MODEL N, INC.
Form 10-Q
February 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 December 31, 2017

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: 001-35840

Model N, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	77-0528806 (I.R.S. Employer Identification No.)
777 Mariners Island Boulevard, Suite 300	
San Mateo, California	94404

(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (650) 610-4600

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. Yes No

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 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	(Do not check if a smaller reporting company)	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

As of January 26, 2018, the registrant had 29,483,120 shares of common stock, $0.00015 par value per share, outstanding.

TABLE OF CONTENTS

2

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)
MODEL N, INC.

Condensed Consolidated Balance Sheets

(in thousands, except per share data)

(Unaudited)

	As of December 31, 2017	As of September 30, 2017
Assets		
Current assets:		
Cash and cash equivalents	$48,324	$57,558
Accounts receivable, net of allowance for doubtful accounts of $43 as of December 31, 2017 and $85 as of September 30, 2017	38,679	24,784
Prepaid expenses	2,800	3,733
Other current assets	1,202	1,013
Total current assets	91,005	87,088
Property and equipment, net	3,823	4,611
Goodwill	39,283	39,283
Intangible assets, net	38,738	40,156
Other assets	1,104	798
Total assets	$173,953	$171,936
Liabilities And Stockholders' Equity		
Current liabilities:		
Accounts payable	$4,240	$3,002
Accrued employee compensation	9,143	14,996
Accrued liabilities	4,028	4,979
Deferred revenue, current portion	57,135	49,186
Long term debt, current portion	4,831	4,753
Total current liabilities	79,377	76,916
Long term debt	52,610	52,452
Other long-term liabilities	1,266	1,307
Total liabilities	133,253	130,675
Commitments and contingencies		
Stockholders' equity:		
Common Stock, $0.00015 par value; 200,000 shares authorized; 29,474 and 29,323 shares issued and outstanding at December 31, 2017 and September 30, 2017, respectively	4	4

Preferred Stock, $0.00015 par value; 5,000 shares authorized; no shares issued and outstanding	—	—
Additional paid-in capital	221,639	217,052
Accumulated other comprehensive loss	(393)	(502)
Accumulated deficit	(180,550)	(175,293)
Total stockholders' equity	40,700	41,261
Total liabilities and stockholders' equity	$173,953	$171,936

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

MODEL N, INC.

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

(Unaudited)

	Three Months Ended December 31,	
	2017	2016
Revenues:		
SaaS and maintenance	$ 32,323	$ 22,640
License and implementation	6,744	5,423
Total revenues	39,067	28,063
Cost of revenues:		
SaaS and maintenance	13,024	10,208
License and implementation	3,785	3,614
Total cost of revenues	16,809	13,822
Gross profit	22,258	14,241
Operating expenses:		
Research and development	9,068	5,975
Sales and marketing	8,492	8,734
General and administrative	8,731	7,185
Total operating expenses	26,291	21,894
Loss from operations	(4,033)	(7,653)
Interest expense (income), net	1,423	(33)
Other expenses (income), net	125	(154)
Loss before income taxes	(5,581)	(7,466)
(Benefit) provision for income taxes	(324)	134
Net loss	$ (5,257)	$ (7,600)
Net loss per share attributable to common stockholders:		
Basic and diluted	$ (0.18)	$ (0.27)
Weighted average number of shares used in computing net loss per share attributable to common stockholders:		
Basic and diluted	29,401	28,008

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

MODEL N, INC.

Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

(Unaudited)

	Three Months Ended December 31,	
	2017	2016
Net loss	$ (5,257)	$ (7,600)
Other comprehensive (loss) income, net		
Change in foreign currency translation adjustment	109	(114)
Total comprehensive loss	$ (5,148)	$ (7,714)

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

MODEL N, INC.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Three Months Ended December 31,	
	2017	2016
Cash flows from operating activities:		
Net loss	$ (5,257)	$ (7,600)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	2,265	1,094
Stock-based compensation	4,036	1,895
Amortization of debt discount and issuance cost	236	—
Other non-cash charges	(491)	49
Changes in assets and liabilities, net of acquisition:		
Accounts receivable	(13,846)	655
Prepaid expenses and other assets	363	843
Deferred cost of implementation services	191	701
Accounts payable	1,216	591
Accrued employee compensation	(5,896)	(898)
Other accrued and long-term liabilities	(703)	(1,298)
Deferred revenue	8,145	(4,261)
Net cash used in operating activities	(9,741)	(8,229)
Cash flows from investing activities:		
Purchases of property and equipment	(60)	(194)
Capitalization of software development costs	—	(275)
Cash held in escrow for acquisition	—	(5,000)
Net cash used in investing activities	(60)	(5,469)
Cash flows from financing activities:		
Proceeds from exercise of stock options	552	17
Net cash provided by financing activities	552	17
Effect of exchange rate changes on cash and cash equivalents	15	(22)
Net decrease in cash and cash equivalents	(9,234)	(13,703)
Cash and cash equivalents		
Beginning of period	57,558	66,149
End of period	$ 48,324	$ 52,446

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

6

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. The Company and Significant Accounting Policies and Estimates

Model N, Inc. (Company) was incorporated in Delaware on December 14, 1999. The Company is a provider of revenue management solutions for the life sciences and technology industries. The Company's solutions enable its customers to maximize revenues and reduce revenue compliance risk by transforming their revenue life cycle from a series of tactical, disjointed operations into a strategic end-to-end process, which enables them to manage the strategy and execution of pricing, contracting, incentives and rebates. The Company's corporate headquarters are located in San Mateo, California, with additional offices in the United States, India and Switzerland.

Fiscal Year

The Company's fiscal year ends on September 30. References to fiscal year 2018, for example, refer to the fiscal year ending September 30, 2018.

Basis for Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the fiscal year ended September 30, 2017. There have been no changes in the significant accounting policies from those that were disclosed in the audited consolidated financial statements for the fiscal year ended September 30, 2017 included in the Annual Report on Form 10-K.

In the opinion of management, the unaudited interim consolidated financial statements include all the normal recurring adjustments necessary to present fairly the condensed consolidated financial statements. The results of operations for the three months ended December 31, 2017 were not necessarily indicative of the operating results for the full fiscal year 2018 or any future periods.

The Company's condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated upon consolidation.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses during the reporting periods. Significant items subject to such estimates include revenue recognition, legal contingencies, income taxes, stock-based compensation, and valuation of goodwill and intangibles. These estimates and assumptions are based on management's best estimates and judgment. Management regularly evaluates its estimates and assumptions using historical experience and other factors. However, actual results could differ significantly from these estimates.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued a new standard, Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, as amended, which will supersede nearly all existing revenue recognition guidance. Under ASU 2014-09, an entity is required to recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration received in exchange for those goods or services. ASU 2014-09 defines a five-step process in order to achieve this core principle, which may require the use of judgment and estimates, and also requires expanded qualitative and quantitative disclosures relating to the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, including significant judgments and estimates used.

The FASB has issued several amendments to the new standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. The amendments include ASU 2016-08, Revenue from Contracts with Customers

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Topic 606)—Principal versus Agent Considerations, which was issued in March 2016, and clarifies the implementation guidance for principal versus agent considerations in ASU 2014-09, and ASU 2016-10, Revenue from Contracts with Customers (Topic 606)—Identifying Performance Obligations and Licensing, which was issued in April 2016, and amends the guidance in ASU 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property.

The new standard permits adoption either by using (i) a full retrospective approach for all periods presented in the period of adoption or (ii) a modified retrospective approach with the cumulative effect of initially applying the new standard recognized at the date of initial application and providing certain additional disclosures. The new standard is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted for annual reporting periods beginning after December 15, 2016. The Company does not plan to early adopt, and accordingly, the Company will adopt the new standard effective October 1, 2018. The Company currently anticipates adopting the standard using the modified retrospective method.

