UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2021

or

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

For the transition period from __________ to __________.

Commission file number 0-5734

AGILYSYS, INC.
(Exact name of registrant as specified in its charter)

Ohio **(State or other jurisdiction of incorporation or organization)**	**34-0907152** **(I.R.S. Employer Identification No.)**
1000 Windward Concourse, Suite 250, Alpharetta, Georgia **(Address of principal executive offices)**	**30005** **(ZIP Code)**

(770) 810-7800
(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Shares, without par value	**AGYS**	**NASDAQ**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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	☐	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 ☒

Indicate by check mark whether the registrant has filed all documents and reports required to be filed be sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☒ No ☐

The number of Common Shares of the registrant outstanding as of January 21, 2022 was 24,714,332.

AGILYSYS, INC.

Index

Part I. Financial Information			
	Item 1	Financial Statements (Unaudited)	3
		Condensed Consolidated Balance Sheets – December 31, 2021 (Unaudited) and March 31, 2021	3
		Condensed Consolidated Statements of Operations (Unaudited) - Three and Nine Months Ended December 31, 2021 and December 31, 2020	4
		Condensed Consolidated Statements of Comprehensive Income (Unaudited) - Three and Nine Months Ended December 31, 2021 and December 31, 2020	5
		Condensed Consolidated Statements of Cash Flows (Unaudited) – Nine Months Ended December 31, 2021 and December 31, 2020	6
		Condensed Consolidated Statements of Shareholders' Equity (Unaudited) - Three and Nine Months Ended December 31, 2021 and December 31, 2020	7
		Notes to Condensed Consolidated Financial Statements (Unaudited)	8
	Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	16
	Item 3	Quantitative and Qualitative Disclosures About Market Risk	25
	Item 4	Controls and Procedures	25
Part II. Other Information			
	Item 1	Legal Proceedings	26
	Item 1A	Risk Factors	26
	Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	26
	Item 3	Defaults Upon Senior Securities	26
	Item 4	Mine Safety Disclosures	26
	Item 5	Other Information	26
	Item 6	Exhibits	27
Signatures			28

AGILYSYS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)	**December 31, 2021 (Unaudited)**	March 31, 2021
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 115,122**	$ 99,180
Accounts receivable, net of allowance for expected credit losses of $717 and $1,220, respectively	**24,957**	25,732
Contract assets	**1,628**	2,364
Inventories	**3,256**	1,177
Prepaid expenses and other current assets	**4,651**	4,797
Total current assets	**149,614**	133,250
Property and equipment, net	**6,788**	8,789
Operating lease right-of-use assets	**9,681**	12,210
Goodwill	**19,622**	19,622
Intangible assets, net	**8,400**	8,400
Deferred income taxes, non-current	**2,281**	1,802
Other non-current assets	**5,952**	5,800
Total assets	**$ 202,338**	$ 189,873
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 8,035**	$ 6,346
Contract liabilities	**43,193**	38,394
Accrued liabilities	**8,385**	11,233
Operating lease liabilities, current	**4,531**	5,009
Finance lease obligations, current	**7**	19
Total current liabilities	**64,151**	61,001
Deferred income taxes, non-current	**937**	923
Operating lease liabilities, non-current	**6,187**	8,597
Finance lease obligations, non-current	**3**	6
Other non-current liabilities	**3,647**	4,011
Commitments and contingencies (see Note 7)		
Series A convertible preferred stock, no par value	**35,000**	35,459
Shareholders' equity:		
Common shares, without par value, at $0.30 stated value; 80,000,000 shares authorized; 31,606,831 shares issued; and 24,712,343 and 24,010,727 shares outstanding at December 31, 2021 and March 31, 2021, respectively	**9,482**	9,482
Treasury shares, 6,894,488 and 7,596,104 at December 31, 2021 and March 31, 2021, respectively	**(2,068)**	(2,278)
Capital in excess of stated value	**46,436**	37,257
Retained earnings	**38,495**	35,376
Accumulated other comprehensive income	**68**	39
Total shareholders' equity	**92,413**	79,876
Total liabilities and shareholders' equity	**$ 202,338**	$ 189,873

See accompanying notes to unaudited condensed consolidated financial statements.

AGILYSYS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In thousands, except share data)	Three Months Ended December 31, **2021**	Three Months Ended December 31, 2020	Nine Months Ended December 31, **2021**	Nine Months Ended December 31, 2020
Net revenue:				
Products	**$ 8,101**	$ 7,599	**$ 24,244**	$ 19,396
Support, maintenance and subscription services	**25,136**	22,846	**72,371**	65,647
Professional services	**6,223**	6,230	**19,463**	15,797
Total net revenue	**39,460**	36,675	**116,078**	100,840
Cost of goods sold:				
Products	**4,400**	3,660	**12,420**	9,625
Support, maintenance and subscription services	**5,421**	4,655	**15,184**	13,515
Professional services	**4,923**	4,164	**14,634**	11,802
Total cost of goods sold	**14,744**	12,479	**42,238**	34,942
Gross profit	**24,716**	24,196	**73,840**	65,898
Gross profit margin	**62.6 %**	66.0 %	**63.6 %**	65.3 %
Operating expenses:				
Product development	**11,210**	12,376	**34,074**	28,900
Sales and marketing	**3,943**	3,327	**10,418**	8,278
General and administrative	**6,804**	7,509	**20,330**	18,446
Depreciation of fixed assets	**495**	722	**1,609**	2,160
Amortization of internal-use software	**267**	521	**1,077**	1,490
Severance and other charges	**381**	1,552	**1,187**	2,762
Legal settlements, net	**4**	-	**371**	50
Total operating expense	**23,104**	26,007	**69,066**	62,086
Operating income (loss)	**1,612**	(1,811)	**4,774**	3,812
Other (income) expense:				
Interest income	**(10)**	(27)	**(45)**	(76)
Interest expense	**4**	9	**5**	13
Other expense, net	**52**	95	**53**	284
Income (loss) before taxes	**1,566**	(1,888)	**4,761**	3,591
Income tax expense	**24**	182	**265**	311
Net income (loss)	**$ 1,542**	$ (2,070)	**$ 4,496**	$ 3,280
Series A convertible preferred stock issuance costs	**-**	-	**-**	(1,031)
Series A convertible preferred stock dividends	**(459)**	(459)	**(1,377)**	(1,117)
Net income (loss) attributable to common shareholders	**$ 1,083**	$ (2,529)	**$ 3,119**	$ 1,132
Weighted average shares outstanding - basic	**24,477**	23,429	**24,315**	23,419
Net income (loss) per share - basic:	**$ 0.04**	$ (0.11)	**$ 0.13**	$ 0.05
Weighted average shares outstanding - diluted	**25,392**	23,429	**25,327**	23,903
Net income (loss) per share - diluted:	**$ 0.04**	$ (0.11)	**$ 0.12**	$ 0.05

See accompanying notes to unaudited condensed consolidated financial statements.

AGILYSYS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
(In thousands)	**2021**	2020	**2021**	2020
Net income (loss)	**$ 1,542**	$ (2,070)	**$ 4,496**	$ 3,280
Other comprehensive income (loss), net of tax:				
Unrealized foreign currency translation adjustments	**11**	(64)	**29**	(213)
Total comprehensive income (loss)	**$ 1,553**	$ (2,134)	**$ 4,525**	$ 3,067

See accompanying notes to unaudited condensed consolidated financial statements.

