EPICOR SOFTWARE CORP
Form 10-Q
August 07, 2009
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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 June 30, 2009

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. 000-20740

EPICOR SOFTWARE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**33-0277592**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

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

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 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	x
Non-accelerated filer	¨	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 x

As of August 3, 2009, there were 61,066,913 shares of common stock outstanding.

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Part I

FINANCIAL INFORMATION

Item 1 - Financial Statements:

EPICOR SOFTWARE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

(Unaudited)

	June 30, 2009	December 31, 2008 *As Adjusted* *(Note 1)*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 86,036	$ 89,764
Accounts receivable, net of allowance for doubtful accounts	85,854	90,624
Deferred income taxes	9,106	8,627
Inventory, net	3,072	5,068
Prepaid expenses and other current assets	13,221	11,064
Total current assets	197,289	205,147
Property and equipment, net	30,091	31,987
Deferred income taxes	41,705	42,858
Intangible assets, net	97,921	113,556
Goodwill	366,909	363,589
Other assets	12,869	14,061
Total assets	$ 746,784	$ 771,198
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 13,158	$ 13,913
Accrued compensation and benefits	18,283	21,035
Other accrued expenses	21,597	24,142
Current portion of long-term debt	12,683	10,169
Current portion of accrued restructuring costs	2,444	4,073
Current portion of deferred revenue	93,675	92,361
Total current liabilities	161,840	165,693
Long-term debt, less current portion	250,604	265,257
Accrued restructuring costs	5,092	5,412
Deferred revenue	273	319
Deferred income taxes and other income taxes	36,052	37,621

Other long-term liabilities	3,662	941
Total long-term liabilities	295,683	309,550
Commitments and contingencies (Note 12)		
Stockholders equity:		
Common stock	63	61
Additional paid-in capital	417,315	414,149
Less: treasury stock at cost	(19,439)	(18,458)
Accumulated other comprehensive loss	(4,665)	(4,094)
Accumulated deficit	(104,013)	(95,703)
Total stockholders equity	289,261	295,955
Total liabilities and stockholders equity	$ 746,784	$ 771,198

See accompanying notes to unaudited condensed consolidated financial statements.

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EPICOR SOFTWARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME (LOSS)

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008 *As Adjusted (Note 1)*	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008 *As Adjusted (Note 1)*
Revenues:				
License	$ 17,533	$ 24,357	$ 30,710	$ 42,861
Consulting	32,061	41,026	63,512	72,428
Maintenance	47,340	48,710	94,206	94,866
Hardware and other	3,513	13,852	10,711	20,014
Total revenues	100,447	127,945	199,139	230,169
Cost of revenues	44,009	64,296	90,192	117,840
Amortization of intangible assets	8,221	8,934	16,626	16,000
Total cost of revenues	52,230	73,230	106,818	133,840
Gross profit	48,217	54,715	92,321	96,329
Operating expenses:				
Sales and marketing	18,151	21,253	36,241	42,630
Software development	12,432	14,296	24,838	27,323
General and administrative	14,033	13,556	28,224	25,509
In-process research and development				200
Restructuring charges	(204)	89	1,207	4,172
Total operating expenses	44,412	49,194	90,510	99,834
Income (loss) from operations	3,805	5,521	1,811	(3,505)
Interest expense	(4,877)	(6,062)	(10,870)	(10,633)
Interest and other income (expense), net	(65)	978	(231)	1,825
Income (loss) before income taxes	(1,137)	437	(9,290)	(12,313)
Income tax provision (benefit)	5,543	158	(982)	(4,568)
Net income (loss)	$ (6,680)	$ 279	$ (8,308)	$ (7,745)
Comprehensive income (loss):				
Net income (loss)	$ (6,680)	$ 279	$ (8,308)	$ (7,745)
Unrealized foreign currency translation gain (loss)	2,154	731	(508)	1,849

Net unrealized gain (loss) on derivative financials instruments, net of tax		94				(15)		
Net unrealized loss on defined benefit pension plan liabilities, net of tax		(35)				(48)		
Comprehensive income (loss):	$	(4,467)	$	1,010	$	(8,879)	$	(5,896)
Net income (loss) per share:								
Basic	$	(0.11)	$	0.00	$	(0.14)	$	(0.13)
Diluted	$	(0.11)	$	0.00	$	(0.14)	$	(0.13)
Weighted average common shares outstanding:								
Basic		59,486		58,449		59,237		58,174
Diluted		59,486		58,862		59,237		58,174

See accompanying notes to unaudited condensed consolidated financial statements.

