EGAIN COMMUNICATIONS CORP
Form 10-Q
February 14, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended December 31, 2011

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 No. 001-35314

eGAIN COMMUNICATIONS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**77-0466366**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1252 Borregas Avenue, Sunnyvale, CA

(Address of principal executive offices)

94089

(Zip Code)

(408) 636-4500

(Registrant s telephone number, including area code)

(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 x 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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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 (check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at February 9, 2012
Common Stock $0.001 par value	24,363,020

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eGAIN COMMUNICATIONS CORPORATION

Quarterly Report on Form 10-Q

For the Quarterly Period Ended December 31, 2011

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

eGAIN COMMUNICATIONS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value data)

	December 31, 2011 (Unaudited)	June 30, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,540	$ 12,424
Short-term investments		633
Current portion of restricted cash	34	39
Accounts receivable, less allowance for doubtful accounts of $256 and $181 at December 31, 2011 and June 30, 2011	5,548	8,197
Prepaid and other current assets	636	553
Total current assets	17,758	21,846
Property and equipment, net	1,555	1,015
Goodwill	4,880	4,880
Restricted cash, net of current portion	1,000	
Other assets	619	483
Total assets	$ 25,812	$ 28,224
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,058	$ 924
Accrued compensation	2,488	3,279
Accrued liabilities	1,484	1,911
Capital lease obligation		28
Related party notes payable	5,291	4,975
Current portion of deferred revenue	4,624	5,215
Current portion of bank borrowings	1,667	1,667
Total current liabilities	16,612	17,999
Deferred revenue, net of current portion	479	609
Bank borrowings, net of current portion	2,500	3,333
Other long term liabilities	250	271
Total liabilities	19,841	22,212
Commitments and contingencies (Notes 10 and 12)		
Stockholders equity :		
Common stock, $0.001 par value authorized: 50,000 shares; outstanding: 24,353 shares as of December 31, 2011 and 24,062 shares as of June 30, 2011	24	24
Additional paid-in capital	325,897	325,569

Notes receivable from stockholders	(83)	(82)
Accumulated other comprehensive loss	(900)	(800)
Accumulated deficit	(318,967)	(318,699)
Total stockholders equity	5,971	6,012
Total liabilities and stockholders equity	$ 25,812	$ 28,224

See accompanying notes to unaudited condensed consolidated financial statements

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eGAIN COMMUNICATIONS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(in thousands, except per share data)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Revenue:				
License	$ 3,033	$ 2,677	$ 5,918	$ 10,037
Recurring revenue	5,725	5,236	11,506	9,686
Professional services	2,078	1,563	3,796	2,839
Total revenue	10,836	9,476	21,220	22,562
Cost of license	(1)	7	(11)	21
Cost of recurring revenue	1,291	1,288	2,557	2,521
Cost of professional services	1,961	1,482	3,510	2,709
Gross profit	7,585	6,699	15,164	17,311
Operating expenses:				
Research and development	1,377	1,343	2,807	2,757
Sales and marketing	5,010	2,916	9,056	6,430
General and administrative	1,728	785	2,841	1,589
Total operating expenses	8,115	5,044	14,704	10,776
Income/ (loss) from operations	(530)	1,655	460	6,535
Interest expense, net	(214)	(286)	(389)	(562)
Other income / (expense), net	(51)	(310)	(262)	(29)
Income/ (loss) before income taxes	(795)	1,059	(191)	5,944
Income tax provision	(47)	(45)	(77)	(84)
Net income/ (loss)	$ (842)	$ 1,014	$ (268)	$ 5,860
Per share information:				
Basic net income/ (loss) per common share	$ (0.03)	$ 0.05	$ (0.01)	$ 0.27
Diluted net income/ (loss) per common share	$ (0.03)	$ 0.04	$ (0.01)	$ 0.24
Weighted average shares used in computing basic net income/ (loss) per common share	24,351	22,031	24,246	22,078
Weighted average shares used in computing diluted net income/ (loss) per common share	24,351	24,549	24,246	24,256

See accompanying notes to unaudited condensed consolidated financial statements

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eGAIN COMMUNICATIONS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

