AGILYSYS INC
Form 10-Q
November 05, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2010

or

o **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 jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
28925 Fountain Parkway, Solon, Ohio	44139
(Address of principal executive offices)	(ZIP Code)

(440) 519-8700

(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 þ No o

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 o No o

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 o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o

(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 o No þ

The number of Common Shares of the registrant outstanding as of October 29, 2010 was 23,041,111.

AGILYSYS, INC.
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AGILYSYS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended September 30		Six months ended September 30	
(In thousands, except share and per share data)	**2010**	2009	**2010**	2009
Net sales:				
Products	$ 151,230	$ 126,811	$ 255,359	$ 231,234
Services	32,582	29,362	60,896	54,943
Total net sales	183,812	156,173	316,255	286,177
Cost of goods sold:				
Products	128,893	99,508	215,570	184,919
Services	14,134	12,791	26,034	25,534
Total cost of goods sold	143,027	112,299	241,604	210,453
Gross margin	40,785	43,874	74,651	75,724
Operating expenses:				
Selling, general, and administrative expenses	43,473	40,033	83,538	84,840
Asset impairment charges	59		59	
Restructuring charges	10	54	403	68
Operating (loss) income	(2,757)	3,787	(9,349)	(9,184)
Other (income) expenses:				
Other income, net	(873)	(316)	(1,956)	(1,071)
Interest income	(17)	(3)	(40)	(26)
Interest expense	278	230	564	429
(Loss) income before income taxes	(2,145)	3,876	(7,917)	(8,516)
Income tax expense	69	988	4,549	1,003
(Loss) income from continuing operations	(2,214)	2,888	(12,466)	(9,519)
Loss from discontinued operations, net of taxes		(52)		(41)
Net (loss) income	$ (2,214)	$ 2,836	$ (12,466)	$ (9,560)
(Loss) income per share basic:				
(Loss) income from continuing operations	$ (0.10)	$ 0.13	$ (0.55)	$ (0.42)
Loss from discontinued operations				
Net (loss) income	$ (0.10)	$ 0.13	$ (0.55)	$ (0.42)
(Loss) income per share diluted:				
(Loss) income from continuing operations	$ (0.10)	$ 0.12	$ (0.55)	$ (0.42)
Loss from discontinued operations				

Net (loss) income	$	(0.10)	$	0.12	$	(0.55)	$	(0.42)
Weighted average shares outstanding:								
Basic		22,750,474		22,625,654		22,750,254		22,626,491
Diluted		22,750,474		22,879,030		22,750,254		22,626,491
Cash dividends per share	$		$	0.03	$		$	0.06

See accompanying notes to condensed consolidated financial statements.

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AGILYSYS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts at September 30, 2010 are unaudited)

(In thousands, except share and per share data)	**September 30, 2010**	March 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 39,073	$ 65,535
Accounts receivable, net of allowances of $2,093 and $1,716, respectively	157,627	104,808
Inventories, net	22,555	14,446
Deferred income taxes current, net		144
Prepaid expenses and other current assets	3,851	5,047
Income taxes receivable	10,268	10,394
Total current assets	233,374	200,374
Goodwill	50,557	50,418
Intangible assets, net of accumulated amortization of $58,492 and $55,806, respectively	30,789	32,510
Deferred income taxes non-current, net		899
Other non-current assets	17,866	18,175
Property and equipment:		
Furniture and equipment	40,878	40,299
Software	49,099	41,864
Leasehold improvements	9,703	9,699
Project expenditures not yet in use	2,440	7,025
	102,120	98,887
Accumulated depreciation and amortization	74,986	70,892
Property and equipment, net	27,134	27,995
Total assets	$ 359,720	$ 330,371
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 103,725	$ 70,171
Deferred revenue	25,907	23,810
Accrued liabilities	18,066	17,705
Deferred income taxes current, net	303	
Capital lease obligations current	492	311
Total current liabilities	148,493	111,997
Deferred income taxes non-current, net	3,530	412
Other non-current liabilities	19,576	19,038
Commitments and contingencies (see Note 10)		
Shareholders equity		

