

ULTIMATE SOFTWARE GROUP INC

Form 10-Q

August 11, 2008

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**UNITED STATES
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 June 30, 2008

○ 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: 0-24347

THE ULTIMATE SOFTWARE GROUP, INC.

(Exact name of Registrant as specified in its charter)

Delaware

65-0694077

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

2000 Ultimate Way, Weston, FL

33326

(Address of principal executive offices)

(Zip Code)

(954) 331-7000

(Registrant's telephone number, including area code)

None

(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

☐ 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 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 ☐ Non-accelerated filer ○ Smaller reporting company ○

(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 ○ No ☐

As of August 1, 2008, there were 24,699,880 shares of the Registrant's Common Stock, par value \$0.01, outstanding.

**THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES
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PART 1 FINANCIAL INFORMATION
Item 1 Financial Statements
THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share and per share data)

	As of June 30, 2008	As of December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 20,870	\$ 17,462
Short-term investments in marketable securities	5,061	17,120
Accounts receivable, net of allowance for doubtful accounts of \$700 for 2008 and 2007, respectively	32,123	34,658
Prepaid expenses and other current assets	12,020	9,801
Deferred tax assets, net	3,516	3,516
Total current assets before funds held for clients	73,590	82,557
Funds held for clients	1,875	
Total current assets	75,465	82,557
Property and equipment, net	22,434	18,238
Capitalized software, net	5,648	3,631
Goodwill	4,063	4,063
Long-term investments in marketable securities		1,298
Other assets, net	10,784	9,365
Long-term deferred tax assets, net	16,378	16,004
Total assets	\$ 134,772	\$ 135,156

LIABILITIES AND STOCKHOLDERS EQUITY

Current liabilities:		
Accounts payable	\$ 6,707	\$ 3,528
Accrued expenses	10,822	11,405
Current portion of deferred revenue	44,839	43,262
Current portion of capital lease obligations	1,789	2,002
Current portion of long-term debt	404	572
Total current liabilities before client funds obligations	64,561	60,769
Client funds obligations	1,875	
Total current liabilities	66,436	60,769

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Deferred revenue, net of current portion	8,324	8,446
Deferred rent	3,134	2,652
Capital lease obligations, net of current portion	1,209	1,991
Long-term debt, net of current portion	320	320
Total liabilities	79,423	74,178
Stockholders' equity:		
Preferred Stock, \$.01 par value, 2,000,000 shares authorized, no shares issued or outstanding		
Series A Junior Participating Preferred Stock, \$.01 par value, 500,000 shares authorized, no shares issued or outstanding		
Common Stock, \$.01 par value, 50,000,000 shares authorized, 26,711,692 and 26,219,789 shares issued in 2008 and 2007, respectively	267	262
Additional paid-in capital	156,401	143,913
Accumulated other comprehensive loss	(5)	(18)
Accumulated deficit	(50,832)	(50,371)
	105,831	93,786
Treasury stock, 2,020,375 and 1,452,375 shares, at cost, for 2008 and 2007, respectively	(50,482)	(32,808)
Total stockholders' equity	55,349	60,978
Total liabilities and stockholders' equity	\$ 134,772	\$ 135,156

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	For the Three Months		For the Six Months	
	Ended June 30,		Ended June 30,	
	2008	2007	2008	2007
Revenues:				
Recurring	\$ 25,377	\$ 21,075	\$ 51,073	\$ 40,546
Services	13,165	11,274	27,285	23,461
License	2,957	2,608	6,610	7,492
Total revenues	41,499	34,957	84,968	71,499
Cost of revenues:				
Recurring	7,002	5,480	13,527	10,979
Services	10,580	9,081	21,879	19,373
License	464	265	892	674
Total cost of revenues	18,046	14,826	36,298	31,026
Gross profit	23,453	20,131	48,670	40,473
Operating expenses:				
Sales and marketing	11,236	8,442	23,065	17,225
Research and development	9,299	6,663	18,178	13,834
General and administrative	4,405	3,253	8,701	6,700
Total operating expenses	24,940	18,358	49,944	37,759
Operating income (loss)	(1,487)	1,773	(1,274)	2,714
Other income (expense):				
Interest expense and other	(61)	(53)	(140)	(100)
Other income, net	222	4,774	579	5,169
Total other income, net	161	4,721	439	5,069
Income (loss) before benefit (provision) for income taxes	(1,326)	6,494	(835)	7,783
Benefit (provision) for income taxes	575	(85)	374	(115)
Net income (loss)	\$ (751)	\$ 6,409	\$ (461)	\$ 7,668
Net income (loss) per share:				
Basic	\$ (0.03)	\$ 0.26	\$ (0.02)	\$ 0.31
Diluted	\$ (0.03)	\$ 0.23	\$ (0.02)	\$ 0.28

