VARONIS SYSTEMS INC
Form 10-Q
August 09, 2016

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, 2016

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: 001-36324

VARONIS SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**57-1222280**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1250 Broadway, 29th Floor New York, NY 10001	**10001**
(Address of principal executive offices)	**(Zip Code)**

(877) 292-8767

(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 and 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, non-accelerated filer or a smaller reporting company. See 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	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

At August 5, 2016, there were 26,389,830 shares of Common Stock, par value $0.001 per share, outstanding.

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	June 30, 2016 (unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$56,102	$49,241
Short-term deposits	52,353	57,103
Trade receivables (net of allowance for doubtful accounts of $358 and $156 at June 30, 2016 and December 31, 2015, respectively)	33,493	47,436
Prepaid expenses and other current assets	2,623	2,622
Total current assets	144,571	156,402
Long-term assets:		
Other assets	511	477
Property and equipment, net	8,646	8,265
Total long-term assets	9,157	8,742
Total assets	$153,728	$165,144
Liabilities and stockholders’ equity		
Current liabilities:		
Trade payables	$2,074	$2,612
Accrued expenses and other liabilities	22,714	23,029
Deferred revenues	44,953	45,675
Total current liabilities	69,741	71,316
Long-term liabilities:		
Deferred revenues	2,674	3,096
Severance pay	1,549	1,528
Other liabilities	5,393	5,617
Total long-term liabilities	9,616	10,241
Stockholders’ equity:		
Share capital		
Common stock of $ 0.001 par value - Authorized: 200,000,000 shares at June 30, 2016 and December 31, 2015; Issued and outstanding: 26,373,417 shares at June 30, 2016 and 26,069,154 shares at December 31, 2015	26	26

Accumulated other comprehensive income (loss)	48	(331)
Additional paid-in capital	179,574	172,326
Accumulated deficit	(105,277)	(88,434)
Total stockholders’ equity	74,371	83,587
Total liabilities and stockholders’ equity	$153,728	$165,144

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Revenues:				
Licenses	$21,742	$16,011	$35,586	$26,169
Maintenance and services	16,899	13,139	33,525	25,967
Total revenues	38,641	29,150	69,111	52,136
Cost of revenues	3,721	2,863	7,217	5,696
Gross profit	34,920	26,287	61,894	46,440
Operating costs and expenses:				
Research and development	8,905	7,799	17,742	15,532
Sales and marketing	26,840	21,264	51,204	41,455
General and administrative	4,760	3,760	9,322	7,540
Total operating expenses	40,505	32,823	78,268	64,527
Operating loss	(5,585)	(6,536)	(16,374)	(18,087)
Financial income (expenses), net	(605)	402	40	(639)
Loss before income taxes	(6,190)	(6,134)	(16,334)	(18,726)
Income taxes	(303)	(188)	(509)	(266)
Net loss	$(6,493)	$(6,322)	$(16,843)	$(18,992)
Net loss per share of common stock, basic and diluted	$(0.25)	$(0.25)	$(0.64)	$(0.77)
Weighted average number of shares used in computing net loss per share of common stock, basic and diluted	26,273,380	24,875,227	26,195,269	24,809,006

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss	$(6,493)	$(6,322)	$(16,843)	$(18,992)
Other comprehensive income (loss):				
Unrealized gains (losses) on derivative instruments	(845)	1,056	379	936
Total other comprehensive income (loss)	(845)	1,056	379	936
Comprehensive loss	$(7,338)	$(5,266)	$(16,464)	$(18,056)

