UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2022

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: 000-5734

AGILYSYS, INC.

(Exact Name of Registrant as Specified in its Charter)

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

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

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 Stock, without par value	AGYS	NASDAQ Global Market

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, 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 by 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 ☐

As of October 21, 2022, the registrant had 25,064,471 shares of common stock outstanding.

AGILYSYS, INC.

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AGILYSYS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)	September 30, 2022 (Unaudited)	March 31, 2022
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 96,196**	$ 96,971
Accounts receivable, net of allowance for expected credit losses of $452 and $318, respectively	**21,030**	25,175
Contract assets	**3,712**	1,669
Inventories	**9,659**	6,940
Prepaid expenses and other current assets	**5,830**	5,418
Total current assets	**136,427**	136,173
Property and equipment, net	**6,288**	6,345
Operating lease right-of-use assets	**15,715**	9,889
Goodwill	**32,759**	32,759
Intangible assets, net	**19,492**	20,178
Deferred income taxes, non-current	**2,789**	2,664
Other non-current assets	**7,296**	6,154
Total assets	**$ 220,766**	$ 214,162
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 10,428**	$ 9,766
Contract liabilities	**37,560**	46,095
Accrued liabilities	**9,959**	10,552
Operating lease liabilities, current	**4,104**	5,049
Finance lease obligations, current	**3**	4
Total current liabilities	**62,054**	71,466
Deferred income taxes, non-current	**948**	938
Operating lease liabilities, non-current	**11,882**	5,649
Finance lease obligations, non-current	**—**	2
Other non-current liabilities	**3,829**	3,304
Commitments and contingencies		
Series A convertible preferred stock, no par value	**35,459**	35,459
Shareholders' equity:		
Common shares, without par value, at $0.30 stated value; 80,000,000 shares authorized; 31,606,831 shares issued; and 25,058,198 and 24,728,532 shares outstanding at September 30, 2022 and March 31, 2022, respectively	**9,482**	9,482
Treasury shares, 6,548,633 and 6,878,299 at September 30, 2022 and March 31, 2022, respectively	**(1,965)**	(2,063)
Capital in excess of stated value	**54,072**	49,963
Retained earnings	**45,715**	40,018
Accumulated other comprehensive loss	**(710)**	(56)
Total shareholders' equity	**106,594**	97,344
Total liabilities and shareholders' equity	**$ 220,766**	$ 214,162

See accompanying notes to unaudited condensed consolidated financial statements.

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

(In thousands, except per share data)	Three months ended September 30, 2022	Three months ended September 30, 2021	Six Months Ended September 30, 2022	Six Months Ended September 30, 2021
Net revenue:				
Products	**$ 10,548**	$ 7,299	**$ 21,594**	$ 16,143
Subscription and maintenance	**29,036**	24,027	**56,763**	47,234
Professional services	**8,158**	6,566	**16,891**	13,240
Total net revenue	**47,742**	37,892	**95,248**	76,617
Cost of goods sold:				
Products	**5,434**	3,660	**11,314**	8,020
Subscription and maintenance	**6,170**	5,019	**12,456**	9,763
Professional services	**6,773**	4,958	**13,618**	9,711
Total cost of goods sold	**18,377**	13,637	**37,388**	27,494
Gross profit	**29,365**	24,255	**57,860**	49,123
Gross profit margin	**61.5%**	64.0%	**60.7%**	64.1%
Operating expenses:				
Product development	**12,577**	11,379	**24,134**	22,864
Sales and marketing	**5,320**	3,423	**10,733**	6,475
General and administrative	**7,570**	6,523	**14,922**	13,526
Depreciation of fixed assets	**461**	548	**934**	1,114
Amortization of internal-use software and intangibles	**443**	345	**896**	810
Other charges	**67**	580	**281**	805
Legal settlements	**—**	337	**—**	367
Total operating expense	**26,438**	23,135	**51,900**	45,961
Operating income	**2,927**	1,120	**5,960**	3,162
Other (income) expense:				
Interest income	**(380)**	(14)	**(482)**	(35)
Interest expense	**1**	1	**1**	2
Other (income) expense, net	**(112)**	103	**(414)**	—
Income before taxes	**3,418**	1,030	**6,855**	3,195
Income tax (benefit) expense	**(158)**	48	**240**	241
Net income	**$ 3,576**	$ 982	**$ 6,615**	$ 2,954
Series A convertible preferred stock dividends	**(459)**	(459)	**(918)**	(918)
Net income attributable to common shareholders	**$ 3,117**	$ 523	**$ 5,697**	$ 2,036
Weighted average shares outstanding - basic	**24,652**	24,451	**24,625**	24,233
Net income per share - basic:	**$ 0.13**	$ 0.02	**$ 0.23**	$ 0.08
Weighted average shares outstanding - diluted	**25,783**	25,409	**25,591**	25,296
Net income per share - diluted:	**$ 0.12**	$ 0.02	**$ 0.22**	$ 0.08

See accompanying notes to unaudited condensed consolidated financial statements.

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

(In thousands)	Three months ended September 30, **2022**	Three months ended September 30, 2021	Six months ended September 30, **2022**	Six months ended September 30, 2021
Net income	**3,576**	$ 982	**6,615**	$ 2,954
Other comprehensive (loss) income, net of tax:				
Unrealized foreign currency translation adjustments	**(256)**	20	**(654)**	18
Total comprehensive income	**$ 3,320**	$ 1,002	**$ 5,961**	$ 2,972

See accompanying notes to unaudited condensed consolidated financial statements.

