EMBARCADERO TECHNOLOGIES INC
Form 10-Q
August 06, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2001.

¨ **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 000-30293

EMBARCADERO TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**68-0310015**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

425 MARKET STREET, SUITE 425
SAN FRANCISCO, CA 94105
(415) 834-3131
(Address of principal executive offices)

Indicate by check mark whether the registrant (1) 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 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. x Yes ¨ No

The number of shares outstanding of the Registrant s Common Stock as of July 31, 2001 was 27,130,092.

EMBARCADERO TECHNOLOGIES, INC.

INDEX

Page

PART I. FINANCIAL INFORMATION

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EMBARCADERO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value)
(unaudited)

	June 30, 2001	December 31, 2000
ASSETS		
Current Assets:		
Cash and cash equivalents	$40,984	$34,745
Trade accounts receivable, net	6,894	6,622
Prepaid and other current assets	2,028	3,408
Total current assets	49,906	44,775
Property and equipment, net	3,613	3,299
Goodwill and other intangible assets, net	20,290	20,522
Deferred income taxes	1,117	1,117
Other assets	276	264
Total assets	$75,202	$69,977

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

EMBARCADERO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Revenues:				
License	$ 9,793	$ 6,336	$18,941	$11,922
Maintenance	4,806	2,744	9,349	5,041
Total revenues	14,599	9,080	28,290	16,963
Cost of revenues:				
License:				
License, other	241	186	414	295
Amortization of acquired technology	202		404	
Total license	443	186	818	295
Maintenance:				

	Three Months Ended June 30,		Six Months Ended June 30,	
Maintenance, other	503	287	1,158	600
Amortization of non-cash stock-based compensation	3	10	7	23
Total maintenance	506	297	1,165	623
Total cost of revenues	949	483	1,983	918
Gross profit	13,650	8,597	26,307	16,045
Operating expenses:				
Research and development:				
Research and development, other	3,485	2,128	6,896	3,850
Amortization of non-cash stock-based compensation	36	94	81	202
Total research and development	3,521	2,222	6,977	4,052
Sales and marketing:				
Sales and marketing, other	5,302	2,856	10,124	5,110
Amortization of non-cash stock-based compensation	415	914	907	2,105
Total sales and marketing	5,717	3,770	11,031	7,215
General and administrative:				
General and administrative, other	1,024	717	1,973	1,573
Amortization of non-cash stock-based compensation	712	1,013	1,556	3,819
Total general and administrative	1,736	1,730	3,529	5,392
Amortization of goodwill and other intangible assets	1,405		2,810	
Total operating expenses	12,379	7,722	24,347	16,659
Income (loss) from operations	1,271	875	1,960	(614)
Other income, net	335	498	539	530
Expenses related to proposed public offering			(350)	
Income (loss) before income taxes	1,606	1,373	2,149	(84)
Provision for income taxes	(1,048)	(1,278)	(1,834)	(2,455)
Income (loss) before share in affiliated company loss	558	95	315	(2,539)
Share in loss of affiliated company		(115)		(165)
Net income (loss)	558	(20)	315	(2,704)
Deemed preferred stock dividend				(1,218)
Net income (loss) available to common stockholders	$ 558	$ (20)	$ 315	$(3,922)
Basic and Diluted Net Income (Loss) Per Share Available to Common Stockholders	$ 0.02	$ 0.00	$ 0.01	$ (0.17)
Weighted Average Shares Used in Per Share Calculation:				
Basic	27,085	25,181	27,050	23,200
Diluted	29,588	25,181	29,660	23,200

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

EMBARCADERO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30,	
	2001	**2000**
Cash Flows from Operating Activities:		
Net income (loss)	$ 315	$(2,704)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	703	256
Provision for doubtful accounts	20	
Amortization of acquired technology	404	
Amortization of goodwill and other intangible assets	2,810	
Amortization of deferred stock-based compensation	2,551	6,149
Share in loss of affiliated company		165
Loss on disposal of property and equipment	170	19
Deferred income taxes, net	(489)	274
Changes in assets and liabilities:		
Trade accounts receivable	(292)	(1,181)
Prepaid expenses and other assets	1,461	(1,205)
Accounts payable and accrued liabilities	959	1,883
Deferred revenue	1,212	1,798
Net cash provided by operating activities	9,824	5,454
Cash Flows from Investing Activities:		
Purchase of property and equipment	(1,187)	(913)
Purchase of technology	(3,075)	
Net cash used in investing activities	(4,262)	(913)
Cash Flows from Financing Activities:		
Proceeds from issuance of preferred stock		1,828
Proceeds from issuance of common stock		43,557
Proceeds from exercise of stock options	677	9
Payments on notes payable to stockholders		(1,000)
Net cash provided by financing activities	677	44,394
Net increase in cash and cash equivalents	6,239	48,935
Cash and cash equivalents at beginning of period	34,745	1,804
Cash and cash equivalents at end of period	$40,984	$50,739
Supplemental Non-cash Investing and Financing Activities:		
Deferred stock-based compensation	$	$ 6,767
Conversion of preferred stock to common stock	$	$ 1,828

