

ZIX CORP
Form 10-Q
November 04, 2009

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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 September 30, 2009

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: 0-17995

ZIX CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Texas

(State of Incorporation)

75-2216818

(I.R.S. Employer Identification Number)

2711 North Haskell Avenue

Suite 2200, LB 36

Dallas, Texas 75204-2960

(Address of Principal Executive Offices)

(214) 370-2000

(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 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

Smaller reporting

(Do not check if a
smaller reporting
company)

company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class

Outstanding at November 2, 2009

Common Stock, par value \$0.01 per share

63,650,997

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ZIX CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2009	December 31, 2008
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,392,000	\$ 13,245,000
Marketable securities	25,000	
Receivables, net	681,000	476,000
Prepaid and other current assets	1,065,000	1,145,000
 Total current assets	 14,163,000	 14,866,000
Restricted cash		28,000
Property and equipment, net	2,333,000	2,236,000
Goodwill	2,161,000	2,161,000
Other assets	276,000	66,000
 Total assets	 \$ 18,933,000	 \$ 19,357,000
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	\$ 923,000	\$ 512,000
Accrued expenses	2,810,000	2,404,000
Deferred revenue	14,505,000	14,960,000
License subscription note payable	123,000	
 Total current liabilities	 18,361,000	 17,876,000
Long-term liabilities:		
Deferred revenue	2,681,000	2,484,000
License subscription note payable	218,000	
Deferred rent	251,000	300,000
 Total long-term liabilities	 3,150,000	 2,784,000
 Total liabilities	 21,511,000	 20,660,000
Commitments and contingencies (see Note 9)		
Stockholders' deficit:		
Preferred stock, \$1 par value, 10,000,000 shares authorized; none issued and outstanding		
Common stock, \$0.01 par value, 175,000,000 shares authorized; 65,861,716 issued and 63,534,535 outstanding in 2009 and 65,646,663 issued and 63,319,482 outstanding in 2008	659,000	656,000
Additional paid-in capital	336,454,000	333,608,000
Treasury stock, at cost; 2,327,181 common shares in 2009 and 2008	(11,507,000)	(11,507,000)
Accumulated deficit	(328,184,000)	(324,060,000)
 Total stockholders' deficit	 (2,578,000)	 (1,303,000)

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Total liabilities and stockholders' deficit	\$ 18,933,000	\$ 19,357,000
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See notes to condensed consolidated financial statements.

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ZIX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended		Nine Months Ended September	
	September 30,		30,	
	2009	2008	2009	2008
Revenues	\$ 7,835,000	\$ 6,709,000	\$ 22,462,000	\$ 20,866,000
Cost of revenues	2,249,000	2,383,000	7,088,000	7,505,000
Gross profit	5,586,000	4,326,000	15,374,000	13,361,000
Operating expenses:				
Research and development	1,760,000	1,590,000	5,238,000	4,516,000
Selling, general and administrative	4,557,000	4,232,000	14,429,000	13,656,000
Total operating expenses	6,317,000	5,822,000	19,667,000	18,172,000
Operating loss	(731,000)	(1,496,000)	(4,293,000)	(4,811,000)
Other income, net	35,000	97,000	176,000	435,000
Loss before income taxes	(696,000)	(1,399,000)	(4,117,000)	(4,376,000)
Provision for income taxes	39,000	(110,000)	(7,000)	(187,000)
Net loss	\$ (657,000)	\$ (1,509,000)	\$ (4,124,000)	\$ (4,563,000)
Basic and diluted loss per common share	\$ (0.01)	\$ (0.02)	\$ (0.07)	\$ (0.07)
Basic and diluted weighted average common shares outstanding	63,367,037	63,072,191	63,335,508	62,893,809

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT
(Unaudited)

	Common Stock		Stockholders Deficit			Total Stockholders Deficit
			Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	
	Shares	Amount				
Balance, December 31, 2008	65,646,663	\$ 656,000	\$ 333,608,000	\$ (11,507,000)	\$ (324,060,000)	\$ (1,303,000)
Issuance of common stock upon exercise of stock options	7,492	1,000	12,000			13,000
Issuance of common stock upon exercise of warrants	207,561	2,000	337,000			339,000
Employee stock-based compensation costs			2,473,000			2,473,000
Non-employee stock-based compensation costs			24,000			24,000
Net loss					(4,124,000)	(4,124,000)
Balance, September 30, 2009	65,861,716	\$ 659,000	\$ 336,454,000	\$ (11,507,000)	\$ (328,184,000)	\$ (2,578,000)

