SPS COMMERCE INC
Form 10-Q
August 08, 2011

Table of Contents

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: June 30, 2011

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 001-34702

SPS COMMERCE, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**41-2015127**
(State or Other Jurisdiction of Incorporation or Organization)	***(I.R.S. Employer Identification No.)***

333 South Seventh Street, Suite 1000, Minneapolis, MN 55402

(Address of Principal Executive Offices, Including Zip Code)

(612) 435-9400

(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 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 (§229.405 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 þ 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.

Large Accelerated Filer o	Accelerated Filer o	Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company þ

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 shares of the registrant s common stock, par value $0.001 per share, outstanding at July 29, 2011 was 11,962,690 shares.

SPS COMMERCE, INC.
QUARTERLY REPORT ON FORM 10-Q
INDEX

SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

This Quarterly Report on Form 10-Q contains forward-looking statements regarding us, our business prospects and our results of operations that are subject to certain risks and uncertainties posed by many factors and events that could cause our actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those described under the heading *Risk Factors* included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the Commission that advise interested parties of the risks and factors that may affect our business.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SPS COMMERCE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited; in thousands, except share amounts)

	June 30, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 29,788	$ 40,473
Accounts receivable, less allowance for doubtful accounts of $193 and $209	7,353	5,574
Deferred costs, current	5,177	4,720
Prepaid expenses and other current assets	1,564	874
Total current assets	43,882	51,641
PROPERTY AND EQUIPMENT, net	2,896	2,760
GOODWILL	5,877	1,166
INTANGIBLE ASSETS, net	6,287	290
OTHER ASSETS		
Deferred costs, net of current portion	2,193	1,943
Other non-current assets	80	80
	$ 61,215	$ 57,880
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Capital lease obligations, current	$	$ 122
Accounts payable	1,821	998
Accrued compensation and benefits	3,836	3,577
Accrued expenses and other current liabilities	1,260	807
Deferred revenue, current	3,734	3,585
Total current liabilities	10,651	9,089
OTHER LIABILITIES		
Deferred revenue, less current portion	5,461	5,002
Other non-current liabilities	247	281
Total liabilities	16,359	14,372
COMMITMENTS and CONTINGENCIES		
STOCKHOLDERS EQUITY		

Preferred stock, $0.001 par value; 5,000,000 shares authorized; 0 shares issued and outstanding		
Common stock, $0.001 par value; 55,000,000 shares authorized; 11,955,017 and 11,849,572 shares issued and outstanding, respectively	12	12
Additional paid-in capital	107,229	106,264
Accumulated deficit	(62,385)	(62,768)
Total stockholders equity	44,856	43,508
	$ 61,215	$ 57,880

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

Table of Contents

SPS COMMERCE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenues	$ 13,937	$ 10,944	$ 26,586	$ 21,187
Cost of revenues	3,750	3,101	7,071	6,082
Gross profit	10,187	7,843	19,515	15,105
Operating expenses				
Sales and marketing	5,852	4,122	10,978	7,629
Research and development	1,414	1,067	2,654	2,110
General and administrative	2,839	1,975	5,294	3,640
Amortization of intangible assets	123		123	
Total operating expenses	10,228	7,164	19,049	13,379
Income (loss) from operations	(41)	679	466	1,726
Other income (expense)				
Interest expense		(13)		(58)
Interest income	26		58	
Other income (expense)	(16)	10	(34)	(8)
Total other income (expense), net	10	(3)	24	(66)
Income (loss) before income taxes	(31)	676	490	1,660
Income tax expense	(78)	(38)	(107)	(103)
Net income (loss)	$ (109)	$ 638	$ 383	$ 1,557
Net income (loss) per share				
Basic	$ (0.01)	$ 0.08	$ 0.03	$ 0.36
Diluted	$ (0.01)	$ 0.05	$ 0.03	$ 0.15
Weighted average common shares used to compute net income (loss) per share				
Basic	11,919	8,301	11,892	4,358
Diluted	11,919	11,844	12,659	10,699

