

SERENA SOFTWARE INC
Form 10-Q
August 30, 2013
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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 July 31, 2013

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NO. 000-25285

SERENA SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

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DELAWARE **94-2669809**
(State or other jurisdiction of **(I.R.S. Employer**
incorporation or organization) **Identification No.)**
1850 GATEWAY DRIVE, SAN MATEO, CALIFORNIA 94404-4060
(Address of principal executive offices, including zip code)
650-481-3400
(Registrant's telephone number, including area code)

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.

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
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 July 31, 2013, 99,148,724 shares of the registrant's common stock, \$0.01 par value per share, were outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****SERENA SOFTWARE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except par values)**

(Unaudited)

	July 31, 2013	January 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 102,282	\$ 97,315
Accounts receivable, net of allowance of \$1,094 at July 31, 2013 and January 31, 2013, respectively	12,180	16,113
Deferred tax assets, net	5,682	5,730
Prepaid expenses and other current assets	13,442	9,405
Total current assets	133,586	128,563
Property and equipment, net	3,441	4,314
Intangible assets, net	26,588	45,661
Goodwill	462,400	462,400
Other long-term assets	4,071	5,089
TOTAL ASSETS	\$ 630,086	\$ 646,027
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,294	\$ 2,330
Accrued expenses	16,090	17,507
Accrued interest payable	4,536	4,614
Deferred revenue	62,727	67,056
Total current liabilities	84,647	91,507
Long-term debt	410,042	410,042
Long-term deferred revenue	7,703	9,026
Deferred tax liabilities, net	1,889	9,326
Other long-term liabilities	4,380	4,563
Total liabilities	508,661	524,464
Commitments and contingencies		
Stockholders equity:		

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Preferred stock, \$0.01 par value; 10,000,000 shares authorized; none issued and outstanding		
Series A Preferred stock, \$0.01 par value; 1 share authorized; none issued and outstanding		
Common stock, \$0.01 par value; 200,000,000 shares authorized; 99,148,724 and 99,084,473 shares issued and outstanding at July 31, 2013 and January 31, 2013, respectively	991	991
Additional paid-in capital	518,226	516,986
Accumulated other comprehensive loss	(2,002)	(1,809)
Accumulated deficit	(395,790)	(394,605)
Total stockholders equity	121,425	121,563
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 630,086	\$ 646,027

See accompanying notes to condensed consolidated financial statements.

Table of Contents**SERENA SOFTWARE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS****For the Three and Six Months Ended July 31, 2013 and 2012****(In thousands)****(Unaudited)**

	Three Months Ended July 31,		Six Months Ended July 31,	
	2013	2012	2013	2012
Revenue:				
Software licenses	\$ 8,516	\$ 11,590	\$ 13,103	\$ 19,519
Maintenance	33,483	34,575	66,676	68,937
Professional services	4,564	6,283	9,087	11,911
Total revenue	46,563	52,448	88,866	100,367
Cost of revenue:				
Software licenses	236	425	481	972
Maintenance	2,785	2,783	5,783	5,657
Professional services	4,434	5,785	8,767	11,319
Amortization of technology	459		919	
Total cost of revenue	7,914	8,993	15,950	17,948
Gross profit	38,649	43,455	72,916	82,419
Operating expenses:				
Sales and marketing	10,493	14,315	23,538	29,148
Research and development	6,330	6,735	13,062	13,710
General and administrative	4,215	4,352	7,335	8,267
Amortization of intangible assets	9,154	9,076	18,299	18,259
Restructuring, acquisition and other charges	5,258	1,617	8,865	2,009
Total operating expenses	35,450	36,095	71,099	71,393
Operating income	3,199	7,360	1,817	11,026
Other income (expense):				
Interest income	54	46	89	98
Interest expense	(6,620)	(7,498)	(13,122)	(14,666)
Loss on early extinguishment of debt		(154)		(154)
Amend and extend transaction fees				(577)
Total other expense, net	(6,566)	(7,606)	(13,033)	(15,299)
Loss before income taxes	(3,367)	(246)	(11,216)	(4,273)

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Income tax (benefit) provision	(3,419)	68	(10,031)	(846)
Net income (loss)	52	(314)	(1,185)	(3,427)
Foreign currency translation adjustments	(195)	(142)	(193)	(385)
Comprehensive loss	\$ (143)	\$ (456)	\$ (1,378)	\$ (3,812)

See accompanying notes to condensed consolidated financial statements.