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

(In thousands)	Six Months Ended September 30, 2022	Six Months Ended September 30, 2021
Operating activities		
Net income	**$ 6,615**	$ 2,954
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on disposal of property & equipment	**—**	123
Depreciation of fixed assets	**934**	1,114
Amortization of internal-use software and intangibles	**896**	810
Deferred income taxes	**(306)**	(303)
Share-based compensation	**5,944**	6,963
Changes in operating assets and liabilities	**(10,966)**	12
Net cash provided by operating activities	**3,117**	11,673
Investing activities		
Capital expenditures	**(797)**	(786)
Additional investments in corporate-owned life insurance policies	**(2)**	(2)
Net cash used in investing activities	**(799)**	(788)
Financing activities		
Payment of preferred stock dividends	**(918)**	(918)
Repurchase of common shares to satisfy employee tax withholding	**(1,455)**	(2,709)
Principal payments under long-term obligations	**(2)**	(11)
Net cash used in financing activities	**(2,375)**	(3,638)
Effect of exchange rate changes on cash	**(718)**	(38)
Net (decrease) increase in cash and cash equivalents	**(775)**	7,209
Cash and cash equivalents at beginning of period	**96,971**	99,180
Cash and cash equivalents at end of period	**$ 96,196**	$ 106,389

See accompanying notes to unaudited condensed consolidated financial statements.

AGILYSYS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

Three Months Ended September 30, 2022

	Common Shares				Capital in excess of		Accumulated other	
	Issued		In Treasury					
(In thousands, except share data)	Shares	Stated value	Shares	Stated value	Stated value	Retained earnings	comprehensive income (loss)	Total
Balance at June 30, 2022	**31,607**	**$ 9,482**	**(6,582)**	**$ (1,974)**	**$ 51,624**	**$ 42,598**	**$ (454)**	**$ 101,276**
Share-based compensation	**—**	**—**	**—**	**—**	**3,396**	**—**	**—**	**3,396**
Restricted shares issued, net	**—**	**—**	**(5)**	**(2)**	**2**	**—**	**—**	**—**
Shares issued upon exercise of SSARs	**—**	**—**	**54**	**16**	**(16)**	**—**	**—**	**—**
Shares withheld for taxes upon exercise of SSARs or vesting of restricted shares	**—**	**—**	**(17)**	**(5)**	**(934)**	**—**	**—**	**(939)**
Net income	**—**	**—**	**—**	**—**	**—**	**3,576**	**—**	**3,576**
Series A convertible preferred stock dividends	**—**	**—**	**—**	**—**	**—**	**(459)**	**—**	**(459)**
Unrealized translation adjustments	**—**	**—**	**—**	**—**	**—**	**—**	**(256)**	**(256)**
Balance at September 30, 2022	**31,607**	**$ 9,482**	**(6,550)**	**$ (1,965)**	**$ 54,072**	**$ 45,715**	**$ (710)**	**$ 106,594**

Three Months Ended September 30, 2021

	Common Shares				Capital in excess of		Accumulated other	
	Issued		In Treasury					
(In thousands, except share data)	Shares	Stated value	Shares	Stated value	Stated value	Retained earnings	comprehensive income (loss)	Total
Balance at June 30, 2021	31,607	$ 9,482	(7,038)	$ (2,111)	$ 40,190	$ 36,889	$ 37	$ 84,487
Share-based compensation	—	—	—	—	3,327	—	—	3,327
Restricted shares issued, net	—	—	1	—	—	—	—	—
Shares issued upon exercise of SSARs	—	—	51	15	(15)	—	—	—
Shares withheld for taxes upon exercise of SSARs or vesting of restricted shares	—	—	(14)	(4)	(635)	—	—	(639)
Net income	—	—	—	—	—	982	—	982
Series A convertible preferred stock dividends	—	—	—	—	—	(459)	—	(459)
Unrealized translation adjustments	—	—	—	—	—	—	20	20
Balance at September 30, 2021	31,607	$ 9,482	(7,000)	$ (2,100)	$ 42,867	$ 37,412	$ 57	$ 87,718

Six Months Ended September 30, 2022

	Common Shares				Capital in excess of		Accumulated other	
	Issued		In Treasury					
(In thousands, except share data)	Shares	Stated value	Shares	Stated value	Stated value	Retained earnings	comprehensive income (loss)	Total
Balance at March 31, 2022	**31,607**	**$ 9,482**	**(6,879)**	**$ (2,063)**	**$ 49,963**	**$ 40,018**	**$ (56)**	**$ 97,344**
Share-based compensation	**—**	**—**	**—**	**—**	**6,019**	**—**	**—**	**6,019**
Restricted shares issued, net	**—**	**—**	**245**	**73**	**(73)**	**—**	**—**	**—**
Shares issued upon exercise of SSARs	**—**	**—**	**123**	**37**	**(37)**	**—**	**—**	**—**
Shares withheld for taxes upon exercise of SSARs or vesting of restricted shares	**—**	**—**	**(39)**	**(12)**	**(1,800)**	**—**	**—**	**(1,812)**
Net income	**—**	**—**	**—**	**—**	**—**	**6,615**	**—**	**6,615**
Series A convertible preferred stock dividends	**—**	**—**	**—**	**—**	**—**	**(918)**	**—**	**(918)**
Unrealized translation adjustments	**—**	**—**	**—**	**—**	**—**	**—**	**(654)**	**(654)**
Balance at September 30, 2022	**31,607**	**$ 9,482**	**(6,550)**	**$ (1,965)**	**$ 54,072**	**$ 45,715**	**$ (710)**	**$ 106,594**

