DIGITAL INSIGHT CORP
Form 10-Q
November 13, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2003

Commission file number 0-27459

Digital Insight Corporation

(Exact name of registrant as specified in its charter)

Delaware	77-0493142
(State of incorporation)	(IRS Employer Identification Number)

26025 Mureau Road, Calabasas, CA 91302

(Address of principal executive offices, including zip code)

(818) 871-0000

(Registrant s telephone number, including area 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 x   No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).   Yes x   No ¨

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

Common Stock, $0.001 par value

33,204,117 shares outstanding as of October 31, 2003

DIGITAL INSIGHT CORPORATION

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PART I FINANCIAL INFORMATION

ITEM 1. Consolidated Financial Statements

DIGITAL INSIGHT CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except share information)

	September 30, 2003	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 53,146	$ 48,130
Short-term investments	34,058	26,249
Accounts receivable, net of allowance for doubtful accounts of $738 and $745	17,148	17,899
Accumulated implementation costs	3,632	4,478
Prepaid and other current assets	1,965	5,655
Total current assets	109,949	102,411
Property and equipment, net of accumulated depreciation of $45,230 and $35,712	27,405	30,621
Goodwill	101,040	101,690
Intangible assets, net of accumulated amortization of $21,083 and $16,845	14,987	19,225
Accumulated implementation costs	4,167	4,841
Long-term investments	1,003	
Other assets	199	275
Total assets	$ 258,750	$ 259,063
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,717	$ 6,059
Accrued compensation and related benefits	4,974	3,526
Customer deposits and deferred revenue	7,123	7,738
Other accrued liabilities	9,576	17,853
Line of credit		6,765
Current portion of capital lease obligations	97	484
Current portion of long-term debt		938
Total current liabilities	25,487	43,363
Customer deposits and deferred revenue	5,840	6,037
Total liabilities	31,327	49,400
Stockholders equity:		
Common stock, $.001 par value; 100,000,000 shares authorized; 33,198,462 and 32,435,156 shares issued and outstanding	33	32
Additional paid-in capital	393,338	386,629
Accumulated deficit	(165,948)	(176,998)

Total stockholders equity	227,423	209,663
Total liabilities and stockholders equity	$ 258,750	$ 259,063

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

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DIGITAL INSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2003	**2002**	**2003**	**2002**
Revenues	$ 39,429	$ 33,853	$ 112,198	$ 96,055
Cost of revenues (including amortization of deferred stock-based compensation of $22 and $430 for the three months and nine months ended September 30, 2002)	18,358	17,310	53,657	50,387
Gross profit	21,071	16,543	58,541	45,668
Operating expenses:				
Sales, general and administrative (including amortization of deferred stock-based compensation of $100 and $785 for the three months and nine months ended September 30, 2002)	10,762	8,959	31,400	28,333
Research and development (including amortization of deferred stock-based compensation of $12 and $132 for the three months and nine months ended September 30, 2002)	4,001	4,296	11,230	12,452
Amortization of intangible assets	1,407	1,455	4,235	4,352
Restructuring, asset impairment, and other charges		351		5,330
Total operating expenses	16,170	15,061	46,865	50,467
Income (loss) from operations	4,901	1,482	11,676	(4,799)
Interest and other income, net	149	170	397	514
Net income (loss) before provision for income taxes and cumulative effect of change in accounting method	5,050	1,652	12,073	(4,285)
Provision for income taxes	407		1,023	
Net income (loss) before cumulative effect of change in accounting method	4,643	1,652	11,050	(4,285)
Cumulative effect of change in accounting method				(29,036)
Net income (loss)	$ 4,643	$ 1,652	$ 11,050	$ (33,321)
Basic net income (loss) per share before cumulative effect of change in accounting method	$ 0.14	$ 0.05	$ 0.34	$ (0.14)
Per share cumulative effect of change in accounting method				(0.91)
Basic net income (loss) per share	$ 0.14	$ 0.05	$ 0.34	$ (1.05)
Diluted net income (loss) per share before cumulative effect of change in accounting method	$ 0.14	$ 0.05	$ 0.33	$ (0.14)
Per share cumulative effect of change in accounting method				(0.91)
Diluted net income (loss) per share	$ 0.14	$ 0.05	$ 0.33	$ (1.05)

Shares used to compute basic net income (loss) per share	32,945	32,214	32,677	31,844
Shares used to compute diluted net income (loss) per share	34,380	33,089	33,499	31,844

