

CSG SYSTEMS INTERNATIONAL INC
Form 10-Q
November 09, 2018

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, 2018

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 0-27512

CSG SYSTEMS INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware 47-0783182
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)

6175 S. Willow Drive, 10th Floor

Greenwood Village, Colorado 80111

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(Address of principal executive offices, including zip code)

(303) 200-2000

(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 NO

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Shares of common stock outstanding at November 2, 2018: 33,328,416

CSG SYSTEMS INTERNATIONAL, INC.

FORM 10-Q for the Quarter Ended September 30, 2018

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CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED

(in thousands, except per share amounts)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 197,172	\$ 122,243
Short-term investments	2,130	139,117
Total cash, cash equivalents and short-term investments	199,302	261,360
Trade accounts receivable:		
Billed, net of allowance of \$4,182 and \$4,149	246,731	219,531
Unbilled	36,847	31,187
Income taxes receivable	7,452	13,839
Other current assets	38,706	28,349
Total current assets	529,038	554,266
Non-current assets:		
Property and equipment, net of depreciation of \$108,266 and \$123,126	78,265	44,651
Software, net of amortization of \$116,761 and \$108,986	31,953	26,906
Goodwill	210,697	210,080
Client contracts, net of amortization of zero and \$97,109	-	43,626
Acquired client contracts, net of amortization of \$81,286 and zero	39,863	-
Client contract costs, net of amortization of \$37,038 and zero	35,584	-
Deferred income taxes	11,011	14,057
Other assets	10,898	10,948
Total non-current assets	418,271	350,268
Total assets	\$ 947,309	\$ 904,534
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 7,500	\$ 22,500
Client deposits	36,079	31,053
Trade accounts payable	39,054	38,420
Accrued employee compensation	56,578	62,984
Deferred revenue	41,388	41,885
Income taxes payable	448	1,216
Other current liabilities	21,590	24,535
Total current liabilities	202,637	222,593
Non-current liabilities:		
Long-term debt, net of unamortized discounts of \$15,641 and \$18,264	353,109	309,236
Deferred revenue	13,578	12,346
Income taxes payable	2,372	2,415
Deferred income taxes	5,881	4,584
Other non-current liabilities	11,313	10,614
Total non-current liabilities	386,253	339,195
Total liabilities	588,890	561,788
Stockholders' equity:		
Preferred stock, par value \$.01 per share; 10,000 shares authorized; zero shares issued and outstanding	-	-

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Common stock, par value \$.01 per share; 100,000 shares authorized; 33,451 and 33,516 shares outstanding	693	689
Common stock warrants; 439 warrants vested; 1,425 issued	9,082	9,082
Additional paid-in capital	436,412	427,091
Treasury stock, at cost; 34,470 and 34,075 shares	(831,585)	(814,732)
Accumulated other comprehensive income (loss):		
Unrealized loss on short-term investments, net of tax	(7)	(88)
Cumulative foreign currency translation adjustments	(37,364)	(28,734)
Accumulated earnings	781,188	749,438
Total stockholders' equity	358,419	342,746
Total liabilities and stockholders' equity	\$ 947,309	\$ 904,534

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

CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME - UNAUDITED

(in thousands, except per share amounts)

	Quarter Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Revenues:				
Cloud and related solutions	\$ 186,473	\$ 164,789	\$ 551,390	\$ 481,445
Software and services	14,283	15,726	39,573	46,680
Maintenance	12,299	18,680	36,829	56,253
Total revenues	213,055	199,195	627,792	584,378
Cost of revenues (exclusive of depreciation, shown separately below):				
Cloud and related solutions	95,092	79,856	277,212	233,194
Software and services	8,669	9,725	25,816	31,404
Maintenance	5,291	10,136	16,612	30,487
Total cost of revenues	109,052	99,717	319,640	295,085
Other operating expenses:				
Research and development	31,477	30,324	91,809	85,103
Selling, general and administrative	39,243	35,816	120,515	109,981
Depreciation	4,831	3,344	13,293	9,975
Restructuring and reorganization charges	2,799	1,618	7,028	4,597
Total operating expenses	187,402	170,819	552,285	504,741
Operating income	25,653	28,376	75,507	79,637
Other income (expense):				
Interest expense	(4,456)	(4,186)	(13,202)	(12,638)
Amortization of original issue discount	(671)	(634)	(1,984)	(2,147)
Interest and investment income, net	675	800	2,256	2,310
Loss on extinguishment of debt	-	-	(810)	-
Other, net	(709)	(970)	(347)	(1,123)
Total other	(5,161)	(4,990)	(14,087)	(13,598)
Income before income taxes	20,492	23,386	61,420	66,039
Income tax provision	(4,391)	(8,806)	(16,188)	(19,641)
Net income	\$ 16,101	\$ 14,580	\$ 45,232	\$ 46,398
Weighted-average shares outstanding:				
Basic	32,507	32,561	32,541	32,383
Diluted	32,806	32,901	32,939	32,825
Earnings per common share:				
Basic	\$ 0.50	\$ 0.45	\$ 1.39	\$ 1.43
Diluted	0.49	0.44	1.37	1.41

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

CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME - UNAUDITED

(in thousands)

	Quarter Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2018	2017	2018	2017
Net income	\$16,101	\$ 14,580	\$45,232	\$ 46,398
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	(109)	5,609	(8,630)	15,173
Unrealized holding gains on short-term investments arising during period	107	7	81	154
Other comprehensive income (loss), net of tax	(2)	5,616	(8,549)	15,327
Total comprehensive income, net of tax	\$16,099	\$ 20,196	\$36,683	\$ 61,725

