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, 2023

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.)
3655 Brookside Parkway, Suite 300	
Alpharetta, Georgia	**30022**
(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 ☒

As of October 20, 2023, the registrant had 25,373,280 shares of common stock outstanding.

AGILYSYS, INC.

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AGILYSYS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)		September 30, 2023 (Unaudited)		March 31, 2023
ASSETS				
Current assets:				
Cash and cash equivalents	**$**	**107,413**	$	112,842
Accounts receivable, net of allowance for expected credit losses of $723 and $610, respectively		**27,762**		22,378
Contract assets		**3,278**		2,242
Inventories		**7,485**		9,774
Prepaid expenses and other current assets		**7,473**		7,422
Total current assets		**153,411**		154,658
Property and equipment, net		**17,477**		14,576
Operating lease right-of-use assets		**23,097**		12,708
Goodwill		**32,755**		32,638
Intangible assets, net		**17,505**		18,140
Deferred income taxes, non-current		**3,153**		2,790
Other non-current assets		**7,816**		7,526
Total assets	**$**	**255,214**	$	243,036
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	**$**	**10,069**	$	9,418
Contract liabilities		**43,334**		52,124
Accrued liabilities		**13,764**		13,708
Operating lease liabilities, current		**5,540**		3,263
Finance lease obligations, current		**—**		2
Total current liabilities		**72,707**		78,515
Deferred income taxes, non-current		**2,278**		2,257
Operating lease liabilities, non-current		**23,294**		13,477
Other non-current liabilities		**4,858**		4,018
Commitments and contingencies				
Series A convertible preferred stock, no par value		**35,459**		35,459
Shareholders' equity:				
Common shares, without par value, at $0.30 stated value; 80,000,000 shares authorized; 31,606,831 shares issued; and 25,370,482 and 25,326,626 shares outstanding at September 30, 2023 and March 31, 2023, respectively		**9,482**		9,482
Treasury shares, 6,236,349 and 6,280,205 at September 30, 2023 and March 31, 2023, respectively		**(1,871)**		(1,884)
Capital in excess of stated value		**55,154**		52,978
Retained earnings		**57,939**		52,764
Accumulated other comprehensive loss		**(4,086)**		(4,030)
Total shareholders' equity		**116,618**		109,310
Total liabilities and shareholders' equity	**$**	**255,214**	$	243,036

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, 2023	Three months ended September 30, 2022	Six Months Ended September 30, 2023	Six Months Ended September 30, 2022
Net revenue:				
Products	**$ 12,640**	$ 10,548	**$ 25,422**	$ 21,594
Subscription and maintenance	**34,248**	29,036	**66,373**	56,763
Professional services	**11,728**	8,158	**22,881**	16,891
Total net revenue	**58,616**	47,742	**114,676**	95,248
Cost of goods sold:				
Products	**6,751**	5,434	**13,317**	11,314
Subscription and maintenance	**7,804**	6,170	**15,441**	12,456
Professional services	**8,965**	6,773	**17,764**	13,618
Total cost of goods sold	**23,520**	18,377	**46,522**	37,388
Gross profit	**35,096**	29,365	**68,154**	57,860
Gross profit margin	**59.9%**	61.5%	**59.4%**	60.7%
Operating expenses:				
Product development	**14,583**	12,577	**27,904**	24,134
Sales and marketing	**6,400**	5,320	**13,701**	10,733
General and administrative	**8,785**	7,570	**18,150**	14,922
Depreciation of fixed assets	**1,209**	461	**2,133**	934
Amortization of internal-use software and intangibles	**347**	443	**776**	896
Other charges	**210**	67	**969**	281
Total operating expense	**31,534**	26,438	**63,633**	51,900
Operating income	**3,562**	2,927	**4,521**	5,960
Other income (expense):				
Interest income	**1,227**	380	**2,328**	482
Interest expense	**—**	(1)	**—**	(1)
Other income (expense), net	**51**	112	**(109)**	**414**
Income before taxes	**4,840**	3,418	**6,740**	6,855
Income tax provision (benefit)	**295**	(158)	**647**	240
Net income	**$ 4,545**	$ 3,576	**$ 6,093**	$ 6,615
Series A convertible preferred stock dividends	**(459)**	(459)	**(918)**	(918)
Net income attributable to common shareholders	**$ 4,086**	$ 3,117	**$ 5,175**	$ 5,697
Weighted average shares outstanding - basic	**25,022**	24,652	**24,979**	24,625
Net income per share - basic:	**$ 0.16**	$ 0.13	**$ 0.21**	$ 0.23
Weighted average shares outstanding - diluted	**26,117**	25,783	**26,148**	25,591
Net income per share - diluted:	**$ 0.16**	$ 0.12	**$ 0.20**	$ 0.22