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

EMBARCADERO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 The Company and Basis of Presentation

Embarcadero Technologies, Inc. (the Company) was incorporated in California on July 23, 1993 and reincorporated in Delaware on February 15, 2000. The Company provides software products that enable organizations to build and manage e-business applications and their underlying databases. The Company s suite of products allows customers to manage the database life cycle, which is the process of creating, deploying and enhancing databases in response to evolving business and software application requirements. By simplifying the management of the database life cycle, the Company s products allow organizations to rapidly develop and ensure the availability of critical e-business applications.

The Company markets its software and related maintenance services directly through telesales and field sales organizations in the United States, Canada and the United Kingdom, and indirectly through independent distributors in Australia, Latin America and Japan.

The accompanying unaudited condensed consolidated financial statements reflect all adjustments, which, in the opinion of the Company, are necessary for a fair presentation of the results for the interim periods presented. All such adjustments are normal recurring adjustments. These financial statements have been prepared in accordance with generally accepted accounting principles related to interim financial statements and the applicable rules of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The balance sheet at December 31, 2000 was derived from audited financial statements, but it does not include all disclosures required by generally accepted accounting principles.

The financial statements and related disclosures have been prepared with the presumption that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these financial statements should be read in conjunction with the audited financial statements and the related notes thereto contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2000 filed on March 20, 2001.

Operating results for the three and six months ended June 30, 2001 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2001 or for any future period. Further, the preparation of condensed consolidated financial statements requires management to make estimates and assumptions that affect the recorded amounts reported therein. A change in facts or circumstances surrounding the estimates could result in a change to the estimates and impact future operating results.

Recent accounting pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) unanimously approved the issuance of two statements, Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 addresses financial accounting and reporting for business combinations and amends APB No. 16 Business Combinations. All business combinations in the scope of this Statement are to be accounted for using one method, the purchase method. SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB No. 17, Intangible Assets . It changes the accounting for goodwill from an amortization method to an impairment only approach. The Company will cease the amortization of goodwill that was recorded in past business combinations on December 31, 2001, as required by SFAS No. 142. The Company is still evaluating how the adoption of these pronouncements will impact the financial statements.

EMBARCADERO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

In June 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS 133 establishes new standards of accounting and reporting for derivative instruments and hedging activities and was adopted by the Company on January 1, 2001. SFAS 133 requires that all derivatives be recognized at fair value in the statement of financial position, and that the corresponding gains or losses be reported either in the statement of operations or as a component of comprehensive income, depending on the type of hedging relationship that exists. The adoption of SFAS 133 did not have a material impact on the Company s financial position and results of operations.

NOTE 2 Related-party Transactions

During the three and six months ended June 30, 2000, the Company had software product and maintenance revenue from its then affiliated company, Embarcadero Europe Ltd. (EEL), totaling $707,000 and $1.2 million, respectively. In October 2000, the Company acquired the remaining ownership in EEL. Accordingly, the results of EEL s operations for the three and six months ended June 30, 2001 are included in the Company s consolidated results of operations.

NOTE 3 Earnings per Share

Basic net income (loss) per common share excludes the effect of potentially dilutive securities and is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per share reflects the potential dilution of securities by including stock options in the weighted average number of common shares outstanding for a period, if dilutive.

A reconciliation of the numerator and denominator used in the calculation of historical basic and diluted net income (loss) per share is as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	**2000**	**2001**	**2000**
Historical net income (loss) available to common stockholders per share, basic and diluted:				
Numerator for net income (loss) available to common stockholders, basic and diluted	$ 558	$ (20)	$ 315	$(3,922)
Denominator for basic net income (loss) per share:				
Weighted average common shares outstanding	27,085	25,181	27,050	23,200
Net income (loss) per share, basic	$ 0.02	$ 0.00	$ 0.01	$ (0.17)
Denominator for diluted net income (loss) per share:				
Weighted average common shares outstanding.	27,085	25,181	27,050	23,200
Effect of dilutive securities common stock options	2,473		2,610	
Weighted average common and common equivalent shares	29,558	25,181	29,660	23,200
Net income (loss) available to common stockholders per share, diluted	$ 0.02	$ 0.00	$ 0.01	$ (0.17)
Anti-dilutive securities not included in net income (loss) available to common stockholders per share calculation common stock options	1,566	3,660	1,476	3,660

EMBARCADERO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

In connection with the sale of 253,893 shares of Series A convertible preferred stock at a price below the deemed fair market value, the Company recognized a non-cash charge (deemed preferred stock dividend) against earnings attributable to common stockholders of approximately $1.2 million in the six months ended June 30, 2000. There was no such deemed preferred stock dividend in six months ended June 30, 2001.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included in this Form 10-Q and with our management s discussion and analysis included in the Company s Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 20, 2001.