AGILYSYS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	Nine Months Ended December 31, **2021**	2020
Operating activities		
Net income	**$ 4,496**	$ 3,280
Adjustments to reconcile net income to net cash provided by operating activities		
Loss on disposal of property & equipment	**123**	—
Depreciation	**1,609**	2,160
Amortization of internal-use software	**1,077**	1,490
Deferred income taxes	**(491)**	(499)
Share-based compensation	**10,802**	9,312
Changes in operating assets and liabilities	**4,199**	(659)
Net cash provided by operating activities	**21,815**	15,084
Investing activities		
Capital expenditures	**(1,078)**	(1,076)
Additional investments in corporate-owned life insurance policies	**(3)**	(2)
Net cash used in investing activities	**(1,081)**	(1,078)
Financing activities		
Repurchase of common shares to satisfy employee tax withholding	**(2,902)**	(1,069)
Series A convertible preferred stock issuance proceeds, net of issuance costs	**—**	33,969
Payment of preferred stock dividends	**(1,836)**	(1,117)
Principal payments under long-term obligations	**(16)**	(18)
Net cash (used in) provided by financing activities	**(4,754)**	31,765
Effect of exchange rate changes on cash	**(38)**	184
Net increase in cash and cash equivalents	**15,942**	45,955
Cash and cash equivalents at beginning of period	**99,180**	46,653
Cash and cash equivalents at end of period	**$ 115,122**	$ 92,608

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

AGILYSYS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)

Three Months Ended December 31, 2021

	Common Shares				Capital in		Accumulated	
	Issued		In Treasury		excess of		other	
(In thousands)	Shares	Stated value	Shares	Stated value	stated value	Retained earnings	comprehensive income	Total
Balance at September 30, 2021	31,607	$ 9,482	(7,000)	$ (2,100)	$ 42,867	$ 37,412	$ 57	$ 87,718
Share-based compensation	—	—	—	—	3,794	—	—	3,794
Restricted shares issued, net	—	—	92	28	(28)	—	—	—
Shares issued upon exercise of SSARs	—	—	17	5	(5)	—	—	—
Shares withheld for taxes upon exercise of stock options, SSARs or vesting of restricted shares	—	—	(4)	(1)	(192)	—	—	(193)
Net income	—	—	—	—	—	1,542	—	1,542
Series A convertible preferred stock dividends	—	—	—	—	—	(459)	—	(459)
Unrealized translation adjustments	—	—	—	—	—	—	11	11
Balance at December 31, 2021	31,607	$ 9,482	(6,895)	$ (2,068)	$ 46,436	$ 38,495	$ 68	$ 92,413

Three Months Ended December 31, 2020

	Common Shares				Capital in		Accumulated	
	Issued		In Treasury		excess of		other	
(In thousands)	Shares	Stated value	Shares	Stated value	stated value	Retained earnings	comprehensive income	Total
Balance at September 30, 2020	31,607	$ 9,482	(8,019)	$ (2,406)	$ 8,151	$ 62,645	$ 52	$ 77,924
Share-based compensation	—	—	—	—	6,558	—	—	6,558
Restricted shares issued, net	—	—	43	13	(13)	—	—	—
Shares issued upon exercise of SSARs	—	—	10	3	(3)	—	—	—
Shares withheld for taxes upon exercise of stock options, SSARs or vesting of restricted shares	—	—	(3)	(1)	(109)	—	—	(110)
Net loss	—	—	—	—	—	(2,070)	—	(2,070)
Series A convertible preferred stock dividends	—	—	—	—	—	(459)	—	(459)
Unrealized translation adjustments	—	—	—	—	—	—	(64)	(64)
Balance at December 31, 2020	31,607	$ 9,482	(7,969)	$ (2,391)	$ 14,584	$ 60,116	$ (12)	$ 81,779

Nine Months Ended December 31, 2021

	Common Shares				Capital in		Accumulated	
	Issued		In Treasury		excess of		other	
(In thousands)	Shares	Stated value	Shares	Stated value	stated value	Retained earnings	comprehensive income	Total
Balance at March 31, 2021	31,607	$ 9,482	(7,596)	$ (2,278)	$ 37,257	$ 35,376	$ 39	$ 79,876
Share-based compensation	—	—	—	—	10,847	—	—	10,847
Restricted shares issued, net	—	—	103	31	(31)	—	—	—
Shares issued upon exercise of SSARs	—	—	626	187	(187)	—	—	—
Shares withheld for taxes upon exercise of stock options, SSARs or vesting of restricted shares	—	—	(28)	(8)	(1,450)	—	—	(1,458)
Net income	—	—	—	—	—	4,496	—	4,496
Series A convertible preferred stock dividends	—	—	—	—	—	(1,377)	—	(1,377)
Unrealized translation adjustments	—	—	—	—	—	—	29	29
Balance at December 31, 2021	31,607	$ 9,482	(6,895)	$ (2,068)	$ 46,436	$ 38,495	$ 68	$ 92,413

Nine Months Ended December 31, 2020

	Common Shares				Capital in		Accumulated	
	Issued		In Treasury		excess of		other	
(In thousands)	Shares	Stated value	Shares	Stated value	stated value	Retained earnings	comprehensive income	Total
Balance at March 31, 2020	31,607	$ 9,482	(7,997)	$ (2,401)	$ 5,491	$ 58,984	$ 201	$ 71,757
Share-based compensation	—	—	—	—	9,393	—	—	9,393
Restricted shares issued, net	—	—	2	1	(1)	—	—	—
Shares issued upon exercise of SSARs	—	—	38	12	(12)	—	—	—
Shares withheld for taxes upon exercise of stock options, SSARs or vesting of restricted shares	—	—	(12)	(3)	(287)	—	—	(290)
Net income	—	—	—	—	—	3,280	—	3,280
Series A convertible preferred stock issuance costs	—	—	—	—	—	(1,031)	—	(1,031)
Series A convertible preferred stock dividends	—	—	—	—	—	(1,117)	—	(1,117)
Unrealized translation adjustments	—	—	—	—	—	—	(213)	(213)
Balance at December 31, 2020	31,607	$ 9,482	(7,969)	$ (2,391)	$ 14,584	$ 60,116	$ (12)	$ 81,779

See accompanying notes to unaudited condensed consolidated financial statements.

AGILYSYS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Nature of Operations and Financial Statement Presentation

Nature of Operations

Agilysys has been a leader in hospitality software for more than 40 years, delivering innovative cloud native SaaS and on-premise guest-centric technology solutions for gaming, hotels, resorts and cruise, corporate foodservice management, restaurants, universities, stadia and healthcare. Agilysys offers the most comprehensive software solutions in the industry, including point-of-sale (POS), property management (PMS), inventory and procurement, payments, and related applications, to manage the entire guest journey.

The Company has just one reportable segment serving the global hospitality industry. Agilysys operates across North America, Europe, the Middle East, Asia-Pacific and India with headquarters located in Alpharetta, GA.

COVID-19 Pandemic

The World Health Organization declared COVID-19 a pandemic on March 11, 2020. COVID-19 has had a significant impact on our business since that time. The extent to which COVID-19 will continue impacting our financial condition and results of operations remains uncertain and depends on various factors, including the ongoing or recurring impact on our customers, partners, and vendors and on the operation of the global markets in general. Because an increasing portion of our business is based on a subscription model, the effect of COVID-19 on our results of operations may also not be fully reflected for some time.

See Part I, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Overview— Recent Developments” of this report for more discussion of the impact of COVID-19 on our business.

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include our accounts consolidated with our wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Our fiscal year ends on March 31st. References to a particular year refer to the fiscal year ending in March of that year. For example, fiscal 2022 refers to the fiscal year ending March 31, 2022.

Our unaudited interim financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information, the instructions to the Quarterly Report on Form 10-Q (Quarterly Report) under the Securities Exchange Act of 1934, as amended (the Exchange Act), and Rule 10-01 of Regulation S-X under the Exchange Act. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations relating to interim financial statements.

The Condensed Consolidated Balance Sheet as of December 31, 2021, as well as the Condensed Consolidated Statements of Operations, Condensed Consolidated Statements of Comprehensive Income, Condensed Consolidated Statements of Shareholders’ Equity for the three and nine months ended December 31, 2021 and 2020, and the Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2021 and 2020 are unaudited. However, these financial statements have been prepared on the same basis as those in the audited annual financial statements, except for the recently adopted accounting pronouncements described below. In the opinion of management, all adjustments of a recurring nature necessary to fairly state the results of operations, financial position, and cash flows have been made.

These unaudited interim financial statements should be read together with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2021, filed with the Securities and Exchange Commission (SEC) on May 21, 2021.

Use of estimates

Preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that may affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods.

Considering the currently unknown extent and duration of the COVID-19 pandemic, we face a greater degree of uncertainty than normal in making the judgments and estimates needed to apply to certain of our significant accounting policies. We assessed certain accounting matters that generally require consideration of forecasted financial information in context with the information reasonably available to us and the unknown future impacts COVID-19 as of December 31, 2021 and through the date of this report. These estimates may change, as new events occur and additional information is obtained. Actual results could differ materially from these estimates under different assumptions or conditions.