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three months ended September 30,		Six months ended September 30,	
(In thousands)	**2023**	2022	**2023**	2022
Net income	**4,545**	$ 3,576	**6,093**	$ 6,615
Other comprehensive (loss), net of tax:				
Unrealized foreign currency translation adjustments	**(579)**	(256)	**(56)**	(654)
Total comprehensive income	**$ 3,966**	$ 3,320	**$ 6,037**	$ 5,961

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, 2023	2022
Operating activities		
Net income	**$ 6,093**	$ 6,615
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of fixed assets	**2,133**	934
Amortization of internal-use software and intangibles	**776**	896
Deferred income taxes	**(389)**	(306)
Share-based compensation	**5,851**	5,944
Changes in operating assets and liabilities	**(8,994)**	(10,966)
Net cash provided by operating activities	**5,470**	3,117
Investing activities		
Capital expenditures	**(6,002)**	(797)
Additional investments in corporate-owned life insurance policies	**(2)**	(2)
Net cash used in investing activities	**(6,004)**	(799)
Financing activities		
Payment of preferred stock dividends	**(918)**	(918)
Repurchase of common shares to satisfy employee tax withholding	**(3,868)**	(1,455)
Principal payments under long-term obligations	**(2)**	(2)
Net cash used in financing activities	**(4,788)**	(2,375)
Effect of exchange rate changes on cash	**(107)**	(718)
Net decrease in cash and cash equivalents	**(5,429)**	(775)
Cash and cash equivalents at beginning of period	**112,842**	96,971
Cash and cash equivalents at end of period	**$ 107,413**	$ 96,196

See accompanying notes to unaudited condensed consolidated financial statements.

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

Three Months Ended September 30, 2023

(In thousands, except share data)	Common Shares Issued Shares	Common Shares Issued Stated value	Common Shares In Treasury Shares	Common Shares In Treasury Stated value	Capital in excess of Stated value	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance at June 30, 2023	**31,607**	**$ 9,482**	**(6,255)**	**$ (1,877)**	**$ 53,735**	**$ 53,853**	**$ (3,507)**	**$ 111,686**
Share-based compensation	**—**	**—**	**—**	**—**	**2,534**	**—**	**—**	**2,534**
Restricted shares issued, net	**—**	**—**	**(8)**	**(2)**	**2**	**—**	**—**	**—**
Shares issued upon exercise of SSARs	**—**	**—**	**40**	**12**	**(12)**	**—**	**—**	**—**
Shares withheld for taxes upon exercise of SSARs or vesting of restricted shares	**—**	**—**	**(13)**	**(4)**	**(1,105)**	**—**	**—**	**(1,109)**
Net income	**—**	**—**	**—**	**—**	**—**	**4,545**	**—**	**4,545**
Series A convertible preferred stock dividends	**—**	**—**	**—**	**—**	**—**	**(459)**	**—**	**(459)**
Unrealized translation adjustments	**—**	**—**	**—**	**—**	**—**	**—**	**(579)**	**(579)**
Balance at September 30, 2023	**31,607**	**$ 9,482**	**(6,236)**	**$ (1,871)**	**$ 55,154**	**$ 57,939**	**$ (4,086)**	**$ 116,618**

Three Months Ended September 30, 2022

(In thousands, except share data)	Common Shares Issued Shares	Common Shares Issued Stated value	Common Shares In Treasury Shares	Common Shares In Treasury Stated value	Capital in excess of Stated value	Retained earnings	Accumulated other 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

Six Months Ended September 30, 2023

(In thousands, except share data)	Common Shares Issued Shares	Common Shares Issued Stated value	Common Shares In Treasury Shares	Common Shares In Treasury Stated value	Capital in excess of Stated value	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance at March 31, 2023	**31,607**	**$ 9,482**	**(6,280)**	**$ (1,884)**	**$ 52,978**	**$ 52,764**	**$ (4,030)**	**$ 109,310**
Share-based compensation	**—**	**—**	**—**	**—**	**5,911**	**—**	**—**	**5,911**
Restricted shares issued, net	**—**	**—**	**4**	**1**	**(1)**	**—**	**—**	**—**
Shares issued upon exercise of SSARs	**—**	**—**	**90**	**27**	**(27)**	**—**	**—**	**—**
Shares withheld for taxes upon exercise of SSARs or vesting of restricted shares	**—**	**—**	**(50)**	**(15)**	**(3,707)**	**—**	**—**	**(3,722)**
Net income	**—**	**—**	**—**	**—**	**—**	**6,093**	**—**	**6,093**
Series A convertible preferred stock dividends	**—**	**—**	**—**	**—**	**—**	**(918)**	**—**	**(918)**
Unrealized translation adjustments	**—**	**—**	**—**	**—**	**—**	**—**	**(56)**	**(56)**
Balance at September 30, 2023	**31,607**	**$ 9,482**	**(6,236)**	**$ (1,871)**	**$ 55,154**	**$ 57,939**	**$ (4,086)**	**$ 116,618**