This report contains forward-looking statements within the meaning of the federal securities laws that relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expect, plan, anticipate, believe, estimate, predict, intend, potential or continue or the negative of these terms or other comparable terminology. Such statements are only predictions. Risks and uncertainties and the occurrence of other events could cause actual results to differ materially from these predictions. The factors discussed below under Factors That May Affect Future Results should be considered carefully in evaluating Embarcadero and its business. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of these statements. We are under no duty to update any of the forward-looking statements after the date of this report or to conform these statements to actual results.

Overview

We provide software products that enable organizations to build and manage e-business applications and their underlying databases. Our suite of products allows customers to manage the database life cycle, which is the process of creating, deploying and enhancing databases in response to evolving business and software application requirements. By simplifying the management of the database life cycle, our products allow organizations to rapidly develop and ensure the availability of critical e-business applications.

We were incorporated in California as Client Worx, Inc. in July 1993 and changed our name to Embarcadero Technologies, Inc. in October 1993. We reincorporated in Delaware in February 2000. At our inception, we focused on developing and marketing software for use with Sybase and Microsoft SQL Server databases. In December 1993, we introduced Rapid SQL for Sybase and Microsoft SQL Server database development. In July 1994, we introduced DBArtisan for the administration of Sybase and Microsoft SQL Server databases. In June 1996, we released ER/Studio, our database design solution, which was our first product to offer support for IBM DB2 Universal Database, Informix and Oracle, as well as Sybase and Microsoft SQL Server.

The success of ER/Studio s multi-vendor support led us to add support for other major databases to our other products. We added Oracle support to DBArtisan in April 1997 and to Rapid SQL in January 1998. We added support for IBM DB2 Universal Database to both products in mid-1998. In 1998, we also began to enhance our products with add-ons and companion products. In October 1998, we offered our first standalone companion product, ER/Studio Viewer, which complemented the ER/Studio product. In April 1999, we introduced DBArtisan Schema Manager as a standalone companion product and changed the product name to DBArtisan Change Manager in January 2000. In October 2000, we introduced DBArtisan Job Scheduler, designed to simplify database administration by enabling database professionals to automate their scheduling tasks and manage them from a single, easy-to-use graphical console. We introduced PL/SQL Debugger and SQL Profiler add-ons to extend the functionality of Rapid SQL and DBArtisan in January 2000. During the first quarter of 2001, we introduced Performance Center and SQL Tuner; both products help improve the availability and performance of databases.

During the fourth quarter of 2000, we completed three acquisitions: Embarcadero Europe Ltd., Advanced Software Technologies, Inc. and EngineeringPerformance, Inc. Embarcadero Europe Ltd. serves as our sales and marketing office for Europe, the Middle East and Africa. In connection with our acquisition of Advanced Software Technologies, Inc., we introduced GDPro (recently renamed Describe), an application design product.

Sources of Revenue and Revenue Recognition Policy

Total revenues consist of revenues earned under software license agreements and maintenance agreements. Revenues from software license agreements are recognized upon shipment, provided that a signed contract exists, the fee is fixed or determinable and collection of the resulting receivable is probable.

We recognize revenues from maintenance fees, including amounts allocated from product revenues for ongoing customer support and product updates and upgrades, ratably over the period of the maintenance contract. Payments for maintenance fees are generally made in advance and are non-refundable. For contracts with multiple obligations (e.g., deliverable products and maintenance), revenues are allocated to each undelivered component of the contract based on objective evidence of its fair value, which is specific to the Company. We recognize revenues allocated when the criteria for revenue recognition set forth above are met.

We market our software and related maintenance services directly through our telesales and field sales organizations in the United States, Canada and the United Kingdom, and indirectly through our distribution partners worldwide. We intend to expand our international sales activities in an effort to increase revenues from foreign sales. To date, our primary international distributor has been our wholly-owned subsidiary, Embarcadero Europe Ltd.

