

AGILYSYS INC
Form 10-Q
August 04, 2016
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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 June 30, 2016

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 34-0907152
(State
or
other (I.R.S.
jurisdiction) employer
of Identification
incorporation)
or
organization)

425
Walnut
Street,
Suite 45202
1800,
Cincinnati,
Ohio
(Address
of
principal (ZIP Code)
executive
offices)

(770) 810-7800

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(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

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 August 1, 2016 was 22,939,102.

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AGILYSYS, INC.

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AGILYSYS, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited)

	June 30, 2016	March 31, 2016
(In thousands, except share data)		
ASSETS		
Current assets:		
Cash and cash equivalents	\$55,312	\$60,608
Accounts receivable, net of allowance for doubtful accounts of \$507 and \$617, respectively	17,312	22,017
Inventories	2,280	2,692
Prepaid expenses and other current assets	8,930	10,184
Total current assets	83,834	95,501
Property and equipment, net	13,976	14,197
Goodwill	19,622	19,622
Intangible assets, net	8,565	8,576
Software development costs, net	46,253	44,215
Other non-current assets	2,876	3,046
Total assets	\$175,126	\$185,157
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$7,501	\$7,761
Deferred revenue	28,781	33,241
Accrued liabilities	9,690	12,980
Capital lease obligations, current	122	118
Total current liabilities	46,094	54,100
Deferred income taxes, non-current	3,139	3,075
Capital lease obligations, non-current	194	215
Other non-current liabilities	4,230	4,294
Commitments and contingencies (see Note 7)		
Shareholders' equity:		
Common shares, without par value, at \$0.30 stated value; 80,000,000 shares authorized; 31,606,831 shares issued; and 22,939,102 and 22,942,586 shares outstanding at June 30, 2016 and March 31, 2016, respectively	9,482	9,482
Treasury shares, 8,667,729 and 8,664,245 at June 30, 2016 and March 31, 2016, respectively	(2,601)	(2,600)
Capital in excess of stated value	(7,343)	(7,645)
Retained earnings	122,116	124,413
Accumulated other comprehensive loss	(185)	(177)
Total shareholders' equity	121,469	123,473
Total liabilities and shareholders' equity	\$175,126	\$185,157

See accompanying notes to condensed consolidated financial statements.

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

(In thousands, except share data)	Three months ended	
	June 30,	
	2016	2015
Net revenue:		
Products	\$9,520	\$8,811
Support, maintenance and subscription services	14,948	14,899
Professional services	6,485	3,781
Total net revenue	30,953	27,491
Cost of goods sold:		
Products (inclusive of developed technology amortization)	6,532	4,922
Support, maintenance and subscription services	3,856	3,495
Professional services	4,374	2,675
Total cost of goods sold	14,762	11,092
Gross profit	16,191	16,399
	52.3	% 59.7
Operating expenses:		
Product development	6,855	6,268
Sales and marketing	5,634	4,461
General and administrative	4,873	5,177
Depreciation of fixed assets	598	518
Amortization of intangibles	336	298
Restructuring, severance and other charges	89	(46)
Operating loss	(2,194)	(277)
Other (income) expense:		
Interest income	(33)	(44)
Interest expense	4	8
Other expense (income), net	90	(32)
Loss before taxes	(2,255)	(209)
Income tax expense (benefit)	42	(24)
Net loss	\$(2,297)	\$(185)
Weighted average shares outstanding	22,599	22,220
Loss per share - basic and diluted:		
Loss per share	\$(0.10)	\$(0.01)

See accompanying notes to condensed consolidated financial statements.

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

(In thousands)	Three months ended June 30,	
	2016	2015
Net loss	\$(2,297)	\$(185)
Other comprehensive loss, net of tax:		
Unrealized foreign currency translation adjustments	(8)	(10)
Total comprehensive loss	\$(2,305)	\$(195)

See accompanying notes to condensed consolidated financial statements.

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

(In thousands)	Three months ended June 30,	
	2016	2015
Operating activities		
Net loss	\$(2,297)	\$(185)
Adjustments to reconcile loss from operations to net cash used in operating activities		
Net restructuring, severance and other charges	(389)	(308)
Net legal settlements	(100)	—
Depreciation	598	518
Amortization	336	297
Amortization of developed technology	1,266	256
Deferred income taxes	64	40
Share-based compensation	346	404
Change in cash surrender value of company owned life insurance policies	(5)	—
Changes in operating assets and liabilities:		
Accounts receivable	4,700	6,245
Inventories	413	121
Prepaid expense	816	160
Accounts payable	(408)	(6,543)
Deferred revenue	(3,812)	(1,395)
Accrued liabilities	(2,391)	(1,397)
Income taxes payable	(42)	7
Other changes, net	(114)	(85)
Net cash used in operating activities	(1,019)	(1,865)
Investing activities		
Capital expenditures	(410)	(1,212)
Capitalized software development costs	(3,278)	(5,572)
Additional (investments in) proceeds from corporate-owned life insurance policies	(1)	(21)
Net cash used in investing activities	(3,689)	(6,805)
Financing activities		
Payments to settle contingent consideration arising from business acquisition	(197)	—
Repurchase of common shares to satisfy employee tax withholding	(346)	(412)
Principal payments under long-term obligations	(24)	(10)
Net cash used in financing activities	(567)	(422)
Effect of exchange rate changes on cash	(21)	59
Net decrease in cash and cash equivalents	(5,296)	(9,033)
Cash and cash equivalents at beginning of period	\$60,608	\$75,067
Cash and cash equivalents at end of period	\$55,312	\$66,034
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING ACTIVITIES:		
Accrued capital expenditures	\$343	\$78
Accrued capitalized software development costs	985	2,738

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 technology company that provides innovative software for point-of-sale (POS), property management (PMS), inventory and procurement, workforce management, analytics, document management and mobile and wireless solutions and services to the hospitality industry. Our solutions and services allow property managers to better connect, interact and transact with their customers and enhance their customer relationships by streamlining operations, improving efficiency, increasing guest recruitment and wallet share, and enhancing the overall guest experience. We serve four major market sectors: Gaming, both corporate and tribal; Hotels, Resorts and Cruise; Foodservice Management; and Restaurants, Universities, Stadia and Healthcare. A significant portion of our consolidated revenue is derived from contract support, maintenance and subscription services.

