EMBARCADERO TECHNOLOGIES INC
Form 10-Q
November 08, 2002
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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 September 30, 2002.

o **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 **(State or other jurisdiction of incorporation or organization)**	**68-0310015** **(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 o No

The number of shares outstanding of the Registrant s Common Stock as of September 30, 2002 was 27,223,721.

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PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EMBARCADERO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)
(unaudited)

	September 30, 2002	December 31, 2001
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 20,271	$ 23,371
Short-term investments	23,244	16,532
Trade accounts receivable, net	6,438	6,221
Prepaid expenses and other current assets	1,951	1,711
Total current assets	51,904	47,835
Property and equipment, net	4,000	3,766
Goodwill and other intangible assets, net	17,317	19,334
Deferred income taxes	4,914	4,914
Other assets	257	313
Total assets	$ 78,392	$ 76,162
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable and accrued liabilities	$ 2,906	$ 5,264
Deferred revenue	10,369	9,099
Deferred income taxes	2,317	2,317
Total current liabilities	15,592	16,680
Stockholders Equity:		
Common stock	27	27
Treasury stock	(1,926)	(1,781)
Additional paid-in capital	74,734	74,220
Accumulated other comprehensive income	169	116
Deferred stock-based compensation	(847)	(2,531)
Accumulated deficit	(9,357)	(10,569)
Total stockholders equity	62,800	59,482

Total liabilities and stockholders equity	$ 78,392	$ 76,162

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

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EMBARCADERO TECHNOLOGIES, INC.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	**2001**	**2002**	**2001**
Revenues:				
License	$ 6,648	$ 6,123	$ 20,260	$ 25,064
Maintenance	5,403	4,950	16,212	14,299
Total revenues	12,051	11,073	36,472	39,363
Cost of revenues:				
License:				
License, other	125	165	409	579
Amortization of acquired technology	455	202	1,129	606
Total license	580	367	1,538	1,185
Maintenance:				
Maintenance, other	534	517	1,682	1,675
Non-cash stock-based compensation		3	2	10
Total maintenance	534	520	1,684	1,685
Total cost of revenues	1,114	887	3,222	2,870
Gross profit	10,937	10,186	33,250	36,493
Operating expenses:				
Research and development:				
Research and development, other	3,519	3,915	10,788	10,811
Purchased research and development			1,100	
Non-cash stock-based compensation	6	29	27	110
Total research and development	3,525	3,944	11,915	10,921
Sales and marketing:				
Sales and marketing, other	4,744	5,022	13,780	15,146
Non-cash stock-based compensation	171	352	629	1,259
Total sales and marketing	4,915	5,374	14,409	16,405
General and administrative:				
General and administrative, other	1,099	945	3,093	2,918

Non-cash stock-based compensation	271	600	1,026	2,156
Total general and administrative	1,370	1,545	4,119	5,074
Amortization of goodwill and other intangible assets	385	1,405	1,155	4,215
Lease related impairment loss		1,490		1,490
Total operating expenses	10,195	13,758	31,598	38,105
Income (loss) from operations	742	(3,572)	1,652	(1,612)
Interest income	143	271	499	977
Other expenses				(167)
Expenses related to proposed public offering				(350)
Income (loss) before benefit from (provision for) income taxes and share in loss of joint venture	885	(3,301)	2,151	(1,152)
Benefit from (provision for) income taxes	(204)	887	(516)	(947)
Income (loss) before share in loss of joint venture	681	(2,414)	1,635	(2,099)
Share in loss of joint venture, net			(423)	
Net income (loss)	$ 681	$ (2,414)	$ 1,212	$ (2,099)
Net income (loss) per share:				
Basic	$ 0.03	$ (0.09)	$ 0.04	$ (0.08)
Diluted	$ 0.02	$ (0.09)	$ 0.04	$ (0.08)
Weighted average shares used in per share calculation:				
Basic	27,225	27,130	27,197	27,078
Diluted	28,879	27,130	29,184	27,078

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

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EMBARCADERO TECHNOLOGIES, INC.

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

	Nine Months Ended September 30,	
	2002	**2001**
Cash Flows from Operating Activities:		
Net income (loss)	$ 1,212	$ (2,099)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,553	1,281
Provision for doubtful accounts	343	15
Amortization of developed technology	135	29
Amortization of goodwill and other intangible assets	2,285	4,821
Amortization of deferred stock-based compensation	1,684	3,533
Share in loss of joint venture	423	
Lease related impairment loss		1,490
Changes in assets and liabilities:		
Trade accounts receivable	(560)	805
Prepaid expenses and other assets	(262)	1,525
Deferred income taxes, net		(799)
Accounts payable and accrued liabilities	346	(115)
Deferred revenue	1,270	989
Net cash provided by operating activities	8,429	11,475
Cash Flows from Investing Activities:		
Sales and maturities of investments	9,020	
Purchase of investments	(15,732)	
Purchase of property and equipment	(1,787)	(1,570)
Technology acquired and developed	(950)	(4,662)
Deferred payment in connection with acquisition of subsidiary	(2,000)	
Investment in joint venture	(500)	
Net cash used in investing activities	(11,949)	(6,232)
Cash Flows from Financing Activities:		
Proceeds from exercise of stock options	512	679
Payments for repurchase of common stock	(145)	(75)
Net cash provided by financing activities	367	604
Effect of exchange rate changes on cash	53	116
Net increase (decrease) in cash and cash equivalents	(3,100)	5,963

