

PEGASYSTEMS INC  
Form 10-Q  
April 22, 2010  
Table of Contents

**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 March 31, 2010

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: 1-11859

**PEGASYSTEMS INC.**

*(Exact name of Registrant as specified in its charter)*

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**Massachusetts**  
*(State or other jurisdiction of*

*incorporation or organization)*

**101 Main Street Cambridge, MA**  
*(Address of principal executive offices)*

**(617) 374-9600**

*(Registrant's telephone number including area code)*

**04-2787865**  
*(IRS Employer*

*Identification No.)*

**02142-1590**  
*(Zip Code)*

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 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.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

There were 37,022,810 shares of the Registrant's common stock, \$.01 par value per share, outstanding on April 12, 2010.

**Table of Contents**

**PEGASYSTEMS INC.**

**Index to Form 10-Q**

	<b>Page</b>
<b><u>Part I Financial Information</u></b>	
Item 1. <u>Financial Statements:</u>	
<u>Unaudited Condensed Consolidated Balance Sheets at March 31, 2010 and December 31, 2009</u>	3
<u>Unaudited Condensed Consolidated Statements of Income for the three months ended March 31, 2010 and 2009</u>	4
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2010 and 2009</u>	5
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	11
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	19
Item 4. <u>Controls and Procedures</u>	20
<b><u>Part II Other Information</u></b>	
Item 1A. <u>Risk Factors</u>	20
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	20
Item 6. <u>Exhibits</u>	20
<u>SIGNATURE</u>	21

**Table of Contents****PEGASYSTEMS INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands)

	As of March 31, 2010	As of December 31, 2009
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 201,065	\$ 63,857
Marketable securities	1,000	138,796
Total cash, cash equivalents, and marketable securities	202,065	202,653
Trade accounts receivable, net of allowance of \$924 and \$649	42,333	39,396
Short-term license installments	2,727	2,829
Deferred income taxes	2,481	2,523
Income taxes receivable and other current assets	9,792	8,840
Total current assets	259,398	256,241
Long-term license installments, net	2,685	2,976
Property and equipment, net	10,013	8,931
Long-term deferred income taxes and other assets	8,667	8,710
Intangible assets, net	301	336
Goodwill	2,391	2,391
Total assets	\$ 283,455	\$ 279,585
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,815	4,791
Accrued expenses	11,452	6,748
Accrued compensation and related expenses	12,253	23,280
Deferred revenue	42,129	32,870
Total current liabilities	68,649	67,689
Income taxes payable	4,930	4,828
Other long-term liabilities	1,776	1,849
Total liabilities	75,355	74,366
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, 1,000 shares authorized; no shares issued and outstanding		
Common stock and additional paid-in capital, 70,000 shares authorized; 37,025 shares and 36,818 shares issued and outstanding	122,769	121,757
Retained earnings and accumulated other comprehensive income of \$815 and \$1,686	85,331	83,462
Total stockholders' equity	208,100	205,219
Total liabilities and stockholders' equity	\$ 283,455	\$ 279,585

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See notes to unaudited condensed consolidated financial statements.

**Table of Contents****PEGASYSTEMS INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Revenue:</b>		
Software license	\$ 30,343	\$ 28,036
Maintenance	15,086	11,948
Professional services	29,655	22,383
<b>Total revenue</b>	<b>75,084</b>	<b>62,367</b>
<b>Cost of revenue:</b>		
Cost of software license	31	31
Cost of maintenance	1,937	1,437
Cost of professional services	24,468	19,063
<b>Total cost of revenue</b>	<b>26,436</b>	<b>20,531</b>
<b>Gross profit</b>	<b>48,648</b>	<b>41,836</b>
<b>Operating expenses:</b>		
Selling and marketing	21,893	15,436
Research and development	11,626	9,119
General and administrative	5,059	4,946
Acquisition-related costs	1,508	-
<b>Total operating expenses</b>	<b>40,086</b>	<b>29,501</b>
<b>Income from operations</b>	<b>8,562</b>	<b>12,335</b>
Foreign currency transaction loss	(3,074)	(812)
Interest income, net	513	802
Installment receivable interest income	52	75
Other income, net	241	10
<b>Income before provision for income taxes</b>	<b>6,294</b>	<b>12,410</b>
Provision for income taxes	2,443	3,768
<b>Net income</b>	<b>\$ 3,851</b>	<b>\$ 8,642</b>
<b>Earnings per share</b>		
Basic	\$ 0.10	\$ 0.24
Diluted	\$ 0.10	\$ 0.23

