sales returns and allowances.

Products revenue - Revenue earned from the sales of hardware equipment and proprietary and remarketed software.

Support, maintenance and subscription services revenue - Revenue earned from the sale of proprietary and remarketed ongoing support, maintenance and subscription or hosting services.

Professional services revenue - Revenue earned from the delivery of implementation, integration and installation services for proprietary and remarketed products.

Matters Affecting Comparability

On July 1, 2013, we completed the sale of RSG to Kyru Solutions, Inc., an affiliate of Clearlake Capital Group, L.P. For financial reporting purposes, RSG's operating results for fiscal 2013 through the completion of the sale were classified within discontinued operations. Accordingly, the discussion and analysis presented below, reflects the continuing business of Agilysys.

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## Results of Operations

## Third Fiscal Quarter 2014 Compared to Third Fiscal Quarter 2013

## Net Revenue and Operating Loss

The following table presents our consolidated revenue and operating results for continuing operations for the three months ended December 31, 2013 and 2012:

| (Dollars in thousands)                         | Three months ended   |           | Increase (decrease) |         |    |
|--|----------------------|-----------|---------------------|---------|----|
|  | December 31,<br>2013 | 2012      | \$                  | %       |    |
| Net revenue:                                   |                      |           |                     |         |    |
| Products                                       | \$8,693              | \$12,467  | \$(3,774)           | (30.3)  | )% |
| Support, maintenance and subscription services | 13,607               | 12,245    | 1,362               | 11.1    | %  |
| Professional services                          | 3,707                | 3,478     | 229                 | 6.6     | %  |
| Total net revenue                              | 26,007               | 28,190    | (2,183)             | (7.7)   | )% |
| Cost of goods sold:                            |                      |           |                     |         |    |
| Products                                       | 4,663                | 8,135     | (3,472)             | (42.7)  | )% |
| Support, maintenance and subscription services | 3,129                | 2,561     | 568                 | 22.2    | %  |
| Professional services                          | 2,508                | 2,144     | 364                 | 17.0    | %  |
| Total net cost of goods sold                   | 10,300               | 12,840    | (2,540)             | (19.8)  | )% |
| Gross profit                                   | 15,707               | 15,350    | 357                 | 2.3     | %  |
| Gross profit margin                            | 60.4                 | % 54.5    | %                   |         |    |
| Operating expenses:                            |                      |           |                     |         |    |
| Product development                            | 6,074                | 6,260     | (186)               | (3.0)   | )% |
| Sales and marketing                            | 3,400                | 3,667     | (267)               | (7.3)   | )% |
| General and administrative                     | 5,981                | 5,852     | 129                 | 2.2     | %  |
| Depreciation of fixed assets                   | 584                  | 508       | 76                  | 15.0    | %  |
| Amortization of intangibles                    | 2,365                | 806       | 1,559               | 193.4   | %  |
| Asset impairments and related charges          | 309                  | —         | 309                 | nm      |    |
| Restructuring, severance and other charges     | 206                  | (31)      | 237                 | (764.5) | )% |
| Operating loss                                 | \$(3,212)            | \$(1,712) | \$(1,500)           | 87.6    | %  |
| Operating loss percentage                      | (12.4)               | )% (6.1)  | )%                  |         |    |

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The following table presents the percentage relationship of our Condensed Consolidated Statement of Operations line items to our consolidated net revenues for continuing operations for the periods presented:

|  | Three months ended |       |    |    |
|--|--------------------|-------|----|----|
|  | December 31,       |       |    |    |
|  | 2013               | 2012  |    |    |
| Net revenue:                                   |                    |       |    |    |
| Products                                       | 33.4               | 44.2  | %  | %  |
| Support, maintenance and subscription services | 52.3               | 43.4  |    |    |
| Professional services                          | 14.3               | 12.4  |    |    |
| Total  | 100.0              | 100.0 |    |    |
| Cost of goods sold:                            |                    |       |    |    |
| Products                                       | 17.9               | 28.9  |    |    |
| Support, maintenance and subscription services | 12.0               | 9.1   |    |    |
| Professional services                          | 9.6                | 7.6   |    |    |
| Total  | 39.6               | 45.5  |    |    |
| Gross profit                                   | 60.4               | 54.5  |    |    |
| Operating expenses:                            |                    |       |    |    |
| Product development                            | 23.4               | 22.2  |    |    |
| Sales and marketing                            | 13.1               | 13.0  |    |    |
| General and administrative                     | 23.0               | 20.8  |    |    |
| Depreciation of fixed assets                   | 2.2                | 1.8   |    |    |
| Amortization of intangibles                    | 9.1                | 2.9   |    |    |
| Asset impairments and related charges          | 1.2                | —     |    |    |
| Restructuring, severance and other charges     | 0.8                | (0.1) |    | )  |
| Operating loss                                 | (12.4)             | (6.1) | )% | )% |