Table of Contents**SERENA SOFTWARE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Six Months Ended July 31, 2013 and 2012****(In thousands)****(Unaudited)**

	Six Months Ended July 31,	
	2013	2012
Cash flows from operating activities:		
Net loss	\$ (1,185)	\$ (3,427)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	20,118	19,565
Stock-based compensation	1,345	1,009
Deferred income taxes	(7,389)	(7,122)
Loss on early extinguishment of debt		154
Amortization and write-off of debt issuance costs	831	1,082
Amend and extend transaction fees		577
Changes in operating assets and liabilities:		
Accounts receivable	3,933	4,030
Prepaid expenses and other assets	(4,326)	396
Accounts payable	(1,036)	447
Income taxes (receivable) payable	(35)	358
Accrued expenses and other liabilities	536	(2,341)
Accrued interest payable	(78)	(1,245)
Deferred revenue	(5,652)	(3,506)
Net cash provided by operating activities	7,061	9,977
Cash flows from investing activities:		
Purchases of property and equipment	(275)	(908)
Purchases of intangible assets	(1,522)	(4,216)
Net cash used in investing activities	(1,797)	(5,124)
Cash flows from financing activities:		
Exercise of stock options under employee stock option plan	9	67
Repurchase of common stock for taxes due from option exercises and restricted stock unit releases	(113)	(149)
Proceeds from borrowings		84,400
Payments on debt		(92,507)
Debt issuance costs paid		(3,807)
Net cash used in financing activities	(104)	(11,996)
Effect of exchange rate changes on cash	(193)	(385)
Net increase (decrease) in cash and cash equivalents	4,967	(7,528)
Cash and cash equivalents at beginning of period	97,315	109,688

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Cash and cash equivalents at end of period	\$ 102,282	\$ 102,160
Supplemental disclosures of cash flow information:		
Income taxes paid, net of refunds	\$ 1,745	\$ 5,739
Interest expense paid	\$ 12,369	\$ 14,816

See accompanying notes to condensed consolidated financial statements.

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SERENA SOFTWARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Basis of Presentation

The unaudited condensed consolidated financial statements of Serena Software, Inc. (Serena or the Company) have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial information as well as the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The condensed consolidated balance sheet as of January 31, 2013, is derived from the audited consolidated financial statements for the year ended January 31, 2013. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. The results of operations for the three and six months ended July 31, 2013, are not necessarily indicative of the results that may be expected for the year ending January 31, 2014, or any future period. The information included in this Quarterly Report on Form 10-Q (Report) should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, Quantitative and Qualitative Disclosures About Market Risk, and the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended January 31, 2013.

Use of Estimates

The preparation of the financial statements and related disclosures in conformity with U.S. GAAP requires the Company to make judgments, assumptions, and estimates that affect the amounts reported in the condensed consolidated financial statements and the accompanying notes. The Company bases its estimates and assumptions on current facts, historical experience, and various other factors that it believes are reasonable under the circumstances, to determine the carrying values of assets and liabilities that are not readily apparent from other sources. To the extent there are material differences between the Company's estimates and the actual results, the Company's future consolidated results of operations may be affected.

Significant Accounting Policies

There have been no material changes to the Company's significant accounting policies as compared to the accounting policies described in Note 2, *Summary of Significant Accounting Policies*, to the consolidated financial statements in Item 8 of Part II of the Company's Annual Report on Form 10-K for the year ended January 31, 2013.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2013-11, Topic 740 *Income Taxes, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (a consensus of the FASB Emerging Issues Task Force) (ASU 2013-11), to provide explicit guidance on the presentation of an unrecognized tax benefit on the financial statements when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014 for non-public entities. The Company intends to adopt this standard prospectively in the first quarter of fiscal year 2016. The adoption is not expected to have an impact on the Company's consolidated results of operations but may impact the presentation of certain tax items.

In February 2013, the FASB issued ASU No. 2013-02, Topic 350 *Comprehensive Income* (ASU 2013-02), which amends Topic 220 to improve the reporting of classifications out of accumulated other comprehensive income to the respective line items in net income. ASU 2013-02 is effective for reporting periods beginning after December 15, 2012. The Company adopted this standard in the first quarter of fiscal year 2014. The adoption did not impact the Company's consolidated results of operations or financial position as the Company does not currently have any significant reclassifications out of accumulated other comprehensive loss.

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The following table represents the Company's financial instruments measured at fair value on a recurring basis (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
As of July 31, 2013:				
Money market funds (1)	\$ 84,714	\$	\$	\$ 84,714
As of January 31, 2013:				
Money market funds (1)	\$ 68,971	\$	\$	\$ 68,971

(1) Included in cash and cash equivalents on the condensed consolidated balance sheets

The carrying amount of the Company's financial instruments including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair values due to their short-term maturities. The estimated fair value of the Company's long-term debt is disclosed in Note 4 herein.

3. GOODWILL AND INTANGIBLE ASSETS*Goodwill*

There were no changes in the carrying amount of goodwill during the three and six months ended July 31, 2013. Goodwill is not amortized, but instead tested for impairment annually during the fourth quarter. Goodwill may also be tested for impairment between annual tests in the presence of impairment indicators. There were no impairments to goodwill during the three and six months ended July 31, 2013 and 2012, respectively.

