

CSG SYSTEMS INTERNATIONAL INC
Form 10-Q
May 08, 2014

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 March 31, 2014

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.)

9555 Maroon Circle

Englewood, Colorado 80112

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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 and posted on its corporate Website, 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.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) 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

Shares of common stock outstanding at May 2, 2014: 34,090,671

CSG SYSTEMS INTERNATIONAL, INC.

FORM 10-Q for the Quarter Ended March 31, 2014

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CSG SYSTEMS INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED

(in thousands, except per share amounts)

	March 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$65,454	\$82,686
Short-term investments	117,558	128,151
Total cash, cash equivalents and short-term investments	183,012	210,837
Trade accounts receivable:		
Billed, net of allowance of \$3,104 and \$2,359	195,736	178,511
Unbilled	39,541	38,365
Deferred income taxes	9,398	15,085
Income taxes receivable	4,625	3,815
Other current assets	29,461	28,762
Total current assets	461,773	475,375
Non-current assets:		
Property and equipment, net of depreciation of \$132,028 and \$129,522	33,681	35,061
Software, net of amortization of \$80,057 and \$77,504	43,287	43,565
Goodwill	234,362	233,599
Client contracts, net of amortization of \$80,339 and \$75,382	52,064	55,191
Deferred income taxes	8,958	7,447
Income taxes receivable	1,846	1,930
Other assets	18,444	16,812
Total non-current assets	392,642	393,605
Total assets	\$854,415	\$868,980
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$16,875	\$15,000
Client deposits	31,571	30,431
Trade accounts payable	31,994	33,376
Accrued employee compensation	36,802	58,434
Deferred revenue	50,373	47,131
Income taxes payable	2,515	2,814
Other current liabilities	24,345	19,620
Total current liabilities	194,475	206,806
Non-current liabilities:		
Long-term debt, net of unamortized original issue discount of \$18,547 and \$19,950	245,828	250,050
Deferred revenue	7,875	9,221
Income taxes payable	1,613	1,909
Deferred income taxes	18,894	20,274
Other non-current liabilities	14,451	14,616
Total non-current liabilities	288,661	296,070
Total liabilities	483,136	502,876

Stockholders' equity:

Preferred stock, par value \$.01 per share; 10,000 shares authorized; zero shares issued and outstanding	-	-
Common stock, par value \$.01 per share; 100,000 shares authorized; 34,085 and 33,745 shares outstanding	661	658
Additional paid-in capital	472,766	473,190
Treasury stock, at cost, 32,030 and 32,030 shares	(738,372)	(738,372)
Accumulated other comprehensive income (loss):		
Unrealized gain on short-term investments, net of tax	60	41
Unrecognized loss on change in fair value of interest rate swap contracts, net of tax	-	(98)
Cumulative foreign currency translation adjustments	2,578	1,674
Accumulated earnings	633,586	629,011
Total stockholders' equity	371,279	366,104
Total liabilities and stockholders' equity	\$854,415	\$868,980

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	
	March 31,	
	2014	2013
Revenues:		
Processing and related services	\$ 142,358	\$ 134,634
Software and services	24,856	25,364
Maintenance	20,814	20,634
Total revenues	188,028	180,632
Cost of revenues (exclusive of depreciation, shown separately below):		
Processing and related services	68,427	61,577
Software and services	25,320	21,439
Maintenance	8,357	10,338
Total cost of revenues	102,104	93,354
Other operating expenses:		
Research and development	25,007	28,545
Selling, general and administrative	35,299	34,797
Depreciation	3,486	5,000
Restructuring charges	1,218	901
Total operating expenses	167,114	162,597
Operating income	20,914	18,035
Other income (expense):		
Interest expense	(2,772)	(2,929)
Amortization of original issue discount	(1,404)	(1,299)
Interest and investment income, net	213	155
Other, net	51	(418)
Total other	(3,912)	(4,491)
Income before income taxes	17,002	13,544
Income tax (provision) benefit	(7,311)	1,354
Net income	\$9,691	\$14,898
Weighted-average shares outstanding:		
Basic	32,319	32,133
Diluted	34,035	32,527
Earnings per common share:		
Basic	\$0.30	\$0.46
Diluted	0.28	0.46
Cash dividends declared per common share:	\$0.15	\$-