Net revenue. Total net revenue decreased \$2.2 million, or 7.7%, during the third quarter of fiscal 2014 compared to the third quarter of fiscal 2013. Products revenue decreased \$3.8 million, or 30.3%, primarily as a result of a reduction in large remarketed product sales in the third quarter of fiscal 2013 that did not recur in the third quarter of fiscal 2014. Support, maintenance and subscription services revenue increased \$1.4 million, or 11.1%, as a result of continued focus on selling subscription based hosting revenue, and ongoing support from our growing proprietary product sales, offset by a reduction in remarketed support revenue due to a strategic change in one of our third party providers that lowered our costs and the costs to our customers. Professional services revenue increased \$0.2 million or 6.6% due to timing of customer installations.

Gross profit and gross profit margin. Our total gross profit increased \$0.4 million, or 2.3%, for third quarter of fiscal 2014 and total gross profit margin increased 590 basis points to 60.4%. Products gross profit decreased \$0.3 million while gross profit margin increased 1,160 basis points to 46.4% mainly as a result of certain developed technology amortization reaching its useful life during the fourth quarter of fiscal 2013 and the continued focus on higher margin proprietary software sales which made up a larger portion of total product sales in the third quarter of fiscal 2014 as compared to the third quarter of fiscal 2013. Support, maintenance and subscription services gross profit increased \$0.8 million while gross margin decreased 210 basis points to 77.0% due to a change in the mix of labor resources needed for maintenance of our products. Professional services gross margin decreased \$0.1 million and gross profit margin decreased 600 basis points to 32.3% as a result of higher cost of labor required to meet the needs of timing of customer installations.



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## Operating expenses

Operating expenses, excluding the charges for asset impairments and related charges and restructuring, severance and other charges, increased \$1.3 million, or 7.7%, in the third quarter of fiscal 2014 compared with the third quarter of fiscal 2013.

**Product development.** Product development includes all expenses associated with research and development. Product development decreased \$0.2 million, or 3.0% in the third quarter of fiscal 2014 compared with the third quarter of fiscal 2013. This decrease is driven by a greater percentage of our third party costs being capitalized during the third quarter of fiscal 2014 compared to the third quarter of fiscal 2013 as we are in the later development stage activities of our next generation products. Certain research and development costs are capitalized as software development costs for future use. We capitalized approximately \$4.3 million and \$1.5 million during the three months ended December 31, 2013 and 2012, respectively.

**Sales and marketing.** Sales and marketing decreased \$0.3 million, or 7.3%, in the third quarter of fiscal 2014 compared with the third quarter of fiscal 2013. The decrease is due mainly to a general decline in personnel related fringe expenses corresponding with the end of the calendar year.

**General and administrative.** General and administrative remained relatively flat reflecting the benefits of the initiatives implemented with the sale of RSG in the third quarter of fiscal 2014, which resulted in lower employee related costs and certain efficiencies in back-office processes, offset by certain software licenses fees incurred in the third quarter of fiscal 2014 that are not expected to recur.

**Depreciation of fixed assets.** Depreciation of fixed assets increased slightly due to the timing of asset acquisitions.

**Amortization of intangibles.** In October 2013, we initiated an internal enterprise resource planning (ERP) system replacement project and determined that amortization for our existing ERP system should be accelerated. We recorded approximately \$1.6 million in the third quarter of fiscal 2014 of additional amortization in connection with this acceleration. The existing ERP system will be fully amortized as of May 31, 2014.

**Asset impairment and related charges.** During the third quarter of fiscal 2014, in connection with the ERP system replacement project, we determined that certain internal use developed software would not be continued. As a result, we impaired \$0.3 million.