2. Summary of Significant Accounting Policies

A detailed description of our significant accounting policies can be found in the audited financial statements for the fiscal year ended March 31, 2021, included in our Annual Report on Form 10-K. There have been no other material changes to our significant accounting policies from those disclosed therein.

Adopted and Recently Issued Accounting Pronouncements

In October 2021, the FASB issued ASU No. 2021-08, *Accounting for Contract Assets and Contract Liabilities From Contracts With Customers*, which amends Accounting Standards Codification (ASC) 805 to require acquiring entities to apply Topic 606 to recognize and measure contract assets and contract liabilities in a business combination. The ASU is intended to improve the accounting for acquired revenue contracts with customers in a business combination by addressing diversity in practice and inconsistency related to the recognition of an acquired contract liability as well as the payment terms and their impact on subsequent revenue recognized by the acquirer. The new standard will be effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We intend to adopt ASU 2021-08 during the three months ending March 31, 2022 – see Note 11, *Business Combination*.

In August 2020, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2020-06, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging— Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*, which simplifies the accounting for convertible instruments by eliminating the requirement to separate embedded conversion features from the host contract when the conversion features are not required to be accounted for as derivatives under Topic 815, Derivatives and Hedging, or that do not result in substantial premiums accounted for as paid-in capital. By removing the separation model, a convertible debt instrument will be reported as a single liability instrument with no separate accounting for embedded conversion features. This new standard also removes certain settlement conditions that are required for contracts to qualify for equity classification and simplifies the diluted earnings per share calculations by requiring that an entity use the if-converted method and that the effect of potential share settlement be included in diluted earnings per share calculations. The new standard will be effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. Early adoption is permitted, but no earlier than fiscal years beginning after December 15, 2020. We adopted ASU 2020-06 as of April 1, 2021 with no impact on our condensed consolidated financial statements.

In December 2019, the FASB issued ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, which affects general principles within Topic 740, Income Taxes, and is meant to simplify and reduce the cost of accounting for income taxes. The new standard will be effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. We adopted ASU 2019-12 as of April 1, 2021 with no material impact on our condensed consolidated financial statements.

3. Revenue Recognition

Our customary business practice is to enter into legally enforceable written contracts with our customers. The majority of our contracts are governed by a master agreement between us and the customer, which sets forth the general terms and conditions of any individual contract between the parties, which is then supplemented by a customer purchase order to specify the different goods and services, the associated prices, and any additional terms for an individual contract. Performance obligations specific to each individual contract are defined within the terms of each purchase order. Each performance obligation is identified based on the goods and services that will be transferred to our customer that are both capable of being distinct and are distinct within the context of the contract. The transaction price is determined based on the consideration to which we will be entitled and expect to receive in exchange for transferring goods or services to the customer. Typically, our contracts do not provide our customer with any right of return or refund; we do not constrain the contract price as it is probable that there will not be a significant revenue reversal due to a return or refund.

Typically, our customer contracts contain one or more of the following goods or services which constitute performance obligations.

Our software licenses typically provide for a perpetual right to use our software. Generally, our contracts do not provide significant services of integration, and customization and installation services are not required to be purchased directly from us. The software is delivered before related services are provided and is functional without professional services, updates and technical support. We have concluded that the software license is distinct as the customer can benefit from the software on its own. Software revenue is typically recognized when the software is delivered or made available for download to the customer.

Revenue for hardware sales is recognized when the product is shipped to the customer and when obligations that affect the customer's final acceptance of the arrangement have been fulfilled. Hardware is purchased from suppliers and provided to the end-user customers via drop-ship or from inventory. We are responsible for negotiating price both with the supplier and the customer, payment to the supplier, establishing payment terms and product returns with the customer, and we bear the credit risk if the customer does not pay for the goods. As the principal contact with the customer, we recognize revenue and cost of goods sold when we are notified by the supplier that the product has been shipped. In certain limited instances, as shipping terms dictate, revenue is recognized upon receipt at the point of destination or upon installation at the customer site.

Support and maintenance revenue is derived from providing telephone and on-line technical support services, bug fixes, and unspecified software updates and upgrades to customers on a when-and-if-available basis. These services represent a stand-ready obligation that is concurrently delivered and has the same pattern of transfer to the customer; we account for these support and maintenance services as a single performance obligation recognized over the term of the maintenance agreement.

Our subscription service revenue is comprised of fees for contracts that provide customers a right to access our software for a subscribed period. We do not provide the customer the contractual right to license the software at any time outside of the subscription period under these contracts. The customer can only benefit from the software and software maintenance when provided the right to access the software. Accordingly, each of the rights to access the software, the maintenance services, and any hosting services is not considered a distinct performance obligation in the context of the contract and should be combined into a single performance obligation to be recognized over the contract period. The Company recognizes subscription revenue over a one-month period based on the typical monthly invoicing and renewal cycle in accordance with our customer agreement terms.

Professional services revenues primarily consist of fees for consulting, installation, integration and training and are generally recognized over time as the customer simultaneously receives and consumes the benefits of the professional services as the services are being performed. Professional services can be provided by internal or external providers, do not significantly affect the customer's ability to access or use other provided goods or services, and provide a measure of benefit beyond that of other promised goods or services in the contract. As a result, professional services are considered distinct in the context of the contract and represent a separate performance obligation. Professional services that are billed on a time and materials basis are recognized over time as the services are performed. For contracts billed on a fixed price basis, revenue is recognized over time using an input method based on labor hours expended to date relative to the total labor hours expected to be required to satisfy the related performance obligation.

We use the market approach to drive standalone selling price ("SSP") by maximizing observable data points (in the form of recently executed customer contracts) to determine the price customers are willing to pay for the goods and services transferred. If the contract contains a single performance obligation, the entire transaction price is allocated to that performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on a relative SSP basis.

Shipping and handling fees billed to customers are recognized as revenue and the related costs are recognized in cost of goods sold. Revenue is recorded net of any applicable taxes collected and remitted to governmental agencies.

Disaggregation of Revenue

We derive and report our revenue from the sale of products (software licenses, third party hardware and operating systems), support, maintenance and subscription services and professional services. Revenue recognized at a point in time (products) totaled $8.1 million and $24.2 million, and $7.6 million and $19.4 million for the three and nine months ended December 31, 2021 and 2020. Revenue recognized over time (support, maintenance and subscription services and professional services) totaled $31.4 million and $91.8 million, and $29.1 million and $81.4 million for the three and nine months ended December 31, 2021 and 2020, respectively.

Contract Balances

Contract assets are rights to consideration in exchange for goods or services that we have transferred to a customer when that right is conditional on something other than the passage of time. The majority of our contract assets represent unbilled amounts related to professional services. We expect billing and collection of our contract assets to occur within the next twelve months. We receive payments from customers based upon contractual billing schedules and accounts receivable are recorded when the right to consideration becomes unconditional. Contract liabilities represent consideration received or consideration which is unconditionally due from customers prior to transferring goods or services to the customer under the terms of the contract.

Revenue recognized from amounts included in contract liabilities at the beginning of the period was $7.5 million and $9.1 million for the three months ended December 31, 2021 and 2020, respectively and $36.9 million and $38.1 million for the nine months ended December 31, 2021 and 2020, respectively. Because the right to the transaction became unconditional, we transferred to accounts receivable from contract assets at the beginning of the period, $0.1 million and $0.1 million for the three months ended December 31, 2021 and 2020, respectively, and $2.3 million and $1.8 million for the nine months ended December 31, 2021 and 2020, respectively.

Our arrangements are for a period of one year or less. As a result, unsatisfied performance obligations as of December 31, 2021 are expected to be satisfied and the allocated transaction price recognized in revenue within a period of 12 months or less.