	Six Months Ended December 31, 2011	Six Months Ended December 31, 2010
Cash flows from operating activities:		
Net income/ (loss)	$ (268)	$ 5,860
Adjustments to reconcile net income/ (loss) to net cash provided by operating activities:		
Depreciation	360	291
Stock-based compensation	265	104
Provisions (recovery) for doubtful accounts	86	(3)
Accrued interest and amortization of discount on related party notes payable	316	558
Changes in operating assets and liabilities:		
Accounts receivable	2,420	58
Prepaid expenses and other assets	(316)	(129)
Accounts payable	168	(367)
Accrued compensation	(743)	(34)
Accrued liabilities	(339)	(349)
Deferred revenue	(753)	1,615
Other long term liabilities	107	171
Net cash provided by operating activities	1,303	7,775
Cash flows from investing activities:		
Purchases of property and equipment	(944)	(383)
Proceeds from sale (purchases) of short-term investments	605	(589)
Net cash used in investing activities	(339)	(972)
Cash flows from financing activities:		
Payments on bank borrowings	(833)	(63)
Payments on capital lease obligations	(28)	(87)
Increase in restricted cash	(1,000)	
Payments to repurchase stock		(265)
Proceeds from exercise of stock options	61	5
Net cash used in financing activities	(1,800)	(410)
Effect of change in exchange rates on cash and cash equivalents	(48)	2
Net increase/ (decrease) in cash and cash equivalents	(884)	6,495
Cash and cash equivalents at beginning of period	12,424	5,733
Cash and cash equivalents at end of period	$ 11,540	$ 12,128
Supplemental cash flow disclosures:		
Cash paid for interest	$ 83	$ 6
Cash paid for taxes	$ 73	$ 88

See accompanying notes to unaudited condensed consolidated financial statements

eGAIN COMMUNICATIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. Organization, Nature of Business and Basis of Presentation

eGain Communications Corporation is one of the premier providers of cloud and on-premise customer interaction software for sales and service. For over a decade, eGain solutions have helped improve customer experience, grow sales, and optimize service processes across the web, social, and phone channels. Hundreds of global enterprises rely on eGain to transform fragmented sales engagement and customer service operations into unified Customer Interaction Hubs. The company has operations in the United States, United Kingdom, Netherlands, Ireland, Italy, Germany, and India.

We have prepared the condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission and included the accounts of our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, or GAAP, have been condensed or omitted pursuant to such rules and regulations although we believe that the disclosures made are adequate to make the information not misleading. In our opinion, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of our financial position, results of operations and cash flows for the periods presented.

These financial statements and notes should be read in conjunction with our audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2011, included in our Annual Report on Form 10-K. The condensed consolidated balance sheet at June 30, 2011 was derived from audited financial statements as of that date but does not include all the information and footnotes required by GAAP for complete financial statements. The results of our operations for the interim periods presented are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending June 30, 2012.

Note 2. Software Revenue Recognition

Revenue Recognition

We derive revenue from three sources: license fees, recurring revenue, and professional services. Recurring revenue includes hosting and software maintenance and support. Maintenance and support consists of technical support and software upgrades and enhancements. Professional services primarily consist of consulting, implementation services and training. Significant management judgments and estimates are made and used to determine the revenue recognized in any accounting period. Material differences may result in changes to the amount and timing of our revenue for any period if different conditions were to prevail. We present revenue net of taxes collected from customers and remitted to governmental authorities.

We apply the provisions of Accounting Standards Codification, or ASC 985-605, *Software Revenue Recognition*, to all transactions involving the licensing of software products. In the event of a multiple element arrangement for a license transaction, we evaluate the transaction as if each element represents a separate unit of accounting taking into account all factors following the accounting standards. We apply ASC 605, *Revenue Recognition,* for hosting transactions to determine the accounting treatment for multiple elements. We also apply ASC 605 for fixed fee arrangements in which we use the percentage of completion method to recognize revenue when reliable estimates are available for the costs and efforts necessary to complete the implementation services. When such estimates are not available, the completed contract method is utilized. Under the completed contract method, revenue is recognized only when a contract is completed or substantially complete.