Six Months Ended September 30, 2022

(In thousands, except share data)	Common Shares Issued Shares	Common Shares Issued Stated value	Common Shares In Treasury Shares	Common Shares In Treasury Stated value	Capital in excess of Stated value	Retained earnings	Accumulated other 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

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.

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 2024 refers to the fiscal year ending March 31, 2024.

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, 2023, 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, 2023 and 2022, and the Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2023 and 2022, 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, 2023, filed with the Securities and Exchange Commission (SEC) on May 19, 2023.

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, 2023, 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 service 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 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 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 ship or 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. Our subscription service revenue is primarily based on rates per location, including rates per points of sale and per room. We recognize certain subscription service revenue on a per-transaction basis. 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, any hosting services, and any transaction-based 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, implementation, 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 derive 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 (proprietary software licenses, third party hardware and operating systems), subscription and maintenance, and professional services. Products revenue recognized at a point in time totaled $12.6 million and $10.5 million, and $25.4 million and $21.6 million for the three and six months ended September 30, 2023 and 2022, respectively. Subscription and maintenance, and professional services revenue recognized substantially over time totaled $46.0 million and $37.2 million, and $89.3 million and $73.7 million for the three and six months ended September 30, 2023 and 2022, 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 products and 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 $14.8 million and $13.9 million for the three months ended September 30, 2023 and 2022, respectively, and $36.9 million and $34.7 million for the six months ended September 30, 2023 and 2022, respectively. Because the right to the transaction became unconditional, we transferred to accounts receivable from contract assets at the beginning of the period, $0.3 million and $0.1 million for the three months ended September 30, 2023 and 2022, respectively, and $1.9 million and $1.6 million for the six months ended September 30, 2023 and 2022, respectively.

Our arrangements are for a period of one year or less. As a result, unsatisfied performance obligations as of September 30, 2023 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 $4.1 million and $3.4 million of capitalized sales incentive costs as of September 30, 2023 and 2022, 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, 2023, we expensed $0.9 million and $1.9 million, respectively, of sales commissions, which included amortization of capitalized amounts of $0.4 million and $0.8 million, respectively. During the comparable periods ending 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. 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, 2023		March 31, 2023
Accrued liabilities:				
Salaries, wages, and related benefits	**$**	**11,264**	$	11,170
Other taxes payable		**1,918**		2,127
Professional fees		**212**		95
Other		**370**		316
Total	**$**	**13,764**	$	13,708
Other non-current liabilities:				
Uncertain tax positions	**$**	**1,190**	$	1,178
Employee benefit obligations		**3,566**		2,742
Other		**102**		98
Total	**$**	**4,858**	$	4,018

During October 2023, we signed an agreement with the landlord of certain leased office space to terminate the existing lease agreements before the expiration of their lease terms. The agreement will result in the removal of approximately $3.9 million in lease liabilities and approximately $3.3 million in associated right-of-use assets with a resulting gain of approximately $0.6 million.

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)		**2023**		2022
Cash receipts for interest, net	**$**	**1,948**	$	407
Cash payments for income tax, net		**900**		624
Cash payments for operating leases		**2,376**		2,619
Cash payments for finance leases		**3**		3
Accrued capital expenditures		**227**		270

6. Income Taxes

The following table compares our income tax provision and effective tax rates for the three and six months ended September 30, 2023 and 2022:

	Three Months Ended September 30,				Six Months Ended September 30,			
(Dollars in thousands)		**2023**		2022		**2023**		2022
Income tax provision (benefit)	**$**	**295**	$	(158)	**$**	**647**	$	240
Effective tax rate		**6.1%**		(4.6)%		**9.6%**		3.5%

For the three months ended September 30, 2023 and 2022, 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.

We have recorded valuation allowances offsetting substantially all the Company’s deferred income tax assets due to the uncertainty of the ultimate realization of the future benefits from those assets. The ultimate realization of deferred tax assets depends on various factors including the generation of taxable income during the future periods in which the underlying temporary differences are deductible. We maintain valuation allowances for deferred tax assets until we have sufficient evidence to support the reversal of all or some portion of the allowances. Based on recent earnings and anticipated future earnings, we believe it is reasonably possible that during the year ending March 31, 2024, we will have sufficient positive evidence to conclude that a significant portion of our valuation allowances will no longer be needed. Releasing the valuation allowances would result in the recognition of certain deferred tax assets and significant income tax benefits. The exact timing and amount of the valuation allowance releases will depend on the level of profitability that we are able to achieve and our visibility into future results. Our recorded effective tax rate may increase in subsequent periods following a valuation allowance release. Any valuation allowance release will not impact the amount of cash paid for income taxes.