Intangible Assets

The Company's intangible assets were as follows (in thousands):

	As of July 31, 2013		
	Gross	Accumulated Amortization	Net
Amortizing intangible assets:			
Technology, licenses and patents	\$ 184,213	\$ (180,078)	\$ 4,135
Customer relationships	278,900	(257,925)	20,975
Trademarks	14,300	(13,222)	1,078
Internal-use software	6,633	(6,233)	400
Total	\$ 484,046	\$ (457,458)	\$ 26,588

	As of January 31, 2013		
	Gross	Accumulated Amortization	Net
Amortizing intangible assets:			
Technology, licenses and patents	\$ 184,213	\$ (179,159)	\$ 5,054
Customer relationships	278,900	(240,663)	38,237

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Trademarks	14,300	(12,334)	1,966
Internal-use software	6,711	(6,307)	404
Total	\$ 484,124	\$ (438,463)	\$ 45,661

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As of July 31, 2013, the estimated future amortization expense of the Company's intangible assets is as follows (in thousands):

For remaining six months of year ending January 31, 2014	\$ 19,198
For year ending January 31, 2015	5,923
For year ending January 31, 2016	1,456
For year ending January 31, 2017	11
Total	\$ 26,588

The Company tests its long-lived assets for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. A long-lived asset is not recoverable, and therefore subject to impairment charge, if its carrying amount exceeds the undiscounted cash flows associated with it. There were no impairment charges in the three and six month periods ended July 31, 2013 and 2012, respectively.

4. DEBT

The following table summarized the Company's long-term debt (in thousands, except percentages):

	July 31, 2013	January 31, 2013
2016 Tranche B term loans: due March 10, 2016, three-month LIBOR plus 4.00% with a 1.00% LIBOR floor	\$ 117,399	\$ 117,399
2016 Extended term loans: due March 10, 2016, three-month LIBOR plus 4.00%	191,101	191,101
Senior Subordinated Notes: due March 15, 2016, 10.375%	101,542	101,542
Total long-term debt	\$ 410,042	\$ 410,042

Senior Secured Credit Agreement

On March 10, 2006, the Company entered into a senior secured credit agreement (the "senior secured credit agreement" or the "Credit Facility"). The Credit Facility originally provided for (1) a seven-year term loan in the amount of \$400.0 million amortizing at a rate of 1.00% per year on a quarterly basis for the first six and three-quarters years with the balance paid at maturity and (2) a six-year revolving credit facility that permitted loans in an aggregate amount of up to \$75.0 million, including a letter of credit facility and a swing-line facility. In addition, subject to certain terms and conditions, the Credit Facility provided for one or more uncommitted incremental term loan or revolving credit facilities in an aggregate amount not to exceed \$150.0 million.

First Amend and Extend Transaction

On March 2, 2011, the Company entered into an amendment to its Credit Facility to extend the final maturity of the outstanding term loans, extend the commitment termination date for a portion of the revolving credit facility and amend the financial covenants (the "First Amend and Extend Transaction"). As a result of the First Amend and Extend Transaction, \$191.1 million of the existing term loans were extended with a new maturity date of March 10, 2016 (the "2016 Extended Term Loans"), and \$20.0 million of the existing revolving credit commitments were extended with a new maturity date of March 10, 2015 (the "Extended Revolving Credit Commitments"). The maturity date of the 2016 Extended Term Loans is subject to a springing maturity date that is the 180th day prior to March 10, 2016, if any of the senior subordinated notes remain outstanding as of the springing maturity date. The remaining \$124.9 million of the existing term loans that were not extended (the "2013 Term Loans"), and the remaining \$55.0 million of the existing revolving credit commitments that were not extended, continued to mature on March 10, 2013 and March 10, 2012, respectively. As a result of the First Amend and Extend Transaction, the interest rate margins were increased by 200 basis points for the extended facilities. After giving effect to the amendment, the aggregate principal amount outstanding under the senior secured credit agreement did not change, and the principal amount of the term loans continue to amortize at a rate of 1.00% per year on a quarterly basis.

Second Amend and Extend Transaction

On April 12, 2012, the Company entered into an Extension Agreement and Amendment (the *Second Amend and Extend Transaction*) to the Credit Facility to extend the final maturity date of the 2013 Term Loans to March 2016. As a result of the *Second Amend and Extend Transaction*, \$117.4 million of the 2013 Term Loans were extended through a combination of the establishment of a series of term loans to new and existing lenders and the repayment of certain amounts to existing and departing lenders. This resulted in \$84.4 million of the 2013 Term Loans being effectively repaid or extinguished and the same amount being considered new