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

Table of Contents

SPS COMMERCE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in thousands)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Cash flows from operating activities		
Net income	$ 383	$ 1,557
Reconciliation of net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	895	745
Amortization of intangible assets	123	
Provision for doubtful accounts	120	165
Stock-based compensation	799	226
Change in carrying value of preferred stock warrants		27
Other		1
Changes in assets and liabilities, net of effect of acquisition		
Accounts receivable	(1,799)	(385)
Prepaid expenses and other current assets	(593)	484
Other assets		2
Deferred costs	(708)	(488)
Accounts payable	823	(362)
Deferred revenue	608	590
Accrued compensation and benefits	259	491
Accrued expenses and other current liabilities	216	(351)
Net cash provided by operating activities	1,126	2,702
Cash flows from investing activities		
Acquisition of Direct EDI	(10,865)	
Purchases of property and equipment	(989)	(1,214)
Net cash used in investing activities	(11,854)	(1,214)
Cash flows from financing activities		
Borrowings on line of credit		4,450
Payments on line of credit		(5,950)
Payments on equipment loans		(732)
Payments of capital lease obligations	(122)	(116)
Net proceeds from initial public offering		32,902
Stock offering costs	(108)	
Net proceeds from exercise of options to purchase common stock	273	
Net cash provided by financing activities	43	30,554
Net increase (decrease) in cash and cash equivalents	(10,685)	32,042
Cash and cash equivalents at beginning of period	40,473	5,931
Cash and cash equivalents at end of period	$ 29,788	$ 37,973

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

Table of Contents

SPS COMMERCE, INC.
Notes to Condensed Consolidated Financial Statements (Unaudited)
NOTE A General

Business Description

We are a leading provider of on-demand supply chain management solutions, providing integration, collaboration, connectivity, visibility and data analytics to thousands of customers worldwide. We provide our solutions through SPSCommerce.net, a hosted software suite that improves the way suppliers, retailers, distributors and other customers manage and fulfill orders. We deliver our solutions to our customers over the Internet using a Software-as-a-Service model and derive the majority of our revenues from thousands of monthly recurring subscriptions from businesses that utilize our solutions.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these condensed consolidated financial statements do not include all of the information and footnotes required by GAAP. We have included all normal recurring adjustments considered necessary to give a fair statement of our financial position, results of operations and cash flows for the interim periods shown. Operating results for these interim periods are not necessarily indicative of the results to be expected for the full year. The December 31, 2010 balance sheet data was derived from our audited financial statements at that date. For further information, refer to the consolidated financial statements and accompanying notes for the year ended December 31, 2010 included in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 3, 2011.

Use of Estimates

Preparing 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 periods. Actual results could differ from those estimates.

Business Combinations

We account for acquisitions of businesses pursuant to FASB ASC 805, Business Combinations. In accordance with ASC 805, we recognize separately from goodwill the fair value of the assets acquired and the liabilities assumed at the acquisition date as defined by FASB ASC 820, Fair Value Measurements and Disclosures. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition date amounts of the assets acquired and the liabilities assumed. Assets acquired include tangible and intangible assets. We determine the value and useful lives of purchased intangible assets with the assistance of an independent third-party valuation firm using certain estimates and assumptions.

While we use estimates and assumptions that we believe are reasonable as a part of the purchase price allocation process to accurately value the assets acquired and the liabilities assumed at the acquisition date, they are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the fair value of the assets acquired and the liabilities assumed based on new information about facts and circumstances that existed as of the acquisition date. Any such adjustments would be recorded as an offset to goodwill. Upon the conclusion of the measurement period or final determination of the fair values, whichever comes first, any subsequent adjustments would be recorded in our statements of operations.

Significant Accounting Policies

During the six months ended June 30, 2011, there were no material changes in our significant accounting policies. See Note A to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on March 3, 2011 for additional information regarding our significant accounting policies.

Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-13, Revenue Recognition (ASC Topic 605), *Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force.* This guidance modifies the fair value requirements of ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements,* by allowing the use of the best estimate of selling price in addition to Vendor Specific Objective Evidence and third-party evidence (or TPE) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when Vendor Specific Objective Evidence or TPE of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted.

In October 2009, the FASB issued ASU No. 2009-14, Software (ASC Topic 985), *Certain Revenue Arrangements That Include Software Elements, a consensus of the FASB Emerging Issues Task Force.* This guidance modifies the scope of ASC subtopic 965-605, *Software-Revenue Recognition,* to exclude from its requirements (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionality.

ASU No. 2009-13 and ASU No. 2009-14 both require expanded qualitative and quantitative disclosures and are effective for fiscal years beginning on or after June 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (ASC Topic 820), *Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 enhances the disclosure requirements to include transfers in and out of Level 1 and 2 and the associated reasons, which was effective for fiscal years beginning on or after December 15, 2009. ASU No. 2010-06 also requires the disclosure of a disaggregated gross reconciliation of Level 3 fair value measurements, which is effective for fiscal years beginning on or after December 15, 2010. We have adopted these updates and they did not have a material impact on our financial statements.