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EPICOR SOFTWARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008 *As Adjusted (Note 1)*
Operating activities		
Net loss	$ (8,308)	$ (7,745)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	20,745	19,914
Stock-based compensation expense	4,062	4,395
Provision for doubtful accounts	2,102	486
Provision for excess and obsolete inventory	199	288
Amortization of debt issuance fees	1,861	740
Amortization of long-term debt discount	3,882	3,612
Restructuring charges	1,207	4,172
Excess tax benefits from share-based payment arrangements	(2)	(819)
In-process research and development charge		200
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:		
Accounts receivable	4,886	23,936
Inventory	1,799	(4,371)
Prepaid expenses and other current assets	(2,145)	1,309
Other assets	(353)	445
Income taxes	(5,359)	(7,884)
Accounts payable	(968)	2,091
Accrued expenses	(5,620)	(3,070)
Accrued restructuring costs	(3,853)	(4,466)
Deferred revenue	(630)	1,636
Other long-term liabilities	2,217	(30)
Net cash provided by operating activities	15,722	34,839
Investing activities		
Purchases of property and equipment	(2,039)	(5,615)
Sale of short term investment		1,371
Cash paid for business combinations, net of cash acquired	(953)	(285,205)
Cash designated for acquisition		161,000
Net cash used in investing activities	(2,992)	(128,449)
Financing activities		
Proceeds from long-term debt		160,000
Principal payments on long-term debt	(16,065)	(2,769)
Debt issuance fees		(4,990)
Proceeds from exercise of stock options	9	1,569
Proceeds from employee stock purchase plan	244	326

Excess tax benefits from share-based payment arrangements	2	819
Purchase of treasury stock	(980)	(4,502)
Net cash provided by (used in) financing activities	(16,790)	150,453
Effect of exchange rate changes on cash	332	430
Net (decrease) increase in cash and cash equivalents	(3,728)	57,273
Cash and cash equivalents at beginning of period	89,764	75,158
Cash and cash equivalents at end of period	$ 86,036	$ 132,431

See accompanying notes to unaudited condensed consolidated financial statements.

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EPICOR SOFTWARE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2009

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 for the year ended December 31, 2008.

In the opinion of management, the Unaudited Condensed Consolidated Financial Statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company s financial position, results of operations and cash flows. The Company has evaluated subsequent events for recognition or disclosure through the date of filing this Form 10-Q with the SEC and concluded that no such events have occurred that require recognition or disclosure.

The results of operations for the three and six months ended June 30, 2009, 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, 2009. The Condensed Consolidated Balance Sheet at December 31, 2008, has been derived from the audited financial statements at that date (as adjusted for the effects of retrospective adoption of FSP APB 14-1 as discussed below), 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.

Inventory is comprised solely of finished goods. Accounts receivable is net of allowance for doubtful accounts at June 30, 2009 and December 31, 2008, of $8,574,000 and $7,686,000, respectively.

Change in Accounting Principle

Effective January 1, 2009, the Company changed its method of accounting for its convertible debt (Note 8) due to adopting Financial Accounting Standards Board (FASB) Staff Position (FSP) APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP APB 14-1). As required by United States generally accepted accounting principles (GAAP), the change has been reflected in the financial statements through retrospective application of the change in accounting principle.

The accounting change impacted the carrying amount of our convertible debt (debt discount), required the Company to record additional interest expense related to the amortization of the debt discount and resulted in reclassification of debt issuance costs, deferred tax liabilities and additional paid in capital, as discussed in more detail in Note 8.