**Restructuring, severance and other charges.** In the third quarter of fiscal 2014, following the sale of RSG, we recorded additional restructuring charges of approximately \$0.2 million for severance and related benefits for a restructuring plan initiated in the first quarter of fiscal 2014 in order to better align corporate functions with our HSG operating unit and to reduce costs. In the third quarter of fiscal 2013, we recorded a decrease of expense for severance and related benefits for the fiscal 2012 restructuring activity. We expect to incur minimal additional restructuring charges during the remainder of fiscal 2014 for the fiscal 2014 restructuring activity. Our restructuring actions are discussed further in Note 5, Restructuring Charges.

## Other (Income) Expenses

| (Dollars in thousands)   | Three months ended |       | (Unfavorable) favorable |         |   |
|--------------------------|--------------------|-------|-------------------------|---------|---|
|                          | December 31, 2013  | 2012  | \$                      | %       |   |
| Other (income) expenses: |                    |       |                         |         |   |
| Interest income          | \$(19              | ) \$— | \$19                    | nm      |   |
| Interest expense         | 44                 | (13   | ) (57                   | ) 438.5 | % |

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|                                   |      |       |       |       |   |
|-----------------------------------|------|-------|-------|-------|---|
| Other (income) expense, net       | (5   | ) 217 | 222   | 102.3 | % |
| Total other expense (income), net | \$20 | \$204 | \$184 | 90.2  | % |

nm - not meaningful.



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Interest expense. Interest expense consists of costs associated with capital leases and loans on corporate-owned life insurance policies. Interest expense increased in the third quarter of fiscal 2014 compared to the third quarter of fiscal 2013 due to an adjustment in the third quarter of fiscal 2013 related to the expiration and non-renewal of certain capital leases.

Other income, net. Other income increased \$0.2 million in the third quarter of fiscal 2014. This is primarily due to gains recognized as a result of movements in foreign currencies relative to the U.S. dollar in the third quarter of fiscal 2013.

## Income Taxes

| (Dollars in thousands) | Three months ended |           | (Unfavorable) favorable |          |
|------------------------|--------------------|-----------|-------------------------|----------|
|                        | December 31,       | 2012      | \$                      | %        |
| Income tax benefit     | \$ (1,154 )        | \$ (813 ) | \$ 341                  | (41.9 )% |
| Effective tax rate     | 35.7               | % 42.4    | %                       |          |

For the third quarter of fiscal 2014, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations. Other items affecting the rate include a decrease in unrecognized tax benefits attributable to the expiration of statute of limitations, recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance, and other U.S. permanent book to tax differences.

For the third quarter of fiscal 2013, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations. Other items affecting the rate include recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance, and other U.S. permanent book to tax differences.

Although the timing and outcome of tax settlements are uncertain, it is reasonably possible that during the next 12 months a reduction in unrecognized tax benefits may occur in the range of zero to \$0.6 million of tax and zero to \$0.3 million of interest based on the outcome of tax examinations and as a result of the expiration of various statutes of limitations. We are routinely audited; due to the ongoing nature of current examinations in multiple jurisdictions, other changes could occur in the amount of gross unrecognized tax benefits during the next 12 months which cannot be estimated at this time.

Because of our losses in prior periods, we have recorded a valuation allowance offsetting substantially all of our deferred tax assets. The amount of the valuation allowance, however, could be reduced in the near term. The exact timing and the portion of the valuation allowance released are subject to change based on the level of profitability that we are able to achieve for the remainder of fiscal 2014 and our visibility into future period results. We expect that any release of the valuation allowance will be recorded as an income tax benefit or an adjustment to paid-in capital at the time of release, significantly increasing our reported net income. Our recorded tax rate may increase in subsequent periods following a significant release of the valuation allowance and our net income may be reduced in periods following the release. Any valuation allowance release will not affect the amount of cash paid for income taxes.