When licenses are sold together with system implementation and consulting services, license fees are recognized upon shipment, provided that (i) payment of the license fees is not dependent upon the performance of the consulting and implementation services, (ii) the services are available from other vendors, (iii) the services qualify for separate accounting as we have sufficient experience in providing such services, have the ability to estimate cost of providing such services, and we have vendor-specific objective evidence of pricing, and (iv) the services are not essential to the functionality of the software.

We use signed software license and services agreements and order forms as evidence of an arrangement for sales of software, hosting, maintenance and support. We use signed engagement letters to evidence an arrangement for professional services.

License Revenue

We recognize license revenue when persuasive evidence of an arrangement exists, the product has been delivered, no significant obligations remain, the fee is fixed or determinable, and collection of the resulting receivable is probable. In software arrangements that include rights to multiple software products and/or services, we use the residual method under which revenue is allocated to the undelivered elements based on vendor-specific objective evidence of the fair value of such undelivered elements. The residual amount of revenue is allocated to the delivered elements and recognized as revenue assuming all other criteria for revenue recognition have been met. Such undelivered elements in these arrangements typically consist of software maintenance and support, implementation and consulting services and, in some cases, hosting services.

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Software is delivered to customers electronically or on a CD-ROM, and license files are delivered electronically. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. We have standard payment terms included in our contracts. We assess collectability based on a number of factors, including the customer s past payment history and its current creditworthiness. If we determine that collection of a fee is not reasonably assured, we defer the revenue and recognize it at the time collection becomes reasonably assured, which is generally upon receipt of cash payment. If an acceptance period is required, revenue is recognized upon the earlier of customer acceptance or the expiration of the acceptance period.

We periodically sell to resellers. License sales to resellers as a percentage of total revenue were approximately 1% and 20% for three months ended December 31, 2011 and 2010, respectively. License sales to resellers as a percentage of total revenue was approximately 1% and 6% for the six months ended December 31, 2011 and 2010, respectively. Revenue from sales to resellers is generally recognized upon delivery to the reseller but depends on the facts and circumstances of the transaction, such as our understanding of the reseller s plans to sell the software, whether there are any return provisions, price protection or other allowances, the reseller s financial status and our past experience with the particular reseller. Historically sales to resellers have not included any return provisions, price protections, or other allowances.

Hosting Revenue

Included in recurring revenue is revenue derived from our hosted service offerings. We recognize hosting services revenue ratably over the period of the applicable agreement as services are provided. Hosting agreements typically have an initial term of one or two years and automatically renew unless either party cancels the agreement. The majority of the hosting services customers purchase a combination of our hosting service and professional services. In some cases the customer may also acquire a license for our software.

We evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by ASC 605, using all applicable facts and circumstances, including whether (i) we sell or could readily sell the element unaccompanied by the other elements, (ii) the element has stand-alone value to the customer, and (iii) there is a general right of return. We use vendor specific objective evidence, or VSOE, of fair value for each of those units, when available. For revenue recognition with multiple-deliverable elements, in certain limited circumstances when vendor specific objective evidence of fair value does not exist, we apply the selling price hierarchy. We consider the applicability of ASC 985-605, on a contract-by-contract basis. In hosted term-based agreements, where the customer does not have the contractual right to take possession of the software, the revenue is recognized on a monthly basis over the term of the contract. Invoiced amounts are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met. For professional services that we determine do not have stand-alone value to the customer, we recognize the services revenue ratably over the longer of the remaining contractual period or the average estimated life of the customer hosting relationship, once hosting has gone live or system ready. We currently estimate the life of the customer hosting relationship to be approximately 26 months, based on the average life of all hosting customer relationships.

We consider a software element to exist when we determine that the customer has the contractual right to take possession of our software at any time during the hosting period without significant penalty and can feasibly run the software on its own hardware or enter into another arrangement with a third party to host the software. Additionally, we have established vendor-specific objective evidence of fair value for the hosting and support elements of perpetual license sales, based on the prices charged when sold separately and substantive renewal terms. Accordingly, when a software element exists in a hosting services arrangements, license revenue for the perpetual software license element is determined using the residual method and is recognized upon delivery. Revenue for the hosting and support elements is recognized ratably over the contractual time period. Professional services are recognized as described below under Professional Services Revenue. If vendor-specific evidence of fair value cannot be established for the undelivered elements of an agreement, the entire amount of revenue from the arrangement is recognized ratably over the period that these elements are delivered.

