

PEGASYSTEMS INC  
Form 10-Q/A  
April 25, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q/A**

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**(Amendment No. 1)**

(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, 2006

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: 1-11859

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**PEGASYSTEMS INC.**

*(Exact name of Registrant as specified in its charter)*

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**Massachusetts**  
*(State or other jurisdiction of*  
  
*incorporation or organization)*

**101 Main Street**

**04-2787865**  
*(IRS Employer*  
  
*Identification No.)*

**02142-1590**

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**Cambridge, MA**

*(Address of principal executive offices)*

*(Zip Code)*

**(617) 374-9600**

*(Registrant's telephone number including area code)*

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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, or a non-accelerated filer. (See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

There were 35,367,873 shares of the Registrant's common stock, \$.01 par value per share, outstanding on April 16, 2007.

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**PEGASYSTEMS INC.**

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**EXPLANATORY NOTE**

On March 5, 2007, Pegasystems Inc. (the Company) issued a press release and filed a related Current Report on Form 8-K with the Securities and Exchange Commission (the SEC), in which it announced that it would be restating its previously issued financial statements and other financial information for the years 2005, 2004 and 2003, and financial information for the years 2002 and 2001, and for each of the quarters in the years 2005 and 2004.

The Company is restating the previously issued financial statements to correct the timing of revenue recognition for arrangements which include fixed-price services. The Company is also restating the previously issued financial statements to correct the timing of revenue recognition for time and materials services provided but not yet invoiced and to correct certain other immaterial errors.

This Amendment No. 1 (this Form 10-Q/A) to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (the Original Form 10-Q) is being filed to restate the condensed consolidated financial statements for the three months ended March 31, 2006 and 2005.

This Form 10-Q/A also includes revisions and additional disclosures in response to comments from the SEC staff. Although the SEC staff did not require the Company to amend its previous filings with respect to these comments, the revisions and additional disclosures included in this Form 10-Q/A reflect the Company's commitment to address the comments in future filings.

Specifically, this Form 10-Q/A amends and restates the following portions of the Original Form 10-Q:

Part I, Item 1. *Unaudited Condensed Consolidated Financial Statements;*

Part I, Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations;*

Part I, Item 4. *Controls and Procedures;*

Part II, Item 1A. *Risk Factors;*

Part II, Item 6. *Exhibits;* and

Exhibits 31.1, 31.2, 32.1 and 32.2.

Except as required to reflect the items described above, no other modifications or updates have been made to the Original Form 10-Q. Information not affected by items described above remains unchanged and reflects the disclosures made at the time of, and as of the dates described in, the Original Form 10-Q. This Form 10-Q/A does not describe events occurring after the Original Form 10-Q (including with respect to exhibits), or modify or update disclosures (including forward-looking statements) which may have been affected by events or changes in facts occurring after the date of the Original Form 10-Q. Accordingly, this Form 10-Q/A should be read in conjunction with the Company's filings made with the SEC subsequent to the filing of the Original Form 10-Q, as information in such filings may update or supersede certain information contained in this Form 10-Q/A.

In light of the restatements referenced above, readers should not rely on our previously issued financial statements for the quarters ended March 31, 2006 and 2005.

**Table of Contents****PEGASYSTEMS INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)**

(in thousands, except share-related data)

	March 31, 2006 (As Restated See Note 4)	December 31, 2005 (As Restated See Note 4)
<b><u>ASSETS</u></b>		
Current assets:		
Cash and cash equivalents	\$ 17,016	\$ 21,314
Short-term investments	99,957	93,421
<b>Total cash and short-term investments</b>	<b>116,973</b>	<b>114,735</b>
Trade accounts receivable, net of allowance for doubtful accounts of \$365 in 2006 and 2005	35,506	26,978
Short-term license installments	25,813	26,537
Prepaid expenses and other current assets	4,221	4,752
<b>Total current assets</b>	<b>182,513</b>	<b>173,002</b>
Long-term license installments, net of unearned interest income	22,281	31,371
Equipment and improvements, net of accumulated depreciation and amortization	2,098	1,947
Computer software for internal use, net of accumulated amortization	1,035	845
Other assets	113	143
Goodwill	2,346	2,346
<b>Total assets</b>	<b>\$ 210,386</b>	<b>\$ 209,654</b>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Current liabilities:		
Accrued payroll related expenses	\$ 4,994	\$ 8,162
Accounts payable and accrued expenses	11,341	10,769
Deferred revenue	24,516	20,528
Current portion of capital lease obligation	104	103
<b>Total current liabilities</b>	<b>40,955</b>	<b>39,562</b>
Long-term deferred income taxes	792	1,176
Capital lease obligation, net of current portion	36	63
Other long-term liabilities	1,484	1,171
<b>Total liabilities</b>	<b>43,267</b>	<b>41,972</b>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value, 1,000,000 shares authorized; no shares issued and outstanding		
Common stock, \$.01 par value, 70,000,000 shares authorized; 35,586,747 and 35,565,918 shares issued and outstanding at March 31, 2006 and December 31, 2005 respectively	356	356
Additional paid-in capital	119,313	118,968

