

EPICOR SOFTWARE CORP
Form 10-Q
May 10, 2006
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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 March 31, 2006

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 No. 0-20740

EPICOR SOFTWARE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

18200 Von Karman Avenue

Suite 1000

Irvine, California 92612

(Address of principal executive offices, zip code)

Registrant's telephone number, including area code: (949) 585-4000

33-0277592
(IRS Employer
Identification No.)

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

As of May 1, 2006, there were 54,829,695 shares of common stock outstanding.

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Table of Contents**PART I****FINANCIAL INFORMATION****Item 1 - Financial Statements:****EPICOR SOFTWARE CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS***(in thousands)**(Unaudited)*

	March 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 51,386	\$ 49,768
Short-term investments		3,271
Accounts receivable, net of allowance for doubtful accounts of \$6,194 and \$6,011 as of 2006 and 2005, respectively	65,697	67,728
Deferred income taxes	20,726	20,726
Inventory	5,083	4,572
Prepaid expenses and other current assets	8,115	6,759
Total current assets	151,007	152,824
Property and equipment, net	10,775	11,347
Deferred income taxes	22,449	22,449
Intangible assets, net	68,998	73,539
Goodwill	165,365	164,451
Other assets	5,474	4,341
Total assets	\$ 424,068	\$ 428,951
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 17,392	\$ 12,150
Accrued compensation and payroll taxes	15,105	27,114
Other accrued expenses	24,544	29,595
Current portion of long-term debt	1,102	100
Current portion of accrued restructuring costs	2,411	2,812
Deferred revenue	60,523	57,183
Total current liabilities	121,077	128,954
Long-term debt, less current portion	121,174	124,639
Long-term portion of accrued restructuring costs	1,400	1,460
Long-term portion of deferred revenue	1,991	2,284
Long-term deferred income taxes	1,164	1,164
Total long-term liabilities	125,729	129,547
Commitments and contingencies (Note 15)		

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Stockholders' equity:		
Common stock	56	56
Additional paid-in capital	338,369	336,139
Less: treasury stock at cost	(10,679)	(10,679)
Accumulated other comprehensive loss	(1,032)	(1,053)
Accumulated deficit	(149,452)	(154,013)
Net stockholders' equity	177,262	170,450
Total liabilities and stockholders' equity	\$ 424,068	\$ 428,951

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**EPICOR SOFTWARE CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME***(in thousands, except per share amounts)**(Unaudited)*

	Three Months Ended	
	March 31, 2006	2005
Revenues:		
License fees	\$ 19,312	\$ 15,673
Consulting	24,958	16,924
Maintenance	36,170	33,246
Hardware and other revenues	4,039	941
Total revenues	84,479	66,784
Cost of revenues	35,761	24,714
Amortization of intangible assets	4,246	2,783
Total cost of revenues	40,007	27,497
Gross profit	44,472	39,287
Operating expenses:		
Sales and marketing	15,001	14,102
Software development	8,332	7,391
General and administrative	12,241	11,154
Total operating expenses	35,574	32,647
Income from operations	8,898	6,640
Interest expense	(1,884)	(279)
Other income (expense), net	284	(154)
Income before income taxes	7,298	6,207
Provision for income taxes	2,737	439
Minority interest		31
Net income	\$ 4,561	\$ 5,737
Other comprehensive income:		
Net income	\$ 4,561	\$ 5,737
Unrealized foreign currency translation	21	380
Comprehensive income	\$ 4,582	\$ 6,117
Net income per share:		
Basic	\$ 0.08	\$ 0.11
Diluted	\$ 0.08	\$ 0.10
Weighted average common shares outstanding:		
Basic	55,601	53,973

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Diluted

See accompanying notes to unaudited condensed consolidated financial statements.

56,639

56,614

Table of Contents**EPICOR SOFTWARE CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(in thousands)**(Unaudited)*

	Three Months Ended	
	March 31, 2006	2005
Operating activities		
Net income	\$ 4,561	\$ 5,737
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,959	3,848
Stock-based compensation expense	855	606
Provision for doubtful accounts	380	368
Excess tax benefits from share-based payment arrangements	(229)	
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	1,677	10,141
Prepaid expenses and other current assets	(434)	69
Other assets	(33)	(3)
Accounts payable	5,080	(2,653)
Accrued expenses	(16,502)	(12,504)
Accrued restructuring costs	(472)	(792)
Deferred revenue	2,338	1,094
Net cash provided by operating activities	3,180	5,911
Investing activities		
Purchases of property and equipment	(572)	(918)
Sale of short-term investments	3,271	
Cash paid for acquisitions, net of cash acquired	(512)	(480)
Net cash provided by (used in) investing activities	2,187	(1,398)
Financing activities		
Proceeds from exercise of stock options	382	996
Proceeds from employee stock purchase plan	764	718
Excess tax benefits from share-based payment arrangements	229	
Proceeds from long-term debt	120,573	25,000
Purchase of treasury stock		(1,635)
Principal payments on long-term debt	(124,527)	(30,089)
Net cash used in financing activities	(2,579)	(5,010)
Effect of exchange rate changes on cash	(1,170)	260
Net increase (decrease) in cash and cash equivalents	1,618	(237)
Cash and cash equivalents at beginning of period	49,768	53,711
Cash and cash equivalents at end of period	\$ 51,386	\$ 53,474

See accompanying notes to unaudited condensed consolidated financial statements.