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. This judgment was affirmed by the U.S. Court of Appeals for the Federal Circuit in November 2019 with respect to all claims under the patent except for two, which were not asserted against Agilysys. In March 2022, the District Court declared the remaining two claims to be patent ineligible, and this judgment was affirmed by the U.S. Court of Appeals for the Federal Circuit in September 2023. Ameranth may still appeal this ruling to the U.S. Supreme Court, and at this time we are not able to predict the outcome of this lawsuit.

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)	**2023**	2022	**2023**	2022
Numerator:				
Net income	**$ 4,545**	$ 3,576	**$ 6,093**	$ 6,615
Series A convertible preferred stock dividends	**(459)**	(459)	**(918)**	(918)
Net income attributable to common shareholders	**$ 4,086**	$ 3,117	**$ 5,175**	$ 5,697
Denominator:				
Weighted average shares outstanding - basic	**25,022**	24,652	**24,979**	24,625
Dilutive SSARs	**919**	992	**964**	881
Dilutive unvested restricted shares	**171**	139	**201**	85
Dilutive unvested restricted stock units	**5**	—	**4**	—
Weighted average shares outstanding - diluted	**26,117**	25,783	**26,148**	25,591
Income per share - basic:	**$ 0.16**	$ 0.13	**$ 0.21**	$ 0.23
Income per share - diluted:	**$ 0.16**	$ 0.12	**$ 0.20**	$ 0.22
Anti-dilutive SSARs, restricted shares, performance shares and preferred shares	**1,735**	1,735	**1,735**	1,736

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 326,290 and 377,491 of restricted shares at September 30, 2023 and 2022, 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 impact of all potentially dilutive securities on earnings per share. We have stock-settled appreciation rights (SSARs), restricted shares, restricted stock units, and preferred shares that are potentially dilutive securities.

9. Share-based Compensation

We may grant incentive stock options, non-qualified stock options, SSARs, restricted shares, restricted stock units, and performance shares under our shareholder-approved 2020 Stock Incentive Plan (the 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 (the 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 maximum aggregate number of restricted shares or restricted stock units 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 grants of restricted shares, restricted stock units or performance shares.

For SSARs, the exercise price must be set at least equal to the closing market price of our common shares on the date of grant. The maximum term of SSARs is seven years from the date of grant. The Compensation Committee of the Board of Directors establishes the period over which SSARs subject to a service condition vest and the vesting criteria for SSARs subject to a market condition.

Restricted shares and restricted stock units, whether time-vested or performance-based, may be issued at no cost or at a purchase price that may be below their fair market value, but are subject to forfeiture and restrictions on their sale or other transfer. Performance-based grants may be conditioned upon the attainment of specified performance objectives and other conditions, restrictions, and contingencies. Restricted shares have the right to receive dividends, if any, upon vesting, subject to the same forfeiture provisions that apply to the underlying grants.

We record compensation expense related to SSARs, restricted shares, restricted stock units, 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 stock unit and 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. For restricted stock unit, 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, performance period term 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 stock units, restricted shares, and SSAR grants subject to a service condition using the graded vesting method. 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 restricted and performance grants included in the condensed consolidated statements of operations:

	Three Months Ended September 30,		Six Months Ended September 30,	
(In thousands)	**2023**	2022	**2023**	2022
Product development	**1,239**	2,141	**2,865**	3,662
Sales and marketing	**94**	290	**259**	565
General and administrative	**1,351**	1,025	**2,727**	1,717
Total share-based compensation expense	**2,684**	3,456	**5,851**	5,944

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, 2023 for SSARs awarded under the 2020 and 2016 Plans:

(In thousands, except share and per share data)	Number of Rights	Weighted-Average Exercise Price (per right)	Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at April 1, 2023	1,572,460	$ 26.04		
Granted	—	—		
Exercised	(118,985)	17.91		
Forfeited	—	—		
Expired	—	—		
Outstanding at September 30, 2023	**1,453,475**	**$ 26.70**	**2.7**	**$ 57,354**
Exercisable at September 30, 2023	**1,453,475**	**$ 26.70**	**2.7**	**$ 57,354**
Vested and expected to vest at September 30, 2023	**1,453,475**	**$ 26.70**	**2.7**	**$ 57,354**

As of September 30, 2023, there was no unrecognized share-based compensation expense related to 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 six months ended September 30, 2023 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, 2023	407,324	$ 47.53
Granted	23,574	70.08
Vested	(85,056)	45.51
Forfeited	(19,552)	46.24
Outstanding at September 30, 2023	**326,290**	**$ 49.77**

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, 2023, total unrecognized share-based compensation expense related to unvested restricted shares was $7.2 million, which is expected to be recognized over a weighted-average vesting period of 1.8 years.