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30, 2016	2015
Cash flows from operating activities:		
Net loss	$(16,843)	$(18,992)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	1,066	689
Stock-based compensation	5,997	3,647
Capital gain from disposal of fixed asset	-	(1)
Changes in assets and liabilities:		
Trade receivables	13,943	8,920
Prepaid expenses and other current assets	47	1,260
Trade payables	(538)	(119)
Accrued expenses and other liabilities	16	439
Severance pay, net	21	17
Deferred revenues	(1,144)	(597)
Other long term liabilities	(224)	(689)
Net cash provided by (used in) operating activities	2,341	(5,426)
Cash flows from investing activities:		
Decrease in short-term deposit	4,750	-
Increase in long-term deposits	(27)	(65)
Increase in restricted cash	(7)	(173)
Purchase of property and equipment	(1,447)	(1,770)
Net cash provided by (used in) investing activities	3,269	(2,008)
Cash flows from financing activities:		
Proceeds from employee stock plans	1,251	619
Net cash provided by financing activities	1,251	619
Increase (decrease) in cash and cash equivalents	6,861	(6,815)
Cash and cash equivalents at beginning of period	49,241	76,593
Cash and cash equivalents at end of period	$56,102	$69,778
Supplemental disclosure of non-cash flow information:		
Deferred rent fixed asset additions	-	1,355
	$-	$1,355
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$96	$163

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1:- GENERAL

a. Varonis Systems, Inc. (“VSI” and together with its subsidiaries, collectively, the “Company”) was incorporated under the laws of the State of Delaware on November 3, 2004 and commenced operations on January 1, 2005.

VSI has five wholly-owned subsidiaries: Varonis Systems Ltd. (“VSL”) incorporated under the laws of Israel on November 24, 2004; Varonis UK (“VSUK”) incorporated under the laws of England on March 14, 2007; Varonis Systems (Deutschland) GmbH (“VSG”) incorporated under the laws of Germany on July 6, 2011; Varonis France SAS (“VSF”) incorporated under the laws of France on February 22, 2012; and Varonis Systems Corp. (“VSC”) incorporated under the laws of British Columbia, Canada on February 19, 2013.

The Company’s software products and services allow enterprises to analyze, secure, manage and better utilize their unstructured data. Unstructured data includes an enterprise’s word processing documents, spreadsheets, presentations, audio files, video files, emails, text messages, and any other data created by employees or stored in enterprise file systems. Through its product families DatAdvantage, DataPrivilege, IDU Classification Framework, DatAnywhere, Data Transport Engine and DatAnswers, enterprises more effectively and efficiently manage and protect their data.

VSI markets and sells products and services mainly in the United States. VSUK, VSG, VSF and VSC resell the Company’s products and services mainly in the UK, Germany, France and rest of Europe, and Canada, respectively. The Company primarily sells its products and services to a global network of distributors and Value Added Resellers (VARs), which sell the products to end users customers.

b. Basis of Presentation:

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with Article 10 of Regulation S-X, “Interim Financial Statements” and the rules and regulations for Form 10-Q of the Securities and Exchange Commission (the “SEC”). Pursuant to those rules and regulations, the Company has condensed or omitted certain information and footnote disclosure it normally includes in its annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”).

In management’s opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its consolidated financial position, results of operations and cash flows. The Company’s interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the 2015 consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2015 filed with the SEC on February 12, 2016 (the "2015 Form 10-K"). There have been no changes in the significant accounting policies from those that were disclosed in the audited consolidated financial statements for the fiscal year ended December 31, 2015 included in the 2015 Form 10-K.

c. Derivative Instruments:

The Company’s primary objective for holding derivative instruments is to reduce its exposure to foreign currency rate changes. The Company reduces its exposure by entering into forward foreign exchange contracts with respect to operating expenses that are forecast to be incurred in currencies other than the U.S. dollar. A majority of the Company’s revenues and a majority of its operating expenditures are transacted in U.S. dollars. However, certain operating expenditures are incurred in or exposed to other currencies, primarily the New Israeli Shekel (“NIS”).

The Company has established forecasted transaction currency risk management programs to protect against fluctuations in fair value and the volatility of future cash flows caused by changes in exchange rates. The Company’s currency risk management program includes forward foreign exchange contracts designated as cash flow hedges. These forward foreign exchange contracts generally mature within 12 months. The Company does not enter into derivative financial instruments for trading purposes.

