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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2019

or

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

For the transition period from _________ to _________.

Commission file number 0-5734

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

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

(770) 810-7800

(Registrant's telephone number, including area code)

N/A

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

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

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

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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 ☒

The number of Common Shares of the registrant outstanding as of July 23, 2019 was 23,675,380.

AGILYSYS, INC.

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AGILYSYS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)	June 30, 2019 (Unaudited)	March 31, 2019
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 37,233**	$ 40,771
Accounts receivable, net of allowance for doubtful accounts of $760 and $788, respectively	**25,690**	27,000
Contract assets	**3,888**	2,921
Inventories	**1,483**	2,044
Prepaid expenses and other current assets	**5,155**	6,272
Total current assets	**73,449**	79,008
Property and equipment, net	**15,067**	15,838
Operating lease right-of-use assets	**13,379**	—
Goodwill	**19,622**	19,622
Intangible assets, net	**8,427**	8,438
Software development costs, net	**31,392**	34,567
Other non-current assets	**6,112**	6,118
Total assets	**$ 167,448**	$ 163,591
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 4,469**	$ 4,718
Contract liabilities	**35,589**	38,669
Accrued liabilities	**9,474**	14,892
Operating lease liabilities, current	**4,202**	—
Finance lease obligations, current	**22**	22
Total current liabilities	**53,756**	58,301
Deferred income taxes, non-current	**866**	861
Operating lease liabilities, non-current	**11,539**	—
Finance lease obligations, non-current	**33**	35
Other non-current liabilities	**1,331**	3,772
Commitments and contingencies (see Note 8)		
Shareholders' equity:		
Common shares, without par value, at $0.30 stated value; 80,000,000 shares authorized; 31,606,831 shares issued; and 23,680,171 and 23,501,193 shares outstanding at June 30, 2019 and March 31, 2019, respectively	**9,482**	9,482
Treasury shares, 7,926,660 and 8,105,638 at June 30, 2019 and March 31, 2019, respectively	**(2,379)**	(2,433)
Capital in excess of stated value	**1,698**	781
Retained earnings	**91,476**	93,051
Accumulated other comprehensive loss	**(354)**	(259)
Total shareholders' equity	**99,923**	100,622
Total liabilities and shareholders' equity	**$ 167,448**	$ 163,591

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 June 30, 2019	Three months ended June 30, 2018
Net revenue:		
Products	**$ 10,869**	$ 9,080
Support, maintenance and subscription services	**20,082**	17,929
Professional services	**7,438**	6,998
Total net revenue	**38,389**	34,007
Cost of goods sold:		
Products (inclusive of developed technology amortization)	**8,623**	7,130
Support, maintenance and subscription services	**4,181**	4,074
Professional services	**5,571**	4,914
Total cost of goods sold	**18,375**	16,118
Gross profit	**20,014**	17,889
Gross profit margin	**52.1%**	52.6%
Operating expenses:		
Product development	**10,064**	7,089
Sales and marketing	**4,498**	4,754
General and administrative	**5,874**	6,005
Depreciation of fixed assets	**213**	606
Amortization of intangibles	**678**	543
Restructuring, severance and other charges	**231**	440
Legal settlements	**—**	91
Total operating expense	**21,558**	19,528
Operating loss	**(1,544)**	(1,639)
Other expense (income):		
Interest (income)	**(80)**	(55)
Interest expense	**1**	3
Other expense, net	**85**	198
Loss before taxes	**(1,550)**	(1,785)
Income tax expense (benefit)	**25**	(49)
Net loss	**$ (1,575)**	$ (1,736)
Weighted average shares outstanding	**23,212**	23,095
Loss per share - basic and diluted:		
Loss per share	**$ (0.07)**	$ (0.08)

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three months ended June 30,	
(In thousands)	**2019**	2018
Net loss	**$ (1,575)**	$ (1,736)
Other comprehensive loss, net of tax:		
Unrealized foreign currency translation adjustments	**(95)**	(8)
Total comprehensive loss	**$ (1,670)**	$ (1,744)

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three months ended June 30,	
(In thousands)	**2019**	2018
Operating activities		
Net loss	**$ (1,575)**	$ (1,736)
Adjustments to reconcile net loss to net cash used in operating activities		
Net restructuring, severance and other charges	**(11)**	15
Net legal settlements	**—**	91
Depreciation	**213**	606
Amortization	**678**	543
Amortization of developed technology	**3,175**	2,663
Deferred income taxes	**5**	28
Share-based compensation	**482**	409
Change in cash surrender value of company owned life insurance policies	**(4)**	(4)
Changes in operating assets and liabilities	**(4,876)**	(3,978)
Net cash used in operating activities	**(1,913)**	(1,363)
Investing activities		
Capital expenditures	**(571)**	(744)
Capitalized software development costs	**—**	(2,132)
Investments in corporate-owned life insurance policies	**(2)**	(2)
Net cash used in investing activities	**(573)**	(2,878)
Financing activities		
Repurchase of common shares to satisfy employee tax withholding	**(1,026)**	(495)
Principal payments under long-term obligations	**(2)**	(30)
Net cash used in financing activities	**(1,028)**	(525)
Effect of exchange rate changes on cash	**(24)**	(101)
Net decrease in cash and cash equivalents	**(3,538)**	(4,867)
Cash and cash equivalents at beginning of period	**$ 40,771**	$ 39,943
Cash and cash equivalents at end of period	**$ 37,233**	$ 35,076
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING ACTIVITIES:		
Accrued capital expenditures	**$ 51**	$ 82
Accrued capitalized software development costs	**—**	57