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September	
	30,	
	2009	2008
Operating activities:		
Net loss	\$ (4,124,000)	\$ (4,563,000)
Non-cash items in net loss:		
Depreciation and amortization	987,000	961,000
Employee stock-based compensation costs	2,473,000	1,905,000
Non-employee stock-based compensation costs	24,000	43,000
Common stock issued to employees as compensation in lieu of cash		1,004,000
Changes in deferred taxes	5,000	37,000
Changes in operating assets and liabilities:		
Receivables	(205,000)	580,000
Prepaid and other current assets	256,000	435,000
Accounts payable	168,000	166,000
Deferred revenue	(258,000)	756,000
Accrued and other liabilities	357,000	89,000
Net cash (used in) provided by operating activities	(317,000)	1,413,000
Investing activities:		
Purchases of property and equipment	(852,000)	(695,000)
Restricted cash and marketable securities, net	3,000	1,734,000
Net cash (used in) provided by investing activities	(849,000)	1,039,000
Financing activities:		
Proceeds from exercise of stock options	13,000	164,000
Proceeds from exercise of warrants	339,000	
Payment of promissory note payable	(39,000)	
Net cash provided by financing activities	313,000	164,000
(Decrease) increase in cash and cash equivalents	(853,000)	2,616,000
Cash and cash equivalents, beginning of period	13,245,000	10,524,000
Cash and cash equivalents, end of period	\$ 12,392,000	\$ 13,140,000

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated financial statements of Zix Corporation (ZixCorp, the Company, we, our, us) should be read in conjunction with the audited consolidated financial statements included in the Company's 2008 Annual Report to Shareholders on Form 10-K. These financial statements are unaudited, but have been prepared in the ordinary course of business for the purpose of providing information with respect to the interim periods. Management of the Company believes that all adjustments necessary for a fair presentation for such periods have been included and are of a normal recurring nature. The results of operations for the three and nine month periods ended September 30, 2009, are not necessarily indicative of the results to be expected for the full year. We have evaluated subsequent events for recognition or disclosure through November 4, 2009, which was the date we filed this Form 10-Q with the SEC.

2. Recent Accounting Standards and Pronouncements

In April 2009 the Financial Accounting Standards Board (the FASB) issued FASB Staff Position No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, currently within the scope of Accounting Standards Code (ASC) 825-10. ASC 825-10 requires disclosures about the fair value of financial instruments whenever a public company issues financial information for interim reporting periods. ASC 825-10 is effective for interim reporting periods ending after June 15, 2009. The Company adopted this staff position upon its issuance, and it had no material impact on its consolidated financial statements. See Note 6 Fair Value Measurements for these disclosures.

In April 2009 the FASB issued Statement of Financial Accounting Standards (SFAS) 165, "*Subsequent Events*", currently within the scope of ASC 855-10. ASC 855-10 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC 855-10 was adopted for the quarter ending June 30, 2009. The adoption had no material impact on our consolidated financial statements. See Note 1 Basis of Presentation .

In June 2009 the FASB issued SFAS 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, currently within the scope of ASC 105-10. ASC 105-10 identifies the FASB Accounting Standards Codification as the authoritative source of generally accepted accounting principles (GAAP) in the United States. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under federal securities laws are also sources of authoritative GAAP for SEC registrants. ASC 105-10 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption had no material impact on our consolidated financial statements.

In February 2008 the FASB issued FASB Staff Position FSP 157-2, *Effective Date of FASB Statement No. 157*, currently within the scope of ASC 820-10. The effective date of ASC 820-10 for all nonfinancial assets and nonfinancial liabilities, except for items recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), was delayed until the beginning of the first quarter 2009. Application of ASC 820-10 did not have a material impact on our results of operations and financial position upon adoption on January 1, 2009.

In December 2007 the FASB issued SFAS 141 (revised 2007) *Business Combinations*, currently within the scope of ASC 805-10. ASC 805-10 establishes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. ASC 805-10 also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. ASC 805-10 was effective for the Company on January 1, 2009, and the Company will apply to all business combinations subsequent to the effective date.

In December 2007 the FASB issued SFAS 160, *Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51*, currently within the scope of ASC 810-10. ASC 810-10 establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. It

clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. ASC 810-10 is effective for fiscal years beginning after December 15, 2008. Adoption did not have a material impact on our consolidated financial statements.

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In April 2008 the FASB issued FASB Staff Position No. FAS 142-3, *Determination of the Useful Life of Intangible Assets*, currently within the scope of ASC 410-20. ASC 410-20 establishes the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. ASC 410-20 removes the requirement to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions and instead, requires an entity to consider its own historical experience in renewing similar arrangements. It also requires expanded disclosure related to the determination of intangible asset useful lives. ASC 410-20 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of this statement did not have a material impact on the Company's consolidated financial statements or footnote disclosures.

