

AGILYSYS INC  
Form 10-Q  
November 09, 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 September 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 November 4, 2016 was 23,398,724.

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AGILYSYS, INC.

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AGILYSYS, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Unaudited)

	September 30, 2016	March 31, 2016
(In thousands, except share data)		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 51,629	\$60,608
Accounts receivable, net of allowance for doubtful accounts of \$492 and \$617, respectively	16,139	22,017
Inventories	2,317	2,692
Prepaid expenses and other current assets	8,992	10,184
Total current assets	79,077	95,501
Property and equipment, net	14,001	14,197
Goodwill	19,622	19,622
Intangible assets, net	8,553	8,576
Software development costs, net	47,469	44,215
Other non-current assets	2,643	3,046
Total assets	\$ 171,365	\$185,157
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 9,250	\$7,761
Deferred revenue	25,412	33,241
Accrued liabilities	9,545	12,980
Capital lease obligations, current	120	118
Total current liabilities	44,327	54,100
Deferred income taxes, non-current	3,184	3,075
Capital lease obligations, non-current	165	215
Other non-current liabilities	4,182	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 23,152,224 and 22,942,586 shares outstanding at September 30, 2016 and March 31, 2016, respectively	9,482	9,482
Treasury shares, 8,454,607 and 8,664,245 at September 30, 2016 and March 31, 2016, respectively	(2,537	) (2,600 )
Capital in excess of stated value	(6,970	) (7,645 )
Retained earnings	119,716	124,413
Accumulated other comprehensive loss	(184	) (177 )
Total shareholders' equity	119,507	123,473
Total liabilities and shareholders' equity	\$ 171,365	\$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		Six months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net revenue:				
Products	\$10,731	\$9,943	\$20,251	\$18,754
Support, maintenance and subscription services	15,906	14,665	30,854	29,564
Professional services	6,039	5,036	12,524	8,817
Total net revenue	32,676	29,644	63,629	57,135
Cost of goods sold:				
Products (inclusive of developed technology amortization)	8,155	5,122	14,687	10,044
Support, maintenance and subscription services	4,394	3,842	8,250	7,337
Professional services	4,248	3,089	8,622	5,765
Total cost of goods sold	16,797	12,053	31,559	23,146
Gross profit	15,879	17,591	32,070	33,989
	48.6	% 59.3	% 50.4	% 59.5
Operating expenses:				
Product development	6,946	6,784	13,799	13,052
Sales and marketing	5,113	5,315	10,748	9,775
General and administrative	5,140	5,202	10,014	10,380
Depreciation of fixed assets	595	541	1,193	1,059
Amortization of intangibles	342	318	678	616
Restructuring, severance and other charges	—	(15 )	89	(62 )
Asset write-offs and other fair value adjustments	—	(175 )	—	(175 )
Legal settlements	85	—	85	—
Operating loss	(2,342 )	(379 )	(4,536 )	(656 )
Other (income) expense:				
Interest income	(16 )	(4 )	(49 )	(48 )
Interest expense	4	5	8	13
Other (income) expense, net	(12 )	9	78	(23 )
Loss before taxes	(2,318 )	(389 )	(4,573 )	(598 )
Income tax expense (benefit)	82	(19 )	124	(44 )
Net loss	\$(2,400 )	\$(370 )	\$(4,697 )	\$(554 )
Weighted average shares outstanding	22,606	22,476	22,603	22,472
Loss per share - basic and diluted:				
Loss per share	\$(0.11 )	\$(0.02 )	\$(0.21 )	\$(0.02 )

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 September 30,		Six months ended September 30,	
	2016	2015	2016	2015
Net loss	\$(2,400)	\$(370)	\$(4,697)	\$(554)
Other comprehensive loss, net of tax:				
Unrealized foreign currency translation adjustments	1	(8 )	(7 )	(18 )
Total comprehensive loss	\$(2,399)	\$(378)	\$(4,704)	\$(572)

See accompanying notes to condensed consolidated financial statements.