Restricted Stock Units

We granted restricted stock units to our Chief Executive Officer, the vesting of which is service-based. Certain restricted stock units are also subject to a market condition. The following table summarizes the activity during six months ended September 30, 2023 for restricted stock units awarded under the 2020 Plan:

	Number of Shares	Weighted-Average Grant-Date Fair Value (per share)
Outstanding at April 1, 2023	67,856	$ 71.62
Granted	—	—
Vested	—	—
Forfeited	—	—
Outstanding at September 30, 2023	**67,856**	**$ 71.62**

As of September 30, 2023, total unrecognized share-based compensation expense related to non-vested restricted stock units was $3.5 million, which is expected to be recognized over the weighted-average vesting period of 2.5 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 5,168 common shares to our Chief Executive Officer in May 2023 that vested immediately for a total value of $0.4 million.

10. Preferred Stock

Series A Convertible 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.

Conversion

Each Holder has the right, at its option, to convert its Convertible Preferred Stock, in whole or in part, into fully paid and non-assessable shares of common stock at a conversion price equal to $20.1676 per share (as may be adjusted from time to time, as described in the Certificate of Designation).

Subject to certain conditions, the Company may, at its option, require conversion of all of the outstanding shares of Convertible Preferred Stock to common stock if, at any time after November 22, 2023, the daily volume-weighted average price of the Company’s common stock is at least 150% of the conversion price for at least 20 trading days during the 30 consecutive trading days immediately preceding the date the Company notifies the Holders of the election to convert.

Dividends

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.

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, 2023, 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, 2023. 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, 2023 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

Macroeconomic Conditions

During the three and six months ended September 30, 2023, global macroeconomic conditions were, and continue to be, impacted by a number of circumstances, including, but not limited to, the Israel-Hamas and Russia-Ukraine wars, labor shortages, supply chain inconsistencies, inflation, and the volatility of foreign currency exchange rates against the U.S. dollar. We believe such conditions continue to influence customer spending and provider pricing decisions resulting in decreased demand, increased costs, and reduced margins particularly in areas outside of the United States.

Our Business

Agilysys exclusively delivers state-of-the-art software solutions and services that help organizations achieve High Return Hospitality™ by maximizing Return on Experience (ROE) through interactions that make 'personal' profitable. Customers around the world use Agilysys Property Management Systems (PMS), Point-of-Sale (POS) solutions and Inventory and Procurement (I&P) systems to consistently delight guests, retain staff and grow margins. Agilysys' 100 percent hospitality customer base includes branded and independent hotels; multi-amenity resorts; 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 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 will continue enhancing existing software products while developing and marketing new software products and expanding 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 sales 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, technical support, and transaction-based fees 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 products.

Results of Operations

Second Fiscal Quarter 2024 Compared to Second Fiscal Quarter 2023

Net Revenue and Operating Income

The following table presents our consolidated revenue and operating results for the three months ended September 30, 2023 and 2022:

	Three Months Ended September 30,		Increase (decrease)	
(Dollars in thousands)	**2023**	2022	$	%
Net revenue:				
Products	**$ 12,640**	$ 10,548	$ 2,092	19.8%
Subscription and maintenance	**34,248**	29,036	5,212	18.0%
Professional services	**11,728**	8,158	3,570	43.8%
Total net revenue	**58,616**	47,742	10,874	22.8%
Cost of goods sold:				
Products	**6,751**	5,434	1,317	24.2%
Subscription and maintenance	**7,804**	6,170	1,634	26.5%
Professional services	**8,965**	6,773	2,192	32.4%
Total cost of goods sold	**23,520**	18,377	5,143	28.0%
Gross profit	**$ 35,096**	$ 29,365	$ 5,731	19.5%
Gross profit margin	***59.9%***	*61.5%*		
Operating expenses:				
Product development	**$ 14,583**	$ 12,577	$ 2,006	15.9%
Sales and marketing	**6,400**	5,320	1,080	20.3%
General and administrative	**8,785**	7,570	1,215	16.1%
Depreciation of fixed assets	**1,209**	461	748	162.3%
Amortization of internal-use software and intangibles	**347**	443	(96)	(21.7)%
Other charges	**210**	67	143	nm
Operating income	**$ 3,562**	$ 2,927	$ 635	21.7%
Operating income percentage	***6.1%***	*6.1%*		