The Company has identified, and is in the process of implementing, appropriate changes to its business processes, systems and controls to support recognition and disclosure under the new standard. Based on the Company's ongoing evaluation, the Company believes the impacts of this ASU will be primarily related to the capitalization and amortization of sales commissions, the timing of revenue recognition for certain sales contracts, and related disclosures. The Company expects that under this ASU it will now be required to capitalize sales commissions and amortize them over the period which the sales commissions are expected to benefit the Company. Sales commissions are currently expensed as incurred. In addition, there will be a change in relation to the timing of revenue recognition for certain sales contracts, due primarily to the removal of the current limitation on contingent revenue. These changes are being evaluated to determine the potential impact to the financial statements and disclosures. While the Company continues to assess the potential impacts of the new standard, including the areas described above, our preliminary conclusions may change.

In February 2016, the FASB issued ASU 2016-02, Lease (Topic 842), guidance on the recognition and measurement of leases. Under the new guidance, lessees are required to recognize a lease liability, which represents the discounted obligation to make future minimum lease payments, and a corresponding right-of-use asset on the balance sheet for most leases. The guidance retains the current accounting for lessors and does not make significant changes to the recognition, measurement, and presentation of expenses and cash flows by a lessee. Enhanced disclosures will also be required to give financial statement users the ability to assess the amount, timing and uncertainty of cash flows arising from leases. The guidance will require modified retrospective application at the beginning of October 1, 2019 for the Company, with optional practical expedients, but permits adoption in an earlier period. The Company is currently evaluating the impact this standard will have on its consolidated financial statements.

In March 2016, FASB issued ASU 2016-9, Compensation – Stock Compensation (Topic 718), which simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public companies, the guidance is effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted for all companies in any interim or annual period. Forfeitures can be estimated, as required today, or recognized when they occur. Estimates of forfeitures will still be required in certain circumstances, such as at the time of modification of an award or issuance of a replacement award in a business combination. The Company adopted this guidance in the first quarter of fiscal year 2018 and has elected to continue to estimate its forfeiture rate. In the year of adoption, the ASU requires that the cumulative effect adjustment be recorded to retained earnings. Due to a full valuation allowance, there is no cumulative effect adjustment to record and the adoption of this guidance had no material impact on the Company’s consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flow (Topic 230), amended the existing accounting standards for the statement of cash flows. The amendments provide guidance on how companies present and classify certain cash receipts and cash payments in the statement of cash flows. The guidance becomes effective for the Company at the beginning of its first quarter of fiscal 2019. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact this standard will have on its consolidated financial statements, but does not believe this will have material impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Restricted Cash (Topic 230), clarifying the classification and presentation of restricted cash in the statement of cash flows. The standard requires that restricted cash and restricted cash equivalents are included in the cash and cash equivalent balance in the statement of cash flows. Further, reconciliation between the balance sheet and statement of cash flows is required when the balance sheet includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents. Therefore, transfers between these balances should no longer be presented as a cash flow activity. The guidance becomes effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

early adoption permitted. The Company does not plan to early adopt, and accordingly the Company will adopt the new standard effective October 1, 2018. The Company is currently evaluating the impact this standard will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combination (Topic 805): clarifying the definition of a business. The amendments in this guidance change the definition of a business to assist with evaluating when a set of transferred assets and activities is a business. The guidance becomes effective for the Company at the beginning of its first quarter of fiscal 2019. Early adoption is permitted. The Company is currently evaluating the impact this standard will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This new accounting standard update simplifies the measurement of goodwill by eliminating the Step two impairment test. Step two measures a goodwill impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. The new guidance requires a comparison of the Company's fair value of with carrying amount and the Company is required to recognize an impairment charge for the amount by which the carrying amount exceeds the fair value. Additionally, we should consider income tax effects from any tax deductible goodwill on the carrying amount when measuring the goodwill impairment loss, if applicable. The new guidance becomes effective for goodwill impairment tests in fiscal years beginning after December 15, 2019, though early adoption is permitted. The Company is currently evaluating the impact this standard will have on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718): providing clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. This ASU does not change the accounting for modifications but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions or award classification and would not be required if the changes are considered non-substantive. The amendments of this ASU are effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The Company is currently evaluating the impact of this standard, but does not believe this will have material impact on its consolidated financial statements.