Six Months Ended September 30, 2021

	Common Shares				Capital in excess of		Accumulated other	
	Issued		In Treasury					
(In thousands, except share data)	Shares	Stated value	Shares	Stated value	Stated value	Retained earnings	comprehensive income (loss)	Total
Balance at March 31, 2021	31,607	$ 9,482	(7,596)	$ (2,278)	$ 37,257	$ 35,376	$ 39	$ 79,876
Share-based compensation	—	—	—	—	7,053	—	—	7,053
Restricted shares issued, net	—	—	11	3	(3)	—	—	—
Shares issued upon exercise of SSARs	—	—	609	182	(182)	—	—	—
Shares withheld for taxes upon exercise of SSARs or vesting of restricted shares	—	—	(24)	(7)	(1,258)	—	—	(1,265)
Net income	—	—	—	—	—	2,954	—	2,954
Series A convertible preferred stock dividends	—	—	—	—	—	(918)	—	(918)
Unrealized translation adjustments	—	—	—	—	—	—	18	18
Balance at September 30, 2021	31,607	$ 9,482	(7,000)	$ (2,100)	$ 42,867	$ 37,412	$ 57	$ 87,718

See accompanying notes to unaudited condensed consolidated financial statements.

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 solutions for hotels, resorts and cruise lines, casinos, corporate foodservice management, restaurants, universities, stadiums, and healthcare. The Company's software solutions include point-of-sale (POS), property management (PMS), inventory and procurement, payments, and related applications that manage and enhance the entire guest journey. Agilysys also is known for its world-class customer-centric service. Many of the top hospitality companies around the world use Agilysys solutions to improve guest loyalty, drive revenue growth, and increase operational efficiencies. Agilysys operates across North America, Europe, the Middle East, Asia-Pacific, and India, with headquarters in Alpharetta, GA.

The Company has just one reportable segment serving the global hospitality industry.

COVID-19 Pandemic

The World Health Organization declared novel coronavirus ("COVID-19") a pandemic on March 11, 2020. The pandemic has created significant economic challenges as organizations and governmental authorities around the world have implemented numerous measures attempting to contain the spread of COVID-19, including travel restrictions, border closings, shelter-in-place orders, and social distancing requirements. Our customers and vendors have closed or have otherwise applied restrictions at certain sites in response to the pandemic. Similarly, we have provided remote working arrangements for our employees, limited business travel, and canceled or shifted various events to virtual attendance. We have localized our pandemic response to the countries and specific locations in which we, our customers and our vendors operate.

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 2023 refers to the fiscal year ending March 31, 2023.

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 September 30, 2022, 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 six months ended September 30, 2022 and 2021, and the Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2022 and 2021, are unaudited. However, these financial statements have been prepared on the same basis as those in the audited annual financial statements. 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, 2022, filed with the Securities and Exchange Commission (SEC) on May 23, 2022.

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. Actual results could differ from those estimates due to uncertainties.

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, 2022, included in our Annual Report on Form 10-K. There have been no material changes to our significant accounting policies from those disclosed therein.

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 proprietary 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.

We recognize revenue for hardware sales 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.

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.

We derive maintenance service revenue from providing unspecified updates, upgrades, bug fixes, and technical support services for our proprietary software. 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 maintenance services as a single performance obligation. Maintenance revenue includes the same services provided by third-parties for remarketed software. We recognize substantially all maintenance revenue over the contract period of the maintenance agreement. We also recognize certain maintenance service revenue based on the volume of payment transactions processed by third parties through access to our software.

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), subscription and maintenance and professional services. Revenue recognized at a point in time (products) totaled $10.5 million and $21.6 million, and $7.3 million and $16.1 million for the three and six months ended September 30, 2022 and 2021, respectively. Revenue recognized over time (subscription and maintenance and professional services) totaled $37.2 million and $73.7 million, and $30.6 million and $60.5 million for the three and six months ended September 30, 2022 and 2021, 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 $13.9 million and $12.2 million for the three months ended September 30, 2022 and 2021, respectively, and $34.7 million and $29.6 million for the six months ended September 30, 2022 and 2021, 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 September 30, 2022 and 2021, respectively, and $1.6 million and $2.3 million for the six months ended September 30, 2022 and 2021, respectively.

Our arrangements are for a period of one year or less. As a result, unsatisfied performance obligations as of September 30, 2022 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 $3.4 million and $3.1 million of capitalized sales incentive costs as of September 30, 2022 and 2021, respectively. These balances are included in other non-current assets on our condensed consolidated balance sheets. During the three and six months ended September 30, 2022, we expensed $0.8 million and $1.5 million, respectively, of sales commissions, which included amortization of capitalized amounts of $0.3 million and $0.6 million, respectively. During the comparable periods ending September 30, 2021, we expensed $0.5 million and $1.2 million, respectively, of sales commissions, which included amortization of capitalized amounts of $0.3 million and $0.6 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)	September 30, 2022	March 31, 2022
Accrued liabilities:		
Salaries, wages, and related benefits	**$ 7,650**	$ 7,870
Other taxes payable	**1,745**	1,994
Professional fees	**242**	373
Other	**322**	315
Total	**$ 9,959**	$ 10,552
Other non-current liabilities:		
Uncertain tax positions	**$ 1,166**	$ 1,154
Deferred rent and asset retirement obligations	**43**	43
Employee benefit obligations	**2,548**	2,037
Other	**72**	70
Total	**$ 3,829**	$ 3,304

During the three months ended September 30, 2022, an operating lease commenced with a lease term of approximately eleven years. Accordingly, we recorded the net lease obligation in operating lease liabilities and the associated operating lease right-of-use asset in the condensed consolidated balance sheet as of September 30, 2022.