We operate throughout North America, Europe and Asia, with corporate services located in Alpharetta, GA, and offices in Singapore, Hong Kong, Malaysia and the Philippines.

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 2017 refers to the fiscal year ending March 31, 2017.

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 June 30, 2016, as well as the Condensed Consolidated Statements of Operations, Condensed Consolidated Statements of Comprehensive Loss, and the Condensed Consolidated Statements of Cash Flow for the three months ended June 30, 2016 and 2015, 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 state the results of operations, financial position, and cash flows have been made.

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, 2016, filed with the Securities and Exchange Commission (SEC) on June 10, 2016.

Correction of Errors

In connection with the preparation of our Condensed Consolidated Financial Statements for the second quarter of fiscal 2016, we identified errors in the manner in which we recognized revenue on contract support. Contract support

revenue is recognized ratably over the term of the customer arrangement. In certain instances where contract support is an element of a multiple-element arrangement, we use a hierarchy to determine the fair value allocation for recognition of revenue on each deliverable. An error related to an input used in this allocation resulted in the overstatement of contract, maintenance, and support revenue of \$0.4 million for the three months ended June 30, 2015. The error was identified and

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corrected during the second quarter of fiscal 2016. Additionally, during the second quarter of fiscal 2016, we identified errors in the manner in which we capitalize internal labor on software development projects. An error in the method by which internal resources account for administrative time resulted in the over capitalization of costs during the last six months of fiscal 2015 and the first three months of fiscal 2016. The error for each of the three months ended December 31, 2014, March 31, 2015, and June 30, 2015, was \$0.1 million. We corrected these errors during the second quarter of fiscal 2016.

In accordance with accounting guidance found in ASC 250-10 (SEC Staff Accounting Bulletin No. 99, Materiality), we assessed the materiality of the errors and concluded that the errors were not material to any of our previously issued financial statements. Correction of the errors is also not material to the three months ended June 30, 2015 or fiscal 2016 results.

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, 2016, included in our Annual Report on Form 10-K. There have been no material changes to our significant accounting policies and estimates from those disclosed therein.

Adopted and Recently Issued Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting. The amendments in this update involve several aspects of accounting for share-based payment transactions, including income tax consequences, classification of awards, and classification on the statement of cash flows. For public business entities, the amendments in this update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. We are evaluating the impact of adopting this guidance on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers. The amendments in this update clarify the implementation guidance on principals versus agent considerations in FASB ASC 606. The effective date and transition requirements for the amendments in this update are the same as the effective date and transition requirements of ASU 2014-09 described below. We are evaluating the impact of adopting this guidance on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. The amendments in this update include a new FASB ASC Topic 842, which supersedes Topic 840. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted for all entities as of the beginning of interim or annual reporting periods. We are evaluating the impact of adopting this guidance on our consolidated financial statements.

In June 2015, Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-10, Technical Corrections and Updates. The amendments in this update cover a wide range of topics in the codification and are generally categorized as follows: Amendments Related to Differences between Original Guidance and the Codification; Guidance Clarification and Reference Corrections; Simplification; and, Minor Improvements. The amendments are effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2015. We adopted this standard during the first quarter of fiscal 2017. As the objectives of this standard are to clarify the codification; correct unintended application of guidance; eliminate inconsistencies; and, to improve the codification's presentation of guidance, the adoption of this standard did not have a material impact on our financial position or results of operations.

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers, which converges the FASB and the International Accounting Standards Board standard on revenue recognition. Areas of revenue recognition that will be affected include, but are not limited to, transfer of control, variable consideration, allocation of transfer pricing, licenses, time value of money, contract costs and disclosures. In August 2015, the FASB amended the effective date and early adoption is permitted only for fiscal years beginning after December 15,

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2016. We are currently evaluating the impact that the adoption of ASU 2014-09 will have on our consolidated financial statements or related disclosures.

The FASB has also issued the following standards which provide additional clarification and implementation guidance on the previously issued ASU 2014-09 and have the same effective date as the original standard: ASU 2016-12 and ASU 2016-10, "Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing (Topic 606). We are currently evaluating the impact that the adoption of the related ASU 2014-09 standards will have 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. 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 2016 Restructuring Activity

Q4 - In the fourth quarter of fiscal 2016, we continued our efforts to better align product development and general and administrative functions with our company strategy and to reduce operating costs. We recorded \$0.3 million in restructuring charges related to the Q4 fiscal 2016 restructuring activity in fiscal 2016, comprised of severance and other employee related benefits. As of June 30, 2016, we had a remaining liability of approximately \$17,000 recorded for the Q4 fiscal 2016 restructuring activity. We expect to record additional restructuring expense related to the Q4 fiscal 2016 restructuring event during fiscal 2017 as those obligations become present and the definition of a liability included in FASB Concepts Statement No. 6, Elements of Financial Statements, is met. These additional charges are not expected to exceed \$0.2 million.

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

	Balance		Balance
	at		at
	March	Provision /	June
	31,	Adjustments	30,
(In thousands)	2016	Payments	2016
Fiscal 2016 Restructuring Plan:			
Severance and other employment costs	\$ 311	\$ —	(\$ 294) \$ 17