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

(In thousands)	Six months ended September 30,	
	2016	2015
Operating activities		
Net loss	\$(4,697 )	\$(554 )
Adjustments to reconcile net loss to net cash used in operating activities		
Net restructuring, severance and other charges	(286 )	(443 )
Net legal settlements	(15 )	—
Depreciation	1,193	1,059
Amortization	678	616
Amortization of developed technology	3,399	511
Deferred income taxes	110	76
Share-based compensation	841	1,400
Asset write-offs and other fair value adjustments	—	(175 )
Change in cash surrender value of company owned life insurance policies	(10 )	—
Changes in operating assets and liabilities:		
Accounts receivable	5,862	8,398
Inventories	371	(583 )
Prepaid expense	534	119
Accounts payable	1,284	(7,110 )
Deferred revenue	(6,765 )	(5,748 )
Accrued liabilities	(2,525 )	2,582
Income taxes payable	(33 )	(59 )
Other changes, net	(125 )	(313 )
Net cash used in operating activities	(184 )	(224 )
Investing activities		
Capital expenditures	(1,487 )	(2,280 )
Capitalized software development costs	(6,609 )	(9,931 )
Investments in corporate-owned life insurance policies	(1 )	(21 )
Net cash used in investing activities	(8,097 )	(12,232 )
Financing activities		
Payments to settle contingent consideration arising from business acquisition	(197 )	—
Repurchase of common shares to satisfy employee tax withholding	(404 )	(435 )
Principal payments under long-term obligations	(56 )	(20 )
Net cash used in financing activities	(657 )	(455 )
Effect of exchange rate changes on cash	(41 )	(55 )
Net decrease in cash and cash equivalents	(8,979 )	(12,966 )
Cash and cash equivalents at beginning of period	\$60,608	\$75,067
Cash and cash equivalents at end of period	\$51,629	\$62,101
<b>SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING ACTIVITIES:</b>		
Accrued capital expenditures	\$223	\$369
Accrued capitalized software development costs	1,003	938
Leasehold improvements acquired under lease arrangement	—	997

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.

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 September 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 and six months ended September 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 corrected during the second quarter of fiscal 2016. Additionally, during the second quarter of fiscal 2016, we identified

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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 and six months ended September 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 August 2016, the FASB issued Accounting Standards Update (ASU) 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 clarifies the classification of receipts and payments in the statement of cash flows. ASU 2016-15 provides guidance related to (1) debt prepayment or debt extinguishment costs, (2) settlement and payment of zero coupon debt instruments, (3) contingent consideration, (4) proceeds from settlement of insurance claims, (5) proceeds from settlement of corporate and bank owned life insurance policies, (6) distributions from equity method investees, (7) cash receipts from beneficial interests obtained by a transferor, and (8) general guidelines for cash receipts and payments that have more than one aspect of classification. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, including interim periods. Early adoption is permitted. We are evaluating the impact the adopting this guidance will have on future financial statements and disclosures.

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

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## 4. Intangible Assets and Software Development Costs

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

	September 30, 2016			March 31, 2016		
	Gross carrying amount	Accumulated amortization	Net carrying amount	Gross carrying amount	Accumulated amortization	Net carrying amount
(In thousands)						
Amortized intangible assets:						
Customer relationships	\$ 10,775	\$ (10,775)	\$—	\$ 10,775	\$ (10,775)	\$—
Non-competition agreements	2,700	(2,700)	—	2,700	(2,700)	—
Developed technology	10,317	(10,055)	262	10,660	(10,398)	262
Accumulated impairment	(262)	N/A	(262)	(262)	N/A	(262)
Trade names	230	(77)	153	230	(54)	176
Patented technology	80	(80)	—	80	(80)	—
	23,840	(23,687)	153	24,183	(24,007)	176
Unamortized intangible assets:						
Trade names	9,200	N/A	9,200	9,200	N/A	9,200
Accumulated impairment	(570)	N/A	(570)	(570)	N/A	(570)
Finite life reclassification	(230)	N/A	(230)	(230)	N/A	(230)
	8,400	N/A	8,400	8,400	N/A	8,400
Total intangible assets	\$ 32,240	\$ (23,687)	\$ 8,553	\$ 32,583	\$ (24,007)	\$ 8,576
Software development costs	\$ 47,989	\$ (5,743)	\$ 42,246	\$ 6,359	\$ (2,344)	\$ 4,015
Project expenditures not yet in use	6,614	—	6,614	41,591	—	41,591