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

DIGITAL INSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Nine months ended September 30,	
	2003	**2002**
Cash flows from operating activities:		
Net income (loss)	$ 11,050	$ (33,321)
Adjustments to reconcile net income (loss) to net cash from operations:		
Cumulative effect of change in accounting method		29,036
Restructuring, asset impairment, and other charges		5,330
Depreciation and amortization of property and equipment	9,627	9,361
Amortization of intangible assets	4,235	4,352
Amortization of deferred stock-based compensation		1,347
Fair value of warrant granted to service provider	345	
Interest income on stockholders notes receivable		(6)
Changes in operating assets and liabilities, net of effect of acquisition:		
Accounts receivable	751	435
Accumulated implementation costs	1,520	1,518
Other current assets	3,690	537
Other assets	839	(118)
Accounts payable	(2,342)	1,142
Accrued compensation and related benefits	1,448	(4,471)
Customer deposits and deferred revenue	(812)	(1,938)
Other accruals	(8,277)	(3,831)
Net cash provided by operating activities	22,074	9,373
Cash flows from investing activities:		
Net (purchases) maturities of investments	(8,812)	8,856
Acquisition of property and equipment	(6,521)	(5,660)
Acquisition of Virtual Financial Services, Inc. (ViFi)		(4,518)
Net cash used in investing activities	(15,333)	(1,322)
Cash flows from financing activities:		
Net repayments of debt	(8,090)	(5,516)
Proceeds from issuance of common stock	6,365	6,424
Proceeds from repayment of stockholders notes receivable		130
Net cash (used in) provided by financing activities	(1,725)	1,038
Net increase in cash and cash equivalents	5,016	9,089
Cash and cash equivalents, beginning of the period	48,130	15,334
Cash and cash equivalents, end of the period	$ 53,146	$ 24,423

Supplementary disclosures of cash flow information:		
Cash paid during the period for interest	$ 58	$ 456
Non-cash financing activity:		
Fair value of warrant granted to service provider	345	
Effect of ViFi acquisition:		
Accounts receivable		(1,153)
Other assets		(985)
Goodwill and intangibles		(57,352)
Accounts payable, accrued compensation, and other accruals		4,815
Customer deposits and deferred revenue		2,057
Other accruals		2,394
Current portion of long-term debt		3,750
Common stock issued in acquisition		41,956

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

DIGITAL INSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company and Summary of its Significant Accounting Policies

The Company

Digital Insight Corporation (the Company), a Delaware corporation, provides Internet banking and online lending services primarily to credit unions, small to mid-sized banks and savings and loans. Its Internet banking services include Internet banking and bill payment services for individual customers, online business banking for business customers, target marketing programs to market financial services to end users, customized web site design and implementation and other services. The Company s lending services allow credit unions and banks to outsource their consumer loan application processing functions. Substantially all of the Company s revenues are derived from these services.

Method of presentation

The accompanying consolidated financial statements for the three months and nine months ended September 30, 2003 and 2002 have been prepared in accordance with generally accepted accounting principles (GAAP) and the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements in accordance with GAAP have been omitted or condensed in accordance with quarterly reporting requirements of the Securities and Exchange Commission (the SEC). Independent accountants have not audited these consolidated financial statements. The consolidated financial statements include all adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary for a fair statement of the consolidated financial condition, results of operations and cash flows for such periods. However, these results are not necessarily indicative of results for any other interim period or for the full year. The accompanying consolidated balance sheet as of December 31, 2002 has been derived from the audited consolidated financial statements, but does not include all disclosures required by GAAP.

Management believes that the disclosures included in the accompanying interim consolidated financial statements and footnotes are adequate to make the information not misleading, but should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2002.

Cumulative effect of change in accounting method

As of January 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 changed the accounting for goodwill from an amortization method to an impairment only approach. Under SFAS No. 142, goodwill is tested at the reporting unit level annually and whenever events or circumstances occur indicating that goodwill might be impaired.

Upon the adoption of SFAS No. 142, the Company evaluated the goodwill related to its prior acquisitions, 1View Network Corporation (1View) and AnyTime Access, Inc. (ATA), using the fair value approach prescribed by SFAS No. 142. The Company determined that there was no impairment related to the 1View goodwill, which is included at the Internet banking reporting unit, based on the enterprise level analysis performed. Based on the analysis of the ATA goodwill at the lending reporting unit, the Company determined that an impairment write-down of $29.0 million was necessary. This amount has been recorded in the consolidated statement of operations for the nine months ended September 30, 2002 as a cumulative effect of change in accounting method.