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borrowings. The Company refers to the incremental term loans and the newly extended term loans as the 2016 Tranche B Term Loans. The 2016 Tranche B Term Loans have an applicable margin for London Interbank Offered Rate, or LIBOR, based loans of 4.0% (or, if the Company exceeds a specified leverage ratio, 4.25%, which was 200 basis points higher than the interest rate under the 2013 Term Loans) and a LIBOR floor of 1.0%. The other terms and conditions of the 2016 Tranche B Term Loans are the same as those for the 2016 Extended Term Loans. After giving effect to the Second Amend and Extend Transaction, all of the Company's outstanding term loans under the Credit Facility have a final maturity date of March 10, 2016 and the aggregate principal amount of the term loans outstanding under the Credit Facility did not change. The Company paid each lender holding 2016 Tranche B Term Loans an original issue discount equal to 1.5% of the principal amount of 2016 Tranche B Term Loans held by such lender.

The Credit Facility bears an annual commitment fee on the undrawn portion of that facility commencing on the date of execution and delivery of the senior secured credit agreement. As a result of the cancellation of the non-extended 2012 revolving credit commitment totaling \$55.0 million during the quarter ended October 31, 2011, the annual commitment fee is limited to the amount of undrawn Extended Revolving Credit Commitments, which was equal to \$20.0 million as of July 31, 2013. Effective February 1, 2011, the annual commitment fee is 0.375% per annum.

Senior Subordinated Notes

The Company has outstanding \$101.5 million principal amount of senior subordinated notes, which bear interest at a rate of 10.375%, payable semi-annually on March 15 and September 15, and which mature on March 15, 2016. Each of the Company's domestic subsidiaries that guarantees the obligations under the Company's senior secured credit agreement will jointly, severally and unconditionally guarantee the notes on an unsecured senior subordinated basis. The Company does not have any domestic subsidiaries and, accordingly, there are no guarantors. The notes are the Company's unsecured, senior subordinated obligations, and the guarantees, if any, will be unsecured, senior subordinated obligations of the guarantors. The notes are governed by the terms and conditions of an indenture dated as of March 10, 2006 (the Indenture). The notes are subject to redemption at the Company's option pursuant to the terms and conditions specified in the Indenture, and may be redeemed at the option of the holders at 101% of their face amount, plus accrued and unpaid interest, upon certain change of control events.

From fiscal year 2009 through fiscal year 2010, the Company repurchased an aggregate of \$57 million of principal amount of its original outstanding \$200.0 million senior subordinated notes. In fiscal year 2011, the Company repurchased an aggregate of \$8.7 million of principal amount of its original outstanding \$200 million senior subordinated notes. The repurchases resulted in a net loss of \$0.2 million from the extinguishment of debt. In fiscal year 2013, the Company repurchased an aggregate of \$32.7 million of principal amount of the senior subordinated notes in two separate privately negotiated transactions. The repurchases resulted in a net loss of \$1.0 million from the extinguishment of debt. The Company may, from time to time, continue to repurchase the senior subordinated notes in open market or privately negotiated purchases or otherwise, or redeem the senior subordinated notes pursuant to the terms of the Indenture.

Debt Covenants

The Credit Facility and the Indenture contain various covenants, including, among other things, limitations on additional indebtedness, capital expenditures, restricted payments, the incurrence of liens, transactions with affiliates and sales of assets. In addition, the Credit Facility requires the Company to comply with certain financial covenants, including leverage and interest coverage ratios and capital expenditure limitations. The Company was in compliance with all of the covenants under the Credit Facility as of July 31, 2013.

The estimated fair values of the Company's long-term debt are as follows (in thousands):

	Carrying Amount	Fair Value
As of July 31, 2013:		
2016 Tranche B Term Loans	\$ 117,399	\$ 115,932
2016 Extended Term Loans	191,101	188,712
Senior Subordinated Notes	101,542	101,034
As of January 31, 2013:		
2013 Tranche B Term Loans	\$ 117,399	\$ 118,432
2016 Extended Term Loans	191,101	191,827
Senior Subordinated Notes	101,542	103,959

The term loans and senior subordinated notes are measured at fair value using significant other observable inputs categorized as Level 2 within the fair value hierarchy. These measurements consider inputs such as observable prices for similar instruments, quoted prices in markets that are

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not active, or other inputs that are observable, either directly or indirectly, including price quotes from independent pricing vendors and broker-dealers and available trade, bid and other market information.

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Restructuring, acquisition and other charges consisted of the following (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2013	2012	2013	2012
Restructuring	\$ 5,205	\$ 480	\$ 8,337	\$ 480
Acquisition and Other Charges:				
Acquisitions and costs related to issuance of debt	46	30	63	122
Sponsor and administration fees paid to Silver Lake	(66)	281	131	500
Severance, facility and other charges not part of restructuring and not part of ongoing operations	73	826	334	907
Total	\$ 5,258	\$ 1,617	\$ 8,865	\$ 2,009

In February, 2013, the Company initiated a restructuring plan in response to a decline in license revenues and to better align its business operations to market opportunities. In June, 2013, the Company initiated a significant restructuring plan to re-focus the Company's strategy on its core mainframe and distributed system products and new release management products, re-organize and enhance the geographical focus of the Company's sales organization and re-align the cost structure of the Company based on these actions.