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Common Shares				Capital in excess of stated value	Retained earnings	Accumulated other comprehensive loss	Total
	Issued		In Treasury					
(In thousands)	Shares	Stated value	Shares	Stated value				
Balance at March 31, 2019	31,607	$ 9,482	(8,105)	$ (2,433)	$ 781	$ 93,051	$ (259)	$ 100,622
Share-based compensation	—	—	—	—	1,067	—	—	1,067
Restricted shares issued, net	—	—	168	51	(51)	—	—	—
Shares issued upon exercise of stock options and SSARs	—	—	14	4	(4)	—	—	—
Shares withheld for taxes upon exercise of stock options, SSARs or vesting of restricted shares	—	—	(4)	(1)	(95)	—	—	(96)
Net loss	—	—	—	—	—	(1,575)	—	(1,575)
Unrealized translation adjustments	—	—	—	—	—	—	(95)	(95)
Balance at June 30, 2019	**31,607**	**$ 9,482**	**(7,927)**	**$ (2,379)**	**$ 1,698**	**$ 91,476**	**$ (354)**	**$ 99,923**
Balance at March 31, 2018	31,607	$ 9,482	(8,283)	$ (2,486)	$ (1,911)	$103,601	$ (255)	$ 108,431
Cumulative effect of change in accounting policy	—	—	—	—	—	2,614	—	2,614
Share-based compensation	—	—	—	—	592	—	—	592
Restricted shares issued, net	—	—	172	52	(52)	—	—	—
Shares issued upon exercise of stock options and SSARs	—	—	41	12	(12)	—	—	—
Shares withheld for taxes upon exercise of stock options, SSARs or vesting of restricted shares	—	—	(10)	(3)	(141)	—	—	(144)
Net loss	—	—	—	—	—	(1,736)	—	(1,736)
Unrealized translation adjustments	—	—	—	—	—	—	(8)	(8)
Balance at June 30, 2018	31,607	$ 9,482	(8,080)	$ (2,425)	$ (1,524)	$104,479	$ (263)	$ 109,749

See accompanying notes to unaudited condensed consolidated financial statements.

AGILYSYS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Table amounts in thousands, except per share data)

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 guest-centric technology solutions for gaming, hotels, resorts and cruise, corporate foodservice management, restaurants, universities, stadia and healthcare. Agilysys offers the most comprehensive solutions in the industry, including point of sale (POS), property management systems (PMS), inventory and procurement, payments, and related applications, to manage the entire guest journey. Agilysys is known for its leadership in hospitality, its broad product offerings and its customer-centric service. Some of the largest hospitality companies around the world use Agilysys solutions to help improve guest loyalty, drive revenue growth and increase operational efficiencies.

We serve four major market sectors: Gaming, both corporate and tribal; Hotels, Resorts and Cruise; Corporate Foodservice Management; and Restaurants, Universities, Stadia and Healthcare. A significant portion of our consolidated revenue is derived from contract support, maintenance and subscription services.

Agilysys operates across North America, Europe, Asia-Pacific, and India with headquarters located in Alpharetta, GA. For more information, visit www.agilysys.com.

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 2020 refers to the fiscal year ending March 31, 2020.

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 June 30, 2019, as well as the Condensed Consolidated Statements of Operations, Condensed Consolidated Statements of Comprehensive Loss, Condensed Consolidated Statements of Cash Flows, and the Condensed Consolidated Statements of Shareholders' Equity for the three months ended June 30, 2019 and 2018, are unaudited. However, these financial statements have been prepared on the same basis as those in the audited annual financial statements, except for the recently adopted accounting pronouncements described below. In the opinion of management, all adjustments of a recurring nature necessary to fairly state the results of operations, financial position, and cash flows have been made.

These unaudited interim financial statements should be read together with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2019, filed with the Securities and Exchange Commission (SEC) on May 24, 2019.

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, 2019, included in our Annual Report on Form 10-K. Our accounting policy for leases changed with the adoption of Accounting Standards Update ("ASU") No. 2016-02 ("Topic 842"), as described further below. There have been no other material changes to our significant accounting policies and estimates from those disclosed therein.