Stock-based compensation

The Company adopted the disclosure provisions of SFAS No. 148, Accounting for Stock-based Compensation Transition Disclosure an Amendment of FAS 123, effective January 1, 2003. The Company accounts for stock-based compensation using the intrinsic value method of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. The following table illustrates the effect on stock-based compensation, net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation (amounts in thousands, except per share data):

	Three months ended September 30,		Nine months ended September 30,	
	2003	**2002**	**2003**	**2002**
Stock-based compensation:				
As reported	$	$ 134	$	$ 1,347
Additional stock-based compensation expense determined under the fair value method	2,909	5,325	8,045	14,613
Pro forma	$ 2,909	$ 5,459	$ 8,045	$ 15,960
Net income (loss):				
As reported	$ 4,643	$ 1,652	$ 11,050	$ (33,321)
Additional stock-based compensation expense determined under the fair value method	(2,909)	(5,325)	(8,045)	(14,613)
Pro forma	$ 1,734	$ (3,673)	$ 3,005	$ (47,934)
Net income (loss) per share basic:				
As reported	$ 0.14	$ 0.05	$ 0.34	$ (1.05)
Per share effect of additional stock-based compensation expense determined under the fair value method	(0.09)	(0.16)	(0.25)	(0.46)
Pro forma	$ 0.05	$ (0.11)	$ 0.09	$ (1.51)
Net income (loss) per share diluted:				
As reported	$ 0.14	$ 0.05	$ 0.33	$ (1.05)
Per share effect of additional stock-based compensation expense determined under the fair value method	(0.09)	(0.16)	(0.24)	(0.46)
Pro forma	$ 0.05	$ (0.11)	$ 0.09	$ (1.51)

Reclassifications

Certain costs and operating expenses have been reclassified on the consolidated financial statements for 2002 in order to conform to the 2003 presentation. These reclassifications affect three categories of expense and include: 1) revenue-sharing fees paid by the Company to data processing vendors which have been reclassified from cost of revenues to sales, general and administrative expense to reflect the increasingly marketing-focused nature of these relationships; 2) most security and compliance costs were reclassified to cost of revenues from research and development expense to reflect the Company s increased security emphasis on its proprietary data center technologies as compared to the historical emphasis on product development; and 3) amortization of capitalized internal use software which was reclassified to cost of revenues from research and development expense to conform to such practice adopted by many application service vendors in recent years.

Previously reported amounts for the costs affected for the three months and nine months ended September 30, 2002, respectively, were: Cost of revenues $17,510,000 and $50,783,000; Research and development $5,057,000 and $14,559,000; and Sales, general and administrative expenses $7,998,000 and $25,830,000.

New accounting standards

In December 2002, Emerging Issues Task Force (EITF) Issue No. 00-21, Revenue Arrangements with Multiple Deliverables, (EITF 00-21) was released effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. EITF 00-21 establishes new requirements for determining whether an arrangement involving multiple deliverables contains more than one unit of accounting. The Company adopted EITF 00-21 during the quarter ended September 30, 2003 and there has been no material impact on the Company s financial position or results of operations from the adoption of EITF 00-21.

In March 2003, EITF Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Cash Consideration Received From a Vendor (EITF 02-16) was released. EITF 02-16 addressed how a reseller of a vendor s products should account for cash consideration received from a vendor. The provisions of EITF 02-16 were effective for new arrangements entered into after December 31, 2002. The adoption of this guidance had no material impact on the Company s financial position or results of operations.

In May 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires an issuer to classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). The provisions of SFAS No. 150 are effective for financial instruments entered into or modified after May 31, 2003, and otherwise are effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 had no material impact on the Company s financial position or results of operations.

2. Restructuring, Asset Impairment, and Other Charges

During the nine months ended September 30, 2002, the Company initiated restructuring activities to optimize its cost structure. As a result of this process, 57 employees were terminated, 18 employees were relocated or reassigned and space utilized at three facilities was reduced. For the nine months ended September 30, 2002, the Company recorded a charge of $850,000 for severance payments and a charge of $1.2 million for the facilities closures. The activity in the restructuring accrual during the nine months ended September 30, 2003 is as follows (in thousands):

	Employee Related	Exit Costs	Total
Restructuring accrual, December 31, 2002	$ 213	186	$ 399
Cash payments	(88)	(156)	(244)
Reclassification to exit costs	(125)	125	
Restructuring accrual, September 30, 2003	$	$ 155	$ 155

The Company recorded an asset impairment charge of $2.9 million during the nine months ended September 30, 2002. This charge reduced the carrying value of certain long-lived assets, consisting primarily of purchased computer software and equipment, that were abandoned or removed from operations, to their estimated fair value less costs to sell.