Assets Recognized from Costs to Obtain a Contract

Sales commission expenses that would not have occurred absent the customer contracts are considered incremental costs to obtain a contract. We expense the incremental costs to obtain a contract as incurred when the expected benefit and amortization period is one year or less. For subscription contracts that are renewed monthly based on an agreement term, we capitalize commission expenses and amortize as we satisfy the underlying performance obligations, generally based on the contract terms and anticipated renewals. Other sales commission expenses have a period of benefit of one year or less and are therefore expensed as incurred in line with the practical expedient elected.

We had $3.1 million and $2.9 million of capitalized sales incentive costs as of December 31, 2021 and March 31, 2021, respectively. These balances are included in other non-current assets on our condensed consolidated balance sheets. During the three and nine months ended December 31, 2021, we expensed $0.6 million and $1.8 million, respectively, of sales commissions, which included amortization of capitalized amounts of $0.3 million and $0.9 million, respectively. During the comparable periods ending December 31, 2020, we expensed $0.7 million and $2.0 million, respectively, of sales commissions, which included amortization of capitalized amounts of $0.3 million and $1.1 million, respectively. These expenses are included in operating expenses – sales and marketing in our condensed consolidated statement of operations. All other costs to obtain a contract are not considered incremental and therefore are expensed as incurred.

4. Additional Balance Sheet Information

Additional information related to the condensed consolidated balance sheets is as follows:

(In thousands)	**December 31, 2021**	March 31, 2021
Accrued liabilities:		
Salaries, wages, and related benefits	**$ 5,687**	$ 8,454
Other taxes payable	**1,989**	1,796
Accrued legal settlements	**—**	200
Severance liabilities	**7**	79
Professional fees	**428**	97
Other	**274**	607
Total	**$ 8,385**	$ 11,233
Other non-current liabilities:		
Uncertain tax positions	**$ 1,148**	$ 1,129
Asset retirement obligations	**43**	170
Employee benefit obligations	**2,386**	2,639
Other	**70**	73
Total	**$ 3,647**	$ 4,011

5. Supplemental Disclosures of Cash Flow Information

Additional information related to the condensed consolidated statements of cash flows is as follows:

	Nine Months Ended December 31,	
(In thousands)	**2021**	2020
Cash receipts for interest, net	**$ (6)**	$ (63)
Cash payments for income taxes, net	**631**	195
Cash payments for operating leases	**3,676**	4,039
Cash payments for finance leases	**15**	21
Accrued capital expenditures	**1**	64

6. Income Taxes

The following table compares our income tax expense and effective tax rates for the three and nine months ended December 31, 2021 and 2020:

(Dollars in thousands)	Three Months Ended December 31, 2021	Three Months Ended December 31, 2020	Nine Months Ended December 31, 2021	Nine Months Ended December 31, 2020
Income tax expense	**$ 24**	$ 182	**$ 265**	$ 311
Effective tax rate	**1.5%**	(9.6)%	**5.6%**	8.7%

For the three and nine months ended December 31, 2021, the effective tax rate was different than the statutory rate due primarily to the recognition of net operating losses as deferred tax assets in the U.S. and certain foreign jurisdictions, which were offset by increases in the valuation allowance, certain foreign and state tax effects and other U.S. permanent book to tax differences. For the three months ended December 31, 2020, the effective tax rate was different than the statutory tax rate due primarily to the recognition of net operating losses that were offset by increased valuation allowance in the U.S, certain foreign and state tax effects and other U.S. permanent book to tax differences. For the nine months ended December 31, 2020, the effective tax rate was different than the statutory tax rate due primarily to the utilization of net operating losses that were offset by decreased valuation allowance in the U.S, certain foreign and state tax effects and other U.S. permanent book to tax differences.

Because of our losses in prior periods, we have recorded and maintain a valuation allowance offsetting substantially all of our deferred tax assets in the U.S. and certain foreign jurisdictions, as management believes that it is more likely than not that we will not realize the benefits of these deductible differences. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible.

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”). The CARES Act provides, among other provisions, for the deferral of the employer-paid portion of social security taxes through the end of 2020, with 50% of the deferred amount due December 31, 2021 and the remaining 50% due December 31, 2022. The company paid $0.9 million in deferred social security taxes during December 2021.

7. Commitments and Contingencies

Agilysys is the subject of various threatened or pending legal actions and contingencies in the normal course of conducting its business. We provide for costs related to these matters when a loss is probable, and the amount can be reasonably estimated. The effect of the outcome of these matters on our future results of operations and liquidity cannot be predicted because any such effect depends on future results of operations and the amount or timing of the resolution of such matters. While it is not possible to predict with certainty, management believes that the ultimate resolution of such individual or aggregated matters will not have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

On April 6, 2012, Ameranth, Inc. filed a complaint against us in the U.S. District Court of Southern District of California alleging that certain of our products infringe patents owned by Ameranth directed to configuring and transmitting hospitality menus (e.g., restaurant menus) for display on electronic devices and synchronizing the menu content between the devices. The case against us was consolidated with similar cases brought by Ameranth against more than 30 other defendants. All but one of the patents at issue in the case were invalidated by the U.S. Court of Appeals for the Federal Circuit in 2016. In September 2018, the District Court found the one surviving Ameranth patent invalid and granted summary judgment in favor of the movant co-defendants. In November 2019, the U.S. Court of Appeals for the Federal Circuit affirmed the lower court’s summary judgement with respect to all claims except for two, which were not asserted against Agilysys. Ameranth’s writ of certiorari to the United States Supreme Court was denied in October 2020. Subsequently, Ameranth filed further pleading amendments and discovery requests with the District Court, which were opposed by the defendants.

We were not a party to the appeal, and it is currently unclear what impact the summary judgement ruling may have on our case. Ameranth seeks monetary damages, injunctive relief, costs and attorneys' fees from us. At this time, we are not able to predict the outcome of this lawsuit. However, we dispute the allegations of wrongdoing and are vigorously defending ourselves in this matter.

As of December 31, 2021, we have an additional operating lease that has not yet commenced of approximately $11.7 million. This operating lease will commence in fiscal year 2023 with a lease term of approximately eleven years.

8. Earnings per Share

The following data shows the amounts used in computing earnings per share and the effect on earnings and the weighted average number of shares of dilutive potential common shares.

	Three Months Ended December 31,		Nine Months Ended December 31,	
(In thousands, except per share data)	**2021**	2020	**2021**	2020
Numerator:				
Net income (loss)	**$ 1,542**	$ (2,070)	**$ 4,496**	$ 3,280
Series A convertible preferred stock issuance costs	**—**	—	**—**	(1,031)
Series A convertible preferred stock dividends	**(459)**	(459)	**(1,377)**	(1,117)
Net income (loss) attributable to common shareholders	**$ 1,083**	$ (2,529)	**$ 3,119**	$ 1,132
Denominator:				
Weighted average shares outstanding - basic	**24,477**	23,429	**24,315**	23,419
Dilutive SSARs	**826**	—	**943**	377
Dilutive unvested restricted shares	**89**	—	**69**	107
Weighted average shares outstanding - diluted	**25,392**	23,429	**25,327**	23,903
Income (loss) per share - basic:	**$ 0.04**	$ (0.11)	**$ 0.13**	$ 0.05
Income (loss) per share - diluted:	**$ 0.04**	$ (0.11)	**$ 0.12**	$ 0.05
Anti-dilutive SSARs, restricted shares and preferred shares	**1,764**	4,513	**1,736**	2,692

Basic income (loss) per share is computed as net income (loss) attributable to common shareholders divided by the weighted average basic shares outstanding. The outstanding shares used to calculate the weighted average basic shares excludes 231,199 and 204,009 of restricted shares at December 31, 2021 and 2020, respectively, as these shares were issued but were not vested and therefore, not considered outstanding for purposes of computing basic income (loss) per share at the balance sheet dates.

Diluted income per share includes the effect of all potentially dilutive securities on earnings per share. We have stock-settled appreciation rights ("SSARs"), unvested restricted shares, and preferred shares that are potentially dilutive securities. When a loss is reported, the denominator of diluted earnings per share cannot be adjusted for the dilutive impact of share-based compensation grants because doing so would be anti-dilutive.