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## Results of Operations

## First Nine Months of Fiscal 2014 Compared to First Nine Months of Fiscal 2013

## Net Revenue and Operating Loss

The following table presents our consolidated revenue and operating results for continuing operations for the nine months ended December 31, 2013 and 2012:

| (Dollars in thousands)                         | Nine months ended    |           | Increase (decrease) |        |    |
|--|----------------------|-----------|---------------------|--------|----|
|  | December 31,<br>2013 | 2012      | \$                  | %      |    |
| Net revenue:                                   |                      |           |                     |        |    |
| Products                                       | \$26,294             | \$26,757  | \$(463)             | (1.7)  | )% |
| Support, maintenance and subscription services | 39,945               | 37,147    | 2,798               | 7.5    | %  |
| Professional services                          | 10,847               | 10,907    | (60)                | (0.6)  | )% |
| Total net revenue                              | 77,086               | 74,811    | 2,275               | 3.0    | %  |
| Cost of goods sold:                            |                      |           |                     |        |    |
| Products                                       | 12,443               | 15,555    | (3,112)             | (20.0) | )% |
| Support, maintenance and subscription services | 8,061                | 7,987     | 74                  | 0.9    | %  |
| Professional services                          | 7,320                | 7,002     | 318                 | 4.5    | %  |
| Total net cost of goods sold                   | 27,824               | 30,544    | (2,720)             | (8.9)  | )% |
| Gross profit                                   | 49,262               | 44,267    | 4,995               | 11.3   | %  |
|  | 63.9                 | % 59.2    | %                   |        |    |
| Operating expenses:                            |                      |           |                     |        |    |
| Product development                            | 19,555               | 17,965    | 1,590               | 8.9    | %  |
| Sales and marketing                            | 11,014               | 10,798    | 216                 | 2.0    | %  |
| General and administrative                     | 16,051               | 16,379    | (328)               | (2.0)  | )% |
| Depreciation of fixed assets                   | 1,592                | 1,639     | (47)                | (2.9)  | )% |
| Amortization of intangibles                    | 3,953                | 2,478     | 1,475               | 59.5   | %  |
| Asset impairments and related charges          | 327                  | 208       | 119                 | nm     |    |
| Restructuring, severance and other charges     | 822                  | 1,524     | (702)               | (46.1) | )% |
| Operating loss                                 | \$(4,052)            | \$(6,724) | \$2,672             | (39.7) | )% |
| Operating loss percentage                      | (5.3)                | )% (9.0)  | )%                  |        |    |

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The following table presents the percentage relationship of our Condensed Consolidated Statement of Operations line items to our consolidated net revenues for continuing operations for the periods presented:

|  | Nine months ended<br>December 31, |    |       |    |
|--|-----------------------------------|----|-------|----|
|  | 2013                              |    | 2012  |    |
| Net revenue:                                   |                                   |    |       |    |
| Products                                       | 34.1                              | %  | 35.8  | %  |
| Support, maintenance and subscription services | 51.8                              |    | 49.7  |    |
| Professional services                          | 14.1                              |    | 14.5  |    |
| Total net revenue                              | 100.0                             |    | 100.0 |    |
| Cost of goods sold:                            |                                   |    |       |    |
| Products                                       | 16.1                              |    | 20.8  |    |
| Support, maintenance and subscription services | 10.5                              |    | 10.7  |    |
| Professional services                          | 9.5                               |    | 9.4   |    |
| Total net cost of goods sold                   | 36.1                              |    | 40.8  |    |
| Gross profit                                   | 63.9                              |    | 59.2  |    |
| Operating expenses:                            |                                   |    |       |    |
| Product development                            | 25.4                              |    | 24.0  |    |
| Sales and marketing                            | 14.3                              |    | 14.4  |    |
| General and administrative                     | 20.8                              |    | 21.9  |    |
| Depreciation of fixed assets                   | 2.1                               |    | 2.2   |    |
| Amortization of intangibles                    | 5.1                               |    | 3.3   |    |
| Asset impairments and related charges          | 0.4                               |    | 0.3   |    |
| Restructuring, severance and other charges     | 1.1                               |    | 2.0   |    |
| Operating loss                                 | (5.3                              | )% | (9.0  | )% |

Net revenue. Total net revenue increased \$2.3 million, or 3.0%, during the first nine months of fiscal 2014 compared to the first nine months of fiscal 2013. Products revenue decreased \$0.5 million, or 1.7%, primarily as a result of a reduction in large remarketed product sales in the third quarter of fiscal 2013 that did not recur in the third quarter of fiscal 2014, partially offset by an increase in proprietary product revenues. Support and maintenance and subscription services revenue increased \$2.8 million, or 7.5%, as a result of continued focus on selling subscription based hosting revenue, and ongoing support from our growing proprietary product sales. This is offset by a reduction in remarketed support revenue due to a strategic change in one of our third party providers that lowered our costs and the costs to our customers in the first nine months of fiscal 2014. Professional services revenue decreased slightly due to timing of customer installations.