The effect of adoption on the Company s Condensed Consolidated Balance Sheets is as follows (*in thousands*):

Increased/(Decreased):	**June 30, 2009**	**December 31, 2008**
Other assets	$ (1,066)	$ (1,357)
Deferred income taxes and other income taxes	17,398	18,820
Long-term debt, less current portion	(46,167)	(50,048)
Additional paid-in capital	36,545	36,545
Accumulated deficit	8,845	6,674

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The effect of adoption on the Company s Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) is as follows (*in thousands, except per share amounts*):

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Interest expense	$ 1,772	$ 1,709	$ 3,592	$ 3,382
Income tax benefit	718	653	1,421	1,293
Net loss	1,054	1,056	2,171	2,089
Net loss per share - basic	$ 0.02	$ 0.02	$ 0.04	$ 0.04
Net loss per share - diluted	$ 0.02	$ 0.02	$ 0.04	$ 0.04

Adoption had no impact on cash flows from operations, investing or financing.

Note 2. Basic and Diluted Net Loss Per Share

Net income (loss) per share is calculated in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, Earnings per Share. Under the provisions of SFAS No. 128, basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period, excluding shares of unvested restricted stock. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common and potential common shares outstanding during the period if their effect is dilutive.

The following table computes basic and diluted net income (loss) per share (*in thousands, except per share amounts*):

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Net income (loss) applicable to common stockholders	$ (6,680)	$ 279	$ (8,308)	$ (7,745)
Basic:				
Weighted average common shares outstanding	62,678	60,770	62,392	60,454
Weighted average common shares of unvested restricted stock	(3,192)	(2,321)	(3,155)	(2,280)
Shares used in the computation of basic net income (loss) per share	59,486	58,449	59,237	58,174
Net income (loss) per share applicable to common stockholders basic	$ (0.11)	$ 0.00	$ (0.14)	$ (0.13)
Diluted:				
Shares used in the computation of basic net income (loss) per share	59,486	58,449	59,237	58,174
Stock options and employee stock purchase plan (ESPP) shares		389		
Unvested restricted stock		24		
Shares used in the computation of diluted net income (loss) per share	59,486	58,862	59,237	58,174
Net income (loss) per share applicable to common stockholders diluted	$ (0.11)	$ 0.00	$ (0.14)	$ (0.13)

For the three months ended June 30, 2008, options to purchase 1,176,000 shares of common stock with weighted average price of $12.24 were outstanding but not included in the computation because the effect would be anti-dilutive. Due to net losses for all other periods presented, the assumed exercise of stock options, employee stock purchase plan shares and unvested restricted stock had an anti-dilutive effect and therefore were excluded from the computation of diluted loss per share. On May 8, 2007, the Company closed an offering of $230 million aggregate principal amount of convertible senior notes (Note 8). The notes are only dilutive when the common stock price exceeds the conversion price of approximately $18.10 per share, and no shares have been included in the calculation of diluted net income (loss) per share as the conversion value did not exceed the principal amount of the notes.

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Note 3. Acquisition

Acquisitions have been accounted for under the purchase method of accounting, in accordance with SFAS No. 141, Business Combinations. Any acquisition made after January 1, 2009, will be accounted for in accordance with SFAS No. 141, Business Combinations (revised 2007) (SFAS 141-R). Management is responsible for determining the fair value of the assets acquired and liabilities assumed. The fair value of the assets acquired and liabilities assumed represent management s estimates of fair value. The Company conducts an active mergers and acquisitions program. Acquisition candidates are determined to be viable if they meet the Company s stringent criteria which include, but are not limited to, product and technology fit, culture, geography, revenue synergies and financial contribution. Because the software industry is consolidating, the purchase environment is competitive. Valuations are determined through a combination of earnings per share accretion models which assume certain cost synergies, internal rate of return calculations, discounted cash flow models, outside valuations and appraisals and market conditions. The results of the acquisitions are included in the accompanying Consolidated Statements of Operations from the respective acquisition dates forward.