Adopted and Recently Issued Accounting Pronouncements

In April 2019, the Financial Accounting Standards Board ("FASB") issued ASU No. 2019-04, *Codification Improvements to Topic 326, Financial Instruments - Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments.* ASU 2019-04 provides corrections, updates and clarifications to the previously issued updates ASU 2016-13, ASU 2017-12 and ASU 2016-01. Various areas of the codification were impacted from the update. The standard follows the effective dates of the previously issued ASUs, unless an entity has already early adopted the previous ASUs, in which case the effective date will vary according to each specific ASU adoption. Consistent with the documentation below, we are still assessing the impact of the adoption of ASU 2016-13, and the other two ASUs affected by ASU 2019-04 are not applicable to us. We are currently reviewing this standard to assess the impact on our future consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-1*5, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.* ASU 2018-15 addresses the treatment of implementation costs incurred in a hosting arrangement that is a service contract. The update does not impact the accounting for the service element of a hosting arrangement that is a service contract. The update is effective for annual periods beginning after December 15, 2019, including interim periods within those annual periods, with early adoption (including early adoption in any interim period) permitted. We do not believe the adoption of this guidance will have a material impact on our consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement.* ASU 2018-13 addresses the required disclosures around fair value measurement. The disclosure requirements of the reasons for transfers between Level 1 and Level 2, the policy for timing transfers between levels, and the valuation process for Level 3 measurements have been removed. Certain modifications were made to required disclosures and additional requirements were established. The standard is effective for annual periods beginning after December 15, 2019, including interim periods within those annual periods. Early adoption is permitted. We do not believe the adoption of this guidance will have a material impact on our consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement-Reporting Comprehensive Income (Topic 220).* ASU 2018-02 addresses the effect of the change in the U.S. federal corporate tax rate on items within accumulated other comprehensive income or loss due to the enactment of the Tax Act on December 22, 2017. The new standard is effective for annual periods, and for interim periods within those annual periods beginning after December 15, 2018, with early adoption permitted. We have adopted this standard as of April 1, 2019; the adoption had no impact on our condensed consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles- Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment*. ASU No. 2017-04 eliminates Step 2 of the goodwill impairment test and requires a goodwill impairment to be measured as the amount by which a reporting unit’s carrying amount exceeds its fair value, not to exceed the carrying amount of its goodwill. The ASU is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. While we are still assessing the impact of this standard, we do not believe that the adoption of this guidance will have a material impact on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326)*. This new standard changes the impairment model for most financial assets and certain other instruments. Entities will be required to use a model that will result in the earlier recognition of allowances for losses for trade and other receivables, held-to-maturity debt securities, loans, and other instruments. For available-for-sale debt securities with unrealized losses, the losses will be recognized as allowances rather than as reductions in the amortized cost of the securities. The new standard is effective for annual periods, and for interim periods within those annual periods, beginning after December 15, 2019, with early adoption permitted. We are currently reviewing this standard to assess the impact on our future consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which requires lessees to recognize assets and liabilities for leases with lease terms of more than 12 months. Unlike Accounting Standard Codification Topic 840 ("Topic 840"), which requires only capital leases to be recognized on the balance sheet, the new guidance requires both types of leases to be recognized on the balance sheet. The most prominent change for leasees is the requirement to recognize both Right-of-Use (ROU) assets and lease liabilities for leases classified as operating leases under Topic 840. We adopted Topic 842 as of April 1, 2019 using the current period adjustment method of adoption. Please refer to Note 6, *Leases* for further details.

3. Revenue Recognition

Disaggregation of Revenue

We derive and report our revenue from the sale of products (software licenses, third party hardware and operating systems), support, maintenance and subscription services and professional services. Revenue recognized at a point in time (products) totaled $10.9 million and $9.1 million, and over time (support, maintenance and subscription services and professional services) totaled $27.5 million and $24.9 million for the three months ended June 30, 2019 and 2018, respectively. See Nature of Goods and Services section below for additional information regarding revenue recognition procedures for our revenue streams.

Nature of Goods and Services

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 a refund.

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

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

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

Support and maintenance revenue is derived from providing telephone and on-line technical support services, bug fixes, and unspecified software updates and upgrades to customers on a when-and-if-available basis. Each of these performance obligations provide benefit to the customer on a standalone basis and are distinct in the context of the contract. Each of these distinct performance obligations represent a stand ready obligation to provide service to a customer, which is concurrently delivered and has the same pattern of transfer to the customer, which is why we account for these support services as a single performance obligation, recognized over the term of the maintenance agreement.

Our subscription service revenue is comprised of fees for contracts that provide customers a right to access our software for a subscribed period. We do not provide the customer the contractual right to license the software at any time outside of the subscription period under these contracts. The customer can only benefit from the software and software maintenance when provided the right to access the software. Accordingly, each of the rights to access the software, the maintenance services, and any hosting services is not considered a distinct performance obligation in the context of the contract and should be combined into a single performance obligation to be recognized over the contract period. Typically, we invoice fees monthly and either party has the ability to cancel the agreement at each invoiced period. As a result, the contractual period for revenue recognition purposes is considered to be one month with monthly renewals for the term of the customer agreement.

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. These contracts are reviewed quarterly for loss contract accounting treatment.

We use the market estimate 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.

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 during the three months ended June 30, 2019 and 2018 from amounts included in contract liabilities at the beginning of the period was $15.6 million and $11.6 million, respectively. During the three months ended June 30, 2019 and 2018, we transferred $2.0 million and $3.0 million to accounts receivable from contract assets recognized at March 31, 2019 and April 1, 2018, respectively, because the right to the transaction consideration became unconditional.

Our arrangements are for a period of one year or less. As a result, unsatisfied performance obligations as of June 30, 2019 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 have elected to take the practical expedient available to 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.

As of June 30, 2019, we had $3.3 million of capitalized sales incentive costs. These balances are included in other non-current assets on our condensed consolidated balance sheets. During the three months ended June 30, 2019 and 2018, we expensed $1.0 million and $0.9 million, respectively, of sales commissions, including amortization of capitalized amounts of $0.3 million and $0.3 million, respectively, which is 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. Intangible Assets and Software Development Costs

The following table summarizes our intangible assets and software development costs:

	June 30, 2019			March 31, 2019		
(In thousands)	**Gross carrying amount**	**Accumulated amortization**	**Net carrying amount**	Gross carrying amount	Accumulated amortization	Net carrying amount
Amortized intangible assets:						
Customer relationships	**$ 10,775**	**$ (10,775)**	**$ —**	$ 10,775	$ (10,775)	$ —
Non-competition agreements	**2,700**	**(2,700)**	**—**	2,700	(2,700)	—
Developed technology	**10,398**	**(10,398)**	**—**	10,398	(10,398)	—
Trade names	**230**	**(203)**	**27**	230	(192)	38
Patented technology	**80**	**(80)**	**—**	80	(80)	—
	24,183	**(24,156)**	**27**	24,183	(24,145)	38
Unamortized intangible assets:						
Trade names	**8,400**	**N/A**	**8,400**	8,400	N/A	8,400
Total intangible assets	**$ 32,583**	**$ (24,156)**	**$ 8,427**	$ 32,583	$ (24,145)	$ 8,438
Software development costs	**$ 67,541**	**$ (36,149)**	**$ 31,392**	$ 67,541	$ (32,974)	$ 34,567

The following table summarizes our remaining amortization expense relating to in service intangible assets and software development costs.