Results of Operations

The following table sets forth, for the periods indicated, the percentage relationship of certain items from the Company s condensed consolidated statement of operations to total revenues:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Revenues:				
License	67.1%	69.8%	67.0%	70.3%
Maintenance	32.9%	30.2%	33.0%	29.7%
Total revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues:				
License:				
License, other	1.6%	2.0%	1.5%	1.7%
Amortization of acquired technology	1.4%		1.4%	
Total license	3.0%	2.0%	2.9%	1.7%
Maintenance:				
Maintenance, other	3.5%	3.2%	4.1%	3.5%
Amortization of non-cash stock-based compensation		0.1%		0.2%
Total maintenance	3.5%	3.3%	4.1%	3.7%
Total cost of revenues	6.5%	5.3%	7.0%	5.4%
Gross profit	93.5%	94.7%	93.0%	94.6%
Operating expenses:				
Research and development:				
Research and development, other	23.9%	23.4%	24.4%	22.7%
Amortization of non-cash stock-based compensation	0.2%	1.0%	0.3%	1.2%
Total research and development	24.1%	24.4%	24.7%	23.9%
Sales and marketing:				
Sales and marketing, other	36.3%	31.5%	35.8%	30.1%
Amortization of non-cash stock-based compensation	2.9%	10.1%	3.2%	12.4%
Total sales and marketing	39.2%	41.6%	39.0%	42.5%
General and administrative:				
General and administrative, other	7.0%	7.9%	7.0%	9.3%
Amortization of non-cash stock-based compensation	4.9%	11.2%	5.5%	22.5%
Total general and administrative	11.9%	19.1%	12.5%	31.8%
Amortization of goodwill and other intangible assets	9.6%		9.9%	
Total operating expenses	84.8%	85.1%	86.1%	98.2%
Income (loss) from operations	8.7%	9.6%	6.9%	(3.6)%
Other income, net	2.3%	5.5%	1.9%	3.1%
Expenses related to proposed public offering			(1.2)%	
Income (loss) before income taxes	11.0%	15.1%	7.6%	(0.5)%
Provision for income taxes	(7.2)%	(14.1)%	(6.5)%	(14.5)%

	Three Months Ended June 30,		Six Months Ended June 30,	
Income (loss) before share in affiliated company loss	3.8%	1.0%	1.1%	(15.0)%
Share in loss of affiliated company		(1.2)%		(1.0)%
Net income (loss)	3.8%	(0.2)%	1.1%	(16.0)%
Deemed preferred stock dividend				(7.1)%
Net income (loss) available to common stockholders	3.8%	(0.2)%	1.1%	(23.1)%

Three and Six Months Ended June 30, 2001 and June 30, 2000

Revenues

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	(in thousands)			
Revenues:				
License	$ 9,793	$6,336	$18,941	$11,922
Maintenance	4,806	2,744	9,349	5,041
Total revenues	$14,599	$9,080	$28,290	$16,963

Total Revenues. Total revenues for the three and six months ended June 30, 2001 were $14.6 million and $28.3 million, respectively, representing increases of 60.8% and 66.8% from the comparable periods of 2000.

License. License revenues for the three and six months ended June 30, 2001 were $9.8 million and $18.9 million, respectively, representing increases of 54.6% and 58.9% from the comparable periods of 2000. The increase in license revenues was due to greater market acceptance of our products, greater breadth of product offerings and an increase in sales staff.

Maintenance. Maintenance revenues for the three and six months ended June 30, 2001 were $4.8 million and $9.3 million, respectively, representing increases of 75.1% and 85.5% from the comparable periods of 2000. The increase was due to the increase in the number of licenses sold and a corresponding increase in our installed customer base and maintenance renewals.

Cost of Revenues

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	(in thousands)			
Cost of revenues:				
License:				
License, other	$241	$186	$ 414	$295
Amortization of acquired technology	202		404	
Total license	443	186	818	295
Maintenance:				
Maintenance, other	503	287	1,158	600
Amortization of non-cash stock-based compensation	3	10	7	23

	Three Months Ended June 30,		Six Months Ended June 30,	
Total maintenance	506	297	1,165	623
Total cost of revenues	$949	$483	$1,983	$918

License. Cost of license revenues consists primarily of amortization of acquired technology, product media and packaging, shipping fees, royalties and duplication expenses. Cost of license revenues was $443,000 and $818,000 for the three and six months ended June 30, 2001, respectively, representing increases of 138.2% and 177.3% from the comparable periods of 2000. The increase in absolute dollars from 2000 to 2001 was due to amortization of acquired technology that was purchased in the fourth quarter of 2000 and an increase in the number of licenses sold. Cost of license revenues represented 4.5% and 4.3% of license revenues in the three and six months ending June 30, 2001, respectively, compared to 2.9% and 2.5% for the comparable periods of 2000. Excluding amortization of acquired technology, as a percentage of license revenue cost of license was 2.5% and 2.2% for the three and six months ended June 30, 2001 and 2.9% and 2.5% for the comparable periods of 2000. Cost of license revenues as a percentage of license revenues may vary in the future depending on the mix of internally developed versus externally licensed products and product components.