Common shares, without par value, at $0.30 stated value; 80,000,000 shares authorized; 31,606,831 shares issued; and 23,011,111 and 22,932,043 shares outstanding at September 30, 2010 and March 31, 2010, respectively		9,482		9,482
Treasury shares (8,595,720 at September 30, 2010 and 8,674,788 at March 31, 2010)		(2,578)		(2,602)
Capital in excess of stated value		(7,222)		(8,770)
Retained earnings		189,668		202,134
Accumulated other comprehensive loss		(1,229)		(1,320)
Total shareholders equity		188,121		198,924
Total liabilities and shareholders equity	$	359,720	$	330,371

See accompanying notes to condensed consolidated financial statements.

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

	Six months ended September 30	
(In thousands)	**2010**	2009
Operating activities		
Net loss	$ (12,466)	$ (9,560)
Add: Loss from discontinued operations		41
Loss from continuing operations	(12,466)	(9,519)
Adjustments to reconcile loss from continuing operations to net cash (used for) provided by operating activities:		
Gain on the redemption of Company-owned life insurance policies	(2,065)	
Gain on the redemption of investment in The Reserve Fund s Primary Fund	(147)	(70)
Asset impairment charges	59	
Loss on the sale of securities		91
Depreciation	2,024	1,891
Amortization	4,949	7,827
Deferred income taxes	4,429	(38)
Stock based compensation	1,760	1,073
Change in cash surrender value of Company-owned life insurance policies	618	(699)
Changes in operating assets and liabilities:		
Accounts receivable	(52,847)	28,338
Inventories	(8,103)	5,234
Accounts payable	33,619	64,821
Accrued and other liabilities	2,146	(16,468)
Income taxes payable (receivable)	120	(798)
Other changes, net	922	(889)
Other non-cash adjustments, net	644	77
Total adjustments	(11,872)	90,390
Net cash (used for) provided by operating activities	(24,338)	80,871
Investing activities		
Proceeds from The Reserve Fund s Primary Fund	147	2,337
Proceeds from redemption of/borrowings against Company-owned life insurance policies	2,248	12,500
Additional investments in Company-owned life insurance policies	(746)	(1,176)
Proceeds from the sale of marketable securities	14	42
Additional investments in marketable securities		(45)
Purchases of software, property, and equipment	(3,616)	(5,923)
Net cash (used for) provided by investing activities	(1,953)	7,735
Financing activities		
Floor plan financing agreement, net		(74,468)

Proceeds from borrowings under credit facility	15,325	5,000
Principal payments under credit facility	(15,325)	(5,000)
Debt financing costs		(1,520)
Issuance of common shares		33
Dividends paid		(1,360)
Principal payments under long-term obligations	(308)	(206)
Net cash used for financing activities	(308)	(77,521)
Effect of exchange rate changes on cash	137	664
Cash flows (used for) provided by continuing operations	(26,462)	11,749
Cash flows of discontinued operations:		
Operating cash flows		204
Net (decrease) increase in cash	(26,462)	11,953
Cash at beginning of the period	65,535	36,244
Cash at end of the period	$ 39,073	$ 48,197

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, Inc. and its subsidiaries (the Company) provides innovative information technology (IT) solutions to corporate and public-sector customers with special expertise in select vertical markets, including retail, hospitality, and technology solutions. The Company operates extensively in North America with additional sales and support offices in the United Kingdom and in Asia.

The Company operates in three reportable business segments: Hospitality Solutions Group (HSG), Retail Solutions Group (RSG), and Technology Solutions Group (TSG). Additional information regarding the Company s reportable business segments are described in Note 13 to Condensed Consolidated Financial Statements.

The significant accounting policies applied in preparing the Company s unaudited condensed consolidated financial statements are summarized below:

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the Company s accounts. The Company s investments in subsidiaries are reported using the consolidation method. All inter-company accounts have been eliminated. The Company s fiscal year ends on March 31. References to a particular year refer to the fiscal year ending in March of that year. For example, fiscal 2011 refers to the fiscal year ending March 31, 2011.