NSB Retail Systems PLC

On February 7, 2008, the Company completed its acquisition of NSB Retail Systems PLC (NSB). NSB designs, develops, markets and supports store and merchandising solutions to retailers of apparel, footwear and specialty merchandise. The acquisition of NSB provides an expanded portfolio of products and services for large and mid-sized specialty retailers and department stores, as well as a fully hosted, managed service offering designed for smaller retailers who are interested in rapid implementation via an on-demand versus on-premise offering.

Pursuant to the terms of the acquisition agreement, shareholders of NSB received £0.38 in cash for each NSB ordinary share. The value of the fully diluted share capital of NSB was approximately $311,845,000, not including transaction costs, based on the exchange rates in effect at the time the United States dollars were converted to pounds sterling for purposes of the transaction. The consideration payable under the agreement was funded by the Company with approximately $161,000,000 in existing cash balances, with the balance of the consideration being funded by drawing from funds available pursuant to the 2007 credit facility (Note 8).

The total purchase price for NSB is shown below (*in thousands*):

Cash	$ 311,845
Transaction costs	6,449
Total purchase price	$ 318,294

The acquisition of NSB is accounted for as a purchase business combination as defined in SFAS No. 141, Business Combinations. Under the purchase method of accounting, the purchase price was allocated to NSB s tangible and intangible assets acquired and liabilities assumed based on their estimated fair values as of February 7, 2008, with any excess being ascribed to goodwill. Management is primarily responsible for determining the fair values of these assets. The fair value of the assets acquired and liabilities assumed represent management s estimate of fair values. The Company adjusted goodwill by $14,233,000 since the original allocation on February 7, 2008, primarily related to finalizing the fair value of land and buildings which resulted in an increase in property and equipment of $4,105,000, and a reduction to deferred taxes of $16,593,000. See Note 4 for a discussion of goodwill and intangibles acquired.

The following table summarizes the allocation of the purchase price (*in thousands*):

Fair value of tangible assets acquired:	
Cash and cash equivalents	$ 33,181
Accounts receivable	18,274
Inventory	1,196
Property and equipment	16,038
Prepaid and other assets	4,720
Deferred tax assets	2,047

Total tangible assets acquired	75,456
Acquired technology	58,700
Acquired in-process research and development	200
Customer base	39,300
Trade name	3,500
Goodwill	198,240
Accounts payable and accrued expenses	(24,221)
Deferred revenue	(17,328)
Other long-term liabilities	(2,264)
Deferred tax liabilities	(13,289)
Net assets acquired	$ 318,294

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In connection with the acquisition, the Company formulated a restructuring plan for the NSB operations. As a result, the Company recorded a liability of $4,524,000 for the costs related to involuntary employee terminations. This liability was included in the allocation of the purchase price in accordance with SFAS No. 141, Business Combinations and EITF Issue No. 95-3 Recognition of Liabilities in Connection with a Purchase Business Combination. Execution of the restructuring plan was completed as of December 31, 2008. NSB had previously recognized restructuring charges related to certain of its leased facilities and prior to employee severance. Included in assumed accounts payable and accrued expenses is $7,734,000 of prior restructuring obligations.

Included in the Company s operating results for the six months ended June 30, 2008, is a charge of $200,000 for the acquired in-process research and development projects related to the NSB acquisition. The in-process research and development projects arose from new products that were under development at the date of the acquisition and were expected to eventually lead to new products but had not yet established technological feasibility and for which no future alternative use was identified. The valuation of the in-process research and development projects was based upon the discounted expected future cash flows of the products over the products expected life, reflecting the estimated stage of completion of the projects and the estimate of the costs to complete the projects.

Goodwill is amortizable for tax purposes when determining foreign earnings subject to tax in the United States. A portion of the goodwill is amortizable for tax in the foreign jurisdiction.