(In thousands)	Remaining Amortization Expense
Fiscal year ending March 31,	
2020	$ 9,413
2021	12,515
2022	5,403
2023	3,399
2024	689
Total	$ 31,419

Amortization expense for software development costs related to assets to be sold, leased, or otherwise marketed was $3.2 million and $2.7 million for the three months ended June 30, 2019 and 2018, respectively. These charges are included as costs of goods sold - products in our condensed consolidated statements of operations. Amortization expense relating to other definite-lived intangible assets was $11,500 for the three months ended June 30, 2019 and 2018. These charges are classified as operating expenses - amortization of intangibles in our condensed consolidated statements of operations along with amortization expense related to our capitalized internal-use software that we classify in Property and Equipment, net within the condensed consolidated balance sheets.

Capitalized software development costs for software internally developed to be sold, leased, or otherwise marketed, are carried on our balance sheet at carrying value, net of accumulated amortization. The Company did not capitalize any amounts for external-use software development costs during the three months ended June 30, 2019 due to the current active projects which carry a sufficiently short amount of time between achieving technological feasibility and reaching general availability to preclude capitalization. We capitalized approximately $2.0 million during the three months ended June 30, 2018.

5. Additional Balance Sheet Information

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

(In thousands)	**June 30, 2019**	March 31, 2019
Accrued liabilities:		
Salaries, wages, and related benefits	**$ 7,585**	$ 12,929
Other taxes payable	**1,319**	1,041
Accrued legal settlements	**15**	15
Severance liabilities	**34**	46
Professional fees	**189**	67
Deferred rent	**—**	273
Other	**332**	521
Total	**$ 9,474**	$ 14,892
Other non-current liabilities:		
Uncertain tax positions	**$ 1,090**	$ 1,083
Deferred rent and asset retirement obligations	**165**	2,613
Other	**76**	76
Total	**$ 1,331**	$ 3,772

6. Leases

We adopted Topic 842 on April 1, 2019 using the current period adjustment method of adoption to recognize leases with a duration greater than 12 months on the balance sheet. The impact of adoption on April 1, 2019 was recognition of operating lease liabilities of $16.3 million and related Right-of-Use ("ROU") assets of $13.8 million. Prior period financial statements have not been restated and therefore the comparative amounts are not presented below or on the condensed consolidated balance sheet as of March 31, 2019. For operating leases with a term greater than 12 months, we have recorded the lease liability at the present value of lease payments over the remaining lease term and the related ROU asset. The remaining lease term has been determined for each lease considering factors such as renewal options, termination options, our company's historical practices in exercising such options, and current business knowledge which may impact lease related decisions. The majority of our leases are comprised of real estate leases for our respective offices around the globe. Our finance leases consist of office equipment. We have no residual value guarantees or restrictions or covenants imposed by, or associated with our active leases. Since our current leases do not provide an implicit rate of return, our incremental borrowing rates used to determine the value of lease payments in implementation are estimated at April 1, 2019, based on collateralized rates for a term similar to each lease term.

We have elected the package of practical expedients permitted under the transition guidance which includes the ability to carryforward the previously determined lease classification (operating or financing), forgo the assessment whether active contracts contain a lease, and whether capitalized costs associated with a lease meet the definition of "initial direct costs" as defined within Topic 842. In the event that any of our leases contain nonlease components, we have elected the practical expedient to account for each separate lease component and the associated nonlease component(s) as a single lease component. We have also elected the accounting policy to forgo applying the guidance of Topic 842 to short term leases (defined as a term of 12 month or less, without a purchase option which we are reasonably certain to exercise).

As of June 30, 2019, we have no leases which have not yet commenced. In addition, we do not have any related party leases or sublease arrangements. We have variable payments for expenses such as common area maintenance and taxes. We do not have variable payments that are based on an index or rate. As a result, we do not include variable payments in the calculation of the lease liability. Any variable lease costs are expensed as incurred.