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

CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

(in thousands)

	Nine Months Ended	
	September 30,	September 30,
	2018	2017
Cash flows from operating activities:		
Net income	\$45,232	\$ 46,398
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation	13,293	9,975
Amortization	31,974	21,670
Amortization of original issue discount	1,984	2,147
Asset impairment	1,428	2,135
Gain on short-term investments and other	(65)	(76)
Loss on extinguishment of debt	810	-
Deferred income taxes	2,150	1,487
Stock-based compensation	14,805	16,659
Changes in operating assets and liabilities, net of acquired amounts:		
Trade accounts receivable, net	(15,952)	7,567
Other current and non-current assets	(21,763)	(1,788)
Income taxes payable/receivable	5,365	1,715
Trade accounts payable and accrued liabilities	(13,174)	(16,007)
Deferred revenue	7,182	10,940
Net cash provided by operating activities	73,269	102,822
Cash flows from investing activities:		
Purchases of software, property and equipment	(44,047)	(23,370)
Purchases of short-term investments	(53,285)	(116,203)
Proceeds from sale/maturity of short-term investments	190,467	150,768
Acquisition of and investments in business, net of cash acquired	(71,443)	-
Acquisition of and investments in client contracts	-	(10,082)
Net cash provided by investing activities	21,692	1,113
Cash flows from financing activities:		
Proceeds from issuance of common stock	1,701	1,259
Payment of cash dividends	(21,197)	(20,405)
Repurchase of common stock	(24,034)	(24,764)
Proceeds from long-term debt	150,000	-
Payments on long-term debt	(123,750)	(11,250)
Settlement of convertible notes	-	(34,771)
Payments of deferred financing costs	(1,490)	-
Net cash used in financing activities	(18,770)	(89,931)
Effect of exchange rate fluctuations on cash	(1,262)	2,396
Net increase in cash and cash equivalents	74,929	16,400

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Cash and cash equivalents, beginning of period	122,243	126,351
Cash and cash equivalents, end of period	\$197,172	\$ 142,751

Supplemental disclosures of cash flow information:

Cash paid during the period for-

Interest	\$14,181	\$ 13,638
Income taxes	8,426	16,407

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

CSG SYSTEMS INTERNATIONAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. GENERAL

We have prepared the accompanying unaudited condensed consolidated financial statements as of September 30, 2018 and December 31, 2017, and for the quarters and nine months ended September 30, 2018 and 2017, in accordance with accounting principles generally accepted (“GAAP”) in the United States of America (“U.S.”) for interim financial information, and pursuant to the instructions to Form 10-Q and the rules and regulations of the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of our management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of our financial position and operating results have been included. The unaudited Condensed Consolidated Financial Statements (the “Financial Statements”) should be read in conjunction with the Consolidated Financial Statements and notes thereto, together with Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”), contained in our Annual Report on Form 10-K for the year ended December 31, 2017 (our “2017 10-K”), filed with the SEC. The results of operations for the quarter and nine months ended September 30, 2018 are not necessarily indicative of the expected results for the entire year ending December 31, 2018.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates in Preparation of Financial Statements. The preparation of the accompanying Financial Statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our Financial Statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Revenue. We adopted Topic 606 Revenue from Contracts with Customers (“ASC 606”) as of January 1, 2018 using the cumulative effect method and have applied ASC 606 to all contracts with clients that had not been completed as of the date of initial application. In conjunction with the adoption of ASC 606, we recorded a cumulative adjustment increasing beginning retained earnings (net of tax) by approximately \$7 million, primarily related to contracts that we were previously required to defer revenue as we did not have vendor specific objective evidence (“VSOE”) of fair value for certain undelivered elements. Since we adopted ASC 606 using the cumulative effect method, comparative information in our Financial Statements has not been adjusted and continues to be as previously reported.

The following tables summarize the impacts of adopting ASC 606 on our Financial Statements as of and for the quarter and nine months ended September 30, 2018 (in thousands, except per share amounts):

	As of September 30, 2018		
Condensed Balance Sheet	As		Balances
	Reported	Adjustments	without adoption of ASC 606

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Unbilled trade accounts receivable	\$36,847	\$ (533)	\$36,314
Other current assets	38,706	4,014	42,720
Client contracts, net of amortization	-	66,364	66,364
Acquired client contracts, net of amortization	39,863	(39,863)	-
Client contract costs, net of amortization	35,584	(35,584)	-
Other non-current assets	10,898	5,069	15,967
Other assets	785,411	-	785,411
Total assets (1)	\$947,309	\$ (533)	\$946,776
Deferred revenue	\$54,966	\$ 2,655	\$57,621
Deferred income taxes	5,881	8	5,889
Other liabilities	528,043	-	528,043
Total liabilities	588,890	2,663	591,553
Accumulated earnings	781,188	(3,196)	777,992
Other stockholders' equity	(422,769)	-	(422,769)
Total stockholders' equity	358,419	(3,196)	355,223
Total stockholders' equity and liabilities	\$947,309	\$ (533)	\$946,776

(1) See Note 3 for further discussion related to the reclassification of our client contracts and client contract costs.

Quarter Ended September 30, 2018			
Condensed Statement of Income	As Reported	Adjustments	Balances without adoption of ASC 606
Revenues:			
Cloud and related services (2)	\$ 186,473	\$ (6,162)	\$ 180,311
Software and services (2)	14,283	1,589	15,872