Gross profit and gross profit margin. Our total gross profit increased \$5.0 million, or 11.3%, for the first nine months of fiscal 2014 and total gross profit margin increased 470 basis points to 63.9%. Products gross profit increased \$2.6 million and gross profit margin increased 1,080 basis points to 52.7% mainly as a result of certain developed technology amortization reaching its useful life during the first nine months of fiscal 2013 and the continued focus on higher margin proprietary software sales which made up a larger portion of total product sales in the first nine months of fiscal 2014 compared to the first nine months of fiscal 2013. Support, maintenance and subscription services gross profit increased \$2.7 million and gross margin increased 130 basis points to 79.8% as less labor resources were needed for maintenance of our products. Professional services gross margin decreased \$0.4 million and gross profit margin decreased 330 basis points to 32.5% as a result of higher cost of labor required to meet the needs of timing of customer installations.



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## Operating expenses

Operating expenses, excluding the charges for asset impairments and related charges and restructuring, severance and other charges, increased \$2.9 million, or 5.9%, in the first nine months of fiscal 2014 compared with the first nine months of fiscal 2013.

Product development. Product development increased \$1.6 million, or 8.9% in the first nine months of fiscal 2014 compared with the first nine months of fiscal 2013. This increase is driven by the continued investment in internal and third party resources to enhance the existing products as well as the early stage development of our future platforms. Certain research and development costs are capitalized as software development costs for future use. We capitalized approximately \$10.0 million and \$3.1 million during the nine months ended December 31, 2013 and 2012, respectively.

Sales and marketing. Sales and marketing increased \$0.2 million, or 2.0%, in the first nine months of fiscal 2014 compared with the first nine months of fiscal 2013. The increase is due to continued investment in domestic sales resources and incremental incentive compensation expense incurred in the first nine months of fiscal 2014 to finalize fiscal 2013 compensation plans.

General and administrative. General and administrative decreased \$0.3 million, or 2.0%, in the first nine months of fiscal 2014 compared to the first nine months of fiscal 2013. This is a result of initiatives implemented with the sale of RSG, which resulted in lower employee related costs and certain efficiencies in back-office processes, offset by certain software license fees incurred in the third quarter of fiscal 2014 that are not expected to recur.

Depreciation of fixed assets. Depreciation of fixed assets was relatively flat for the first nine months of fiscal 2014 compared to the first nine months of fiscal 2013.

Amortization of intangibles. In October 2013, we initiated an internal enterprise resource planning (ERP) system replacement project and determined that amortization for our existing ERP system should be accelerated. We recorded approximately \$1.6 million in the first nine months of fiscal 2014 of additional amortization in connection with this acceleration. The existing ERP system will be fully amortized as of May 31, 2014.

Asset impairment and related charges. During the third quarter of fiscal 2014, in connection with the ERP system replacement project, we determined that certain internal use developed software would not be continued. As a result, we impaired the entire asset and \$0.3 million was recorded as an impairment charge. During fiscal 2013, we recorded \$0.2 million of additional impairment charges from the fiscal 2012 impairment of certain developed technologies.

Restructuring, severance and other charges. In the first nine months of fiscal 2014, following the sale of RSG, we recorded restructuring charges for severance and related benefits for a restructuring plan initiated in the first quarter of fiscal 2014 of approximately \$0.8 million in order to better align corporate functions with our HSG operating unit and to reduce costs. In the first nine months of fiscal 2013, we recorded additional expense of \$1.6 million for severance and related benefits for the fiscal 2012 restructuring activity. We expect to incur minimal additional restructuring charges during the remainder of fiscal 2014 for the fiscal 2014 restructuring activity. Our restructuring actions are discussed further in Note 5, Restructuring Charges.

## Other (Income) Expenses

|                          | Nine months ended |      | (Unfavorable) favorable |   |
|--------------------------|-------------------|------|-------------------------|---|
| (Dollars in thousands)   | December 31,      |      | \$                      | % |
|                          | 2013              | 2012 |                         |   |
| Other (income) expenses: |                   |      |                         |   |

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|                                    |       |        |        |      |   |
|------------------------------------|-------|--------|--------|------|---|
| Interest income                    | \$(52 | ) \$(8 | ) \$44 | nm   |   |
| Interest expense                   | 150   | 231    | 81     | 35.1 | % |
| Other (income) expense, net        | (45   | ) 201  | 246    | nm   |   |
| Total other (income) expenses, net | \$53  | \$424  | \$371  | 87.5 | % |

nm - not meaningful.