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 March 31,	
	2014	2013
Net income	\$9,691	\$14,898
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	904	(8,788)
Unrealized holding gains (losses) on short-term investments arising during period	19	(1)
Defined benefit pension plan:		
Net loss arising from period (net of tax effect of \$0 and \$(119))	-	(183)
Amortization of net actuarial loss included in net periodic pension cost (net of tax effect of \$0 and \$28)	-	43
Partial settlement of pension plan liability (net of tax effect of \$0 and \$336)	-	546
Net change in defined benefit pension plan	-	406
Cash flow hedges:		
Unrealized gains on change in fair value of interest rate swap contracts (net of tax effect of \$110 and \$133)	195	210
Reclassification adjustment for losses included in net income (net of tax effect of \$(55) and \$(66))	(97)	(104)
Net change in cash flow hedges	98	106
Other comprehensive income (loss), net of tax	1,021	(8,277)
Total comprehensive income, net of tax	\$10,712	\$6,621

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)

	Quarter Ended March 31,	
	2014	2013
Cash flows from operating activities:		
Net income	\$9,691	\$14,898
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation	3,486	5,000
Amortization	8,590	9,736
Amortization of original issue discount	1,404	1,299
Loss on short-term investments and other	453	867
Gain on disposition of business operations	(222)	-
Deferred income taxes	2,772	6,447
Excess tax benefit of stock-based compensation awards	(1,974)	(537)
Stock-based employee compensation	3,783	3,610
Changes in operating assets and liabilities, net of acquired amounts:		
Trade accounts receivable, net	(18,029)	12,763
Other current and non-current assets	(3,448)	(3,342)
Income taxes payable/receivable	707	(8,641)
Trade accounts payable and accrued liabilities	(17,464)	(29,450)
Deferred revenue	1,673	9,894
Net cash provided by (used in) operating activities	(8,578)	22,544
Cash flows from investing activities:		
Purchases of property and equipment	(4,499)	(4,492)
Purchases of short-term investments	(40,531)	(23,220)
Proceeds from sale/maturity of short-term investments	50,855	29,500
Acquisition of and investments in client contracts	(1,509)	(407)
Proceeds from the disposition of business operations	630	-
Net cash provided by investing activities	4,946	1,381
Cash flows from financing activities:		
Proceeds from issuance of common stock	340	610
Payment of cash dividends	(5,162)	-
Repurchase of common stock	(6,518)	(11,343)
Payments on long-term debt	(3,750)	(3,750)
Excess tax benefit of stock-based compensation awards	1,974	537
Net cash used in financing activities	(13,116)	(13,946)
Effect of exchange rate fluctuations on cash	(484)	(108)
Net increase (decrease) in cash and cash equivalents	(17,232)	9,871
Cash and cash equivalents, beginning of period	82,686	133,747
Cash and cash equivalents, end of period	\$65,454	\$143,618

Supplemental disclosures of cash flow information:

Cash paid during the period for-

Interest	\$3,322	\$3,378
Income taxes	3,755	611

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 March 31, 2014 and December 31, 2013, and for the quarters ended March 31, 2014 and 2013, in accordance with accounting principles generally accepted in the United States of America (“U.S.”) (“GAAP”) 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 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, 2013 (our “2013 10-K”), filed with the SEC. The results of operations for the quarter ended March 31, 2014 are not necessarily indicative of the expected results for the entire year ending December 31, 2014.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates in Preparation of Financial Statements. The preparation of the accompanying 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 our Financial Statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Reclassifications. Maintenance revenues, as well as the cost of maintenance revenues, previously included in software, maintenance and service revenues and software, maintenance and services costs of revenues, respectively, have been presented separately in the Condensed Consolidated Statements of Income (“Income Statements” or “Income Statement”) for the quarter ended March 31, 2013. In addition, certain other 2013 amounts have been reclassified to conform to the 2014 presentation.