Cash and cash equivalents at beginning of period		23,371		34,745
Cash and cash equivalents at end of period	$	20,271	$	40,708
Supplemental Cash Flow Information:				
Cash paid for income taxes	$	190	$	

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

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EMBARCADERO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 THE COMPANY AND BASIS OF PRESENTATION

Embarcadero Technologies, Inc. (with its subsidiaries, collectively referred to as 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 effectively manage their database infrastructure. The Company is headquartered in San Francisco, California and has international operations in Toronto, Canada and Maidenhead, United Kingdom.

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 accounting principles generally accepted in the United States of America 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 accounting principles generally accepted in the United States of America for complete financial statements. The balance sheet at December 31, 2001 was derived from audited financial statements, but it does not include all disclosures required by accounting principles generally accepted in the United States of America.

The financial statements and related disclosures have been prepared based on 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, 2001, filed on March 26, 2002.

Operating results for the three and nine months ended September 30, 2002 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2002 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.

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EMBARCADERO TECHNOLOGIES, INC.

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

NOTE 2 COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) consists of foreign currency translation adjustments during the period. For the three and nine months ended September 30, 2002, other comprehensive income amounted to approximately $13,000 and $53,000, respectively, and accumulated other comprehensive income was $169,000 at September 30, 2002. For both the three and nine months ended September 30, 2001, other comprehensive income amounted to approximately $116,000 and accumulated other comprehensive income was $116,000 at September 30, 2001.

The components of comprehensive income (loss) are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
	(unaudited)		(unaudited)	
Net income (loss)	$ 681	$ (2,414)	$ 1,212	$ (2,099)
Foreign currency translation adjustments	13	116	53	116
Comprehensive income (loss)	$ 694	$ (2,298)	$ 1,265	$ (1,983)

NOTE 3 LEASE RELATED IMPAIRMENT LOSS

During the third quarter of 2001, the Company recorded a provision for an impairment loss of $1.5 million related to office leases in San Francisco and Boston for space no longer used for operations. The impairment loss consists of approximately $1.0 million in contractual obligations under the facilities leases, net of estimated sub-lease income from the projected date of abandonment to the end of the lease term. The remaining $500,000 consists of write-downs to leasehold improvements and other assets attributable to the abandoned space, as well as other expenses related to securing the sublease arrangements. No additional impairment charges have been taken since the initial provision was recorded. At September 30, 2002, there was a remaining balance of approximately $730,000, which was included in accounts payable and accrued liabilities.

NOTE 4 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) 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 adding dilutive stock options to the weighted average number of common shares outstanding for the period.

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EMBARCADERO TECHNOLOGIES, INC.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
	(unaudited)		(unaudited)	
Calculation of basic net income (loss) per share:				
Net income (loss)	$ 681	$ (2,414)	$ 1,212	$ (2,099)
Weighted average common shares outstanding	27,225	27,130	27,197	27,078
Net income (loss) per share, basic	$ 0.03	$ (0.09)	$ 0.04	$ (0.08)
Calculation of diluted net income (loss) per share:				
Net income (loss)	$ 681	$ (2,414)	$ 1,212	$ (2,099)
Weighted average common shares outstanding	27,225	27,130	27,197	27,078
Dilutive securities- common stock options	1,654		1,987	
Weighted average common and common equivalent shares	28,879	27,130	29,184	27,078
Net income (loss) per share, diluted	$ 0.02	$ (0.09)	$ 0.04	$ (0.08)
Anti-dilutive common stock options not included in net income (loss) per share calculation	2,111	4,172	1,238	4,172

NOTE 5 CHANGES IN ACCOUNTING FOR BUSINESS COMBINATIONS, GOODWILL AND OTHER INTANGIBLE ASSETS

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, which is effective for fiscal years beginning after December 15, 2001. SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions upon adoption for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for impairment of existing goodwill and other intangibles. The standard also requires that goodwill be allocated to a company s reporting units for purposes of impairment testing. The Company has only one reporting unit.

The Company adopted the provisions of SFAS No. 142 effective January 1, 2002. On January 1, 2002, $3.5 million of intangible assets related to the workforce, net of accumulated amortization of $840,000, were reclassified to goodwill. As a result, approximately $10.3 million of remaining unamortized goodwill will no longer be amortized. In lieu of amortization, the Company performed an impairment review of its goodwill balance upon the initial adoption of SFAS No. 142. The impairment review performed by the Company involves a two-step process as follows:

Step 1 The Company compares the market value of its reporting unit to the carrying value, including goodwill of the unit. If the carrying value of the reporting unit, including goodwill, exceeds the unit s market value, the Company moves on to step 2. If the market value of the reporting unit exceeds the carrying value, no further work is performed and no impairment charge is necessary.