Weighted average shares outstanding:

Basic	24,670	24,713	24,676	24,621
Diluted	24,670	27,571	24,676	27,479

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	For the Six Months Ended June 30,	
	2008	2007
Cash flows from operating activities:		
Net income (loss)	\$ (461)	\$ 7,668
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	4,483	3,302
Provision for doubtful accounts	944	723
Non-cash stock-based compensation expense	8,033	4,737
Deferred income taxes	(374)	
Changes in operating assets and liabilities:		
Accounts receivable	1,591	492
Prepaid expenses and other current assets	(2,219)	(427)
Other assets	(1,512)	(1,260)
Accounts payable	3,179	(443)
Accrued expenses and deferred rent	(1,601)	(1,254)
Deferred revenue	1,455	823
Net cash provided by operating activities	13,518	14,361
Cash flows from investing activities:		
Purchases of marketable securities	(642)	(10,636)
Maturities of marketable securities	14,022	8,845
Capitalized software	(889)	(925)
Acquisition-related expenses		(24)
Purchases of property and equipment	(8,111)	(3,493)
Net cash provided by (used in) investing activities	4,380	(6,233)
Cash flows from financing activities:		
Repurchases of Common Stock	(17,674)	(7,706)
Principal payments on capital lease obligations	(1,098)	(922)
Repayments of borrowings of long-term debt	(168)	(251)
Net proceeds from issuances of Common Stock	4,460	4,038
Net cash used in financing activities	(14,480)	(4,841)
Effect of exchange rate changes on cash	(10)	3
Net increase in cash and cash equivalents	3,408	3,290
Cash and cash equivalents, beginning of period	17,462	16,734

Cash and cash equivalents, end of period	\$ 20,870	\$ 20,024
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 39	\$ 49
Cash paid for income taxes	\$ 227	\$

Supplemental disclosure of non-cash financing activities:

The Company entered into capital lease obligations to acquire new equipment totaling \$103 and \$1,719 for the six months ended June 30, 2008 and 2007, respectively.

The Company entered into an agreement to purchase software from NOVAtime Technology, Inc., a third-party vendor, for \$2.0 million, of which \$0.5 million was paid during the six months ended June 30, 2008.

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND
COMPREHENSIVE (LOSS)

(In thousands)

	Common Stock		Accumulated		Treasury Stock		Total	
	Shares	Amount	Additional Paid-in Capital	Other Comprehensive (Loss)	Accumulated Deficit	Shares	Amount	Stockholders' Equity
Balance, December 31, 2007	26,220	\$ 262	\$ 143,913	\$ (18)	\$ (50,371)	1,452	\$(32,808)	\$ 60,978
Net loss					(461)			(461)
Unrealized gain on investments in marketable securities available for sale				23				23
Unrealized loss on foreign currency translation				(10)				(10)
Comprehensive loss								(448)
Repurchases of Common Stock						568	(17,674)	(17,674)
Issuances of Common Stock from exercises of stock options	492	5	4,455					4,460
Non-cash stock-based compensation			8,033					8,033
Balance, June 30, 2008	26,712	\$ 267	\$ 156,401	\$ (5)	\$ (50,832)	2,020	\$(50,482)	\$ 55,349

The accompanying Notes to Unaudited Condensed Consolidated Financial Statements are an integral part of these financial statements.

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**THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

1. Nature of Operations

The Ultimate Software Group, Inc. and subsidiaries (Ultimate Software or the Company) designs, markets, implements and supports human resources, payroll and talent management solutions, marketed primarily to middle-market organizations with 200 to 15,000 employees. The Company reaches its customer base and target market through its direct sales force.

2. Basis of Presentation, Consolidation and the Use of Estimates

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. The information in this report should be read in conjunction with the Company s audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2007 filed with the SEC on March 13, 2008 (the Form 10-K).

The unaudited condensed consolidated financial statements included herein reflect all adjustments (consisting only of normal, recurring adjustments) which are, in the opinion of the Company s management, necessary for a fair presentation of the information for the periods presented. The preparation of financial statements in conformity with 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 the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Interim results of operations for the three and six months ended June 30, 2008 and 2007 are not necessarily indicative of operating results for the full fiscal years or for any future periods.

The unaudited condensed consolidated financial statements reflect the financial position and operating results of the Company and include its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

3. Summary of Significant Accounting Policies and Recent Accounting Pronouncements

Summary of Significant Accounting Policies

The Company s significant accounting policies discussed in Note 3 to its audited consolidated financial statements for the fiscal year ended December 31, 2007, included in the Form 10-K, have not significantly changed, except as noted below.