The components of lease expenses for the three months ended June 30, 2019 were as follows:

(in thousands)		Three months ended June 30, 2019
Operating leases expense	$	1,013
Finance lease expense:		
Amortization of ROU assets		6
Interest on lease liabilities		2
Total finance lease expense		8
Variable lease costs		68
Short term lease expense		14
Total lease expense	$	1,103

Other information related to leases was as follows:

		Three months ended June 30, 2019
Supplemental cash flow information		
Cash paid for amounts included in the measurement of lease liabilities (in thousands):		
Operating cash flows for operating leases	$	1,014
Operating cash flows for finance leases		6
Financing cash flows for finance leases		2
ROU assets obtained in exchange for lease obligations (in thousands):		
Operating leases	$	185
Finance leases		—
Weighted average remaining lease terms		
Operating leases		5.57
Finance leases		2.35
Weighted average discount rates		
Operating leases		9.85%
Finance leases		4.25%

The table below reconciles the undiscounted future minimum lease payments (displayed by year and in the aggregate) under non-cancelable leases with terms of more than one year to the total lease liabilities recognized on the condensed consolidated balance sheet as of June 30, 2019:

(in thousands)	**Operating leases**	**Finance leases**
2020 (excluding the three months ended June 30, 2019)	$ 3,260	$ 22
2021	4,432	23
2022	3,669	15
2023	2,291	—
2024	2,099	—
Thereafter	5,913	—
Total undiscounted future minimum lease payments	21,664	60
Less: difference between undiscounted lease payments and discounted operating lease liabilities	(5,923)	(5)
Total operating lease liabilities	$ 15,741	$ 55

As previously disclosed on our March 31, 2019 Form 10-K and under the previous lease accounting standard, future minimum lease payments under non-cancelable operating leases as of March 31, 2019 were as follows:

Year ending (in thousands)	Operating leases	Finance leases
2020	$ 4,143	$ 27
2021	3,945	23
2022	3,166	15
2023	1,916	—
2024	1,770	—
Thereafter	4,497	—
Total lease payments	19,437	65
Less: Amounts representing interest	—	(8)
Present value of lease liabilities	$ 19,437	$ 57

7. Income Taxes

The following table compares our income tax expense (benefit) and effective tax rates for the three months ended June 30, 2019 and 2018:

	Three months ended June 30,	
(Dollars in thousands)	**2019**	2018
Income tax expense (benefit)	**$ 25**	$ (49)
Effective tax rate	**(1.6)%**	2.7%

For the three months ended June 30, 2019 and 2018, the effective tax rate was different than the statutory rate due primarily to the recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance, certain foreign and state tax effects and other U.S. permanent book to tax differences.

We have recorded a valuation allowance offsetting substantially all of our deferred tax assets. 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, management believes that it is more-likely-than-not that we will not realize the benefits of these deductible differences.

8. 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. Most of the patents at issue in the case were invalidated by the U.S. Court of Appeals for the Federal Circuit in 2016. Cases against us and our co-defendants remained pending in the District Court with respect to one surviving Ameranth patent. In September 2018, the District Court found that patent invalid, and granted summary judgment in favor of the movant co-defendants. In early 2019, Ameranth appealed the District Court's summary judgment ruling to the U.S. Court of Appeals for the Federal Circuit. We are not a party to the appeal, and it is currently unclear what impact the summary judgment ruling or appeal may have on our case. Ameranth seeks monetary damages, injunctive relief, costs and attorneys' fees from us. At this time, we are not able to predict the outcome of this lawsuit. However, we dispute the allegations of wrongdoing and are vigorously defending ourselves in this matter.

9. Loss per Share

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

	Three months ended June 30,	
(In thousands, except per share data)	**2019**	2018
Numerator:		
Net loss	**$ (1,575)**	$ (1,736)
Denominator:		
Weighted average shares outstanding	**23,212**	23,095
Loss per share - basic and diluted:		
Loss per share	**$ (0.07)**	$ (0.08)
Anti-dilutive stock options, SSARs, restricted shares and performance shares	**1,273**	1,356

Basic loss per share is computed as net income available to common shareholders divided by the weighted average basic shares outstanding. The outstanding shares used to calculate the weighted average basic shares excludes 445,829 and 490,117 of restricted shares at June 30, 2019 and 2018, respectively, as these shares were issued but were not vested and therefore, not considered outstanding for purposes of computing basic loss per share at the balance sheet dates.

Diluted loss per share includes the effect of all potentially dilutive securities on earnings per share. We have stock options, stock-settled appreciation rights ("SSARs"), unvested restricted shares and unvested performance 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 awards because doing so would be anti-dilutive. Therefore, for all periods presented, basic weighted-average shares outstanding were used in calculating the diluted net loss per share.

10. Share-based Compensation

We may grant non-qualified stock options, incentive stock options, SSARs, restricted shares, and restricted share units under our shareholder-approved 2016 Stock Incentive Plan ("2016 Plan") for up to 2.0 million common shares, plus 957,575 common shares, the number of shares that were remaining for grant under the 2011 Stock Incentive Plan ("2011 Plan") as of the effective date of the 2016 Plan, plus the number of shares remaining for grant under the 2011 Plan that are forfeited, settled in cash, canceled or expired. The maximum aggregate number of restricted shares or restricted share units that may be granted under the 2016 Plan is 1.25 million.

We may distribute authorized but unissued shares or treasury shares to satisfy share option and appreciation right exercises or restricted share and performance share awards.

We record compensation expense related to stock options, 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 and performance share awards is based on the closing price of our common shares on the grant date. The fair value of stock option and SSARs awards is estimated on the grant date using the Black-Scholes-Merton option pricing model, which includes assumptions regarding the risk-free interest rate, dividend yield, life of the award, and the volatility of our common shares.

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

	Three months ended June 30,	
(In thousands)	**2019**	2018
Product development	**$ 268**	$ (85)
Sales and marketing	**62**	65
General and administrative	**152**	429
Total share-based compensation expense	**$ 482**	$ 409

Stock-Settled Appreciation Rights

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

The following table summarizes the activity during the three months ended June 30, 2019 for SSARs awarded under the 2011 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, 2019	1,016,643	$ 11.22		
Granted	91,364	22.41		
Exercised	(23,545)	8.47		
Forfeited	(2,380)	14.22		
Cancelled/expired	(3,839)	9.60		
Outstanding at June 30, 2019	**1,078,243**	**$ 12.23**	**4.8**	**$ 10,048**
Exercisable at June 30, 2019	**733,066**	**$ 11.00**	**4.4**	**$ 7,672**

As of June 30, 2019, total unrecognized share-based compensation expense related to non-vested SSARs was $0.9 million, which is expected to be recognized over a weighted-average vesting period of 2.8 years.