5. Supplemental Disclosures of Cash Flow Information

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

	Six Months Ended September 30,	
(In thousands)	**2022**	2021
Cash (receipts) for interest, net	**$ (407)**	$ (13)
Cash payments for income tax, net	**624**	439
Cash payments for operating leases	**2,619**	2,308
Cash payments for finance leases	**3**	10
Accrued capital expenditures	**270**	45

6. Income Taxes

The following table compares our income tax expense and effective tax rates for the three and six months ended September 30, 2022 and 2021:

	Three Months Ended September 30,		Six Months Ended September 30,	
(Dollars in thousands)	**2022**	2021	**2022**	2021
Income tax (benefit) expense	**$ (158)**	$ 48	**$ 240**	$ 241
Effective tax rate	**(4.6)%**	4.7%	**3.5%**	7.5%

For the three and six months ended September 30, 2022 and 2021, respectively, the effective tax rate was different than the statutory rate due primarily to adjustments to deferred tax assets and to valuation allowances that reduce deferred tax assets and to the recording of net operating losses in a number of foreign jurisdictions offset by current year expense in other foreign jurisdictions. Our India subsidiary operates in a "Special Economic Zone ("SEZ")". One of the benefits associated with the SEZ is that the India subsidiary is not subject to regular India income taxes during its first five years of operations, which included fiscal 2018 through fiscal 2022. The India subsidiary is subject to 50% of regular India income taxes during its second five years of operations, which includes fiscal 2023 through fiscal 2027.

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.

The Coronavirus Aid, Relief, and Economic Security Act ("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, 2022.

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. This judgment was affirmed by the U.S. Court of Appeals for the Federal Circuit in November 2019 with respect to all claims except for two, which were not asserted against Agilysys, and Ameranth's writ of certiorari to the United States Supreme Court was denied in October 2020. In December 2021, the District Court denied Ameranth's motion to assert additional claims against the defendants. In March 2022, the District Court granted summary judgment in favor of the defendants still facing the remaining claims. Subsequently, Ameranth appealed the grant of summary judgment with the U.S. Court of Appeals for the Federal Circuit. On May 11, 2022, in accordance with its prior rulings, the District Court entered judgment in favor of us and against Ameranth on all claims asserted against us, however, Ameranth's appeal remains pending. 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.

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 September 30,		Six Months Ended September 30,	
(In thousands, except per share data)	**2022**	2021	**2022**	2021
Numerator:				
Net income	**$ 3,576**	$ 982	**$ 6,615**	$ 2,954
Series A convertible preferred stock dividends	**(459)**	(459)	**(918)**	(918)
Net income attributable to common shareholders	**$ 3,117**	$ 523	**$ 5,697**	$ 2,036
Denominator:				
Weighted average shares outstanding - basic	**24,652**	24,451	**24,625**	24,233
Dilutive SSARs	**992**	892	**881**	1,005
Dilutive unvested restricted shares	**139**	66	**85**	58
Weighted average shares outstanding - diluted	**25,783**	25,409	**25,591**	25,296
Income per share - basic:	**$ 0.13**	$ 0.02	**$ 0.23**	$ 0.08
Income per share - diluted:	**$ 0.12**	$ 0.02	**$ 0.22**	$ 0.08
Anti-dilutive SSARs, restricted shares, performance shares and preferred shares	**1,735**	1,735	**1,736**	1,735

Basic income per share is computed as net income attributable to common shareholders divided by the weighted average basic shares outstanding. The outstanding shares used to calculate the weighted average basic shares excludes 377,491 and 139,332 of restricted shares at September 30, 2022 and 2021, respectively, as these shares were issued but were not vested and therefore, not considered outstanding for purposes of computing basic income 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.

We record compensation expense related to SSARs, restricted shares, and performance shares granted to certain employees and non-employee directors based on the fair value of the awards on the grant date. The fair value of restricted share grants subject only to a service condition 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. Under the 2020 Plan, the fair value of performance shares is based on the closing price of our common shares on the settlement date of the performance award, for which we record compensation expense over the service period consistent with our annual bonus incentive plan as approved by the Compensation Committee of the Board of Directors.

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 September 30,		Six Months Ended September 30,	
(In thousands)	**2022**	2021	**2022**	2021
Product development	**2,141**	1,751	**3,662**	3,816
Sales and marketing	**290**	335	**565**	666
General and administrative	**1,025**	1,256	**1,717**	2,481
Total share-based compensation expense	**3,456**	3,342	**5,944**	6,963

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 six months ended September 30, 2022 for SSARs awarded under the 2020 and 2016 Plans:

(In thousands, except share and per share data)	Number of Rights		Weighted-Average Exercise Price	Remaining Contractual Term		Aggregate Intrinsic Value
			(per right)	(in years)		
Outstanding at April 1, 2022	2,172,939	$	24.02			
Granted	—		—			
Exercised	(201,612)		17.77			
Forfeited	(24,762)		20.02			
Expired	—		—			
Outstanding at September 30, 2022	**1,946,565**	**$**	**24.72**	**3.9**	**$**	**59,618**
Exercisable at September 30, 2022	**1,619,517**	**$**	**24.82**	**3.8**	**$**	**49,439**
Vested and expected to vest at September 30, 2022	**1,946,565**	**$**	**24.72**	**3.9**	**$**	**59,618**

As of September 30, 2022, total unrecognized share-based compensation expense related to non-vested service condition SSARs was $1.0 million, which is expected to be recognized over a weighted-average vesting period of 0.5 years.