In July 2010, the FASB issued ASU No. 2010-20, Receivables (ASC Topic 310), *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU No. 2010-20 enhances the disclosure requirements about the credit quality and related allowance for credit losses of financing receivables. We will be required to disclose the nature of the inherent risk of receivables, the methodology and analytics that support that assessment, and support any changes to the allowance for doubtful accounts. We will also be required to provide a rollforward of the allowance and disclose the accounts receivable on a disaggregated basis. This update is effective for fiscal years beginning on or after December 15, 2010. We have adopted this update and it did not have a material impact on our financial statements.

In December 2010, the FASB issued ASU No. 2010-29, Business Combinations (ASC Topic 805), *Disclosure of Supplementary Pro Forma Information for Business Combinations*. ASU No. 2010-29 amends the disclosure requirements for supplementary pro forma information for business combinations. This update addresses the diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The update specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. It also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. This update is effective prospectively for business combinations for

Table of Contents

which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. We have adopted this update and, with the acquisition of Direct EDI in May 2011, the required supplementary pro forma information is presented in Note B.

NOTE B Acquisition of Direct EDI

On May 17, 2011, we entered into an asset purchase agreement with Direct EDI LLC, a privately-held provider of cloud-based integration solutions for electronic data interchange, and we completed the asset purchase on May 18, 2011. Under the asset purchase agreement, we purchased and acquired substantially all of the assets of Direct EDI for $10.9 million in cash and assumed certain liabilities of Direct EDI. The acquisition of Direct EDI allows us to expand our base of recurring revenue customers.

Purchase Price Allocation

We accounted for the acquisition as a business combination. We allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. We engaged an independent third-party valuation firm to assist us in the determination of the value of the purchased intangible assets. The excess of the purchase price over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. Goodwill is attributed to a trained workforce and other buyer-specific value resulting from expected synergies, including long-term cost savings, that are not included in the fair values of assets. Goodwill will not be amortized; however it is deductible for tax purposes. Although we believe the purchase price allocation is substantially complete, it is considered preliminary and the finalization of the valuation of the net tangible and intangible assets acquired and liabilities assumed could result in a future adjustment to the purchase price allocation.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date (in thousands):

Current assets	$ 195
Property and equipment	42
Intangible assets	6,120
Goodwill	4,712
Current liabilities	(204)
Total purchase price	$ 10,865

Purchased Intangible Assets

The following table summarizes the estimated fair value of the purchased intangible assets and their estimated useful lives (in thousands):

Purchased Intangible Assets	Estimated Fair Value (in thousands)	Estimated Life (in years)
Subscriber relationships	$ 5,250	7
Non-competition agreements	870	3
Total	$ 6,120	

The purchased intangible assets are being amortized on a straight-line basis over their estimated useful lives. Amortization expense related to these intangible assets was $123,000 for the three and six months ended June 30, 2011.

Acquisition-Related Costs and Post-Acquisition Operating Results

Acquisition-related costs were approximately $232,000, of which $203,000 and $232,000 were recorded in our condensed consolidated statements of operations for the three and six months ended June 30, 2011, respectively. Acquisition-related costs were recorded as general and administrative expense in accordance with the current accounting guidance for business combinations. The operating results of Direct EDI have been included in our condensed consolidated financial statements from May 18, 2011, the date of the acquisition. For the three months ended June 30, 2011, approximately $480,000 of our revenue was derived from Direct EDI customers. The amount of operating income or loss from Direct EDI was not separately identifiable due to our integration.

Unaudited Pro Forma Financial Information

The unaudited pro forma financial information in the table below presents the combined operating results of SPS Commerce and Direct EDI as if the acquisition had occurred on January 1, 2010. The unaudited pro forma information includes the historical operating results of each company and certain pro forma adjustments, including annual amortization expense for purchased intangible assets of approximately $1.0 million and additional annual compensation expense of approximately $280,000 related to employment arrangements entered into as part of the acquisition.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
(in thousands, except per share data)				
Pro forma total revenue	$ 14,528	$ 11,921	$ 28,432	$ 23,040
Pro forma net income (loss)	$ (119)	$ 492	$ 256	$ 1,197
Pro forma net income (loss) per share				
Basic	$ (0.01)	$ 0.06	$ 0.02	$ 0.27
Diluted	$ (0.01)	$ 0.04	$ 0.02	$ 0.11

The unaudited pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have actually been reported had the acquisition occurred on January 1, 2010, nor is it necessarily indicative of our results of operations for any future periods.