During the quarter ended September 30, 2002, the Company recorded a charge of $351,000 related to legal, accounting, and printing costs incurred to prepare for a public offering of common stock that was planned for the quarter ended June 30, 2002 but was subsequently cancelled.

3. Goodwill and Intangible Assets

During the nine months ended September 30, 2003, the Company adjusted the purchase price of Virtual Financial Services, Inc. (ViFi) in accordance with the allocation period provisions of SFAS No. 141, Business Combinations. Based on the Company s reassessment of the net assets acquired, the purchase price was reduced by $650,000 primarily due to the sale of an acquired software license to the former owner of ViFi. This adjustment has been recorded as a decrease in the goodwill associated with the purchase of ViFi. The change in the balance of goodwill during the nine months ended September 30, 2003 is set forth below (in thousands):

	1View	ATA	ViFi	Total
Balance, December 31, 2002	$ 19,041	$ 32,097	$ 50,552	$ 101,690
Less: ViFi purchase price adjustment			(650)	(650)
Balance, September 30, 2003	$ 19,041	$ 32,097	$ 49,902	$ 101,040

As of September 30, 2003, all other intangible assets were subject to amortization. A summary of the other intangible assets as of September 30, 2003 and December 31, 2002 is set forth below (in thousands):

	Gross Balance	Accumulated Amortization	Carrying Amount
September 30, 2003:			
Customer relationships	$ 27,030	$ (13,903)	$ 13,127
Acquired technology	9,040	(7,180)	1,860
Total intangible assets	$ 36,070	$ (21,083)	$ 14,987
December 31, 2002:			
Customer relationships	$ 27,030	$ (10,205)	$ 16,825
Acquired technology	9,040	(6,640)	2,400
Total intangible assets	$ 36,070	$ (16,845)	$ 19,225

Estimated intangible asset amortization expense remaining for the year ended December 31, 2003 and for the next four years ending December 31 is as follows (in thousands):

2003	$ 1,414
2004	5,646
2005	5,330
2006	1,373
2007	1,133

4. Reportable Segments and Major Customers

The Company manages its business through two reportable segments: the Internet banking division and the lending division. The results of operations from these reportable segments were as follows for the three months and nine months ended September 30, 2003 and 2002 (in thousands):

	Internet Banking Division	Lending Division	Unallocated Expenses (3)	Total
Three months ended September 30, 2003:				
Revenues	$ 35,087	$ 4,342	$	$ 39,429
Cost of revenues	15,819	2,539		18,358
Gross profit	19,268	1,803		21,071
Operating expenses (1)	13,360	1,403	1,407	16,170
Income (loss) from operations	5,908	400	(1,407)	4,901
Total assets at September 30, 2003	$ 210,548	$ 48,202	$	$ 258,750
Three months ended September 30, 2002:				
Revenues	$ 29,803	$ 4,050	$	$ 33,853
Cost of revenues (2)	14,821	2,467	22	17,310

Gross profit	14,982	1,583	(22)	16,543
Operating expenses [2]	11,858	1,285	1,918	15,061
Income (loss) from operations	3,124	298	(1,940)	1,482
Total assets at September 30, 2002	$ 200,604	$ 53,446	$	$ 254,050

(1) Operating expenses include $1,407 of intangible asset amortization.

(2) Cost of revenues includes $22 of deferred stock-based compensation. Operating expenses include $112 of deferred stock-based compensation, $1,455 of intangible asset amortization, and $351 of other charges.

(3) Unallocated expenses are comprised of deferred stock-based compensation, intangible asset amortization, and other charges that are not used by segment management to operate their businesses.

	Internet Banking Division	Lending Division	Unallocated Expenses (3)	Total
Nine months ended September 30, 2003:				
Revenues	$ 99,284	$ 12,914	$	$ 112,198
Cost of revenues	46,203	7,454		53,657
Gross profit	53,081	5,460		58,541
Operating expenses (1)	38,482	4,148	4,235	