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 six months ended September 30, 2022 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, 2022	147,973	$	43.56
Granted	253,968		42.94
Vested	(15,878)		44.70
Forfeited	(8,572)		44.67
Outstanding at September 30, 2022	**377,491**	**$**	**43.09**

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 September 30, 2022, total unrecognized share-based compensation expense related to unvested restricted shares was $11.2 million, which is expected to be recognized over a weighted-average vesting period of 2.4 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 5,384 common shares to our Chief Executive Officer in May 2022 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

On January 5, 2022 (the acquisition date), we acquired all the issued and outstanding shares of ResortSuite Inc. ("ResortSuite"), a Canada-based fully integrated property management solutions provider focused on the complex multi-amenity and resort market. The condensed consolidated financial statements include the results of ResortSuite's operations since the acquisition date. The acquisition extends our solutions to customers in the complex multi-amenity and resort market.

The purchase price consisted of $22.6 million of cash paid at closing, funded from cash on hand, partially offset by $0.3 million of ResortSuite's cash received in the acquisition, and $2.2 million of cash paid in March for certain ResortSuite tax liabilities resulting in net cash consideration of $24.5 million. We allocated the purchase price for ResortSuite to the intangible and certain tangible assets acquired and certain liabilities assumed based on their estimated fair values on the acquisition date, with the remaining unallocated purchase price recorded as goodwill. We determined the fair values assigned to identifiable intangible assets acquired primarily by using the income approach, which discounts the expected future cash flows to present value using estimates and assumptions determined by management.

In accordance with Accounting Standards Update (ASU) No. 2021-08, we applied Accounting Standards Codification Topic 606 to record certain customer accounts receivable and the contract liabilities assumed in the acquisition, which consisted of undelivered performance obligations under customer contracts. We adopted ASU 2021-08 early as permitted. As a result, in allocating the purchase price, we recorded $2.8 million of contract liabilities, representing the revenue that will be recognized as the underlying performance obligations are delivered.

The following table sets forth the components and the allocation of the purchase price for our acquisition of ResortSuite:

(In thousands)		Total
Components of Purchase Price:		
Cash	$	24,800
Total purchase price	**$**	**24,800**
Allocation of Purchase Price:		
Net tangible assets (liabilities):		
Accounts receivable, net	$	2,025
Other current assets, including cash acquired		519
Other assets		567
Current and other liabilities		(768)
Contract liabilities		(2,835)
Net tangible assets (liabilities)		**(492)**
Identifiable intangible assets:		
Customer relationships		9,634
Non-competition agreements		848
Developed technology		827
Trade names		846
Total identifiable intangible assets		**12,155**
Goodwill		13,137
Total purchase price allocation	**$**	**24,800**

We assigned the acquired customer relationships, non-competition agreements, developed technology, and trade names estimated useful lives of 15 years, two years, five years, and five years, respectively, the weighted average of which is approximately 12.7 years. The acquired identifiable intangible assets are being amortized on a straight-line basis, which we believe approximates the pattern in which the assets are utilized, over their estimated useful lives.

The goodwill recognized in the ResortSuite purchase price allocation is attributable to synergies in products and technologies to serve a broader customer base, and the addition of a skilled, assembled workforce. The acquisition resulted in the recognition of $13.1 million of goodwill, which is expected to be deductible for income tax purposes.

The Company recognized acquisition costs of $0.1 million related to the acquisition of ResortSuite, consisting primarily of professional fees, during the six months ended September 30, 2022. The condensed consolidated statement of operations includes these costs in other charges.

Revenue attributable to ResortSuite included in our consolidated statement of operations for the three and six months ended September 30, 2022, respectively, was $1.3 million and $2.6 million. Net income was not material.

We have prepared the purchase price allocation for ResortSuite on a preliminary basis. Changes to the allocation may occur as additional information becomes available during the measurement period (up to one year from the acquisition date).

Effective April 1, 2022, ResortSuite became Agilysys Canada, Inc. a wholly-owned subsidiary of Agilysys, Inc.

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, 2022, 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, 2022. 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, 2022 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.

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 is well known for its long heritage of hospitality-focused technology innovation. The Company delivers modular and integrated software solutions and expertise to businesses seeking to maximize Return on Experience (ROE) through hospitality encounters that are both personal and profitable. Over time, customers achieve High Return Hospitality by consistently delighting guests, retaining staff and growing margins. Customers around the world include: branded and independent hotels; multi-amenity resort properties; casinos; property, hotel and resort management companies; cruise lines; corporate dining providers; higher education campus dining providers; food service management companies; hospitals; lifestyle communities; senior living facilities; stadiums; and theme parks. The Agilysys Hospitality Cloud™ combines core operational systems for property management (PMS), point-of-sale (POS) and Inventory and Procurement (I&P) with Experience Enhancers™ that meaningfully improve interactions for guests and for employees across dimensions such as digital access, mobile convenience, self-service control, personal choice, payment options, service coverage and real-time insights to improve decisions. Core solutions and Experience Enhancers are selectively combined in Hospitality Solution Studios™ tailored to specific hospitality settings and business needs.