2.Business Combination

Revitas Acquisition

On January 5, 2017, the Company completed the acquisition of 100% of the equity interests of Sapphire Stripe Holdings, Inc., the parent company of Revitas, Inc. ("Revitas"). Pursuant to the Agreement and Plan of Merger ("Merger Agreement"), the Company paid approximately $52.8 million in cash and issued to the sellers two $5.0 million promissory notes, one which will mature 18 months after the closing and the other which will mature 36 months after the closing. The Company acquired Revitas to, among other things, expand the Company's revenue management solutions for customers.

In connection with Revitas acquisition, the Company funded, in part, the cash portion of the purchase price with a five year term loan in the aggregate amount of $50.0 million. See Note 5, “Debt”, for additional information.

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Purchase Price Allocation

The total purchase price for Revitas was approximately $61.5 million, which was comprised of $52.8 million in cash and the fair value of the promissory note of $8.6 million, see Note 5, "Debt", for additional details. The allocation of the purchase price is based on valuations derived from estimated fair value assessments and assumptions used by the Company. As of the acquisition date, the final allocation of the purchase price is as follows:

	Estimated Fair Value (in thousands)
Cash and cash equivalents	$ 5,067
Accounts receivable	6,184
Prepaid expenses	1,067
Other current assets	47
Property, plant and equipment	1,506
Intangible assets	39,100
Goodwill	32,344
Other assets	25
Total assets acquired	85,340
Accounts payable	(1,352)
Accrued employee compensation	(3,983)
Accrued liabilities	(1,410)
Deferred revenue liability	(12,856)
Other liabilities	(4,256)
Total liabilities assumed	(23,857)
Net acquired assets	$ 61,483

The following table presents certain information on the acquired identifiable assets:

Intangible assets	Fair value (in thousands)	Estimated useful lives (years)	Weighted-average estimated useful lives (years)
Developed technology	$ 6,770	6	6
Customer relationship	32,180	10	10

Trade name	$ 150	1	1

The purchase accounting allocation resulted in an ascribed value to the acquired intangible assets of $39.1 million and goodwill of $32.3 million. The key factors attributable to the creation of goodwill by the transaction are synergies in skill-sets, return on future technology and customer development.

We do not expect the goodwill recognized as a part of the acquisition to be deductible for income tax purposes. See Note 4, “Goodwill” for additional information.

Unaudited Pro Forma Combined Consolidated Financial Information

The results of operations for Revitas and the estimated fair values of the assets acquired and liabilities assumed have been included in the Company’s consolidated financial statements since the respective dates of acquisition.

The unaudited pro forma combined consolidated financial information is presented for illustrative purpose only and is not necessarily indicative of the result of operations that would have actually been reported had the acquisitions occurred on the above dates, nor is it necessarily indicative of the future results of operations of the combined company. The unaudited pro forma combined consolidated financial information reflects certain adjustments, such as amortization, interest expense, deferred tax valuation allowance and transaction related costs.

MODEL N, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The following unaudited pro forma combined consolidated financial information has been prepared by the Company using the acquisition method of accounting to give effect to the Revitas acquisition as if it had occurred on October 1, 2015. The following table sets forth the unaudited pro forma consolidated combined results of operations:

	Three Months Ended December 31, 2016 (in thousands, except per share data)		
Revenue	$	37,121	
Net loss		(10,910	)
Net loss per shares-basic and diluted	$		