9. Share-based Compensation

We may grant incentive stock options, non-qualified stock options, SSARs, restricted shares, and performance shares under our shareholder-approved 2020 Equity Incentive Plan ("2020 Plan") for up to 2.25 million common shares, plus 868,864 common shares, the number of shares that were remaining for grant under the 2016 Stock Incentive Plan ("2016 Plan") as of the effective date of the 2020 Plan, plus the number of shares remaining for grant under the 2016 Plan that are forfeited, settled in cash, canceled or expired. The aggregate number of shares that may be granted under the 2020 Plan is 3.1 million.

We may distribute authorized but unissued shares or treasury shares to satisfy share option and SSAR exercises or restricted share and performance share grants.

The fair value of restricted share grants subject only to a service condition and performance share grants is based on the closing price of our common shares on the grant date. For stock option and SSAR grants subject only to a service condition, we estimate the fair value on the grant date using the Black-Scholes-Merton option pricing model with inputs including the closing market price at grant date, exercise price and assumptions regarding the risk-free interest rate, expected volatility of our common shares based on historical volatility, and expected term as estimated using the simplified method. For restricted share and SSAR grants subject to a market condition, we estimate the fair value on the grant date through a lattice option pricing model that utilizes a Monte Carlo analysis with inputs including the closing market price at grant date, share price threshold and assumptions regarding the risk-free interest rate and expected volatility of our common shares based on historical volatility. Inputs for SSAR grants subject to a market condition also include exercise price, remaining contractual term, and suboptimal exercise factor. We record compensation expense for restricted shares and SSAR grants subject to a service condition using the graded vesting method. We record compensation expense for SSAR grants subject only to a market condition over the derived service period, which is an output of the lattice option pricing model.

The following table summarizes the share-based compensation expense for SSARs, restricted and performance grants included in the condensed consolidated statements of operations:

	Three Months Ended December 31,		Nine Months Ended December 31,	
(In thousands)	**2021**	2020	**2021**	2020
Product development	**$ 2,217**	$ 3,362	**$ 6,033**	$ 3,773
Sales and marketing	**345**	666	**1,011**	735
General and administrative	**1,277**	2,602	**3,758**	4,804
Total share-based compensation expense	**$ 3,839**	$ 6,630	**$ 10,802**	$ 9,312

Stock-Settled Appreciation Rights

SSARs are rights granted to an employee to receive value equal to the difference between the price of our common shares on the date of exercise and the exercise price. The value is settled in common shares of Agilysys, Inc.

The following table summarizes the activity during the nine months ended December 31, 2021 for SSARs awarded under the 2020 and 2016 Plans:

	Number of Rights	Weighted-Average Exercise Price (per right)	Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at April 1, 2021	3,068,253	$ 20.90		
Exercised	(820,341)	12.72		
Forfeited	(49,750)	20.02		
Expired	(246)	14.22		
Outstanding at December 31, 2021	**2,197,916**	**$ 23.97**	**4.9**	**$ 45,041**
Exercisable at December 31, 2021	**1,262,704**	**$ 23.54**	**4.7**	**$ 26,421**
Vested and expected to vest at December 31, 2021	**2,197,916**	**$ 23.97**	**4.9**	**$ 45,041**

As of December 31, 2021, total unrecognized share-based compensation expense related to non-vested service condition SSARs was $6.3 million, which is expected to be recognized over a weighted-average vesting period of 1.2 years.

As of December 31, 2021, there was no unrecognized share-based compensation expense related to non-vested market condition SSARs.

Restricted Shares

We granted shares to certain of our Directors, executives and key employees, the vesting of which is service-based. Certain restricted shares are also subject to a market condition. The following table summarizes the activity during the nine months ended December 31, 2021 for restricted shares awarded under the 2020 and 2016 Plans:

	Number of Shares	Weighted-Average Grant-Date Fair Value (per share)
Outstanding at April 1, 2021	132,198	$ 37.67
Granted	108,473	43.77
Vested	(1,056)	52.29
Forfeited	(8,416)	37.66
Outstanding at December 31, 2021	**231,199**	**$ 40.34**

The weighted-average grant date fair value of the restricted shares includes grants subject only to a service condition and certain grants subject to both a service condition and a market condition. As of December 31, 2021, total unrecognized share-based compensation expense related to unvested restricted stock was $5.4 million, which is expected to be recognized over a weighted-average vesting period of 2.3 years.

Performance Shares

Upon approval of the Compensation Committee of our Board of Directors, after achieving the performance conditions associated with our annual bonus plan, we granted 3,403 common shares to our Chief Executive Officer in May 2021 that vested immediately for a total value of $0.2 million.

10. Preferred Stock

On May 22, 2020, we completed the sale of 1,735,457 shares of our preferred stock, without par value, designated as “Series A Convertible Preferred Stock” (the “Convertible Preferred Stock”) to MAK Capital Fund L.P. and MAK Capital Distressed Debt Fund I, LP (the “Holders”) each, in its capacity as a designee of MAK Capital One LLC (the “Purchaser”), pursuant to the terms of the Investment Agreement, dated as of May 11, 2020, between the Company and the Purchaser, for an aggregate purchase price of $35 million. We incurred issuance costs of $1.0 million. We added all issuance costs that were netted against the proceeds upon issuance of the Convertible Preferred Stock to its redemption value. As disclosed in our Annual Report for the fiscal year ended March 31, 2021, Michael Kaufman, the Chairman of the Company’s Board of Directors, is the Chief Executive Officer of MAK Capital One LLC.

The Holders are entitled to dividends on the Liquidation Preference at the rate of 5.25% per annum, payable semi-annually either (i) 50% in cash and 50% in kind as an increase in the then-current Liquidation Preference or (ii) 100% in cash, at the option of the Company. We pay dividends in the same period as declared by the Company’s Board of Directors.

11. Business Combination

In December 2021, the Company entered into a definitive agreement to acquire ResortSuite Inc. (“ResortSuite”), a Canada-based fully integrated property management solutions provider focused on the complex multi-amenity and resort market. The acquisition extends our solutions to customers in the complex multi-amenity and resort market. Under the terms of the agreement, the Company agreed to pay approximately $25 million in cash consideration for all the issued and outstanding shares of ResortSuite. The Company is funding the consideration with cash on the Company’s balance sheet. The acquisition closed on January 5, 2022, with a closing payment of $22.7 million. The Company expects to record a total purchase price of approximately $25 million after payment of certain pre-closing tax liabilities. As a result of the acquisition, ResortSuite has become a wholly-owned subsidiary of Agilysys, Inc. During the three months ended December 31, 2021, we incurred immaterial acquisition-related expenses associated with the acquisition of ResortSuite, which were recorded in severance and other charges. The initial accounting for this acquisition is not complete due to the timing of the transaction and the pending measurement of assets acquired and liabilities assumed as of the January 5, 2022 acquisition date.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

In "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"), management explains the general financial condition and results of operations for Agilysys and subsidiaries including:

— *what factors affect our business;*
— *what our earnings and costs were;*
— *why those earnings and costs were different from the year before;*
— *where the earnings came from;*
— *how our financial condition was affected; and*
— *where the cash will come from to fund future operations.*

The MD&A analyzes changes in specific line items in the Condensed Consolidated Statements of Operations and Condensed Consolidated Statements of Cash Flows and provides information that management believes is important to assessing and understanding our consolidated financial condition and results of operations. This Quarterly Report on Form 10-Q updates information included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2021, filed with the Securities and Exchange Commission (SEC). This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and related Notes that appear in Item 1 of this Quarterly Report as well as our Annual Report for the year ended March 31, 2021. Information provided in the MD&A may include forward-looking statements that involve risks and uncertainties. Many factors could cause actual results to be materially different from those contained in the forward-looking statements. See "Forward-Looking Information" on page 24 of this Quarterly Report, Item 1A "Risk Factors" in Part II of this Quarterly Report, and Item 1A "Risk Factors" in Part I of our Annual Report for the fiscal year ended March 31, 2021 for additional information concerning these items. Management believes that this information, discussion, and disclosure is important in making decisions about investing in Agilysys.

Overview

Recent Developments

COVID-19 Pandemic

The World Health Organization declared COVID-19 a pandemic on March 11, 2020. COVID-19 has had a significant impact on our business since that time. The extent to which COVID-19 will continue impacting our financial condition and results of operations remains uncertain and depends on various factors, including the ongoing or recurring impact on our customers, partners, and vendors and on the operation of the global markets in general. Because an increasing portion of our business is based on a subscription model, the effect of COVID-19 on our results of operations may also not be fully reflected for some time.