Pro Forma Information

Actual results of operations of NSB are included in the consolidated financial statements from the acquisition date of February 7, 2008. The unaudited pro forma statement of operations data of the Company set forth below gives effect to the acquisition by Epicor of NSB using the purchase method as if it occurred on January 1, 2008, and includes amortization of identified intangibles, interest expense on debt incurred to finance the acquisitions, elimination of amortization related to NSB intangibles not assumed in the acquisition, and the in-process research and development charge. This pro forma information is presented for illustrative purposes only and is not necessarily indicative of the combined financial results of operations for future periods or the financial results of operations that actually would have been realized had the acquisition occurred at that time (*in thousands, except per share data*).

	(Unaudited) **Six Months Ended June 30, 2008 Pro Forma**	
Total revenues	$	235,885
Net loss	$	(12,339)
Net loss per share:		
Basic	$	(0.21)
Diluted	$	(0.21)

Note 4. Goodwill and Intangible Assets

In acquisitions accounted for using the purchase method, goodwill is recorded for the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net tangible and identified intangible assets acquired. SFAS No. 142, Goodwill and Other Intangible Assets, requires an annual review of goodwill and indefinite-lived intangibles for possible impairment. In accordance with SFAS No. 142, the Company performed its annual impairment review of its recorded goodwill in 2008, and determined that no impairment of goodwill existed at that time because the estimated fair value of each reporting unit exceeded its carrying amount. The Company monitors the indicators for goodwill impairment testing between annual tests. Certain adverse business conditions

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impacting one or more of the Company s reporting units would cause the Company to test goodwill for impairment. No such events occurred during the six months ended June 30, 2009. The following table represents the balance and changes in goodwill by reporting unit as of and for the six months ended June 30, 2009 (*in thousands*):

	License	Consulting	Maintenance	Total
Balance as of December 31, 2008	$ 138,936	$ 68,835	$ 155,818	$ 363,589
NSB purchase price allocation adjustment	701	246	624	1,571
Adjustment of tax liabilities assumed in a business combination	(114)	(76)	(191)	(381)
Scala acquisition purchase price adjustment	74	63	403	540
Foreign currency translation	327	933	330	1,590
Balance as of June 30, 2009	$ 139,924	$ 70,001	$ 156,984	$ 366,909

The average amortization period for intangible assets are as follows:

	Average Amortization Periods
Acquired technology	5 years
Customer base	7 years
Trademark	5 years
Covenants not to compete	1-2 years

The following represents the change in intangible assets recorded during 2009, which includes additional change due to foreign currency translation (*in thousands*):

	Foreign Currency Translation	Other	Total
Acquired technology	$ (3)	$ 443	$ 440
Customer base	977		977
Covenant not to compete	1		1
Total	$ 975	$ 443	$ 1,418

Intangible assets are amortized over the estimated economic life of the assets. As of June 30, 2009, the Company has not identified any indicators of impairment associated with intangible assets.

The following table summarizes the components of intangible assets (*in thousands):*

	As of June 30, 2009			As of December 31, 2008		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Acquired technology	$ 137,830	$ 86,630	$ 51,200	$ 137,390	$ 75,788	$ 61,602
Customer base	75,377	32,019	43,358	74,400	26,995	47,405
Trademark	13,796	10,433	3,363	13,796	9,247	4,549
Covenant not to compete	2,148	2,148		2,147	2,147	

Total	$ 229,151	$ 131,230	$ 97,921	$ 227,733	$ 114,177	$ 113,556

Amortization expense of the Company s intangible assets is included in cost of revenues and for the three months ended June 30, 2009 and 2008, was $8,221,000 and $8,934,000, respectively. Amortization expense of the Company s intangible assets is included in cost of revenues for the six months ended June 30, 2009 and 2008, was $16,626,000 and $16,000,000, respectively. Estimated amortization expense for the remainder of 2009, 2010, 2011, 2012, 2013 and thereafter, is approximately $14,189,000, $27,783,000, $21,517,000, $20,022,000, $7,836,000 and $6,574,000, respectively.

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Note 5. Restructuring Charges

During 2009, the Company recorded restructuring charges of $1,207,000. These charges represent $1,758,000 of severance related costs associated with the cost reduction initiatives taken