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EPICOR SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2006

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements included herein have been prepared by Epicor Software Corporation (the Company) in conformity with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial information for reporting on Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2005.

In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments necessary for a fair presentation of the Company's financial position, results of operations and cash flows.

The results of operations for the three months ended March 31, 2006, are not necessarily indicative of the results of operations that may be reported for any other interim period or for the entire year ending December 31, 2006. The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements, as permitted by SEC rules and regulations for interim reporting.

As described in our 2005 Form 10-K/A, the Company restated quarterly financial data for each of the first three quarters of 2005 to correct the Company's allocation of revenue between license fees and maintenance in multiple element arrangements and the recognition of these revenues.

Note 2. Stock-Based Compensation

The Company adopted the Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123-R) during the three months ended March 31, 2006. Prior to that, the Company followed the disclosure-only provisions of SFAS No. 123,

Accounting for Stock-Based Compensation (SFAS 123), as amended by SFAS 148, Accounting for Stock-Based Compensation Transition and Disclosure, and, accordingly, accounted for its employee stock-based compensation plans using the intrinsic value method under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations. SFAS 123-R requires share-based payments, including grants of employee stock options, to be recognized in the Condensed Consolidated Statement of Income and Comprehensive Income as an expense, based on their grant date fair values with such fair values amortized over the estimated service period. The Company elected to utilize the modified prospective method for the transition to SFAS 123-R. Under the modified prospective method, SFAS 123-R applies to all awards granted or modified after the date of adoption. In addition, under the modified prospective method, compensation expense will be recognized for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on grant-date fair values estimated in accordance with the original provisions of SFAS 123.

No stock-based employee compensation cost associated with stock options was recognized in the Condensed Consolidated Statement of Income and Comprehensive Income for the three months ended March 31, 2005, as all options granted under those plans had an exercise price equal to the market value for the underlying common stock on the date of grant. In accordance with the modified prospective method of transition to SFAS 123-R, prior periods were not restated to reflect the impact of adopting the new standard.

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The following table sets forth the total stock-based compensation expense resulting from stock options, nonvested stock awards, and employee stock purchase plan included in our Condensed Consolidated Statements of Income and Comprehensive Income (*in thousands*):

	Three Months Ended	
	March 31,	
	2006	2005
Cost of revenues	\$ 132,000	\$ 4,000
Sales and marketing	253,000	4,000
Software development	86,000	1,000
General and administrative	384,000	597,000
Total stock-based compensation expense	\$ 855,000	\$ 606,000

Net cash proceeds from the exercise of stock options were \$382,000 and \$996,000 for the three months ended March 31, 2006 and 2005, respectively. In accordance with SFAS 123-R, we present excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows. For the three months ended March 31, 2006, net cash provided by operating activities decreased and net cash provided by financing activities increased by \$229,000 related to excess tax benefits from exercise of stock-based awards.

Under SFAS 123 the Company based its expense calculation for the stock compensation pro forma footnote disclosure on actual forfeitures; however, SFAS 123-R requires an estimate of forfeitures be used in the calculation. Upon adoption of SFAS 123-R the Company changed its methodology to include an estimate of forfeitures.

During the three months ended March 31, 2006, the share-based compensation expense related to stock options and employee stock purchase plan included in expenses and the related tax benefits were \$688,000 and \$211,000 respectively. No share-based compensation was capitalized for the three months ended March 31, 2006 and 2005. The impact of share-based compensation on basic and diluted earnings per share was \$0.01 for the three months ended March 31, 2006 and 2005.

For the three months ended March 31, 2005, the Company complied with APB No. 25 Accounting for Stock Issued to Employees in accounting for stock options issued to employees. Stock options are granted with an exercise price equal to the fair market value on the date of grant. Accordingly, no compensation expense was recognized for options issued to employees and stock issued under the stock purchase plan.

Had compensation costs for the Company's stock option plans and stock purchase plan been determined based upon fair value at the grant date consistent with SFAS No. 123, Accounting for Stock-Based Compensation, the Company's net income and net income per share would have been as follows (*in thousands, except per share amounts*):

	Three Months Ended	
	March 31, 2005	
Net income as reported	\$	5,737
Stock-based employee compensation expense determined under fair value based method for all awards		(880)
Net income pro forma	\$	4,857
Net income per share as reported:		
Basic	\$	0.11
Diluted	\$	0.10
Net income per share pro forma:		
Basic	\$	0.09