We have taken actions to mitigate the impact on our business. We continue to conduct business with substantial modifications to employee travel, employee work locations, virtualization of customer and employee events, and partially remote sales, implementation, and support activities, among other modifications. These modifications may continue to delay or reduce sales and harm productivity and collaboration. The pandemic could have an ongoing adverse impact on demand for our customers' products and services, which in turn could negatively impact the willingness of our customers to enter into or renew contracts with us. The pandemic has impacted our ability to complete certain implementations timely, which negatively impacts our ability to recognize revenue.

While we have previously taken certain cost reduction measures, we may take further actions that alter our business operations in response to changes in the global environment. As a result, the ultimate impact of the COVID-19 pandemic and the effects of the operational alterations we have made in response on our business, financial condition, liquidity, and financial results cannot be predicted at this time.

Our Business

Agilysys has been a leader in hospitality software for more than 40 years, delivering innovative modern cloud native SaaS and on-premise guest-centric technology solutions for gaming, hotels, resorts and cruise, corporate foodservice management, restaurants, universities, stadia and healthcare. Agilysys offers the most comprehensive software solutions in the hospitality industry, including point-of-sale (POS), property management (PMS), inventory and procurement, payments, and related applications, to manage the entire guest journey. Agilysys is also known for its world class customer-centric service. During recent years, Agilysys has made major R&D investments and has successfully modernized virtually all its longstanding trusted software solutions. Some of the largest hospitality companies around the world use Agilysys solutions to help improve guest loyalty, drive revenue growth and increase operational efficiencies.

The Company has just one reportable segment serving the global hospitality industry. Agilysys operates across North America, Europe, the Middle East, Asia-Pacific and India with headquarters located in Alpharetta, Georgia.

Our top priority is increasing shareholder value by improving operating and financial performance and profitably growing the business through superior products and services. To that end, we expect to invest a certain portion of our cash on hand to fund enhancements to existing software products, to develop and market new software products, and to expand our customer breadth, both vertically and geographically.

Our strategic plan specifically focuses on:

- Putting the customer first
- Focusing on product innovation and development
- Growing revenue through increased investments in sales and marketing initiatives
- Increasing organizational efficiency and teamwork
- Developing our employees and leaders
- Growing revenue by improving the breadth and depth of our product set across both point-of-sale and property management applications
- Growing revenue through international expansion

The primary objective of our ongoing strategic planning process is to create shareholder value by capitalizing on growth opportunities, remaining profitable and strengthening our competitive position within the specific technology solutions and end markets we serve. Profitability and industry leading growth will be achieved through effective management of operating expenses and sharpening the focus of our investments to concentrate on growth opportunities.

Revenue - Defined

As required by the SEC, we separately present revenue earned as products revenue, support, maintenance and subscription services revenue or professional services revenue in our condensed consolidated statements of operations. In addition to the SEC requirements, we may, at times, also refer to revenue as defined below. The terminology, definitions, and applications of terms we use to describe our revenue may be different from those used by other companies and caution should be used when comparing these financial measures to those of other companies. We use the following terms to describe revenue:

- Revenue - We present revenue net of sales returns and allowances.
- Products revenue – Revenue earned from the sales of software licenses, third party hardware and operating systems.
- Support, maintenance and subscription services revenue – Revenue earned from the sale of proprietary and remarketed ongoing support, maintenance and subscription services.
- Professional services revenue – Revenue earned from the delivery of implementation, integration and installation services for proprietary and remarketed products.

Results of Operations

Third Fiscal Quarter 2022 Compared to Third Fiscal Quarter 2021

Net Revenue and Operating Income

The following table presents our consolidated revenue and operating results for the three months ended December 31, 2021 and 2020:

	Three months ended December 31,		Increase (decrease)	
(Dollars in thousands)	**2021**	2020	$	%
Net revenue:				
Products	**$ 8,101**	$ 7,599	$ 502	6.6%
Support, maintenance and subscription services	**25,136**	22,846	2,290	10.0
Professional services	**6,223**	6,230	(7)	nm
Total net revenue	**39,460**	36,675	2,785	7.6
Cost of goods sold:				
Products	**4,400**	3,660	740	20.2
Support, maintenance and subscription services	**5,421**	4,655	766	16.5
Professional services	**4,923**	4,164	759	18.2
Total cost of goods sold	**14,744**	12,479	2,265	18.2
Gross profit	**$ 24,716**	$ 24,196	$ 520	2.1%
Gross profit margin	**62.6 %**	66.0%		
Operating expenses:				
Product development	**$ 11,210**	$ 12,376	$ (1,166)	(9.4)%
Sales and marketing	**3,943**	3,327	616	18.5
General and administrative	**6,804**	7,509	(705)	(9.4)
Depreciation of fixed assets	**495**	722	(227)	(31.4)
Amortization of internal-use software	**267**	521	(254)	(48.8)
Severance and other charges	**381**	1,552	(1,171)	(75.5)
Legal settlements, net	**4**	-	4	nm
Operating income (loss)	**$ 1,612**	$ (1,811)	$ 3,423	189.0%
Operating income (loss) percentage	**4.1 %**	(4.9)%		

nm - not meaningful

The following table presents the percentage relationship of our condensed consolidated statement of operations line items to our consolidated net revenues for the periods presented:

	Three months ended December 31,	
	2021	2020
Net revenue:		
Products	**20.5 %**	20.7 %
Support, maintenance and subscription services	**63.7**	62.3
Professional services	**15.8**	17.0
Total net revenue	**100.0 %**	100.0 %
Cost of goods sold:		
Products	**11.2 %**	10.0 %
Support, maintenance and subscription services	**13.7**	12.7
Professional services	**12.5**	11.3
Total cost of goods sold	**37.4 %**	34.0 %
Gross profit	**62.6 %**	66.0 %
Operating expenses:		
Product development	**28.4 %**	33.7 %
Sales and marketing	**10.0**	9.1
General and administrative	**17.2**	20.5
Depreciation of fixed assets	**1.2**	2.0
Amortization of internal-use software	**0.7**	1.4
Severance and other charges	**1.0**	4.2
Legal settlements, net	**0.0**	—
Operating income (loss)	**4.1 %**	(4.9)%

nm - not meaningful

Net revenue. Total net revenue increased $2.8 million, or 7.6%, during the third quarter of fiscal 2022 compared to the third quarter of fiscal 2021. Products revenue increased $0.5 million, or 6.6%, due to higher sales and deliveries as our customers re-open their locations for business. Support, maintenance and subscription services revenue increased $2.3 million, or 10.0%, compared to the third quarter of fiscal 2021 driven by continued growth in subscription-based service revenue, which increased 24.9% during the third quarter of fiscal 2022 compared to the third quarter of fiscal 2021. The increase in subscription revenue is due to increased sales and implementations of our newer cloud native add-on modules. Professional services revenue was consistent with the third quarter of fiscal 2021 as customers continue to struggle with labor availability causing delay in certain projects during the quarter while complex implementations require additional time for completion.

Gross profit and gross profit margin. Our total gross profit increased $0.5 million, or 2.1%, for the third quarter of fiscal 2022 and total gross profit margin decreased from 66.0% to 62.6% driven by changes in the composition of revenue by category. Products gross profit decreased $0.2 million, or 6.0%, and products gross profit margin decreased from 51.8% to 45.7% due to a higher proportion of third-party products over proprietary software revenue. Support, maintenance and subscription services gross profit increased $1.5 million, or 8.4%, and gross profit margin decreased from 79.6% to 78.4% as certain variable costs increased ahead of related revenue. Professional services gross profit decreased $0.8 million due to delays in certain professional service projects with a decrease in gross profit margin from 33.2% to 20.9% due to an increase in costs as our implementation teams continue to hire and train new staff while project backlogs increase from ongoing sales activity and certain project delays.

Operating expenses

Operating expenses, excluding legal settlements, severance and other charges, decreased $1.7 million, or 7.1%, during the third quarter of fiscal 2022 compared with the third quarter of fiscal 2021.