3. Segment Information

We have concluded our business has two reportable segments: Email Encryption and e-Prescribing. Our senior management team measures the performance of each segment and determines the related allocation of resources.

To determine the allocation of resources, the senior management team generally assesses the performance of each segment based on revenue, gross profit, and direct expenses which include research and development expenses and selling and marketing expenses that are directly attributable to the segments. Most assets and most corporate costs are not allocated to the segments and are not used to determine resource allocation. Any transactions that are considered a one-time occurrence or not likely to be repeated in future periods are excluded from these assessments. The accounting policies of the reportable segments are the same as those applied to the consolidated financial statements.

Corporate includes charges such as corporate management, compliance and other non-operational activities that cannot be directly attributed to a reporting segment.

	Three Months Ended September 30, 2009				Three Months Ended September 30, 2008			
	Email		Corporate	Total	Email		Corporate	Total
	Encryption	e-Prescribing			Encryption	e-Prescribing		
Revenues	\$ 6,685,000	\$ 1,150,000	\$	\$ 7,835,000	\$ 5,578,000	\$ 1,131,000	\$	\$ 6,709,000
Cost of revenues	1,179,000	1,070,000		2,249,000	985,000	1,398,000		2,383,000
Gross profit	5,506,000	80,000		5,586,000	4,593,000	(267,000)		4,326,000
Direct expenses	2,882,000	1,460,000		4,342,000	2,643,000	1,762,000		4,405,000
Segment contribution (loss)	2,624,000	(1,380,000)		1,244,000	1,950,000	(2,029,000)		(79,000)
Unallocated (expense) /								
Income:								
Selling, general and administrative			(1,975,000)	(1,975,000)			(1,417,000)	(1,417,000)
Investment and other income			43,000	43,000			97,000	97,000
Interest expense			(8,000)	(8,000)				
Total			(1,940,000)	(1,940,000)			(1,320,000)	(1,320,000)

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Income (loss) before provision for income taxes	\$ 2,624,000	\$ (1,380,000)	\$ (1,940,000)	\$ (696,000)	\$ 1,950,000	\$ (2,029,000)	\$ (1,320,000)	\$ (1,399,000)
Depreciation expense	\$ 211,000	\$ 81,000	\$ 47,000	\$ 339,000	\$ 176,000	\$ 95,000	\$ 41,000	\$ 312,000

Nine Months Ended September 30, 2009

Nine Months Ended September 30, 2008

	Email				Email			
	Encryption	e-Prescribing	Corporate	Total	Encryption	e-Prescribing	Corporate	Total
Revenues	\$ 19,306,000	\$ 3,156,000	\$	\$ 22,462,000	\$ 16,534,000	\$ 4,332,000	\$	\$ 20,866,000
Cost of revenues	3,280,000	3,808,000		7,088,000	3,094,000	4,411,000		7,505,000
Gross profit	16,026,000	(652,000)		15,374,000	13,440,000	(79,000)		13,361,000
Direct expenses	8,617,000	5,054,000		13,671,000	8,266,000	5,314,000		13,580,000
Segment contribution (loss)	7,409,000	(5,706,000)		1,703,000	5,174,000	(5,393,000)		(219,000)
Unallocated (expense) /								
Income:								
Selling, general and administrative			(5,996,000)	(5,996,000)			(4,592,000)	(4,592,000)
Investment and other income			189,000	189,000			435,000	435,000
Interest expense			(13,000)	(13,000)				
Total			(5,820,000)	(5,820,000)			(4,157,000)	(4,157,000)

Income (loss) before provision for income taxes	\$ 7,409,000	\$ (5,706,000)	\$ (5,820,000)	\$ (4,117,000)	\$ 5,174,000	\$ (5,393,000)	\$ (4,157,000)	\$ (4,376,000)
Depreciation expense	\$ 596,000	\$ 259,000	\$ 132,000	\$ 987,000	\$ 546,000	\$ 288,000	\$ 127,000	\$ 961,000

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Revenues from international customers and long lived assets outside of the United States (U.S.) are not material to the condensed consolidated financial statements.

As mentioned above, the Company generally does not allocate resources based on assets; however, for disclosure purposes total assets by segment are shown below. Assets reported under each segment include only those that provide a direct and exclusive benefit to that segment. Assets assigned to each segment include accounts receivable and related allowances, prepaid and other assets, property and equipment and related accumulated depreciation, goodwill, and intangible assets and related accumulated amortization. All other corporate and shared assets are recorded under Corporate.

	September 30, 2009	December 31, 2008
Total assets:		
Email Encryption	\$ 3,872,000	\$ 3,335,000