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
- Improving our liquidity
- 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, increasing profitability and strengthening our competitive position within the specific technology solutions and end markets we serve. Profitability and industry-leading growth will be achieved through tighter management of operating expenses and sharpening the focus of our investments to concentrate on growth opportunities that offer the highest returns.

Revenue - Defined

As required by the SEC, we separately present revenue earned as products revenue, subscription and maintenance 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 delivery of software licenses, third party hardware and operating systems.
- Subscription and maintenance revenue – Revenue earned from the ongoing delivery of software updates, upgrades, bug fixes and technical support over the period covered by subscription or maintenance agreements with our customers for both proprietary and remarketed solutions.
- Professional services revenue – Revenue earned from the delivery of implementation, integration and installation services for proprietary and remarketed solutions.

Results of Operations

Second Fiscal Quarter 2023 Compared to Second Fiscal Quarter 2022

Net Revenue and Operating Income

The following table presents our consolidated revenue and operating results for the three months ended September 30, 2022 and 2021:

	Three Months Ended September 30,		Increase (decrease)	
(Dollars in thousands)	**2022**	2021	$	%
Net revenue:				
Products	**$ 10,548**	$ 7,299	$ 3,249	44.5%
Subscription and maintenance	**29,036**	24,027	5,009	20.8%
Professional services	**8,158**	6,566	1,592	24.2%
Total net revenue	**47,742**	37,892	9,850	26.0%
Cost of goods sold:				
Products	**5,434**	3,660	1,774	48.5%
Subscription and maintenance	**6,170**	5,019	1,151	22.9%
Professional services	**6,773**	4,958	1,815	36.6%
Total cost of goods sold	**18,377**	13,637	4,740	34.8%
Gross profit	**$ 29,365**	$ 24,255	$ 5,110	21.1%
Gross profit margin	***61.5%***	*64.0%*		
Operating expenses:				
Product development	**$ 12,577**	$ 11,379	$ 1,198	10.5%
Sales and marketing	**5,320**	3,423	1,897	55.4%
General and administrative	**7,570**	6,523	1,047	16.1%
Depreciation of fixed assets	**461**	548	(87)	(15.9)%
Amortization of internal-use software and intangibles	**443**	345	98	28.4%
Other charges	**67**	580	(513)	nm
Legal settlements	**-**	337	(337)	nm
Operating income	**$ 2,927**	$ 1,120	$ 1,807	161.3%
Operating income percentage	***6.1%***	*3.0%*		

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 September 30,	
	2022	2021
Net revenue:		
Products	**22.1%**	19.3%
Subscription and maintenance	**60.8**	63.4
Professional services	**17.1**	17.3
Total net revenue	**100.0%**	100.0%
Cost of goods sold:		
Products	**11.4%**	9.7%
Subscription and maintenance	**12.9**	13.2
Professional services	**14.2**	13.1
Total net cost of goods sold	**38.5%**	36.0%
Gross profit	**61.5%**	64.0%
Operating expenses:		
Product development	**26.3%**	30.0%
Sales and marketing	**11.2**	9.0
General and administrative	**15.9**	17.2
Depreciation of fixed assets	**1.0**	1.5
Amortization of internal-use software and intangibles	**0.9**	0.9
Other charges	**0.1**	1.5
Legal settlements	**-**	0.9
Operating income	**6.1%**	3.0%

Net revenue. Total net revenue increased $9.9 million, or 26.0%, during the second quarter of fiscal 2023 compared to the second quarter of fiscal 2022. Products revenue increased $3.2 million, or 44.5%, due to higher sales and deliveries to new customers and expansion with existing customers. Subscription and maintenance revenue increased $5.0 million, or 20.8%, compared to the second quarter of fiscal 2022 driven by continued growth in subscription-based service revenue, which increased 28.6% during the second quarter of fiscal 2023 compared to the second quarter of fiscal 2022. Professional services revenue increased $1.6 million, or 24.2%, due to higher sales and service activity as our new and existing customers continue implementing technology to improve their operations.

Gross profit and gross profit margin. Our total gross profit increased $5.1 million, or 21.1%, during the second quarter of fiscal 2023 and total gross profit margin decreased from 64.0% to 61.5% compared to the second quarter of fiscal 2022 driven by changes in the composition of revenue by category. Products gross profit increased $1.5 million, or 40.5%, and products gross profit margin decreased from 49.9% to 48.5% due to the composition of hardware products delivered. Subscription and maintenance gross profit increased $3.9 million, or 20.3%, and gross profit margin decreased from 79.1% to 78.8% as certain variable costs increased ahead of related revenue. Professional services gross profit margin decreased from 24.5% to 17.0% reflecting lower utilization rates due to higher non-billable hours on new, more complex multi-solution implementations.

Operating expenses

Operating expenses, excluding other charges and legal settlements, increased $4.2 million, or 18.7%, during the second quarter of fiscal 2023 compared with the second quarter of fiscal 2022.

Product development. Product development increased $1.2 million, or 10.5%, in the second quarter of fiscal 2023 compared with the second quarter of fiscal 2022 due to hiring and increased salary rates across our development teams.