As part of these restructuring plans, the Company reduced its workforce by approximately 8% (55 employees) in the three months ended April 30, 2013 and approximately 24% (120 employees) in the three months ended July 31, 2013. These actions affected all parts of the organization through workforce reductions worldwide and facility closures and reductions in North America, Europe and Asia. Additional facility reductions are currently in process and are expected to be completed during the quarter ending October 31, 2013.

The Company has realized, and expects to continue to realize, cost savings going forward as a result of these restructurings. In connection with these actions, the Company recorded net restructuring charges of \$8.3 million during the six months ended July 31, 2013 consisting principally of severance, payroll taxes, employee benefits, facilities and related restructuring charges. Restructuring charges were based on the Company's restructuring plans that were committed to by management. Any changes in the cost estimates of executing the approved plans are reflected in the Company's results of operations. Restructuring liabilities are reported within other accrued expenses in the condensed consolidated balance sheets.

The following table summarizes restructuring charges accrued and paid/written-off as of July 31, 2013 by category (in thousands):

	Severance, payroll taxes and other employee benefits	Facilities closures, legal and other miscellaneous	Total restructuring charges and accruals
Balances as of January 31, 2013	\$	\$	\$
Activity during the six months ended July 31, 2013:			
Accrued	\$ 6,935	\$ 1,402	\$ 8,337
Paid/written-off	(5,506)	(381)	(5,887)
Balances as of July 31, 2013	\$ 1,429	\$ 1,021	\$ 2,450

6. STOCK-BASED COMPENSATION*Stock-Based Compensation Plans*

In March 2006, the Company established the 2006 Stock Incentive Plan (the "2006 Plan") governing, among other things, the grant of stock options, restricted stock units ("RSUs"), and other forms of share-based incentives to its employees, directors and consultants. In the quarter ended

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October 31, 2009, the Company completed a tender offer permitting all eligible employees and its independent directors to exchange, on a one-for-one basis, stock options granted under the 2006 Plan for new stock options granted under Serena's Amended and Restated 2006 Stock Incentive Plan (the Amended 2006 Plan) having a lower exercise price and different vesting terms. In addition, as part of the Company's merger in March 2006, the Company assumed certain stock options that were held by management participants immediately prior to the merger.

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The stock option grants generally vest either over a three-year period (time-based options) or based on the achievement of certain performance targets over a three fiscal year period (performance-based options). All options granted have a maximum contractual life of ten years from the date of grant. For performance-based options, the actual number of option grants eligible to vest during a fiscal year range from 50% to 150% of the number of options initially granted, and is dependent upon levels of achievement of certain performance targets if baseline performance conditions are met. Based upon current expectations of performance targets achievement, approximately \$0.1 million of expense is expected to be recognized over the remaining future vesting periods of approximately 2 to 3 years.

The following table sets forth a summary of stock option activity:

	Options Available for Grant	Number of Options Outstanding	Weighted Average Exercise Price (Per share)	Weighted Average Grant Date Fair Value (Per share)	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Balances as of January 31, 2013	7,612,156	7,799,011	\$ 3.02		5.75	\$ 1,091
Granted	(3,345,000)	3,345,000	2.50	\$ 0.84		
Exercised		(13,167)	1.25			\$ 16
Expired (1)		(122,889)	1.25			
Cancelled	2,992,626	(2,992,626)	3.27			
Restricted stock units granted, net of cancellations (2)	(3,939,350)					
Balances as of July 31, 2013	3,320,432	8,015,329	\$ 2.73		7.32	\$ 847
As of July 31, 2013:						
Vested and expected to vest		7,701,046	\$ 2.73		7.17	\$ 847
Vested and exercisable		3,114,577	\$ 2.70		4.46	\$ 847

(1) Represents cancelled options which are not returned to the available-for-grant stock option pool.

(2) RSUs are granted from the available-for-grant stock option pool. In the six months ended July 31, 2013, a total of 4.7 million units were granted with 0.8 million units cancelled and returned to the available-for-grant stock option pool.

The pre-tax intrinsic value of options exercised represents the difference between the fair value of the Company's common stock on the date of exercise and the exercise price of each option.

Aggregated intrinsic value represents the difference between the fair value of the Company's stock on the date of grant and the exercise price multiplied by the number of related options. To assist management in determining the estimated fair value of the Company's common stock, the Company previously engaged a third-party valuation specialist to perform a valuation on a semi-annual basis as of January 31 and July 31. For purposes of determining the estimated common stock fair value as of July 31, 2013, management performed the valuation based on the approach previously used by its third-party valuation specialist. In estimating the fair value of the Company's common stock, both the external valuation firm and management employed a two-step approach that first estimates the fair value of the Company as a whole, and then allocated the adjusted value of stockholders' equity to the Company's common stock.