Restricted Shares

We granted shares to certain of our Directors, executives and key employees, the vesting of which is service-based. The following table summarizes the activity during the three months ended June 30, 2019 for restricted shares awarded under the 2011 and 2016 Plans:

(In thousands, except share and per share data)	Number of Shares	Weighted-Average Grant-Date Fair Value (per share)
Outstanding at April 1, 2019	237,146	$ 13.46
Granted	189,160	22.47
Vested	—	—
Forfeited	(10,597)	13.06
Outstanding at June 30, 2019	**415,709**	**$ 17.56**

The weighted-average grant date fair value of the restricted shares is determined based upon the closing price of our common shares on the grant date. As of June 30, 2019, total unrecognized share-based compensation expense related to non-vested restricted stock was $4.7 million, which is expected to be recognized over a weighted-average vesting period of 2.8 years.

Performance Shares

We awarded certain restricted shares to our Chief Executive Officer, the vesting of which is performance based. The number of shares that vest will be based on relative attainment of a performance metric and any unvested shares will forfeit upon settlement of the bonus.

The following table summarizes the activity during the three months ended June 30, 2019 for the performance shares awarded under the 2016 Plan:

(In thousands, except share and per share data)	Number of Shares
Outstanding at April 1, 2019	63,291
Granted	30,120
Vested	(23,526)
Forfeited	(39,765)
Outstanding at June 30, 2019	**30,120**

Based on the performance goals, management estimates a liability of $450,000 to be settled through the vesting of a variable number of the performance shares subsequent to March 31, 2020. As of June 30, 2019, total unrecognized share-based compensation expense related to non-vested performance shares was $405,000, which is expected to be recognized over the remaining vesting period of 9 months.

11. Fair Value Measurements

We estimate the fair value of financial instruments using available market information and generally accepted valuation methodologies. We assess the inputs used to measure fair value using a three-tier hierarchy. The hierarchy indicates the extent to which pricing inputs used in measuring fair value are observable in the market. Level 1 inputs include unadjusted quoted prices for identical assets or liabilities and are the most observable. Level 2 inputs include unadjusted quoted prices for similar assets and liabilities that are either directly or indirectly observable, or other observable inputs such as interest rates, foreign currency exchange rates, commodity rates, and yield curves. Level 3 inputs are not observable in the market and include our own judgments about the assumptions market participants would use in pricing the asset or liability. The use of observable and unobservable inputs is reflected in the hierarchy assessment disclosed in the tables below.

There were no transfers between Levels 1, 2, and 3 during the three months ended June 30, 2019 and 2018.

The following tables present information about our financial assets measured at fair value on a recurring basis and indicate the fair value hierarchy of the valuation techniques utilized to determine such fair value:

		Fair value measurement used		
	Recorded value as of	Active markets for identical assets or liabilities	Quoted prices in similar instruments and observable inputs	Active markets for unobservable inputs
(In thousands)	June 30, 2019	(Level 1)	(Level 2)	(Level 3)
Assets:				
Corporate-owned life insurance — non-current	**$ 901**	**—**	**—**	**$ 901**

		Fair value measurement used		
	Recorded value as of	Active markets for identical assets or liabilities	Quoted prices in similar instruments and observable inputs	Active markets for unobservable inputs
(In thousands)	March 31, 2019	(Level 1)	(Level 2)	(Level 3)
Assets:				
Corporate-owned life insurance — non-current	$ 895	—	—	$ 895

The recorded value of the corporate-owned life insurance policies is adjusted to the cash surrender value of the policies obtained from the third party life insurance providers, which are not observable in the market, and therefore, are classified within Level 3 of the fair value hierarchy. Changes in the cash surrender value of these policies are recorded within "Other (income) expenses, net" in the condensed consolidated statements of operations.

The following table presents a summary of changes in the fair value of the Level 3 assets:

	Three months ended June 30,	
(In thousands)	**2019**	2018
Corporate-owned life insurance:		
Balance on April 1	**$ 895**	$ 853
Unrealized gain relating to instruments held at reporting date	**4**	4
Purchases, sales, issuances and settlements, net	**2**	2
Balance on June 30	**$ 901**	$ 859

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, 2019, 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, 2019. 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 27 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, 2019 for additional information concerning these items. Management believes that this information, discussion, and disclosure is important in making decisions about investing in Agilysys.

Overview

Agilysys has been a leader in hospitality software for more than 40 years, delivering innovative guest-centric technology solutions for gaming, hotels, resorts and cruise, corporate foodservice management, restaurants, universities, stadia and healthcare. Agilysys offers the most comprehensive solutions in the industry, including point of sale (POS), property management systems (PMS), inventory and procurement, payments, and related applications, to manage the entire guest journey. Agilysys is known for its leadership in hospitality, its broad product offerings and its customer-centric service. Some of the largest hospitality companies around the world use Agilysys solutions to help improve guest loyalty, drive revenue growth and increase operational efficiencies.