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Weighted-average number of common shares outstanding			
Basic		36,873	35,670
Diluted		38,702	37,421
Cash dividends declared per share		\$ 0.03	\$ 0.03

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****PEGASYSTEMS INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Operating activities:</b>		
Net income	\$ 3,851	\$ 8,642
Adjustment to reconcile net income to cash provided by operating activities:		
Excess tax benefits from exercise or vesting of equity awards	(3,906)	(2,188)
Deferred income taxes	123	(625)
Depreciation, amortization and other non-cash items	885	609
Amortization of investments and realized gain on sale of investments	658	943
Stock-based compensation expense	1,446	1,698
Change in operating assets and liabilities:		
Trade accounts receivable	(2,937)	(3,195)
License installments	393	323
Other current assets	(1,002)	196
Accounts payable and accrued expenses	(3,992)	(4,691)
Deferred revenue	9,259	12,029
Other long-term assets and liabilities	46	110
 Cash provided by operating activities	 4,824	 13,851
<b>Investing activities:</b>		
Purchase of marketable securities	(49,005)	(12,593)
Matured and called marketable securities	25,280	7,975
Sale of marketable securities	160,372	
Contingent consideration paid for an acquisition in 2008	(250)	
Investment in property and equipment	(1,926)	(1,160)
 Cash provided by (used in) investing activities	 134,471	 (5,778)
<b>Financing activities:</b>		
Issuance of common stock for share-based compensation plans	630	551
Excess tax benefits from exercise or vesting of equity awards	3,906	2,188
Dividend payments to shareholders	(1,105)	(1,080)
Common stock repurchases for tax withholdings for net settlement of equity awards	(3,410)	(1,513)
Common stock repurchases under share repurchase programs	(1,621)	(6,283)
 Cash used in financing activities	 (1,600)	 (6,137)
 Effect of exchange rate on cash and cash equivalents	 (487)	 (224)
 Net increase in cash and cash equivalents	 137,208	 1,712
Cash and cash equivalents, beginning of period	63,857	36,087
 Cash and cash equivalents, end of period	 \$ 201,065	 \$ 37,799

See notes to unaudited condensed consolidated financial statements.





**Table of Contents****PEGASYSTEMS INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. ACCOUNTING POLICIES*****Basis of Presentation***

The Company has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ( U.S. ) for complete financial statements and should be read in conjunction with the Company's audited financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2009.

In the opinion of management, the Company has prepared the accompanying unaudited condensed consolidated financial statements on the same basis as its audited financial statements, and these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full year 2010.

***Acquisition-related costs***

Acquisition-related costs are expensed as incurred and include costs to effect an impending or completed acquisition and direct and incremental costs associated with an acquisition. During the first quarter of 2010, acquisition-related costs were primarily legal and advisory fees, finder's fees and due diligence costs associated with our acquisition of Chordiant Software, Inc. ( Chordiant ). See Note 11 Subsequent Event for further discussion of the acquisition.

**2. FAIR VALUE MEASUREMENTS**

Fair value is an exit price, representing the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value, was established as follows: (Level 1) observable inputs such as quoted prices in active markets for identical assets or liabilities; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets at fair value, consisting of the Company's marketable securities and cash equivalents.

The fair value hierarchy of the Company's cash equivalents and marketable securities at fair value is as follows:

	March 31, 2010	Fair Value Measurements at Reporting Date Using	
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
(in thousands)			
Cash equivalents	\$ 166,591	\$ 166,591	\$

Marketable securities:

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Municipal bonds	\$	1,000	\$	1,000	\$
Total marketable securities:	\$	1,000	\$	1,000	\$

**Table of Contents**

	Fair Value Measurements at Reporting Date Using		
	December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
<i>(in thousands)</i>			
Cash equivalents	\$ 9,880	\$ 9,880	\$
Marketable securities:			
Municipal bonds	\$ 112,723	\$ 27,152	\$ 85,571
Government sponsored enterprise bonds	19,560		19,560
Corporate bonds	6,513	6,513	
Total marketable securities:	\$ 138,796	\$ 33,665	\$ 105,131

**3. TRADE ACCOUNTS RECEIVABLE, NET OF ALLOWANCES**

Unbilled trade accounts receivable relate to services earned under time and material arrangements and license arrangements that had not been invoiced as of March 31, 2010 and December 31, 2009, respectively.

	As of March 31, 2010	As of December 31, 2009
<i>(in thousands)</i>		
Trade accounts receivable	\$ 31,993	\$ 32,042
Unbilled accounts receivable	11,264	8,003
Total accounts receivable	43,257	40,045