NOTE C Intangible Assets

Intangible assets included the following (in thousands):

	June 30, 2011			December 31, 2010		
	Carrying Amount	Accumulated Amortization	Net	Carrying Amount	Accumulated Amortization	Net
Subscriber relationships	$ 7,180	$ (2,019)	$ 5,161	$ 1,930	$ (1,930)	$
Covenants not-to-compete	1,450	(324)	1,126	580	(290)	290
	$ 8,630	$ (2,343)	$ 6,287	$ 2,510	$ (2,220)	$ 290

Amortization expense for intangible assets was $123,000 for the three and six months ended June 30, 2011. There was no amortization expense for intangible assets for the three or six months ended June 30, 2010.

Table of Contents

At June 30, 2011, future amortization expense for intangible assets was as follows (in thousands):

Remainder of 2011	$ 520
2012	1,040
2013	1,040
2014	861
2015	750
Thereafter	2,076
	$ 6,287

NOTE D Stock-Based Compensation

Our equity compensation plans provide for the grant of incentive and nonqualified stock options, as well as other stock-based awards, to employees, non-employee directors and other consultants who provide services to us. Stock options generally vest over three to four years and have a contractual term of ten years from the date of grant. At June 30, 2011, there were approximately 668,000 shares available for grant under approved equity compensation plans.

We recorded stock-based compensation expense of $487,000 and $175,000 for the three months ended June 30, 2011 and 2010, respectively. We recorded stock-based compensation expense of $799,000 and $226,000 for the six months ended June 30, 2011 and 2010, respectively. This expense was allocated as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Cost of revenues	$ 72	$ 24	$ 118	$ 34
Operating expenses:				
Sales and marketing	137	48	226	65
Research and development	16	4	23	5
General and administrative	262	99	432	122
Total stock-based compensation expense	$ 487	$ 175	$ 799	$ 226

As of June 30, 2011, there was approximately $5.2 million of unrecognized stock-based compensation expense under our equity compensation plans, which is expected to be recognized on a straight line basis over a weighted average period of approximately two years.

Our stock option activity was as follows:

	Options (#)	Weighted Average Exercise Price ($/share)
Outstanding at December 31, 2010	1,549,344	$ 4.59
Granted	420,042	16.97
Exercised	(105,445)	2.59
Forfeited	(19,129)	10.80
Outstanding at June 30, 2011	1,844,812	7.46

The weighted average fair value per share of options granted during the first six months of 2011 was $8.21 and this was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

Weighted-average volatility	45.0%
Expected dividend yield	0%
Expected life (in years)	6.25
Weighted-average risk-free interest rate	2.47%-3.05%

NOTE E Income Taxes

We recorded a provision for income taxes of $78,000 and $38,000 for the three months ended June 30, 2011 and 2010, respectively. We recorded a provision for income taxes of $107,000 and $103,000 for the six months ended June 30, 2011 and 2010, respectively. We record our interim provision for income taxes based on our estimated annual effective tax rate for the year. Our provision for income taxes includes estimated federal alternative minimum taxes and state income taxes, as well as deferred tax expense resulting from the book and tax basis difference in goodwill from asset acquisitions.

As of December 31, 2010, we had net operating loss carryforwards of $49.9 million for U.S. federal tax purposes and $31.4 million for state tax purposes. These loss carryforwards expire between 2011 and 2029. Section 382 of the U.S. Internal Revenue Code generally imposes an annual limitation on the amount of net operating loss carryforwards that might be used to offset taxable income when a corporation has undergone significant changes in stock ownership. We have performed a Section 382 analysis for the time period from our inception through December 8, 2010. During this time period it was determined that we had six separate ownership changes under Section 382. We believe that approximately $17.6 million of federal losses and $7.0 million of state losses will expire unused due to Section 382 limitations; however, additional state net operating loss carryforwards could expire unused due to future changes in apportionment factors. This limitation could be further restricted if ownership changes occur in future years. Our deferred tax asset is reported net of this limitation.

Realization of our net operating loss carryforwards and other deferred tax temporary differences are contingent upon future taxable earnings. Our net deferred tax assets have been reduced fully by a valuation allowance, as realization is not considered to be likely based on an assessment of the history of losses and the likelihood of sufficient future taxable income. Our deferred tax liability relates to goodwill created in a prior ass