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Interest expense. Interest expense consists of costs associated with capital leases and loans on corporate-owned life insurance policies. Interest expense decreased in the first nine months of fiscal 2014 compared to the first nine months of fiscal 2013 due to expiration and non-renewal of certain capital leases.

Other (income) expense, net. Other income increased in the first nine months of fiscal 2014. This is primarily due to gains recognized as a result of movements in foreign currencies relative to the U.S. dollar in the first nine months of fiscal 2013.

## Income Taxes

| (Dollars in thousands) | Nine months ended |            | (Unfavorable) favorable |        |
|------------------------|-------------------|------------|-------------------------|--------|
|                        | December 31, 2013 | 2012       | \$                      | %      |
| Income tax benefit     | \$(1,760 )        | \$(1,975 ) | \$(215 )                | 10.9 % |
| Effective tax rate     | 42.9 %            | 27.6 %     |                         |        |

For the first nine months of fiscal 2014, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations. Other items affecting the rate include a decrease in unrecognized tax benefits attributable to the expiration of statute of limitations, recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance, and other U.S. permanent book to tax differences.

For the first nine months of fiscal 2013, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations. Other items affecting the rate include recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance, and other U.S. permanent book to tax differences.

Although the timing and outcome of tax settlements are uncertain, it is reasonably possible that during the next 12 months a reduction in unrecognized tax benefits may occur in the range of zero to \$0.6 million of tax and zero to \$0.3 million of interest based on the outcome of tax examinations and as a result of the expiration of various statutes of limitations. We are routinely audited; due to the ongoing nature of current examinations in multiple jurisdictions, other changes could occur in the amount of gross unrecognized tax benefits during the next 12 months which cannot be estimated at this time.

Because of our losses in prior periods, we have recorded a valuation allowance offsetting substantially all of our deferred tax assets. The amount of the valuation allowance, however, could be reduced in the near term. The exact timing and the portion of the valuation allowance released are subject to change based on the level of profitability that we are able to achieve for the remainder of fiscal 2014 and our visibility into future period results. We expect that any release of the valuation allowance will be recorded as an income tax benefit or an adjustment to paid-in capital at the time of release, significantly increasing our reported net income. Our recorded tax rate may increase in subsequent periods following a significant release of the valuation allowance and our net income may be reduced in periods following the release. Any valuation allowance release will not affect the amount of cash paid for income taxes.

## Acquisitions

On June 10, 2013, Agilysys purchased certain assets and assumed certain liabilities of TimeManagement Corporation (TMC), a privately-owned Minneapolis-based technology provider with solutions that streamline workforce management environments for hospitality operators. This technology based acquisition is consistent with the core value we provide to the industry and integrates with our point-of-sale, inventory and procurement systems, including InfoGenesis™ point of sale system and Eatec® inventory and procurement solution. The purchase consideration consisted of \$1.8 million in cash paid, and \$1.8 million of contingent consideration. The fair value of the contingent consideration was estimated to be \$1.8 million at the date of acquisition and is expected to be paid out over the next six years and payments could vary based on actual revenue during that time. The fair value of the contingent

consideration was determined by calculating the probability-weighted earn-out payments based on the assessment of the likelihood that certain milestones would be achieved. The acquisition was funded with cash on hand. Management concluded that this acquisition was not a material



acquisition under the provision of ASC 805, Business Combinations. The operations of the purchased business have been included in our Condensed Consolidated Financial Statements from the date of acquisition.

The following is a summary of the estimated fair values of the assets acquired and liabilities assumed from the acquisition:

|   |         |
|---|---------|
| (In thousands)                          |         |
| Current assets                          | \$327   |
| Property and equipment                  | 88      |
| Goodwill                                | 3,444   |
| Developed technology                    | 605     |
| Total assets acquired                   | 4,464   |
| Total liabilities assumed (all current) | 914     |
| Net assets acquired                     | \$3,550 |

The goodwill of approximately \$3.4 million arising from the acquisition consists largely of synergies and economies of scale expected from combining the operations of Agilysys and TMC. The goodwill from this acquisition is deductible for tax purposes over a period of 15 years.