Restricted Stock Unit Activities

Restricted Stock Units (RSUs) generally vest on the third anniversary of the date of grant.

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The following table sets forth a summary of RSU activity:

	Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value (In thousands)
Balances as of January 31, 2013	445,000	\$ 3.42	1.71	\$ 1,113
Granted	4,728,100	2.45		
Cancelled	(788,750)	2.75		
Vested	(100,000)	3.08		
Balances as of July 31, 2013	4,284,350	\$ 2.48	2.75	\$ 10,282
As of July 31, 2013:				
Vested and expected-to-vest RSUs	3,721,755		2.74	\$ 8,932

Stock-Based Compensation Expense

The Company determines the fair value of its stock options utilizing the Black-Scholes option pricing model, which incorporates various assumptions including volatility, risk-free interest rate, expected term, and dividend yield. The Company determines the fair value of its RSUs based upon the fair value of the shares of its common stock at the date of grant.

The Company utilizes the graded-vesting attribution method for recognizing stock-based compensation expense. Compensation expense is only recorded for those awards that are expected to vest. Compensation expense for awards with performance-based vesting is recognized only for awards that are deemed probable of achieving the performance condition over the performance-based vesting period.

As of July 31, 2013, total unrecognized compensation costs related to unvested stock options and RSUs were \$2.5 million and \$9.7 million, respectively. Costs related to unvested stock options are expected to be recognized over a period ranging from approximately 2 to 3 years and costs related to the RSUs are expected to be recognized over a period of 3 years from the grant date.

Stock-based compensation expense for the three and six months ended July 31, 2013 and 2012 is categorized as follows (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2013	2012	2013	2012
Cost of revenue - maintenance	\$ 33	\$ 14	\$ 49	\$ 30
Cost of revenue - professional services	12	(3)	(16)	6
Sales and marketing	122	75	295	212
Research and development	208	60	315	124
General and administrative	463	379	702	637
Total stock-based compensation expense	838	525	1,345	1,009
Income tax benefit	(319)	(204)	(512)	(392)
Total stock-based compensation expense, net of tax	\$ 519	\$ 321	\$ 833	\$ 617

7. SEGMENT

The Company's chief operating decision maker (CODM), who is the Chief Executive Officer, allocates resources and assesses performance based on financial information of the Company. The CODM reviews financial information presented on an entity-level basis accompanied by disaggregated information about revenues by product type and information about geographic regions for purposes of making operating decisions and assessing financial performance. The entity level financial information is identical to the information presented in the accompanying consolidated statements of comprehensive loss. Accordingly, the Company has determined that it operates in a single operating and reportable

segment: enterprise change management software.

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The Company attributes revenues to geographic region generally based on the country to which the products are shipped. The following table shows net revenues by geographic region (in thousands):

	For the Three Months Ended July 31,		For the Six Months Ended July 31,	
	2013	2012	2013	2012
North America:				
Software licenses	\$ 6,039	\$ 6,279	\$ 8,012	\$ 11,721
Maintenance and professional services	25,112	27,535	50,216	54,475
	31,151	33,814	58,228	66,196
Europe, Asia and South America:				
Software licenses	2,477	5,311	5,091	7,798
Maintenance and professional services	12,935	13,323	25,547	26,373
	15,412	18,634	30,638	34,171
Total	\$ 46,563	\$ 52,448	\$ 88,866	\$ 100,367

No customer accounted for 10% or more of consolidated revenues for the three and six months ended July 31, 2013 and 2012, respectively.

8. INCOME TAXES

Income tax benefit was \$3.4 million and \$10.0 million in the three and six months ended July 31, 2013, as compared to income tax expense of \$0.1 million and income tax benefit of \$0.8 million in the three and six months ended July 31, 2012. The Company's effective income tax rate for the three and six months ended July 31, 2013, differs from the federal statutory rate of 35% primarily due to the impacts of permanently reinvested foreign earnings, the domestic production deduction, research and development credits, and state taxes. During periods where the Company experiences pre-tax losses, these items will generally increase the effective income tax rate above the statutory rate, whereas during periods where the Company experiences pre-tax profits, they will reduce the effective income tax rate below the statutory rate. Accordingly, the effective tax rate was higher in the three and six months ended July 31, 2013, as compared to the three and six months ended July 31, 2012, due to larger pre-tax losses.

At January 31, 2013, the Company had total federal, state and foreign unrecognized tax benefits of \$3.5 million, including interest of \$0.8 million. During the three and six months ended July 31, 2013, there were no material changes to the total unrecognized tax benefit, and the Company accrued immaterial amounts in interest.