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:

	Three Months Ended September 30,	
	2023	2022
Net revenue:		
Products	**21.6%**	22.1%
Subscription and maintenance	**58.4**	60.8
Professional services	**20.0**	17.1
Total net revenue	**100.0%**	100.0%
Cost of goods sold:		
Products	**11.5%**	11.4%
Subscription and maintenance	**13.3**	12.9
Professional services	**15.3**	14.2
Total net cost of goods sold	**40.1%**	38.5%
Gross profit	**59.9%**	61.5%
Operating expenses:		
Product development	**24.9%**	26.3%
Sales and marketing	**10.9**	11.2
General and administrative	**15.0**	15.9
Depreciation of fixed assets	**2.1**	1.0
Amortization of internal-use software and intangibles	**0.6**	0.9
Other charges	**0.3**	0.1
Operating income	**6.1%**	6.1%

Net revenue. Total net revenue increased $10.9 million, or 22.8%, during the second quarter of fiscal 2024 compared to the second quarter of fiscal 2023. Products revenue increased $2.1 million, or 19.8%, due to higher sales and deliveries to new customers and expansion with existing customers. Subscription and maintenance revenue increased $5.2 million, or 18.0%, compared to the second quarter of fiscal 2023 driven by continued growth in subscription-based service revenue, which increased 29.1% during the second quarter of fiscal 2024 compared to the second quarter of fiscal 2023. Professional services revenue increased $3.6 million, or 43.8%, 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 $5.7 million, or 19.5%, during the second quarter of fiscal 2024 and total gross profit margin decreased from 61.5% to 59.9% compared to the second quarter of fiscal 2023 driven by changes in the composition of revenue by category. Products gross profit increased $0.8 million, or 15.2%, and products gross profit margin decreased from 48.5% to 46.6% due to the composition of hardware products delivered. Subscription and maintenance gross profit increased $3.6 million, or 15.6%, and gross profit margin decreased from 78.8% to 77.2% as certain variable costs increased ahead of related revenue. Professional services gross profit increased $1.4 million, or 99.5%, and gross profit margin increased from 17.0% to 23.6% reflecting improved utilization rates from efficiency gains on multi-solution implementations.

Operating Expenses

Operating expenses, excluding other charges, increased $5.0 million, or 18.8%, during the second quarter of fiscal 2024 compared with the second quarter of fiscal 2023.

Product development. Product development increased $2.0 million, or 15.9%, in the second quarter of fiscal 2024 compared with the second quarter of fiscal 2023 due to hiring and increased salary, incentive and employee benefits rates across our development teams, and higher rent.

Sales and marketing. Sales and marketing increased $1.1 million, or 20.3%, in the second quarter of fiscal 2024 compared with the second quarter of fiscal 2023 due to hiring and increased salary, incentive and employee benefits rates across our sales and marketing teams, higher levels of marketing event and trade show activity and increased commission expense on higher sales activity.

General and administrative. General and administrative increased $1.2 million, or 16.1%, in the second quarter of fiscal 2024 compared with the second quarter of fiscal 2023 due to hiring and increased salary, incentive and employee benefits rates across our administrative teams.

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

Other Income (Expense)

(Dollars in thousands)	Three Months Ended September 30, 2023	2022	(Unfavorable) favorable $	%
Other income (expense):				
Interest income	**$ 1,227**	$ 380	$ (847)	nm
Interest expense	**—**	(1)	(1)	nm
Other income (expense), net	**51**	112	61	nm
Total other income (expense), net	**$ 1,278**	$ 491	$ (787)	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)	Three Months Ended September 30, 2023	2022	(Unfavorable) favorable $	%
Income tax provision (benefit)	**$ 295**	$ (158)	$ (453)	nm
Effective tax rate	**6.1%**	(4.6)%		

nm - not meaningful

For the three months ended September 30, 2023 and 2022, 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.

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 that we cannot anticipate. Although the timing and outcome of tax settlements remain uncertain, we expect that, as a result of the expiration of various statutes of limitations, a reduction in unrecognized tax benefits including related penalties and interest is more likely than not to occur during the year ending March 31, 2024.

Because of our losses in prior periods, we have recorded a valuation allowance offsetting substantially all of the Company's deferred tax assets. The ultimate realization of deferred tax assets depends on various factors including the generation of future taxable income during the periods in which the underlying temporary differences are deductible. We maintain valuation allowances for deferred tax assets until we have sufficient evidence to support the reversal of all or some portion of the allowances. Based on recent earnings and anticipated future earnings, we believe it is reasonably possible that during the fiscal year ending March 31, 2024, we will have sufficient positive evidence to conclude that a significant portion of our valuation allowances will no longer be needed. Releasing the valuation allowances would result in the recognition of certain deferred tax assets and significant income tax benefits.