The following is a summary of the intangible asset acquired and the weighted-average useful life over which it will be amortized.

|                      | Purchased assets | Weighted-average useful life |
|----------------------|------------------|------------------------------|
| Developed technology | \$605            | 5 years                      |

#### Discontinued Operations

##### Sale of Assets of RSG - Fiscal 2014

On July 1, 2013, we completed the sale of our RSG business to, Kyrus, an affiliate of Clearlake Capital Group, L.P., for total consideration of approximately \$37.6 million in cash, including a final working capital adjustment of \$3.1 million. Upon the close of the transaction, the aggregate purchase price was reduced by fees of approximately \$1.6 million for transaction related costs, resulting in net proceeds received of approximately \$36.0 million. In addition to the purchase agreement, we entered into a transition services agreement (TSA) with Kyrus, under which we provided certain transitional administrative and support services to Kyrus through January 31, 2014.

For the nine months ended December 31, 2013 and 2012 the income from discontinued operations was comprised of the following:

| (In thousands)                             | Three months ended |           | Nine months ended |          |
|--|--------------------|-----------|-------------------|----------|
|  | 2013               | 2012      | 2013              | 2012     |
| Discontinued operations:                   |                    |           |                   |          |
| Net revenue                                | \$—                | \$39,258  | \$24,315          | \$99,035 |
| Income from operations of RSG              | —                  | \$2,451   | 895               | \$5,451  |
| Gain on sale of RSG                        | —                  | —         | 23,135            | —        |
| Income of RSG                              | —                  | 2,451     | 24,030            | 5,451    |
| Income tax expense                         | 584                | 832       | 2,579             | 1,906    |
| (Loss) income from discontinued operations | \$(584)            | ) \$1,619 | \$21,451          | \$3,545  |

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## Liquidity and Capital Resources

## Overview

Our operating cash requirements consist primarily of working capital needs, operating expenses, capital expenditures, and payments of principal and interest on indebtedness outstanding, which primarily consists of lease and rental obligations at December 31, 2013. We believe that cash flow from operating activities, cash on hand of \$96.4 million as of December 31, 2013 and access to capital markets will provide adequate funds to meet our short-and long-term liquidity requirements in the next 12 months.

As of December 31, 2013 and March 31, 2013, our total debt was approximately \$0.1 million, comprised of capital lease obligations in both periods.

At December 31, 2013, 100% of our cash and cash equivalents were deposited in bank accounts or invested in highly liquid investments with original maturities of three months or less, including investments in commercial paper, of which 92.0% is located in the United States. Therefore, we believe that credit risk is limited with respect to our cash and cash equivalents balances.

## Cash Flow

|  | Nine months ended<br>December 31, |             |
|--|-----------------------------------|-------------|
| (In thousands)   | 2013                              | 2012        |
| Net cash provided by (used in) continuing operations:  |                                   |             |
| Operating activities                                   | \$(7,503 )                        | \$(18,167 ) |
| Investing activities                                   | 22,654                            | 965         |
| Financing activities                                   | (509 )                            | (338 )      |
| Effect of exchange rate changes on cash                | (1 )                              | 54          |
| Cash flows provided by (used in) continuing operations | 14,641                            | (17,486 )   |
| Operating cash flows used in discontinued operations   | (1,215 )                          | (263 )      |
| Net increase (decrease) in cash and cash equivalents   | \$13,426                          | \$(17,749 ) |

Cash flow used in operating activities from continuing operations. Cash flows used in operating activities were \$7.5 million in the first nine months of fiscal 2014. The use of cash was mostly attributable to \$1.5 million in restructuring, severance and other charges and increases in accounts receivable due to the timing of our annual billing for InfoGenesis™ support and maintenance services.

The \$18.2 million of cash used in operating activities in the first nine months of fiscal 2013 included payments for the Benefit Equalization Plan and Supplemental Executive Retirement Plan of \$4.5 million and \$6.3 million in restructuring. Also contributing to the use of cash were the annual bonus payments of \$1.8 million and \$6.1 million from deferred revenue for services performed during the period.