Product development. Product development decreased $1.2 million, or 9.4%, in the third quarter of fiscal 2022 compared with the third quarter of fiscal 2021 due to higher than usual share-based and other incentive compensation in the prior year which did not reoccur in the current fiscal year.

Sales and marketing. Sales and marketing increased $0.6 million, or 18.5%, in the third quarter of fiscal 2022 compared with the third quarter of fiscal 2021 due to the return of some travel costs due to increased in-person selling activity, and higher advertising and promotions costs due to increased marketing event and trade show activity.

General and administrative. General and administrative decreased $0.7 million, or 9.4%, in the third quarter of fiscal 2022 compared with the third quarter of fiscal 2021 due to higher than usual share-based compensation in the prior year which did not reoccur in the current fiscal year.

Severance and other charges. Severance, and other charges decreased $1.2 million, or 75.5%, in the third quarter of fiscal 2022 compared with the third quarter of fiscal 2021 due to the absence of layoffs and significantly reduced employee terminations in fiscal 2022.

Other (Income) Expenses

	Three Months Ended December 31,		(Unfavorable) favorable	
(Dollars in thousands)	**2021**	2020	$	%
Other expense:				
Interest income	**$ (10)**	$ (27)	$ (17)	(63.0)%
Interest expense	**4**	9	5	nm
Other expense, net	**52**	95	43	(45.3)
Total other expense, net	**$ 46**	$ 77	$ 31	(40.3)%

nm - not meaningful

Interest income. Interest income consists of interest earned through interest-bearing bank accounts and on cash equivalents including short-term investments in commercial paper, treasury bills and money market funds.

Interest expense. Interest expense consists of costs associated with finance leases.

Other expense, net. Other expense, net consists mainly of the impact of foreign currency due to movement of European and Asian currencies against the US dollar.

Income Taxes

	Three Months Ended December 31,		(Unfavorable) favorable	
(Dollars in thousands)	**2021**	2020	$	%
Income tax expense	**$ 24**	$ 182	$ 158	nm
Effective tax rate	**1.5%**	(9.6)%		

nm - not meaningful

For the three months ended December 31, 2021, the effective tax rate was different than the statutory rate due primarily to the recognition of net operating losses as deferred tax assets in the U.S. and certain foreign jurisdictions, which were offset by increases in the valuation allowance, certain foreign and state tax effects and other U.S. permanent book to tax differences. For the three months ended December 31, 2020, the effective tax rate was different than the statutory tax rate due primarily to the recognition of net operating losses that were offset by increased valuation allowance in the U.S, certain foreign and state tax effects and other U.S. permanent book to tax differences.

Although the timing and outcome of tax settlements are uncertain, it is reasonably possible that during the next 12 months an immaterial reduction in unrecognized tax benefits may occur based on the outcome of tax examinations and as a result of the expiration of various statutes of limitations. We are consistently subject to tax audits; due to the nature of examinations in multiple jurisdictions, changes could occur in the amount of gross unrecognized tax benefits during the next 12 months which cannot be estimated at this time.

Because of our losses in prior periods, we have recorded a valuation allowance offsetting substantially all of our deferred tax assets in the U.S. and certain foreign jurisdictions, as management believes that it is more likely than not that we will not realize the benefits of these deductible differences. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible.

Results of Operations

First Nine Months of Fiscal 2022 Compared to First Nine Months of Fiscal 2021

Net Revenue and Operating Income

The following table presents our consolidated revenue and operating results for the three months ended December 31, 2021 and 2020:

	Nine months ended December 31,		Increase (decrease)	
(Dollars in thousands)	**2021**	2020	$	%
Net revenue:				
Products	**$ 24,244**	$ 19,396	$ 4,848	25.0%
Support, maintenance and subscription services	**72,371**	65,647	6,724	10.2
Professional services	**19,463**	15,797	3,666	23.2
Total net revenue	**116,078**	100,840	15,238	15.1
Cost of goods sold:				
Products	**12,420**	9,625	2,795	29.0
Support, maintenance and subscription services	**15,184**	13,515	1,669	12.3
Professional services	**14,634**	11,802	2,832	24.0
Total cost of goods sold	**42,238**	34,942	7,296	20.9
Gross profit	**$ 73,840**	$ 65,898	$ 7,942	12.1%
Gross profit margin	**63.6%**	65.3%		
Operating expenses:				
Product development	**$ 34,074**	$ 28,900	$ 5,174	17.9%
Sales and marketing	**10,418**	8,278	2,140	25.9
General and administrative	**20,330**	18,446	1,884	10.2
Depreciation of fixed assets	**1,609**	2,160	(551)	(25.5)
Amortization of intangibles	**1,077**	1,490	(413)	(27.7)
Severance and other charges	**1,187**	2,762	(1,575)	(57.0)
Legal settlements, net	**371**	50	321	nm
Operating income	**$ 4,774**	$ 3,812	$ 962	(25.2)%
Operating income percentage	**4.1%**	3.8%		

nm - not meaningful

The following table presents the percentage relationship of our condensed consolidated statement of operations line items to our consolidated net revenues for the periods presented:

	Nine months ended December 31,	
Net revenue:	**2021**	2020
Products	**20.9%**	19.2%
Support, maintenance and subscription services	**62.3**	65.1
Professional services	**16.8**	15.7
Total net revenue	**100.0%**	100.0%
Cost of goods sold:		
Products	**10.7%**	9.5%
Support, maintenance and subscription services	**13.1**	13.5
Professional services	**12.6**	11.7
Total cost of goods sold	**36.4%**	34.7%
Gross profit	**63.6%**	65.3%
Operating expenses:		
Product development	**29.4%**	28.7%
Sales and marketing	**9.0**	8.2
General and administrative	**17.5**	18.3
Depreciation of fixed assets	**1.4**	2.1
Amortization of intangibles	**0.9**	1.5
Severance and other charges	**1.0**	2.7
Legal settlements, net	**0.3**	0.0
Operating income	**4.1%**	3.8%

Net revenue. Total net revenue increased $15.2 million, or 15.1%, during the first nine months of fiscal 2022 compared to the first nine months of fiscal 2021. Products revenue increased $4.8 million, or 25.0%, due to higher sales and deliveries as our customers re-open their locations for business. Support, maintenance and subscription services revenue increased $6.7 million, or 10.2%, compared to the first nine months of fiscal 2021 driven by continued growth in subscription-based service revenue, which increased 26.2% during the first nine months of fiscal 2022 compared to the first nine months of fiscal 2021. Professional services revenue increased $3.7 million, or 23.2%, due to higher sales and service activity as our customers re-open their locations for business.

Gross profit and gross profit margin. Our total gross profit increased $7.9 million, or 12.1%, for the first nine months of fiscal 2022 and total gross profit margin decreased from 65.3% to 63.6% driven by changes in the composition of revenue by category. Products gross profit increased $2.1 million, or 21.0%, compared to the first nine months of fiscal 2021 and products gross profit margin decreased from 50.4% to 48.8% due to a higher proportion of third-party products over proprietary software revenue. Support, maintenance and subscription services gross profit increased $5.1 million, or 9.7%, and gross profit margin decreased from 79.4% to 79.0% as certain variable costs increased ahead of related revenue. Professional services gross profit increased $0.8 million, or 20.9%, due to the increase in professional service projects as customers continue to re-open their locations. Professional services gross profit margin decreased from 25.3% to 24.8% due to continued hiring and training of new staff to meet increasing project backlogs from ongoing sales activity and certain project delays.

Operating expenses

Operating expenses, excluding legal settlements, severance and other charges, increased $8.2 million, or 13.9%, during the first nine months of fiscal 2022 compared with the first nine months of fiscal 2021.

Product development. Product development increased $5.2 million, or 17.9%, in the first nine months of fiscal 2022 due to restored base pay and employee benefits as well as higher share-based compensation.

Sales and marketing. Sales and marketing increased $2.1 million, or 25.9%, in the first nine months of fiscal 2022 compared with the first nine months of fiscal 2021 due to restored base pay and employee benefits, increased share-based compensation, a return of some travel costs due to increased in-person selling activity, and higher advertising and promotions costs due to increased marketing event and trade show activity.