Results of Operations

First Half Fiscal 2024 Compared to First Half Fiscal 2023

Net Revenue and Operating Income

The following table presents our consolidated revenue and operating results for the six months ended September 30, 2023 and 2022:

	Six Months Ended September 30,		Increase (decrease)	
(Dollars in thousands)	**2023**	2022	$	%
Net revenue:				
Products	**$ 25,422**	$ 21,594	$ 3,828	17.7%
Subscription and maintenance	**66,373**	56,763	9,610	16.9%
Professional services	**22,881**	16,891	5,990	35.5%
Total net revenue	**114,676**	95,248	19,428	20.4%
Cost of goods sold:				
Products	**13,317**	11,314	2,003	17.7%
Subscription and maintenance	**15,441**	12,456	2,985	24.0%
Professional services	**17,764**	13,618	4,146	30.4%
Total cost of goods sold	**46,522**	37,388	9,134	24.4%
Gross profit	**$ 68,154**	$ 57,860	$ 10,294	17.8%
Gross profit margin	***59.4%***	*60.7%*		
Operating expenses:				
Product development	**$ 27,904**	$ 24,134	$ 3,770	15.6%
Sales and marketing	**13,701**	10,733	2,968	27.7%
General and administrative	**18,150**	14,922	3,228	21.6%
Depreciation of fixed assets	**2,133**	934	1,199	128.4%
Amortization of internal-use software and intangibles	**776**	896	(120)	(13.4)%
Other charges	**969**	281	688	244.8%
Operating income	**$ 4,521**	$ 5,960	$ (1,439)	(24.1)%
Operating income percentage	***3.9%***	*6.3%*		

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,	
	2023	2022
Net revenue:		
Products	**22.1%**	22.7%
Subscription and maintenance	**57.9**	59.6
Professional services	**20.0**	17.7
Total net revenue	**100.0%**	100.0%
Cost of goods sold:		
Products	**11.6%**	11.9%
Subscription and maintenance	**13.5**	13.1
Professional services	**15.5**	14.3
Total net cost of goods sold	**40.6%**	39.3%
Gross profit	**59.4%**	60.7%
Operating expenses:		
Product development	**24.3%**	25.3%
Sales and marketing	**11.9**	11.2
General and administrative	**15.8**	15.7
Depreciation of fixed assets	**1.9**	1.0
Amortization of internal-use software and intangibles	**0.7**	0.9
Other charges	**0.9**	0.3
Operating income	**3.9%**	6.3%

Net revenue. Total net revenue increased $19.4 million, or 20.4%, during the first half of fiscal 2024 compared to the first half of fiscal 2023. Products revenue increased $3.8 million, or 17.7%, due to higher sales and deliveries to new customers and expansion with existing customers. Subscription and maintenance revenue increased $9.6 million, or 16.9%, compared to the first half of fiscal 2023 driven by continued growth in subscription-based service revenue, which increased 28.3% during the first half of fiscal 2024 compared to the first half of fiscal 2023. Professional services revenue increased $6.0 million, or 35.5%, 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 $10.3 million, or 17.8%, during the first half of fiscal 2024 and total gross profit margin decreased from 60.7% to 59.4% compared to the first half of fiscal 2023 driven by changes in the composition of revenue by category. Products gross profit increased $1.8 million, or 17.8%, and products gross profit margin stayed consistent at 47.6%. Subscription and maintenance gross profit increased $6.6 million, or 15.0%, and gross profit margin decreased from 78.1% to 76.7% as certain variable costs increased ahead of related revenue. Professional services gross profit margin increased from 19.4% to 22.4% reflecting improved utilization rates from efficiency gains on multi-solution implementations.

Operating expenses

Operating expenses, excluding other charges, increased $11.0 million, or 21.4%, during the first half of fiscal 2024 compared with the first half of fiscal 2023.

Product development. Product development increased $3.8 million, or 15.6%, in the first half of fiscal 2024 compared with the first half of fiscal 2023 due to hiring and increased salary rates across our development teams, and higher rent.

Sales and marketing. Sales and marketing increased $3.0 million, or 27.7%, in the first half of fiscal 2024 compared with the first half of fiscal 2023 due to hiring and increased salary, incentive and employee benefits rates across our sales and marketing teams, higher levels of marketing event and trade show activity and increased commission expense on higher sales activity.