Agilysys operates across North America, Europe, Asia-Pacific, and India with headquarters located in Alpharetta, GA. For more information, visit www.agilysys.com.

Our top priority is to increase 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
- Accelerating our product development
- Improving organizational efficiency and teamwork
- Developing our employees and leaders
- Growing revenue by improving the breadth and depth of our product set across both our well established products and our newer rGuest platform
- Growing revenue through international expansion

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

Revenue - Defined

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

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

Results of Operations

First Fiscal Quarter 2020 Compared to First Fiscal Quarter 2019

Net Revenue and Operating Loss

The following table presents our consolidated revenue and operating results for the three months ended June 30, 2019 and 2018:

	Three months ended June 30,		Increase (decrease)	
(Dollars in thousands)	**2019**	2018	$	%
Net revenue:				
Products	**$ 10,869**	$ 9,080	$ 1,789	19.7 %
Support, maintenance and subscription services	**20,082**	17,929	2,153	12.0
Professional services	**7,438**	6,998	440	6.3
Total net revenue	**38,389**	34,007	4,382	12.9
Cost of goods sold:				
Products (inclusive of developed technology amortization)	**8,623**	7,130	1,493	20.9
Support, maintenance and subscription services	**4,181**	4,074	107	2.6
Professional services	**5,571**	4,914	657	13.4
Total cost of goods sold	**18,375**	16,118	2,257	14.0
Gross profit	**$ 20,014**	$ 17,889	$ 2,125	11.9 %
Gross profit margin	***52.1 %***	*52.6 %*		
Operating expenses:				
Product development	**$ 10,064**	$ 7,089	$ 2,975	42.0 %
Sales and marketing	**4,498**	4,754	(256)	(5.4)
General and administrative	**5,874**	6,005	(131)	(2.2)
Depreciation of fixed assets	**213**	606	(393)	(64.9)
Amortization of intangibles	**678**	543	135	24.9
Restructuring, severance and other charges	**231**	440	(209)	(47.5)
Legal settlements	**—**	91	(91)	nm
Operating loss	**$ (1,544)**	$ (1,639)	$ 95	(5.8)%
Operating loss percentage	***(4.0)%***	*(4.8)%*		

nm - not meaningful

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

	Three months ended June 30,	
	2019	2018
Net revenue:		
Products	**28.3 %**	26.7 %
Support, maintenance and subscription services	**52.3**	52.7
Professional services	**19.4**	20.6
Total	**100.0 %**	100.0 %
Cost of goods sold:		
Products (inclusive of developed technology amortization)	**22.5 %**	21.0 %
Support, maintenance and subscription services	**10.9**	12.0
Professional services	**14.5**	14.4
Total	**47.9 %**	47.4 %
Gross profit	**52.1 %**	52.6 %
Operating expenses:		
Product development	**26.2 %**	20.8 %
Sales and marketing	**11.7**	14.0
General and administrative	**15.3**	17.7
Depreciation of fixed assets	**0.5**	1.8
Amortization of intangibles	**1.8**	1.6
Restructuring, severance and other charges	**0.6**	1.3
Legal settlements	**—**	0.3
Operating loss	**(4.0)%**	(4.8)%

Net revenue. Total net revenue increased $4.4 million, or 12.9%, during the first quarter of fiscal 2020 compared to the first quarter of fiscal 2019. Products revenue increased $1.8 million, or 19.7%, due to increased sales of on premise software and third party hardware including new customers and expansion with existing customers. Support, maintenance and subscription services revenue increased $2.2 million, or 12.0%, compared to the first quarter of fiscal 2019 driven by growth in customers using our on premise software products which require the payment of support and maintenance along with continued increases in subscription based service revenue, which increased 23.5% during the first quarter of fiscal 2020 compared to the first quarter of fiscal 2019. Professional services revenue increased $0.4 million, or 6.3%, due to growth in our customer base, including installations of our traditional on premise and subscription based software solutions.

Gross profit and gross profit margin. Our total gross profit increased $2.1 million, or 11.9%, for the first quarter of fiscal 2020 and total gross profit margin decreased slightly from 52.6% to 52.1%. Products gross profit increased $0.3 million and gross profit margin decreased approximately 80 basis points to 20.7% primarily as a result of increased developed technology amortization. Support, maintenance and subscription services gross profit increased $2.0 million and gross margin increased 190 basis points to 79.2% due to the scalable nature of our infrastructure supporting and hosting customers. Professional services gross profit decreased $0.2 million and gross profit margin decreased 470 basis points to 25.1% due to the hiring and training of additional team members at the beginning of fiscal 2020 to meet growing demand for professional services.

Operating expenses

Operating expenses, excluding the charges for legal settlements, restructuring, severance and other charges, increased $2.3 million, or 12.3%, during the first quarter of fiscal 2020 compared with the first quarter of fiscal 2019.

Product development. Product development increased $3.0 million, or 42.0%, in the first quarter of fiscal 2020 due primarily to the reduction of cost capitalization and the continued expansion of our product development teams. The products in our rGuest platform for which we capitalized costs reached general availability by the beginning of the second quarter of fiscal 2019. These products join our well established products with the application of agile development practices in a more dynamic development process that involves higher frequency releases of product features and functions. The Company capitalized $2.0 million of external use software development costs, and $0.3 million of internal use software development costs in the three months ended June 30, 2018. The Company capitalized no software development costs in the first quarter of fiscal 2020.

Sales and marketing. Sales and marketing decreased $0.3 million, or 5.4%, in the first quarter of fiscal 2020 compared with the first quarter of fiscal 2019 due primarily to the timing of sales and marketing events.