Sales and marketing. Sales and marketing increased $1.9 million, or 55.4%, in the second quarter of fiscal 2023 compared with the second quarter of fiscal 2022 due to various sales and marketing investments including several key hires, significantly higher levels of marketing event and trade show activity and increased commission expense on higher sales activity.

General and administrative. General and administrative increased $1.0 million, or 16.1%, in the second quarter of fiscal 2023 compared with the second quarter of fiscal 2022 due to hiring and increased salary rates across our administrative teams including information security, information technology, and business operations.

Other charges. Other charges consist of severance costs, infrequent settlements of customer disputes and acquisition costs related to business combinations.

Other (Income) Expenses

	Three Months Ended September 30,		(Unfavorable) favorable	
(Dollars in thousands)	**2022**	2021	$	%
Other (income) expense:				
Interest income	**$ (380)**	$ (14)	$ 366	nm
Interest expense	**1**	1	—	nm
Other (income) expense, net	**(112)**	103	215	nm
Total other (income) expense, net	**$ (491)**	$ 90	$ 581	nm

nm - not meaningful

Interest income. Interest income consists of interest earned 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 (income) expense, net. Other (income) expense, net mainly consists of movement of foreign currencies against the US dollar.

Income Taxes

	Three Months Ended September 30,		(Unfavorable) favorable	
(Dollars in thousands)	**2022**	2021	$	%
Income tax (benefit) expense	**$ (158)**	$ 48	$ 206	429.2%
Effective tax rate	**(4.6)%**	4.7%		

nm - not meaningful

For the three months ended September 30, 2022 and 2021, respectively, the effective tax rate was different than the statutory rate due primarily to adjustments to deferred tax assets and to valuation allowances that reduce deferred tax assets and to the recording of net operating losses in a number of foreign jurisdictions offset by current year expense in other foreign jurisdictions.

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.

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. 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.

Results of Operations

First Half Fiscal 2023 Compared to First Half Fiscal 2022

Net Revenue and Operating Income

The following table presents our consolidated revenue and operating results for the six months ended September 30, 2022 and 2021:

	Six Months Ended September 30,		Increase (decrease)	
(Dollars in thousands)	**2022**	2021	$	%
Net revenue:				
Products	**$ 21,594**	$ 16,143	$ 5,451	33.8%
Subscription and maintenance	**56,763**	47,234	9,529	20.2%
Professional services	**16,891**	13,240	3,651	27.6%
Total net revenue	**95,248**	76,617	18,631	24.3%
Cost of goods sold:				
Products	**11,314**	8,020	3,294	41.1%
Subscription and maintenance	**12,456**	9,763	2,693	27.6%
Professional services	**13,618**	9,711	3,907	40.2%
Total cost of goods sold	**37,388**	27,494	9,894	36.0%
Gross profit	**$ 57,860**	$ 49,123	$ 8,737	17.8%
Gross profit margin	***60.7%***	*64.1%*		
Operating expenses:				
Product development	**$ 24,134**	$ 22,864	$ 1,270	5.6%
Sales and marketing	**10,733**	6,475	4,258	65.8%
General and administrative	**14,922**	13,526	1,396	10.3%
Depreciation of fixed assets	**934**	1,114	(180)	(16.2)%
Amortization of internal-use software and intangibles	**896**	810	86	10.6%
Other charges	**281**	805	(524)	(65.1)%
Legal settlements	**-**	367	(367)	nm
Operating income	**$ 5,960**	$ 3,162	$ 2,798	88.5%
Operating income percentage	***6.3%***	*4.1%*		

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:

	Six Months Ended September 30,	
	2022	2021
Net revenue:		
Products	**22.7%**	21.1%
Subscription and maintenance	**59.6**	61.6
Professional services	**17.7**	17.3
Total net revenue	**100.0%**	100.0%
Cost of goods sold:		
Products	**11.9%**	10.5%
Subscription and maintenance	**13.1**	12.7
Professional services	**14.3**	12.7
Total net cost of goods sold	**39.3%**	35.9%
Gross profit	**60.7%**	64.1%
Operating expenses:		
Product development	**25.3%**	29.8%
Sales and marketing	**11.2**	8.5
General and administrative	**15.7**	17.7
Depreciation of fixed assets	**1.0**	1.3
Amortization of internal-use software and intangibles	**0.9**	1.1
Other charges	**0.3**	1.1
Legal settlements	**-**	0.5
Operating income	**6.3%**	4.1%

Net revenue. Total net revenue increased $18.6 million, or 24.3%, during the first half of fiscal 2023 compared to the first half of fiscal 2022. Products revenue increased $5.5 million, or 33.8%, due to higher sales and deliveries to new customers and expansion with existing customers. Subscription and maintenance revenue increased $9.5 million, or 20.2%, compared to the first half of fiscal 2022 driven by continued growth in subscription-based service revenue, which increased 29.0% during the first half of fiscal 2023 compared to the first half of fiscal 2022. Professional services revenue increased $3.7 million, or 27.6%, due to higher sales and service activity as our new and existing customers continue implementing technology to improve their operations.