General and administrative. General and administrative increased by $1.9 million, or 10.2%, in the first nine months of fiscal 2022 compared with the first nine months of fiscal 2021 due to restored base pay and employee benefits, and higher internal system subscription costs.

Severance and other charges. Severance, and other charges decreased $1.6 million in the first nine months of fiscal 2022 due to layoffs and other employee terminations during the first nine months of fiscal 2021 that did not re-occur during the first nine months of fiscal 2022.

Legal settlements, net. Legal settlements, net increased $0.3 million in the first nine months of fiscal 2022 compared with the first nine months of fiscal 2021 due to settlement of a lawsuit involving a former employee; no further activity is expected on this matter.

Other (Income) Expenses

	Nine Months Ended December 31,		(Unfavorable) favorable	
(Dollars in thousands)	**2021**	2020	$	%
Other expense:				
Interest income	**$ (45)**	$ (76)	$ (31)	(40.8)%
Interest expense	**5**	13	8	nm
Other expense, net	**53**	284	231	nm
Total other expense, net	**$ 13**	$ 221	$ 208	nm

nm - not meaningful

Interest income. Interest income consists of interest earned on cash equivalents including short-term investments in certificates of deposit, commercial paper, treasury bills and money market funds.

Interest expense. Interest expense consists of costs associated with finance leases.

Other expense. Other expense consists mainly of the impact of foreign currency due to movement of European and Asian currencies against the US dollar.

Income Taxes

	Nine Months Ended December 31,		(Unfavorable) favorable	
(Dollars in thousands)	**2021**	2020	$	%
Income tax expense	**$ 265**	$ 311	$ 46	nm
Effective tax rate	**5.6%**	8.7%		

nm - not meaningful

For the nine months ended December 31, 2021, the effective tax rate was different than the statutory tax rate due primarily to the recognition of net operating losses as deferred tax assets in the U.S. and certain foreign jurisdictions, which were offset by increases in the valuation allowance, certain foreign and state tax effects and other U.S. permanent book to tax differences. For the nine months ended December 31, 2020, the effective tax rate was different than the statutory tax rate due primarily to the utilization of net operating losses that were offset by decreases in the valuation allowances in the U.S, certain foreign and state tax effects and other U.S. permanent book to tax differences.

Although the timing and outcome of tax settlements are uncertain, it is reasonably possible that during the next 12 months an immaterial reduction in unrecognized tax benefits may occur based on the outcome of tax examinations and as a result of the expiration of various statutes of limitations. We are consistently subject to tax audits; due to the nature of examinations in multiple jurisdictions, changes could occur in the amount of gross unrecognized tax benefits during the next 12 months which cannot be estimated at this time.

Liquidity and Capital Resources

Overview

Our operating cash requirements consist primarily of working capital needs, operating expenses, capital expenditures and payments on indebtedness outstanding, which primarily consists of lease obligations and preferred stock dividends.

At December 31, 2021, 100% of our cash and cash equivalents, of which 95% were located in the United States, were deposited in bank accounts or invested in highly liquid investments including money market funds and commercial paper with original maturity from the date of acquisition of three months or less. We believe credit risk is limited with respect to our cash and cash equivalents balances.

As of December 31, 2021, and March 31, 2021, our total debt was approximately $0.1 million, comprised of finance lease obligations in both periods.

We believe that cash flow from operating activities, cash on hand of $115.1 million as of December 31, 2021 and access to capital markets will provide adequate funds to meet our short- and long-term liquidity requirements including the acquisition of ResortSuite, which is expected to total approximately $25 million of which Agilysys paid $22.7 million in January 2022.

Cash Flow

	Nine Months Ended December 31,	
(In thousands)	**2021**	2020
Net cash provided by (used in):		
Operating activities	**$ 21,815**	$ 15,084
Investing activities	**(1,081)**	(1,078)
Financing activities	**(4,754)**	31,765
Effect of exchange rate changes on cash	**(38)**	184
Net increase in cash and cash equivalents	**$ 15,942**	$ 45,955

Cash flow provided by operating activities. Cash flow provided by operating activities was $21.8 million in the first nine months of fiscal 2022. The provision of cash was due to cash-based earnings of $17.6 million, adjusted for non-cash expenses of $13.1 million including loss on disposal of property & equipment, depreciation, amortization, and share-based compensation, and an increase of $4.2 million in net operating assets and liabilities.

Cash flow used in investing activities. Consists primarily of property and equipment purchases.

Cash flow (used in) provided by financing activities. During the first nine months of fiscal 2022, the $4.8 million used in financing activities consisted primarily of $2.9 million related to the repurchase of shares to satisfy employee tax withholding on share-based compensation and $1.8 million in preferred stock dividends. During the first nine months of fiscal 2021, the $31.8 million provided by financing activities consisted primarily of $34.0 million in preferred stock issuance proceeds from the MAK Capital investment, net of issuance costs, offset by $1.1 million related to the repurchase of shares to satisfy employee tax withholding on share-based compensation and $1.1 million in preferred stock dividends.

Contractual Obligations

As of December 31, 2021, there were no significant changes to our contractual obligations as presented in our Annual Report for the year ended March 31, 2021.

Off-Balance Sheet Arrangements

We have not entered into any off-balance sheet arrangements that have had or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Critical Accounting Policies

A detailed description of our significant accounting policies is included in our Annual Report for the year ended March 31, 2021. Other than as described in Note 2 to the condensed consolidated financial statements, there have been no material changes in our significant accounting policies and estimates since March 31, 2021.

Forward-Looking Information

This Quarterly Report and other publicly available documents, including the documents incorporated herein and therein by reference, contain, and our officers and representatives may from time to time make, "forward-looking statements" within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as: "anticipate," "intend," "plan," "goal," "seek," "believe," "project," "estimate," "expect," "strategy," "future," "likely," "may," "should," "will" and similar references to future periods. These statements are not guarantees of future performance and involve risks, uncertainties, and assumptions that are difficult to predict. These statements are based on management's current expectations, intentions, or beliefs and are subject to a number of factors, assumptions, and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. Factors that could cause or contribute to such differences or that might otherwise impact the business include the risk factors set forth in Item 1A in Part II of this Quarterly Report and Item IA of our Annual Report for the fiscal year ended March 31, 2021. We undertake no obligation to update any such factor or to publicly announce the results of any revisions to any forward-looking statements contained herein whether as a result of new information, future events, or otherwise.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk affecting us, see Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," contained in our Annual Report for the fiscal year ended March 31, 2021. There have been no material changes in our market risk exposures since March 31, 2021.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision of and with the participation of our Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Corporate Controller and Treasurer, management evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this Quarterly Report. Based on that evaluation, the CEO, CFO and Corporate Controller and Treasurer concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There were no changes to our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934, as amended, that occurred during the nine months ended December 31, 2021, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Due to the COVID-19 pandemic, a significant number of our employees are now working from home. The design of our financial reporting processes, systems, and controls allows for remote execution with accessibility to secure data.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer, Chief Financial Officer and Corporate Controller and Treasurer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system will be achieved. Further, the design of a control system must reflect the impact of resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the possibility that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors. Additionally, controls can be circumvented by individual acts, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all possible future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Other than as described below, there have been no material changes in the risk factors included in our Annual Report for the fiscal year ended March 31, 2021 that may materially affect our business, results of operations, or financial condition.

The full extent to which the COVID-19 pandemic will adversely affect our business and results of operations cannot be predicted at this time. See Part I, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Overview—Recent Developments” of this report for a more detailed discussion of the impact of COVID-19 on our business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Table of Contents

Item 6. Exhibits

31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
31.3	Rule 13a-14(a)/15d-14(a) Certification of Corporate Controller and Treasurer.
32	Certification of Chief Executive Officer, Chief Financial Officer and Corporate Controller and Treasurer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002.
101.INS	Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because XBRL tags are embedded within the Inline XBRL document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)
*	Denotes a management contract or compensatory plan or arrangement.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report to be signed on its behalf by the undersigned thereunto duly authorized.

AGILYSYS, INC.

Date: January 27, 2022	/s/ William David Wood III
	William David Wood III
	Chief Financial Officer
	(Principal Financial Officer and Duly Authorized Officer)