Maintenance and Support Revenue

Included in recurring revenue is revenue derived from maintenance and support services. We use vendor-specific objective evidence of fair value for maintenance and support to account for the arrangement using the residual method, regardless of any separate prices stated within the contract for each element. Maintenance and support revenue is recognized ratably over the term of the maintenance contract, which is typically one year. Maintenance and support is renewable by the customer on an annual basis. Maintenance and support rates, including subsequent renewal rates, are typically established based upon a specified percentage of net license fees as set forth in the arrangement.

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Professional Services Revenue

Included in professional services revenue is revenue derived from system implementation, consulting and training. For license transactions, the majority of our consulting and implementation services qualify for separate accounting. We use vendor-specific objective evidence of fair value for the services to account for the arrangement using the residual method, regardless of any separate prices stated within the contract for each element. Our consulting and implementation service contracts are bid either on a fixed-fee basis or on a time-and-materials basis. Substantially all of our contracts are on a time-and- materials basis. For time-and-materials contracts, where the services are not essential to the functionality, we recognize revenue as services are performed. If the services are essential to functionality, then both the product license revenue and the service revenue are recognized under the percentage of completion method. For a fixed-fee contract we recognize revenue based upon the costs and efforts to complete the services in accordance with the percentage of completion method, provided we are able to estimate such cost and efforts.

For hosting arrangements, consulting and implementation services that do not qualify for separate accounting, we recognize the services revenue ratably over the estimated life of the customer hosting relationship.

Training revenue that meets the criteria to be accounted for separately is recognized when training is provided or, in the case of hosting, when the customer also has access to the hosting services.

Note 3. Stock-Based Compensation

Stock-based compensation as recorded in our consolidated statement of operations is summarized as follows (unaudited, in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	**2010**	**2011**	**2010**
Cost of professional services and recurring revenue	$ 13	$ 8	$ 31	$ 15
Research and development	18	13	41	28
Sales and marketing	63	10	106	21
General and administrative	41	19	87	40
Total stock-based compensation expense	$ 135	$ 50	$ 265	$ 104

Stock-based compensation expense includes the amortization of the fair value of share-based payments made to employees and directors, primarily in the form of stock options. The fair value of stock options granted is recognized as an expense as the underlying stock options vest. The increase in stock-based compensation expense for the three and six months ended December 31, 2011, as compared to the same periods last year, was due to the decrease of our forfeiture rate.

We utilized the Black-Scholes valuation model for estimating the fair value of the stock-based compensation of options granted. All shares of our common stock issued pursuant to our stock option plans are only issued out of an authorized reserve of shares of common stock which were previously registered with the Securities and Exchange Commission on a registration statement on Form S-8.

During the three months ended December 31, 2011 and 2010, we granted options to purchase 124,900 and 72,300 shares of common stock with a weighted-average fair value of $4.19 and $0.82, respectively. Options to purchase 328,200 and 95,700 shares of common stock were granted during the six months ended December 31, 2011 and 2010, with a weighted-average fair value of $3.09 and $0.74, respectively, using the following assumptions:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	**2010**	**2011**	**2010**

Dividend yield				
Expected volatility	85%	80%	85%	80%
Average risk-free interest rate	0.95%	1.49%	1.08%	1.50%
Expected life (in years)	4.50	4.50	4.47	4.50

The dividend yield of zero is based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends. We determined the appropriate measure of expected volatility by reviewing historic volatility in the share price of our common stock, as adjusted for certain events that management deemed to be non-recurring and non-indicative of future events. The risk-free interest rate is derived from the average U.S. Treasury Strips rate with maturities approximating the expected lives of the awards during the period, which approximate the rate in effect at the time of the grant.

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We develop the estimate of the expected life based on the historical exercise behavior, and cancellations of all past option grants made by the company during the time period which its equity shares have been publicly traded, the contractual term of the option, the vesting period and the expected remaining term of the outstanding options.

Total compensation cost, net of forfeitures, of all options granted but not yet vested as of December 31, 2011 was $960,000, which is expected to be recognized over the weighted average period of 1.37 years. There were 29,778 and 69,939 options exercised for the three and six months ended December 31, 2011 and there were 9,433 options exercised for the three and six months ended December 31, 2010.