Step 2 The Company performs an allocation of the market value of the reporting unit to its identifiable tangible and non-goodwill intangible assets and liabilities. This derives an implied fair value for the reporting unit s goodwill. The Company then compares the implied fair value of the reporting unit s goodwill with the

EMBARCADERO TECHNOLOGIES, INC.

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

carrying amount of the reporting unit s goodwill. If the carrying amount of the reporting unit s goodwill is greater than the implied fair value of its goodwill, an impairment charge is recognized for the excess.

The Company performed its initial test upon adoption on January 1, 2002, as required by SFAS No. 142. The results of Step 1 of the goodwill impairment analysis showed that goodwill was not impaired as the market value of its one reporting unit exceeded its carrying value, including goodwill. Accordingly, Step 2 was not performed. The market value of the reporting unit was estimated by multiplying the number of shares outstanding on the analysis date by the stock market closing price on January 2, 2002 (there was a stock market holiday on January 1, 2002).

The Company performed its annual test on September 1, 2002. The results of Step 1 of the goodwill impairment analysis showed that goodwill was not impaired as the market value of its one reporting unit exceeded its carrying value, including goodwill. Accordingly, Step 2 was not performed. The market value of the reporting unit was estimated by multiplying the number of shares outstanding on the analysis date by the most recent stock market closing price. The Company will continue to test for impairment on an annual basis and on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company s reporting unit below its carrying amounts.

The following table presents comparative information showing the effects that non-amortization of goodwill would have had on the income statement for the three and nine months ended September 30, 2001 (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
	(unaudited)		(unaudited)	
Reported net income (loss)	$ 681	$ (2,414)	$ 1,212	$ (2,099)
Goodwill amortization		1,020		3,060
Adjusted net income (loss)	681	(1,394)	1,212	961
Basic net income (loss) per share	0.03	(0.09)	0.04	(0.08)
Goodwill amortization		0.04		0.11
Adjusted basic net income (loss) per share	0.03	(0.05)	0.04	0.03
Diluted net income (loss) per share	0.02	(0.09)	0.04	(0.08)
Goodwill amortization		0.03		0.10
Adjusted diluted net income (loss) per share	$ 0.02	$ (0.06)	$ 0.04	$ 0.02

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EMBARCADERO TECHNOLOGIES, INC.

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

Between January 1, 2002 and September 30, 2002, there were no changes to the Company s goodwill balance. Goodwill information is as follows (in thousands):

	January 1, 2002	Goodwill Acquired	Adjustments	September 30, 2002
North America	$ 10,337	$	$	$ 10,337

Intangible assets subject to amortization consist of technology and non-compete agreements that are being amortized over a period of two to four years. The components of intangible assets, excluding goodwill, are as follows (in thousands):

	As of September 30, 2002			As of December 31, 2001		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Other intangible assets:						
Purchased technology	$ 3,230	$ 1,528	$ 1,702	$ 3,230	$ 922	$ 2,308
Other intangibles	3,080	2,914	166	3,080	1,759	1,321
Total	$ 6,310	$ 4,442	$ 1,868	$ 6,310	$ 2,681	$ 3,629

Expected future intangible asset amortization expense is as follows (in thousands):

Fiscal Years:	
Remainder of 2002	$ 368
2003	$ 808
2004	$ 692
	$ 1,868

The Company accounts for certain software development costs, including purchased software, in accordance with SFAS No. 86, Accounting for Costs of Computer Software to be Sold, Leased or Otherwise Marketed. In the nine months ended September 30, 2002, the Company capitalized approximately $400,000 of software development costs pursuant to SFAS No. 86. Net software development costs capitalized in accordance with SFAS No. 86 were $5.1 million and $5.4 million at September 30, 2002 and December 31, 2001, respectively.

NOTE 6 SEGMENT REPORTING

Operating segments are components of an enterprise about which separate financial information is available and is regularly evaluated by management, namely the chief decision maker of an organization, in order to make operating and resource allocation decisions. By this definition, the Company operates in one reportable operating segment, the design, development, marketing, sales and support of software for database and application development and management.

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EMBARCADERO TECHNOLOGIES, INC.

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

The Company s wholly owned subsidiary, Embarcadero Europe Ltd., transacts all sales in Europe, the Middle East and Africa. Various distributors handle sales in regions outside Europe, the Middle East, Africa and North America. The Company s geographic sales data is based on customer location as defined by the following regions: North America, United Kingdom and Other.

Revenue and long-lived assets by geographic region are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
Geographic Region	**2002**	**2001**	**2002**	**2001**
	(unaudited)		**(unaudited)**	
Revenues:				
North America	$ 9,689	$ 8,874	$ 29,142	$ 32,900
United Kingdom	1,032	990	3,115	3,058
Other	1,330	1,209	4,215	3,405
Total	$ 12,051			