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Stock warrants	107	107
Retained earnings	46,977	47,888
Accumulated other comprehensive income (loss):		
Net unrealized loss on investments available-for-sale	(652)	(623)
Foreign currency translation adjustments	1,018	986
Total stockholders' equity	167,119	167,682
Total liabilities and stockholders' equity	\$ 210,386	\$ 209,654

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****PEGASYSTEMS INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)**

(in thousands, except per share amounts)

	Three months ended	
	2006 (As Restated See Note 4)	March 31, 2005 (As Restated See Note 4)
Revenue:		
Software license	\$ 6,998	\$ 10,880
Services	22,201	13,533
Total revenue	29,199	24,413
Cost of revenue:		
Cost of software license	31	88
Cost of services	14,087	7,165
Total cost of revenue	14,118	7,253
Gross profit	15,081	17,160
Operating expenses:		
Research and development	5,402	4,968
Selling and marketing	9,810	8,888
General and administrative	2,637	3,267
Total operating expenses	17,849	17,123
(Loss) income from operations	(2,768)	37
Installment receivable interest income	447	564
Other interest income, net	1,115	625
Other income (expense), net	245	(316)
Income (loss) before provision (benefit) for income taxes	(961)	910
Provision (benefit) for income taxes	(50)	300
Net income (loss)	\$ (911)	\$ 610
Earnings per share, basic and diluted	\$ (0.03)	\$ 0.02
Weighted average number of common shares outstanding, basic	35,572	36,044
Weighted average number of common shares outstanding, diluted	35,572	36,829

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****PEGASYSTEMS INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

(in thousands)

	Three months ended	
	March 31, 2006 (As Restated See Note 4)	2005 (As Restated See Note 4)
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (911)	\$ 610
Adjustment to reconcile net income (loss) to cash flows from operating activities:		
Stock option income tax benefits	(42)	11
Deferred income taxes	(351)	200
Depreciation, amortization, and other non cash items	611	396
Stock-based compensation expense	263	
Change in operating assets and liabilities:		
Trade accounts receivable and license installments	1,289	7,157
Prepaid expenses and other current assets	534	(742)
Accounts payable and accrued expenses	(2,575)	(2,858)
Deferred revenue	3,988	7,104
Other long-term assets and liabilities	313	105
<b>Cash flows from operating activities</b>	<b>3,119</b>	<b>11,983</b>
<b>Cash flows from investing activities:</b>		
Purchase of investments	(21,608)	(14,088)
Maturing and called investments	14,900	2,000
Sale of investments		11,575
Investment in software, equipment and improvements	(806)	(311)
<b>Cash flows from investing activities</b>	<b>(7,514)</b>	<b>(824)</b>
<b>Cash flows from financing activities:</b>		
Payments under capital lease obligation	(25)	(24)
Excess tax benefit from stock option exercises	42	
Exercise of stock options	351	89
Repurchase of common stock	(311)	(931)
<b>Cash flows from financing activities</b>	<b>57</b>	<b>(866)</b>
<b>Effect of exchange rate on cash and cash equivalents</b>	<b>40</b>	<b>(175)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(4,298)</b>	<b>10,118</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>21,314</b>	<b>20,905</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 17,016</b>	<b>\$ 31,023</b>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid during the year-to-date period for:		



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Interest	\$	3	\$	4
Income taxes	\$	150	\$	154

See notes to unaudited condensed consolidated financial statements.

**Table of Contents****PEGASYSTEMS INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. BASIS OF PRESENTATION**

The Company has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements and should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2005, as amended.

In the opinion of management, the Company has prepared the accompanying unaudited condensed consolidated financial statements on the same basis as the audited financial statements, and these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full year 2006. Certain prior period amounts have been reclassified to conform to the current presentation as described in the following notes.

**2. SIGNIFICANT ACCOUNTING POLICIES***(a) Equipment and improvements, net of accumulated depreciation and amortization*

Equipment and improvements are recorded at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets, which are generally three years for equipment and five years for furniture and fixtures. Leasehold improvements are amortized over the lesser of the life of the lease or the useful life of the asset. Repairs and maintenance costs are expensed as incurred. Equipment and improvements, accumulated depreciation and intangible assets as of December 31, 2005 have been reclassified to conform to the current presentation. The cost and accumulated depreciation of equipment and improvements consisted of the following:

<b>(in thousands)</b>	<b>March 31, 2006</b>	<b>December 31, 2005</b>
Computer equipment	\$ 3,836	\$ 3,669
Furniture and fixtures	2,004	2,004
Leasehold improvements	2,393	2,053
Equipment under capital leases	594	594
	<b>8,827</b>	<b>8,320</b>
Less: accumulated depreciation and amortization	(6,729)	(6,373)
Equipment and improvements, net of accumulated depreciation	<b>\$ 2,098</b>	<b>\$ 1,947</b>

*(b) Computer software for internal use, net of accumulated amortization*

The Company capitalizes and amortizes costs associated with computer software developed or purchased for internal use in accordance with AICPA Statement of Posi