The Company files tax returns in the U.S. federal jurisdiction and in various state and foreign jurisdictions. The statute of limitations on the Company's federal tax return filings remains open for the years ended January 31, 2010 through January 31, 2012. The statute of limitations on the Company's major state tax return filings remains open for the years ended January 31, 2009 through January 31, 2012. The statute of limitations on the Company's U.K. income tax filings remains open for the years ended January 31, 1999 through January 31, 2012. Over the next twelve months, the Company expects a decrease of \$0.5 million in its unrecognized tax benefits primarily as a result of expiring statutes of limitation and settlements with certain state taxing authorities.

9. COMMITMENTS AND CONTINGENCIES*Commitments*

The following table summarizes the Company's future principal contractual obligations as of July 31, 2013 (in thousands):

Remainder of	Payments Due by Period (1) Fiscal year ended January 31,
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	Total	2014	2015	2016	2017	2018	Thereafter
Operating leases	\$ 13,458	\$ 1,731	\$ 2,794	\$ 2,271	\$ 2,168	\$ 1,987	\$ 2,507
Credit Facility:							
2016 Tranche B Term Loans: due March 10, 2016	117,399				117,399 (3)		
2016 Extended Term Loans: due March 10, 2016	191,101				191,101 (3)		
Senior Subordinated Notes: due March 15, 2016	101,542				101,542		
Interest payments on long-term debt (2)	65,236	12,246	24,492	24,429	4,069		
	\$ 488,736	\$ 13,977	\$ 27,286	\$ 26,700	\$ 416,279	\$ 1,987	\$ 2,507

- (1) This table excludes the Company's unrecognized tax benefits totaling \$3.5 million as of July 31, 2013, since the Company has determined that the timing of payments with respect to these liabilities cannot be reasonably estimated.
- (2) Scheduled interest payments are calculated through the instrument's due date and assume no principal pay-downs, borrowings or early repayments triggered by the occurrence of certain events. Scheduled interest payments on debt include the 2016 extended term loans due March 10, 2016, at an assumed annual rate of 4.19%, which is the rate in effect as of July 31, 2013, the 2016 Tranche B Term Loans due March 10, 2016, at an assumed annual rate of 5.00%, which is the rate in effect as of July 31,

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2013, the commitment fee on the unutilized amount of the 2015 extended revolving credit facility due March 10, 2015, at an assumed annual rate of 0.375%, which is the rate in effect as of July 31, 2013, and the ten year senior subordinated notes due March 15, 2016, at the stated annual rate of 10.375%.

- (3) Subject to a springing maturity that is the 180th day prior to March 10, 2016 if the Senior Subordinated Notes remain outstanding as of such springing maturity date.

Office Facility Leases

The Company leases its office facilities under operating lease agreements that expire from 2013 to 2022. The terms of the lease agreements provide for rental payments on a graduated basis. The Company recognizes rent expense on a straight-line basis over the lease period.

Long-Term Debt

As of July 31, 2013, the Company had total outstanding debt of \$410.0 million. All of this debt matures in March 2016, subject, in the case of the Credit Facility, to the springing maturity date describe above. Details of long-term debt are disclosed in Note 4 herein.

Customer Indemnification

In the ordinary course of business, the Company may provide indemnification of varying scope and terms to customers, vendors, lessors, business partners, and other parties with respect to certain matters, including, but not limited to, losses arising out of breach of agreements with such parties, services to be provided by the Company or from intellectual property infringement claims made by third parties.

Legal Proceedings

The Company is involved in various legal proceedings that have arisen during the ordinary course of its business. The reasonably possible or probable range of loss from the final resolution of these matters, individually or in the aggregate, is not expected to be material.

Table of Contents**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Forward-Looking Statements**

This Quarterly Report on Form 10-Q (Report), including the following Management's Discussion and Analysis of Financial Condition and Results of Operations, should be read in conjunction with the Condensed Consolidated Financial Statements and the notes thereto included elsewhere in this Report, and contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to safe harbors under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. These forward-looking statements include, but are not limited to, statements about financial projections, operational plans and objectives, future economic performance and other projections and estimates contained in this Report. When used in this Report, the words expects, anticipates, intends, plans, believes, seeks, estimates and similar expressions identify forward-looking statements. Because these forward-looking statements involve risks and uncertainties, they are subject to important factors that could cause actual results to differ materially from those expressed or implied by the forward-looking statements, including those risk factors discussed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 31, 2013, Part II, Item 1A of our Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2013, Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Report. We assume no obligation to update the forward-looking information contained in this Report. It is important that the discussion below be read together with the unaudited condensed consolidated financial statements and notes thereto in this Report and the risk factors discussed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 31, 2013, Part II, Item 1A of our Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2013, and elsewhere in this Report.