During the second quarter of 2008, the Company introduced a new product, UltiPro Tax Filing, for its Workplace market, which the Company defines as businesses with 200 to 700 employees. Tax filing services provided to Workplace customers through the Company s UltiPro Tax Filing product are being sold directly by the Company to its Workplace customers only on a per employee per month (PEPM) basis in conjunction with UltiPro, its core product. As a result of rolling out its new UltiPro Tax Filing product, the Company holds funds on behalf of its Workplace customers for purposes of paying the appropriate taxing authorities on behalf of such clients. These funds held for clients and the corresponding client funds obligations are included in current assets and current liabilities, respectively, in the Company s unaudited condensed consolidated balance sheet as of June 30, 2008. The Company

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has reported the cash flows related to the cash received from Workplace UltiPro Tax Filing customers and paid on behalf of such customers on a net basis in the financing section of the unaudited condensed consolidated statement of cash flows for the six months ended June 30, 2008, which, for purposes of such reporting period, netted to zero. The associated PEPM fees for UltiPro Tax Filing are included in recurring revenues in the unaudited condensed consolidated statements of operations. The Company holds Workplace customers' tax filing deposits for the period between collection from Workplace customers and remittance to the applicable taxing authority. Currently, the Company is investing these tax filing deposits in overnight Repurchase Agreements backed by U.S. Treasury or U.S. Government Agency securities. Since UltiPro Tax Filing was introduced during the second quarter of 2008, the revenues associated therewith were not material for the three and six months ended June 30, 2008.

Recently Adopted Accounting Pronouncements

In January 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value in GAAP and expands disclosures related to the use of fair value measures in financial statements. SFAS No. 157 does not expand the use of fair value measures in financial statements, but standardizes its definition and guidance in GAAP and emphasizes that fair value is a market-based measurement and not an entity-specific measurement based on an exchange transaction in which the entity sells an asset or transfers a liability (exit price). SFAS No. 157 establishes a fair value hierarchy from observable market data as the highest level to fair value based on an entity's own fair value assumptions as the lowest level. On February 6, 2008, the Financial Accounting Standards Board (FASB) deferred the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. These nonfinancial items include assets and liabilities such as reporting units measured at fair value in a goodwill impairment test and nonfinancial assets acquired and liabilities assumed in a business combination. The effect of the adoption of SFAS No. 157 is discussed in Note 4 Investments in Marketable Securities and Fair Value of Financial Instruments.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities; including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 permits entities to elect to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. If elected, SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and this election is irrevocable. The Company has not elected to apply the fair value option to any of its financial instruments.

Recently Issued Accounting Pronouncements

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS No. 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. SFAS No. 162 directs the GAAP hierarchy to the entity, not the independent auditors, as the entity is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to remove the GAAP hierarchy from the auditing standards. SFAS No. 162 is not expected to have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141R) and SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51 (SFAS No. 160). SFAS No. 141R will change how business acquisitions are accounted for and will impact financial statements both on the acquisition

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date and in subsequent periods. SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 141R and SFAS No. 160 are effective for the Company beginning in the first quarter of 2009. Early adoption is not permitted. SFAS No. 141R and SFAS No. 160 will only affect the Company if the Company makes an acquisition after December 31, 2008.

4. Investments in Marketable Securities and Fair Value of Financial Instruments

The Company classifies its investments in marketable securities with readily determinable fair values as securities available-for-sale in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities and FASB Staff Position No. 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. The Company has classified all investments in marketable securities as available-for-sale. Securities available-for-sale consist of debt and equity securities not classified as trading securities or as securities to be held to maturity. Unrealized gains and losses on securities available-for-sale are reported as a net amount in accumulated other comprehensive loss in stockholders' equity until realized. Gains and losses on the sale of securities available-for-sale are determined using the specific identification method. Included in accumulated other comprehensive loss is \$12 thousand of unrealized gains on securities available-for-sale at June 30, 2008 and \$13 thousand of unrealized losses on securities available-for-sale held at December 31, 2007.

The amortized cost and fair value of the Company's investments in marketable securities available-for-sale at June 30, 2008 are shown in the table below (in thousands):

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Corporate debentures bonds	\$ 3,102	\$ 9	\$ (1)	\$ 3,110
Commercial paper	650			650
Certificates of deposit	650			650
Asset-backed securities	647	4		651
Total investments available-for-sale	\$ 5,049	\$ 13	\$ (1)	\$ 5,061

The amortized cost and fair value of the fixed income securities by contractual maturity at June 30, 2008 are shown below (in thousands):

	Amortized Cost	Fair Value
Due in one year or less	\$ 5,049	\$ 5,061