General and administrative. General and administrative increased $3.2 million, or 21.6%, in the first half of fiscal 2024 compared with the first half of fiscal 2023 due to investments in our information security infrastructure along with hiring and increased salary, incentive, and employee benefits rates across our administrative teams, and higher subscription charges for cloud computing arrangements.

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, 2023	2022	(Unfavorable) favorable $	%
Other income (expense):				
Interest income	**$ 2,328**	$ 482	$ (1,846)	nm
Interest expense	**—**	(1)	(1)	nm
Other income (expense), net	**(109)**	414	523	nm
Total other income (expense), net	**$ 2,219**	$ 895	$ (1,324)	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, 2023	2022	(Unfavorable) favorable $	%
Income tax provision	**$ 647**	$ 240	$ (407)	nm
Effective tax rate	**9.6%**	3.5%		

nm - not meaningful

For the six months ended September 30, 2023, 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.

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 that we cannot anticipate. Although the timing and outcome of tax settlements remain uncertain, we expect that, as a result of the expiration of various statutes of limitations, a reduction in unrecognized tax benefits including related penalties and interest is more likely than not to occur during the year ending March 31, 2024.

Because of our losses in prior periods, we have recorded a valuation allowance offsetting substantially all of the Company's deferred tax assets. The ultimate realization of deferred tax assets depends on various factors including the generation of future taxable income during the periods in which the underlying temporary differences are deductible. We maintain valuation allowances for deferred tax assets until we have sufficient evidence to support the reversal of all or some portion of the allowances. Based on recent earnings and anticipated future earnings, we believe it is reasonably possible that during the fiscal year ending March 31, 2024, we will have sufficient positive evidence to conclude that a significant portion of our valuation allowances will no longer be needed. Releasing the valuation allowances would result in the recognition of certain deferred tax assets and significant income tax benefits.

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, 2023, 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 on hand of $107.4 million as of September 30, 2023, and access to capital markets will provide adequate funds to meet our short- and long-term liquidity requirements.

Cash Flow

	Six Months Ended September 30,	
(In thousands)	**2023**	2022
Net cash provided by (used in):		
Operating activities	**$ 5,470**	$ 3,117
Investing activities	**(6,004)**	(799)
Financing activities	**(4,788)**	(2,375)
Effect of exchange rate changes on cash	**(107)**	(718)
(Decrease) increase in cash	**$ (5,429)**	$ (775)

Cash flow provided by operating activities. Cash flow provided by operating activities was $5.5 million in the first six months of fiscal 2024. The provision of cash was due to cash-based earnings of $14.5 million and a decrease of $9.0 million due to changes in net operating assets and liabilities. Cash-based earnings is net income of $6.1 million plus $8.4 million of non-cash expenses including depreciation, amortization, and share-based compensation.

Cash flow used in investing activities. Consists primarily of property and equipment purchases, which increased significantly during the six months ended September 30, 2023 compared to the six months ended September 30, 2022 due to leasehold improvements and equipment purchases for our new office lease at our development center in Chennai, India.

Cash flow used in financing activities. During the first six months of fiscal 2024, the $4.8 million used in financing activities consisted of $3.9 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, 2023, there were no significant changes to our contractual obligations as presented in our Annual Report for the year ended March 31, 2023.

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, 2023. There have been no material changes in our significant accounting policies and estimates since March 31, 2023.

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, 2023. 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, 2023. There have been no material changes in our market risk exposures since March 31, 2023.

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, as Principal Accounting Officer (“PAO”), 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 PAO 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, 2023 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our CEO, CFO and PAO, 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, 2023 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

On August 1, 2023, MAK Capital One L.L.C. ("MAK Capital") adopted a trading plan (the "Purchase Plan") that is intended to satisfy the affirmative defense set forth in Rule 10b5-1(c)(1) promulgated under the Securities Exchange Act of 1934, as amended, to sell up to 867,728 shares of the Company's common stock which represents 50% of the common shares issuable to MAK Capital upon the Company's mandatory conversion of its outstanding 5.25% Series A Convertible Preferred Shares ("Convertible Preferred Shares") , subject to the restrictions of Rule 144 of the Securities Act of 1933, as amended. The trading period of the Purchase Plan will not commence until the Company's mandatory conversion of its Convertible Preferred Shares, the earliest date of which is November 24, 2023 and the Purchase Plan will terminate on May 1, 2024. No trading will occur under the Purchase Plan on November 24, 2023 and from December 18, 2023 to December 29, 2023. Michael A. Kaufman, a Director of the Company, is managing member of MAK Capital.

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 26, 2023

/s/ William David Wood III

William David Wood III

Chief Financial Officer

(Principal Financial Officer and Duly Authorized Officer)