The unaudited interim financial statements of the Company 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, 2010, as well as the Condensed Consolidated Statements of Operations for the three- and six-month periods ended September 30, 2010 and 2009, and the Condensed Consolidated Statements of Cash Flows for the six-month periods ended September 30, 2010 and 2009, have been prepared by the Company without audit. 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 necessary to fairly present the results of operations, financial position, and cash flows have been made. Except as discussed below, such adjustments were of a normal recurring nature. Further, the Company has evaluated all significant events occurring subsequent to the date of the Condensed Consolidated Financial Statements and through the filing of this Quarterly Report and concluded that there are no additional significant subsequent events requiring recognition or disclosure.

These unaudited interim financial statements of the Company should be read together with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended March 31, 2010, filed with the Securities and Exchange Commission (SEC) on June 10, 2010.

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The Company experiences a disproportionately large percentage of quarterly sales in the last month of its fiscal quarters. In addition, the Company experiences a seasonal increase in sales during its fiscal third quarter ending December 31st. Accordingly, the results of operations for the three and six months ended September 30, 2010 are not necessarily indicative of the operating results for the full fiscal year or any future period.

Use of Estimates

The Company makes certain estimates and assumptions when preparing financial statements according to GAAP that affect the reported amounts of assets and liabilities at the financial statement dates and the reported amounts of revenues and expenses during the periods presented. These estimates and assumptions involve judgments with respect to many factors that are difficult to predict and are beyond the Company s control. Actual results could be materially different from these estimates. The Company revises the estimates and assumptions as new information becomes available.

Reclassifications

Certain fiscal 2010 product and service revenues and costs of sales were reclassified (no impact on total gross margin) in order to conform to current period reporting presentations. Certain fiscal 2010 amounts related to corporate-owned life insurance policies were reclassified to conform to current period reporting presentation (no impact on income from continuing operations or cash flows (used for) provided by operations).

Correction of Error

During the first quarter of fiscal 2011, the Company recorded an adjustment to increase income tax expense by $3.8 million. The adjustment increased the Company s valuation allowance against its U.S. deferred tax assets and represents a correction of an error. In fiscal 2009, the Company erroneously considered the tax effect of indefinite-lived intangible assets as a source of future taxable income, when it established a significant U.S. valuation allowance against its U.S. deferred tax assets. Income (loss) before income taxes did not change. Net loss increased by $3.8 million, or $0.17 per share, due to this adjustment. Management performed an evaluation under Staff Accounting Bulletin No. 108 and concluded the effect of this adjustment was immaterial to prior years financial statements as well as the projected full-year fiscal 2011 financial statements.

2. Summary of Significant Accounting Policies

A detailed description of the Company s significant accounting policies can be found in the audited financial statements for the fiscal year ended March 31, 2010, included in the Company s Annual Report on Form 10-K. Except as described below, there have been no material changes in the Company s significant accounting policies and estimates from those disclosed therein.

Benefit Plans

Effective September 7, 2009, the Company suspended employer matching contributions to The Retirement Plan of Agilysys, Inc., which is the Company s 401(k) plan, and the Agilysys, Inc. Benefits Equalization Plan (BEP), as part of cost reduction initiatives implemented during the second quarter of fiscal 2010. The Company announced that it intends to resume making matching contributions to these defined contribution retirement plans effective January 1, 2011.

Credit Facility

The Company maintains a $50.0 million asset based revolving credit agreement (Credit Facility) with Bank of America, N.A. (the Lender), which may be increased to $75.0 million by a $25.0 million accordion provision for borrowings and letters of credit and will mature on May 5, 2012. The Company had no amounts outstanding under the Credit Facility as of September 30, 2010 and $49.9 million was available for future borrowings. The Company was in compliance with all covenants under the Credit Facility in order to borrow up to the maximum $49.9 million available as of September 30, 2010. However, subsequent to September 30, 2010, the Company was and still would be limited to borrowing no more than $34.9 million under the Credit Facility in order to maintain compliance with the fixed charge coverage ratio as defined in the Credit Facility.