Cash and Cash Equivalents. We consider all highly liquid investments with original maturities of three months or less at the date of the purchase to be cash equivalents. As of March 31, 2014 and December 31, 2013, our cash equivalents consist primarily of institutional money market funds, commercial paper, and time deposits held at major banks.

As of March 31, 2014 and December 31, 2013, we had \$4.9 million and \$4.5 million, respectively, of restricted cash that serves to collateralize outstanding letters of credit. This restricted cash is included in cash and cash equivalents in our Balance Sheet.

Short-term Investments and Other Financial Instruments. Our financial instruments as of March 31, 2014 and December 31, 2013 include cash and cash equivalents, short-term investments, accounts receivable, accounts payable, an interest rate swap contract, and debt. Because of their short maturities, the carrying amounts of cash equivalents, accounts receivable, and accounts payable approximate their fair value.

Our short-term investments and certain of our cash equivalents are considered “available-for-sale” and are reported at fair value in our Balance Sheets, with unrealized gains and losses, net of the related income tax effect, excluded from earnings and reported in a separate component of stockholders’ equity. Realized and unrealized gains and losses were not material in any period presented.

Primarily all short-term investments held by us as of March 31, 2014 and December 31, 2013 have contractual maturities of less than two years from the time of acquisition. Our short-term investments as of March 31, 2014 and December 31, 2013 consisted almost entirely of fixed income securities. Proceeds from the sale/maturity of short-term investments for the first quarters of 2014 and 2013 were \$50.9 million and \$29.5 million, respectively.

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The following table represents the fair value hierarchy based upon three levels of inputs, of which Levels 1 and 2 are considered observable and Level 3 is unobservable, for our financial assets and liabilities measured at fair value (in thousands):

	March 31, 2014			December 31, 2013		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets:						
Cash equivalents:						
Money market funds	\$8,740	\$—	\$8,740	\$13,761	\$—	\$13,761
Commercial paper	—	11,379	11,379	—	19,629	19,629
Short-term investments:						
Corporate debt securities	—	66,915	66,915	—	76,786	76,786
Municipal bonds	—	27,564	27,564	—	29,106	29,106
U.S. government agency bonds	—	14,039	14,039	—	18,050	18,050
Asset-backed securities	—	9,040	9,040	—	4,209	4,209
Total	\$8,740	\$128,937	\$137,677	\$13,761	\$147,780	\$161,541
Liabilities:						
Interest rate swap contract (1)	\$—	\$—	\$—	\$—	\$154	\$154
Total	\$—	\$—	\$—	\$—	\$154	\$154

(1) As of December 31, 2013, the fair value of the interest rate swap contract was classified on our Balance Sheet in other current liabilities.

Valuation inputs used to measure the fair values of our money market funds were derived from quoted market prices. The fair values of all other financial instruments are based upon pricing provided by third-party pricing services. These prices were derived from observable market inputs.

We have chosen not to measure our debt at fair value, with changes recognized in earnings each reporting period. The following table indicates the carrying value and estimated fair value of our debt as of the indicated periods (in thousands):

	March 31, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Credit Agreement (carrying value including current maturities)	\$131,250	\$131,250	\$135,000	\$135,000
Convertible debt (par value)	150,000	185,955	150,000	199,800

The fair value for our Credit Agreement was estimated using a discounted cash flow methodology, while the fair value for our convertible debt was estimated based upon quoted market prices or recent sales activity, both of which are considered Level 2 inputs.

3. STOCKHOLDERS' EQUITY AND EQUITY COMPENSATION PLANS

Stock Repurchase Program. We currently have a stock repurchase program, approved by our Board of Directors (the "Board"), authorizing us to repurchase our common stock from time-to-time as market and business conditions warrant (the "Stock Repurchase Program"). We did not repurchase any shares under our Stock Repurchase Program during the

first quarter of 2014. During the first quarter of 2013, we repurchased 0.3 million shares of our common stock for \$6.5 million (weighted-average price of \$19.80 per share). As of March 31, 2014, the total remaining number of shares available for repurchase under the Stock Repurchase Program totaled 2.1 million shares.