Note 4. Net Income/ (loss) per Common Share

Basic net income/ (loss) per common share is computed using the weighted-average number of shares of common stock outstanding. In periods where net income is reported, the weighted average number of shares outstanding is increased by warrants and options in the money to calculate diluted net income per common share.

The following table represents the calculation of basic and diluted net income/ (loss) per common share (unaudited, in thousands, except per share data):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	**2010**	**2011**	**2010**
Net income/ (loss) applicable to common stockholders	$ (842)	$ 1,014	$ (268)	$ 5,860
Basic net income/ (loss) per common share	$ (0.03)	$ 0.05	$ (0.01)	$ 0.27
Weighted-average common shares used in computing basic net income per common share	24,351	22,031	24,246	22,078
Effect of dilutive options and warrants		2,518		2,178
Weighted-average common shares used in computing diluted net income/ (loss) per common share	24,351	24,549	24,246	24,256
Diluted net income/ (loss) per common share	$ (0.03)	$ 0.04	$ (0.01)	$ 0.24

Weighted average shares of stock options to purchase 432,953 and 972,633 shares of common stock for the three and six months ended December 31, 2010, respectively, were not included in the computation of diluted net income per common share due to their exercise price exceeding the average market price of the common stock during the period.

Weighted average shares of stock options to purchase 2,535,459 and 2,488,734 shares of common stock for the three months and six months ended December 31, 2011, respectively were not included in the computation of diluted net loss per common share due to their anti-dilutive effect. Such securities could have a dilutive effect in future periods.

Note 5. Comprehensive Income/ (Loss)

We report comprehensive income and its components in accordance with ASC 220, *Comprehensive Income.* Under the accounting standards, comprehensive income includes all changes in equity that result from recognized transactions and other economic events during a period except those resulting from investments by or distributions to owners.

The table below summarizes the comprehensive income (unaudited, in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	**2010**	**2011**	**2010**
Net income/ (loss)	$ (842)	$ 1,014	$ (268)	$ 5,860
Foreign currency translation adjustments	(54)	(97)	(100)	(85)
Comprehensive income/ (loss)	$ (896)	$ 917	$ (368)	$ 5,775

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Note 6. Segment Information

We operate in one segment, the development, license, implementation and support of our customer interaction software solutions. Operating segments are identified as components of an enterprise for which discrete financial information is available and regularly reviewed by the Company s chief operating decision-makers in order to make decisions about resources to be allocated to the segment and assess its performance. Our chief operating decision-makers, under ASC 280, *Segment Reporting*, are our executive management team. Our chief operating decision-makers review financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance.

Information relating to our geographic areas for the three and six months ended December 31, 2011 and 2010 are as follows (unaudited, in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Total Revenue:				
North America	$ 5,265	$ 4,965	$ 11,846	$ 8,254
EMEA	5,507	4,490	9,277	14,264
Asia Pacific	64	21	97	44
	$ 10,836	$ 9,476	$ 21,220	$ 22,562
Operating Income/ (loss):				
North America	$ (1,066)	$ 974	$ 138	$ 410
EMEA	1,425	1,517	2,151	7,774
Asia Pacific*	(889)	(836)	(1,829)	(1,649)
	$ (530)	$ 1,655	$ 460	$ 6,535

* Includes costs associated with corporate support.

In addition, identifiable tangible assets corresponding to our geographic areas are as follows (unaudited, in thousands):

	December 31, 2011	June 30, 2011
North America	$ 14,100	$ 15,854
EMEA	5,652	5,800
Asia Pacific	1,180	1,690
	$ 20,932	$ 23,344

The following table provides the revenue for the three and six months ended December 31, 2011 and 2010, respectively, (unaudited, in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010

Revenue :				
License	$ 3,033	$ 2,677	$ 5,918	$ 10,037
Hosting services	2,560	2,460	5,183	4,367
Maintenance and support services	3,165	2,776	6,323	5,319
Professional services	2,078	1,563	3,796	2,839
	$ 10,836	$ 9,476	$ 21,220	$ 22,562