Gross profit and gross profit margin. Our total gross profit increased $8.7 million, or 17.8%, during the first half of fiscal 2023 and total gross profit margin decreased from 64.1% to 60.7% compared to the first half of fiscal 2022 driven by changes in the composition of revenue by category. Products gross profit increased $2.2 million, or 26.6%, and products gross profit margin decreased from 50.3% to 47.6% due to a higher proportion of third-party products over proprietary software revenue. Subscription and maintenance gross profit increased $6.8 million, or 18.2%, and gross profit margin decreased from 79.3% to 78.1% as certain variable costs increased ahead of related revenue. Professional services gross profit margin decreased from 26.7% to 19.4% reflecting lower utilization rates due to higher non-billable hours on new, more complex solution implementations.

Operating expenses

Operating expenses, excluding other charges and legal settlements, increased $6.8 million, or 15.2%, during the first half of fiscal 2023 compared with the first half of fiscal 2022.

Product development. Product development increased $1.3 million, or 5.6%, in the first half of fiscal 2023 compared with the first half of fiscal 2022 due to hiring and increased salary rates across our development teams.

Sales and marketing. Sales and marketing increased $4.3 million, or 65.8%, in the first half of fiscal 2023 compared with the first half of fiscal 2022 due to various sales and marketing investments including several key hires, significantly higher levels of marketing event and trade show activity and increased commission expense on higher sales activity.

General and administrative. General and administrative increased $1.4 million, or 10.3%, in the first half of fiscal 2023 compared with the first half of fiscal 2022 due to investments in our information security and information technology infrastructure along with hiring and increased salary rates across our administrative teams including information security, information technology, and business operations.

Other charges. Other charges consist of severance costs, infrequent settlements of customer disputes and acquisition costs related to business combinations.

Other (Income) Expenses

(Dollars in thousands)	Six Months Ended September 30, 2022	2021	(Unfavorable) favorable $	%
Other (income) expense:				
Interest income	**$ (482)**	$ (35)	$ 447	nm
Interest expense	**1**	2	1	nm
Other (income) expense, net	**(414)**	—	414	nm
Total other (income) expense, net	**$ (895)**	$ (33)	$ 862	nm

nm - not meaningful

Interest income. Interest income consists of interest earned 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 (income) expense, net. Other (income) expense, net mainly consists of movement of foreign currencies against the US dollar.

Income Taxes

(Dollars in thousands)	Six Months Ended September 30, 2022	2021	(Unfavorable) favorable $	%
Income tax expense	**$ 240**	$ 241	$ 1	0.4%
Effective tax rate	**3.5%**	7.5%		

nm - not meaningful

For the six months ended September 30, 2022 and 2021, respectively, the effective tax rate was different than the statutory rate due primarily to adjustments to deferred tax assets and to valuation allowances that reduce deferred tax assets and to the recording of net operating losses in a number of foreign jurisdictions offset by current year expense in other foreign jurisdictions.

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 cash requirements consist primarily of working capital needs, capital expenditures and payments of contractual obligations. Our contractual obligations consist primarily of operating leases for office space and preferred stock dividends.

At September 30, 2022, 100% of our cash and cash equivalents, of which 93% were located in the United States, were deposited in bank accounts or invested in highly liquid investments including commercial paper and treasury bills with original maturity from the date of acquisition of three months or less and money market funds. We determine the fair value of commercial paper using significant other observable inputs based on pricing from independent sources that use quoted prices in active markets for identical assets or other observable inputs including benchmark yields and interest rates. We believe credit risk is limited with respect to our cash and cash equivalents.

We believe that cash flow from operating activities, cash and cash equivalents of $96.2 million as of September 30, 2022, and access to capital markets will provide adequate funds to meet our short- and long-term liquidity requirements.

Cash Flow

(In thousands)	Six Months Ended September 30, **2022**	2021
Net cash provided by (used in):		
Operating activities	**$ 3,117**	$ 11,673
Investing activities	**(799)**	(788)
Financing activities	**(2,375)**	(3,638)
Effect of exchange rate changes on cash	**(718)**	(38)
(Decrease) increase in cash	**$ (775)**	$ 7,209

Cash flow provided by operating activities. Cash flow provided by operating activities was $3.1 million in the first six months of fiscal 2023. The provision of cash was due to cash-based earnings of $6.6 million, adjusted for non-cash expenses of $7.5 million including depreciation, amortization, and share-based compensation, and a decrease of $11.0 million in net operating assets and liabilities.

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

Cash flow used in financing activities. During the first six months of fiscal 2023, the $2.4 million used in financing activities consisted primarily of $1.5 million related to the repurchase of shares to satisfy employee tax withholding on share-based compensation and $0.9 million in preferred stock dividends.

Contractual Obligations

As of September 30, 2022, there were no significant changes to our contractual obligations as presented in our Annual Report for the year ended March 31, 2022, other than the operating lease that commenced during the three months ended September 30, 2022, as described in Note 4, *Additional Balance Sheet Information*, to the condensed consolidated financial statements.

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, 2022. There have been no material changes in our significant accounting policies and estimates since March 31, 2022.

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, 2022. 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, 2022. There have been no material changes in our market risk exposures since March 31, 2022.

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

No changes in our internal control over financial reporting occurred during the six months ended September 30, 2022 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Significant portions of our global workforce continued to operate primarily in a work from home environment for the quarter ended September 30, 2022. The design of our financial reporting processes, systems, and controls allows for remote operation with access 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

There have been no material changes in the risk factors included in our Annual Report for the fiscal year ended March 31, 2022 that may materially affect our business, results of operations, or financial condition.

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.

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: October 28, 2022	/s/ William David Wood III
	William David Wood III Chief Financial Officer (Principal Financial Officer and Duly Authorized Officer)