Cash flow provided by investing activities from continuing operations. In fiscal 2014, the \$22.7 million in cash provided by investing activities was primarily comprised of \$36.0 million net proceed from the sale of RSG, offset by \$1.8 million paid for the acquisition of TMC, \$3.2 million used for the enhancement of internal use software and purchase of property and equipment and \$8.2 million for the development of proprietary software.

In the first nine months of fiscal 2013, the \$1.0 million in cash provided by investing activities was primarily comprised of the \$4.3 million in funds from the marketable securities (Rabbi Trust), offset by \$1.5 million used for the purchase of leasehold improvements and computer equipment and \$1.8 million for the development of proprietary

software. The funds from the Rabbi Trust were used to settle employee benefit obligations.

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Cash flow used in financing activities from continuing operations. During the first nine months of fiscal 2014, the \$0.5 million used in financing activities was primarily comprised of the repurchase of shares to satisfy employee tax withholding and to cover the price of the options, and payments on capital lease obligations.

The \$0.3 million in cash used in financing activities in the first nine months of fiscal 2013 was related to shares withheld for income taxes on the vesting or exercise of stock compensation awards and principal payments on capital lease obligations.

### Contractual Obligations

As of December 31, 2013, there were no other significant changes to our contractual obligations as presented in our Annual Report for the year ended March 31, 2013.

### Off-Balance Sheet Arrangements

We have not entered into any off-balance sheet arrangements that have had or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

### Critical Accounting Policies

A detailed description of our significant accounting policies is included in our Annual Report for the year ended March 31, 2013. There have been no material changes in our significant accounting policies and estimates since March 31, 2013 except as noted in Note 2, Summary of Significant Accounting Policies.

### Forward-Looking Information

This Quarterly Report and other publicly available documents, including the documents incorporated herein and therein by reference, contain, and our officers and representatives may from time to time make, "forward-looking statements" within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as: "anticipate," "intend," "plan," "goal," "seek," "believe," "project," "estimate," "expect," "strategy," "future," "likely," "may," "should," "will" and similar references to future periods. These statements are not guarantees of future performance and involve risks, uncertainties, and assumptions that are difficult to predict. These statements are based on management's current expectations, intentions, or beliefs and are subject to a number of factors, assumptions, and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. Factors that could cause or contribute to such differences or that might otherwise impact the business include the risk factors set forth in Item 1A of our Annual Report for the fiscal year ended March 31, 2013. We undertake no obligation to update any such factor or to publicly announce the results of any revisions to any forward-looking statements contained herein whether as a result of new information, future events, or otherwise.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk affecting us, see Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," contained in our Annual Report for the fiscal year ended March 31, 2013. There have been no material changes in our market risk exposures since March 31, 2013.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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Under the supervision of and with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), management evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this Quarterly Report. Based on that evaluation, the CEO and CFO concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective.

#### Change in Internal Control over Financial Reporting

None.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

On July 9, 2012, a putative class action lawsuit was filed against us in the United States District Court for the Northern District of California alleging violations of federal and state wage and hour laws, rules and regulations pertaining primarily to pay for missed meals and rest periods and failure to reimburse business expenses. On January 9, 2014, the court issued its preliminary approval of a settlement of the lawsuit pursuant to which we would pay a gross settlement in the amount of approximately \$1.5 million. The final approval hearing for the settlement has been set for May 20, 2014.

### Item 1A. Risk Factors

There have been no material changes in the risk factors included in our Annual Report for the fiscal year ended March 31, 2013 that may materially affect our business, results of operations, or financial condition.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

### Item 6. Exhibits

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

<sup>101</sup> The following materials from our quarterly report on Form 10-Q for the quarter ended December 31, 2013, formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets



at December 31, 2013 and March 31, 2013, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2013 and 2012, (iii) Condensed Consolidated Statements of Comprehensive (Loss) Income for the three and nine months ended December 31, 2013 and 2012, (iv) Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2013 and 2012, and (v) Notes to Condensed Consolidated Financial Statements for the three and nine months ended December 31, 2013.



SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report to be signed on its behalf by the undersigned thereunto duly authorized.

AGILYSYS, INC.

Date: February 7, 2014

/s/Janine K. Seebeck  
Janine K. Seebeck  
Senior Vice President, Chief Financial Officer and  
Treasurer  
(Principal Accounting Officer and Duly Authorized Officer)