Derivative instruments measured at fair value and their classification on the consolidated balance sheets are presented in the following table (in thousands):

	Assets as of June 30, 2016 (unaudited)		Liabilities as of December 31, 2015	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Foreign exchange forward contract derivatives in cash flow hedging relationships - included in other current assets and accrued expenses and other liabilities	$24,527	$ 48	$36,070	$(331)

For the three and six months ended June 30, 2016, the unaudited consolidated statements of operations reflect a gain of approximately $154 and $82, respectively, related to the effective portion of foreign currency forward contracts. For the three and six months ended June 30, 2015, the unaudited consolidated statements of operations reflect a loss of approximately $74 and $598, respectively, related to the effective portion of foreign currency forward contracts. There was no ineffective portion for the three and six months ended June 30, 2016 and 2015.

d. Recently Issued Accounting Pronouncements:

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers”, an updated standard on revenue recognition and issued subsequent amendments to the initial guidance in April 2016 and May 2016 within

ASU 2016-10 and 2016-12, respectively. The new standards provide enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using IFRS and US GAAP. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. ASU 2014-09 was initially scheduled to be effective for annual and interim reporting periods beginning after December 15, 2016 and may be adopted either on a full retrospective or modified retrospective approach. However, on July 9, 2015, the FASB approved a one year deferral of the effective date of ASU 2014-09. The revised effective date is for annual reporting periods beginning after December 15, 2017 and interim periods thereafter, with an early adoption permitted as of the original effective date. The Company is still evaluating the impact of implementation of this standard on its consolidated financial statements.

In May 2016, the FASB issued ASU 2016-11, “Revenue Recognition: Customer Payments and Incentives”, which clarifies the guidance in recognizing costs for consideration given by a vendor to a customer as a component of cost of sales. The Company is currently evaluating the impact of this standard on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-09, which effects all entities that issue share-based payment awards to their employees. The amendments in this ASU cover such areas as the recognition of excess tax benefits and deficiencies, the classification of those excess tax benefits on the statement of cash flows, an accounting policy election for forfeitures, the amount an employer can withhold to cover income taxes and still qualify for equity classification and the classification of those taxes paid on the statement of cash flows. This ASU is effective for annual and interim periods beginning after December 15, 2016. This guidance can be applied either prospectively, retrospectively or using a modified retrospective transition method. Early adoption is permitted. The Company has not yet selected a transition date and is currently evaluating this ASU to determine the impact of its adoption on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases”, on the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for in a manner similar to the accounting under existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. ASC 842 supersedes the previous leases standard, ASC 840, "Leases". The guidance is effective for the interim and annual periods beginning on or after December 15, 2018, and early adoption is permitted. The Company is currently evaluating the potential effect of the guidance on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, “Balance Sheet Classification of Deferred Taxes”, which simplifies the presentation of deferred income taxes. This ASU requires that deferred tax assets and liabilities be classified as non-current in a statement of financial position. The Company early adopted ASU 2015-17 effective December 31, 2015 on a prospective basis. No prior periods were retrospectively adjusted.

NOTE 2:- FAIR VALUE MEASUREMENTS

The Company evaluates assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level to classify them for each reporting period. There have been no transfers between fair value measurements levels during the three months ended June 30, 2016.

The authoritative guidance on fair value measurements establishes a consistent framework for measuring fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level. The following are the hierarchical levels of inputs to measure fair value:

- Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: Observable inputs that reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3: Unobservable inputs reflecting our own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

The following table sets forth the Company's assets and liabilities that were measured at fair value as of June 30, 2016 and December 31, 2015 by level within the fair value hierarchy (in thousands):

	As of June 30, 2016 (unaudited)				As of December 31, 2015			
	Level I	Level II	Level III	Fair Value	Level I	**Level II**	Level III	Fair Value
Financial assets:								
Forward foreign exchange contracts	–	48	–	48	–	–		