Additional information with respect to the Credit Facility is contained in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2010, filed with the SEC. Except as discussed in the Company s fiscal 2010 Annual Report, there were no changes to the Credit Facility since it was executed on May 5, 2009.

Recently Adopted Accounting Standards

In January 2010, the Financial Accounting Standards Board (FASB) issued authoritative guidance regarding fair value measurements. This guidance requires additional disclosure within the rollforward of activity for assets and liabilities measured at fair value on a recurring basis, including transfers of assets and liabilities between Level 1 and Level 2 of the fair value hierarchy and the separate presentation of purchases, sales, issuances, and settlements of assets and liabilities within Level 3 of the fair value hierarchy. In addition, this guidance requires enhanced disclosures of the valuation techniques and inputs used in the fair value measurements within Levels 2 and 3. The new disclosure requirements are effective for interim and annual periods beginning after December 15, 2009, except for the disclosure of purchases, sales, issuances, and settlements of Level 3 measurements, which are effective for fiscal years beginning after December 15, 2010. On April 1, 2010, the Company adopted the required provisions of this guidance (see Note 14 to Condensed Consolidated Financial Statements). The adoption of this guidance did not have an impact on the Company s financial position, results of operations, or cash flows.

Recently Issued Accounting Standards

In October 2009, the FASB issued authoritative guidance on revenue arrangements with multiple deliverable elements, which is effective for the Company on April 1, 2011 for new revenue arrangements or material modifications to existing arrangements. The guidance amends the criteria for separating consideration in arrangements with multiple deliverable elements. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable based on: 1) vendor-specific objective evidence; 2) third-party evidence; or 3) estimates. This guidance also eliminates the residual method of allocation and requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. In addition, this guidance significantly expands the required disclosures related to revenue arrangements with multiple deliverable elements. Entities may elect to adopt the guidance through either prospective application for revenue arrangements entered into, or materially modified, after the effective date, or through retrospective application to all revenue arrangements for all periods presented. Early adoption is permitted. The Company is currently evaluating the impact that this guidance will have on its financial position, results of operations, cash flows, or related disclosures.

In October 2009, the FASB issued authoritative guidance on revenue arrangements that include software elements, which is effective for the Company on April 1, 2011. The guidance changes revenue recognition for tangible products containing software elements and non-software elements as follows: 1) the tangible product element is always excluded from the software revenue recognition guidance even when sold together with the software element; 2) the software element of the tangible product element is also excluded from the software revenue guidance when the software and non-software elements function together to deliver the product s essential functionality; and 3) undelivered elements in a revenue arrangement related to the non-software element are also excluded from the software revenue recognition guidance. Entities must select the same transition method and same period for the adoption of both this guidance and the guidance on revenue arrangements with multiple deliverable elements. The Company is currently evaluating the impact that this guidance will have on its financial position, results of operations, cash flows, or related disclosures.

Proposed Accounting Standards

In August 2010, the FASB issued proposed authoritative guidance on lease accounting. This proposal effectively eliminates off-balance sheet accounting for all leases by eliminating the concepts of capital and operating leases. This proposed guidance would require all leased assets and lease obligations to be recognized in financial statements. In addition, expense recognition will be accelerated under the proposed guidance because straight-line rent expense will be replaced by amortization and interest expense. Comments on the proposed guidance are due by December 15, 2010 and there is currently no specified effective date for the proposal. The Company is currently in the process of identifying the anticipated impact this proposed guidance would have on its future financial position, results of operations, cash flows, and related disclosures.

In July 2010, the FASB also issued revised proposed authoritative guidance on loss contingency disclosures, with a focus on providing financial statement users with enhanced information about loss contingencies. The proposed guidance would: (1) expand the scope of loss contingencies subject to disclosure to include certain remote contingencies; (2) increase the quantitative and qualitative disclosures entities must provide to enable users to assess the nature, potential magnitude, and potential timing (if known) of loss contingencies; and (3) for public entities, require a tabular reconciliation for changes in amounts recognized for loss contingencies. Comments on the proposed guidance were due by September 20, 2010. On October 27, 2010, the FASB announced that the expanded disclosure requirements would not be required in 2010 (fiscal 2011 for the Company) and there is currently no specified effective date for the proposal. The Company is currently in the process of determining the anticipated impact of this proposed guidance on its future disclosures.