General and administrative. General and administrative decreased slightly by $0.1 million, or 2.2%, in the first quarter of fiscal 2020 compared with the first quarter of fiscal 2019 due to reduced share-based compensation.

Depreciation. We had a $0.4 million benefit in the fiscal 2020 first quarter that did not impact the fiscal 2019 first quarter and will not affect our ongoing depreciation expense in future quarters.

Restructuring, severance, and other charges. Restructuring, severance, and other charges decreased $0.2 million during the first quarter of fiscal 2020 compared to the first quarter of fiscal 2019 due to a reduction in severance payments and executive search fees.

Other Expenses (Income)

	Three months ended June 30,		(Unfavorable) favorable	
(Dollars in thousands)	**2019**	2018	$	%
Other expense (income):				
Interest (income)	**$ (80)**	$ (55)	$ 25	45.5%
Interest expense	**1**	3	2	nm
Other expense, net	**85**	198	113	nm
Total other expense, net	**$ 6**	$ 146	$ 140	nm

nm - not meaningful

Interest income. Interest income consists of interest earned on short-term investments in treasury bills, commercial paper and corporate-owned life insurance policies.

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

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

Income Taxes

	Three months ended June 30,		(Unfavorable) favorable	
(Dollars in thousands)	**2019**	2018	$	%
Income tax expense (benefit)	**$ 25**	$ (49)	$ (74)	nm
Effective tax rate	**(1.6)%**	2.7%		

nm - not meaningful

For the three months ended June 30, 2019 and 2018, the effective tax rate was different than the statutory rate due primarily to the recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance, certain foreign and state tax effects, and other U.S. permanent book to tax differences.

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

Because of our losses in prior periods, we have recorded a valuation allowance offsetting substantially all of our deferred tax assets. 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, management believes that it is more-likely-than-not that we will not realize the benefits of these deductible differences.

Liquidity and Capital Resources

Overview

Our operating cash requirements consist primarily of working capital needs, operating expenses, capital expenditures, and payments of principal and interest on indebtedness outstanding, which primarily consists of lease and rental obligations at June 30, 2019. We believe that cash flow from operating activities, cash on hand of $37.2 million as of June 30, 2019 and access to capital markets will provide adequate funds to meet our short- and long-term liquidity requirements.

As of June 30, 2019 and March 31, 2019, our total debt was approximately $0.1 million, comprised of finance lease obligations in both periods.

At June 30, 2019, 100% of our cash and cash equivalents of which 92% is located in the United States, were deposited in bank accounts or invested in highly liquid investments with original maturity from the date of acquisition of three months or less, including investments in treasury bills and commercial paper. Therefore, we believe that credit risk is limited with respect to our cash and cash equivalents balances.

Cash Flow

	Three months ended June 30,	
(In thousands)	**2019**	2018
Net cash (used in):		
Operating activities	**$ (1,913)**	$ (1,363)
Investing activities	**(573)**	(2,878)
Financing activities	**(1,028)**	(525)
Effect of exchange rate changes on cash	**(24)**	(101)
Net decrease in cash and cash equivalents	**$ (3,538)**	$ (4,867)

Cash flow used in operating activities. Cash flow used in operating activities was $1.9 million in the first three months of fiscal 2020. The use of cash was due primarily to our operating loss of $1.6 million with offsetting adjustments of $4.5 million in non-cash expense including depreciation, amortization, and share-based compensation and a decrease of $4.9 million in net operating assets and liabilities.

Cash flow used in investing activities. During the first three months of fiscal 2020, the $0.6 million used in investing activities consisted of property and equipment purchases. During the first three months of fiscal 2019, the $2.9 million used in investing activities consisted of $0.7 million of property and equipment purchases along with $2.1 million of capitalized software development costs.

Cash flow used in financing activities. During the first three months of fiscal 2020, the $1.0 million used in financing activities was primarily comprised of $1.0 million related to the repurchase of shares to satisfy employee tax withholding on share-based compensation.

Contractual Obligations

As of June 30, 2019, there were no significant changes to our contractual obligations as presented in our Annual Report for the year ended March 31, 2019.

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, 2019. There have been no material changes in our significant accounting policies and estimates since March 31, 2019 except as noted in Note 2, *Summary of Significant Accounting Policies*.

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, 2019. 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, 2019. There have been no material changes in our market risk exposures since March 31, 2019.

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.

Change in Internal Control over Financial Reporting

In connection with the adoption of Topic 842, we assessed the impact to our internal controls over financial reporting and noted no material changes during the quarter ended June 30, 2019.

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, 2019 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	The following materials from our quarterly report on Form 10-Q for the quarter ended June 30, 2019, formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at June 30, 2019 and March 31, 2019, (ii) Condensed Consolidated Statements of Operations for the three months ended June 30, 2019 and 2018, (iii) Condensed Consolidated Statements of Comprehensive Loss for the three months ended June 30, 2019 and 2018, (iv) Condensed Consolidated Statements of Cash Flows for the three months ended June 30, 2019 and 2018, (v) Condensed Consolidated Statements of Shareholders' Equity for the three months ended June 30, 2019 and 2018 and (vi) Notes to Condensed Consolidated Financial Statements for the three months ended June 30, 2019.

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:	July 29, 2019	/s/ Anthony S. Pritchett
		Anthony S. Pritchett
		Chief Financial Officer
		(Principal Financial Officer and Duly Authorized Officer)