Stock Repurchases for Tax Withholdings. In addition to the above mentioned stock repurchases, during the first quarters of 2014 and 2013, we repurchased and then cancelled 0.2 million shares of common stock for \$6.5 million and 0.2 million shares of common stock for \$4.8 million, respectively, in connection with minimum tax withholding requirements resulting from the vesting of restricted common stock under our stock incentive plans.

Cash Dividend. In June 2013, the Board approved the initiation of a quarterly cash dividend to be paid to our stockholders. During the first quarter of 2014, the Board approved a cash dividend of \$0.15 per share of common stock, totaling \$5.1 million to stockholders of record on March 12, 2014, of which \$4.9 million was paid on March 27, 2014 (with the remaining amount attributed to unvested shares to be paid upon vesting). In addition, during the first quarter of 2014, we paid cash dividends of \$0.3 million related to shares vesting in the first quarter of 2014 (the dividends were previously declared but the shares were unvested at the time of dividend declaration).

Stock-Based Awards. A summary of our unvested restricted common stock activity during the first quarter of 2014 is as follows (shares in thousands):

	Quarter Ended March 31, 2014	
	Weighted- Average Grant	
	Shares	Date Fair Value
Unvested awards, beginning	1,922	\$ 18.57
Awards granted	632	26.32
Awards forfeited/cancelled	(29)	20.50
Awards vested	(677)	18.48
Unvested awards, ending	1,848	\$ 21.21

Included in the awards granted during the first quarter of 2014, are performance-based awards for 0.1 million restricted common stock shares issued to members of executive management, which vest in equal installments over three years upon meeting either pre-established financial performance objectives or pre-established stock price objectives. The performance-based awards become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment.

All other restricted common stock shares granted during the first quarter of 2014 are time-based awards, which vest annually over four years with no restrictions other than the passage of time. Certain shares of the restricted common stock become fully vested upon a change in control, as defined, and the subsequent involuntary termination of employment.

We recorded stock-based compensation expense for the first quarters of 2014 and 2013 of \$3.8 million and \$3.6 million, respectively.

4. EARNINGS PER COMMON SHARE

Basic and diluted earnings per common share (“EPS”) amounts are presented on the face of the accompanying Income Statements.

No reconciliation of the basic and diluted EPS numerators is necessary as net income is used as the numerators for all periods presented. The reconciliation of the basic and diluted EPS denominators related to the common shares is included in the following table (in thousands):

	Quarter Ended March 31,	
	2014	2013
Basic weighted-average common shares	32,319	32,133
Dilutive effect of common stock options	—	3
Dilutive effect of restricted common stock	750	391
Dilutive effect of 2010 Convertible Notes	966	—
Diluted weighted-average common shares	34,035	32,527

There were no potentially dilutive common shares related to stock options and unvested shares of restricted common stock for the first quarters of 2014 and 2013 excluded from the computation of diluted EPS related to common shares.

The 2010 Convertible Notes have a dilutive effect only in those quarterly periods in which our average stock price exceeds the current effective conversion price (see Note 5).

5. DEBT

Our long-term debt, as of March 31, 2014 and December 31, 2013, was as follows (in thousands):

	March 31, 2014	December 31, 2013
2012 Credit Agreement:		
Term loan, due November 2017 (or December 2016 if certain conditions exist), interest at adjusted LIBOR plus 2.00% (combined rate of 2.24% at March 31, 2014 and 2.25% at December 31, 2013)	\$ 131,250	\$ 135,000
\$100 million revolving loan facility, due November 2017 (or December 2016 if certain conditions exist), interest at adjusted LIBOR plus applicable margin	—	—
Convertible Debt Securities:		
2010 Convertible Notes – senior subordinated convertible notes; due March 1, 2017; cash interest at 3.0%; net of unamortized OID of \$18,547 and \$19,950, respectively	131,453	130,050
	262,703	265,050
Current portion of long-term debt	(16,875)	(15,000)
Total long-term debt, net	\$	