Management continually evaluates the potential impact, if any, on its financial position, results of operations, and cash flows, of all recent accounting pronouncements and, if significant, makes the appropriate disclosures required by such new accounting pronouncements.

3. Recent Acquisition

The Company allocates the cost of its acquisitions to the assets acquired and liabilities assumed based on their estimated fair values. The excess of the cost over the fair value of the identified net assets acquired is recorded as goodwill. Additional information with respect to the Company s acquisitions is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2010.

Triangle Hospitality Solutions Limited

As previously disclosed, on April 9, 2008, the Company acquired all of the shares of Triangle Hospitality Solutions Limited (Triangle), the UK-based reseller and specialist for the Company s InfoGenesis products and services, for $2.7 million, comprised of $2.4 million in cash and $0.3 million of assumed liabilities. Based on management s preliminary allocations of the acquisition cost to the net assets acquired (accounts receivable, inventory, and accounts payable), approximately $2.7 million was originally assigned to goodwill. In the third quarter of fiscal 2009, a purchase price adjustment to increase goodwill by $0.4 million was recorded. In the first quarter of fiscal 2010, the Company completed the allocation of acquisition costs to the net assets acquired, which resulted in an increase to goodwill of $0.1 million, net of currency translation adjustments. At September 30, 2010, the goodwill attributed to the Triangle acquisition was $3.0 million. Goodwill resulting from the Triangle acquisition is deductible for income tax purposes.

4. Discontinued Operations

China and Hong Kong Operations

As previously disclosed, in July 2008, the Company decided to discontinue its TSG operations in China and Hong Kong. In January 2009, the Company sold the stock related to TSG s China operations and certain assets of TSG s Hong Kong operations, receiving proceeds of $1.4 million, which resulted in a pre-tax loss on the sale of discontinued operations of $0.8 million. The remaining unsold assets and liabilities related to TSG s Hong Kong operations, which primarily consist of amounts associated with service and maintenance agreements, were substantially settled as of March 31, 2010. The discontinued operations presented on the Company s Condensed Consolidated Statements of Operations for the three and six months ended September 30, 2009 consisted of losses of $52,000 and $41,000, respectively, both net of taxes of zero, from the remaining operations of TSG s Hong Kong operations. Additional information with respect to the Company s discontinued operations is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2010.

5. Comprehensive Loss

Comprehensive loss is the total of net (loss) income as currently reported under GAAP plus other comprehensive (loss) income. Other comprehensive (loss) income considers the effects of additional transactions and economic events that are not required to be recorded in determining net income, but rather are reported as a separate component of shareholders equity. Changes in the components of accumulated other comprehensive loss for the three and six months ended September 30, 2010 and 2009 are as follows:

	Foreign currency translation adjustment	Unamortized net actuarial losses and prior service costs	Accumulated other comprehensive loss	Comprehensive (loss) income
Balance at April 1, 2010	$ (664)	$ (656)	$ (1,320)	
Change during the three months ended June 30, 2010	(204)	57	(147)	(147)
Balance at June 30, 2010	$ (868)	$ (599)	$ (1,467)	
Net loss for the three months ended June 30, 2010				(10,252)
Change during the three months ended September 30, 2010	235	3	238	238
Balance at September 30, 2010	$ (633)	$ (596)	$ (1,229)	
Net loss for the three months ended September 30, 2010				(2,214)
Total comprehensive loss for the six months ended September 30, 2010				$ (12,375)

	Foreign currency translation adjustment	Unrealized loss on securities	Unamortized net actuarial losses and prior service costs	Accumulated other comprehensive loss	Comprehensive income (loss)
Balance at April 1, 2009	$ (1,984)	$ (91)	$ (815)	$ (2,890)	