Business and Market Environment

At Serena Software, we design, develop, and sell application lifecycle management (ALM), application release management, and information technology (IT) software and solutions. We are a leading ALM software vendor and a leader in orchestrating the convergence of application development and IT operations, which we refer to as DevOps. Our ALM and IT management solutions simplify and automate the transition of new versions of applications into production by managing request, development, release, change and support processes across heterogeneous environments, including mainframe and non-mainframe environments.

Our expenses have historically been driven by personnel-related costs, including wages, commissions, bonuses, vacation, employee benefits, stock-based compensation, and travel, and we expect this trend to continue. During the first half of fiscal year 2014, we have continued to experience a global macroeconomic environment in which our customers exercised care and conservatism in their investment prioritization and project deployments. We expect that our customers will continue to remain cautious with their IT spending in the near term, particularly within Europe.

In June 2013, we initiated a significant restructuring plan to re-focus our strategy on our core mainframe and distributed system products and new release management products, re-organize and enhance the geographical focus of our sales organization and re-align the cost structure of our company based on these actions. We have reduced our workforce by 120 employees or approximately 24% of our workforce throughout all parts of the organization. We have recorded restructuring charges related to severance, payroll taxes and employee benefits of \$3.9 million and related to facilities of \$1.3 million, with the majority of the payments made and written-off in the fiscal quarter ended July 31, 2013. The June 2013 Restructuring Plan is expected to be completed in the third quarter of fiscal year 2014. We expect to reduce our operating expenses (exclusive of amortization of intangible assets and restructuring, acquisition and other charges) for fiscal year 2014 by approximately 17% to 19% when compared to similar operating expenses for fiscal year 2013.

Executive Summary

Our financial highlights for the three and six months ended July 31, 2013 and 2012, respectively were as follows (in thousands, except percentages):

	Three Months Ended July 31,				Six Months Ended July 31,			
	2013	2012	\$ Change	% Change	2013	2012	\$ Change	% Change
Revenue	\$ 46,563	\$ 52,448	\$ (5,885)	(11%)	\$ 88,866	\$ 100,367	\$ (11,501)	(11%)
Operating income	3,199	7,360	(4,161)	(57%)	1,817	11,026	(9,209)	(84%)
Percentage of revenue	7%	14%			2%	11%		
Net income (loss)	52	(314)	366	N/M	(1,185)	(3,427)	2,242	(65%)
Percentage of revenue	0%	N/M			N/M	N/M		

* N/M means not meaningful

Revenue: During the three and six months ended July 31, 2013, we experienced declines in software licenses, maintenance contracts and professional services, compared to the same prior year periods. The declines were due primarily to lower software license sales.

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Operating Income: Operating income declined for the three and six months ended July 31, 2013 compared to the same prior year periods primarily due to lower revenue and increased restructuring and other charges, partially offset by declines in other operating expenses.

Net Income: We reported net income for the three months ended July 31, 2013 and a smaller net loss for the six months ended July 31, 2013 when compared to the prior year periods. The increases were primarily due to an increase in the income tax benefit for fiscal year 2014.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires us to make judgments, assumptions, and estimates that affect the amounts reported in the Consolidated Financial Statements and the accompanying notes. We base our estimates and assumptions on current facts, historical experience, and various other factors that we believe are reasonable under the circumstances, to determine the carrying values of assets and liabilities that are not readily apparent from other sources. On an ongoing basis, management evaluates its estimates and judgments, including those related to revenue recognition, trade accounts receivable and allowance for doubtful accounts, impairment or disposal of long-lived assets, accounting for income taxes, impairment of goodwill, valuation of our common stock, and accounting for options and RSUs, among other things. In many instances, we could have reasonably used different accounting estimates. In addition, changes in accounting estimates are reasonably likely to occur from period to period. Thus, actual results could differ significantly from the estimates made by us. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation of our financial condition or results of operations could be affected.

An accounting policy is considered to be critical if the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change, and the effect of the estimates and assumptions on financial condition or operating performance is material. The accounting policies we believe to reflect our more significant estimates, judgments and assumptions and are most critical to understanding and evaluating our reported financial results are as follows:

Revenue recognition,

Stock-based compensation,

Valuation of long-lived assets, including goodwill, and

Accounting for income taxes.

In the three months ended July 31, 2013, there was no significant change in the above critical accounting policies or the underlying assumptions and estimates used in their application. See our Annual Report on Form 10-K for the fiscal year ended January 31, 2013, filed with the SEC on March 29, 2013, for further information regarding our critical accounting policies and estimates.

Recent Accounting Pronouncements

See *Recent Accounting Pronouncements* in the condensed consolidated financial statements in Item 1 of Part I of this Report for a full description of recent accounting pronouncements, including the actual and expected dates of adoption and estimated effects on our consolidated results of operations and financial condition.

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Results of Operations

Revenue

The following table summarizes software licenses, maintenance and professional services revenues for the periods indicated (in thousands, except percentages):