CORILLIAN CORP
Form 10-Q
May 15, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended **March 31, 2003**

OR

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

Commission file number 0-29291

CORILLIAN CORPORATION

(Exact name of registrant as specified in its charter)

OREGON	**91-1795219**
(State or other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification Number)*
3400 NW John Olsen Place Hillsboro, Oregon	**97124**
(Address of principal executive offices)	*(Zip Code)*

(503) 629-3300

(Registrant s telephone number)

Indicate by check mark whether the Regisrant (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 the filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes o No x

The number of shares of the Registrant s Common Stock outstanding as of May 5, 2003 was 36,289,275 shares.

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PART I. FINANCIAL INFORMATION

CORILLIAN CORPORATION
Condensed Consolidated Balance Sheets
(unaudited, in thousands)

	December 31, 2002 [1]	March 31, 2003
Assets		
Current assets:		
Cash and cash equivalents	$ 16,721	$ 21,447
Restricted cash	1,003	1,007
Investments	910	
Accounts receivable, net	3,987	4,256
Revenue in excess of billings	1,542	1,191
Other current assets	3,276	3,337
Total current assets	27,439	31,238
Property and equipment, net	8,376	7,376
Investment in joint venture	1,074	1,675
Other assets	590	536
Total assets	$ 37,479	$ 40,825
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 3,868	$ 3,781
Deferred revenue	13,981	19,319
Current portion of capital lease obligations	380	285
Current portion of long-term borrowings	1,865	1,321
Other current liabilities	1,421	985
Total current liabilities	21,515	25,691
Capital lease obligations, less current portion	32	19
Long-term borrowings, less current portion	1,568	1,125
Other long-term liabilities	1,243	1,198
Total liabilities	24,358	28,033
Shareholders equity:		
Common stock	126,141	126,227
Deferred stock-based compensation	(35)	
Accumulated other comprehensive income	49	40
Accumulated deficit	(113,034)	(113,475)
Total shareholders equity	13,121	12,792
Total liabilities and shareholders equity	$ 37,479	$ 40,825

(1) Derived from Corillian s audited consolidated financial statements as of December 31, 2002.

See accompanying notes to condensed consolidated financial statements.

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CORILLIAN CORPORATION
Condensed Consolidated Statements of Operations
(unaudited, in thousands, except per share data)

	For the Three-Month Period Ended March 31, 2002	For the Three-Month Period Ended March 31, 2003
Revenues	$ 10,063	$ 10,848
Cost of revenues	5,323	5,061
Gross profit	4,740	5,787
Operating expenses:		
Sales and marketing	3,277	1,833
Research and development	1,862	1,730
General and administrative	3,031	2,196
Amortization of deferred stock-based compensation	325	35
Total operating expenses	8,495	5,794
Loss from operations	(3,755)	(7)
Other expense, net	(275)	(434)
Net loss	$ (4,030)	$ (441)
Basic and diluted net loss per share	$(0.11)	$(0.01)
Shares used in computing basic and diluted net loss per share	35,181	36,237

See accompanying notes to condensed consolidated financial statements.

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CORILLIAN CORPORATION

Condensed Consolidated Statements of Cash Flows

(unaudited, in thousands)

	For the Three-Month Period Ended March 31,	
	2002	2003
Cash flows from operating activities:		
Net loss	$ (4,030)	$ (441)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	1,290	1,053
Amortization of deferred stock-based compensation	325	35
Equity in losses of joint venture	158	399
Provision for (recovery of) bad debts	619	(60)
Changes in operating assets and liabilities:		
Restricted cash		(4)
Accounts receivable	766	(205)
Revenue in excess of billings	(239)	351
Other assets	37	(24)
Accounts payable and accrued liabilities	(499)	(86)
Deferred revenue and other liabilities	1,833	4,857
Net cash provided by operating activities	260	5,875
Cash flows from investing activities:		
Purchase of property and equipment	(168)	(53)
Proceeds from the maturities of investments	805	910
Investment in joint venture		(1,000)
Net cash provided by (used in) investing activities	637	(143)
Cash flows from financing activities:		
Proceeds from the issuance of common stock	290	86
Repayments of long-term borrowings	(517)	(987)
Principal payments on capital lease obligations	(113)	(108)
Net cash used in financing activities	(340)	(1,009)
Effect of exchange rate fluctuations on cash and cash equivalents	4	3
Increase in cash and cash equivalents	561	4,726
Cash and cash equivalents at beginning of period	15,798	16,721
Cash and cash equivalents at end of period	$ 16,359	$ 21,447

See accompanying notes to condensed consolidated financial statements.

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CORILLIAN CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Corillian Corporation have been prepared pursuant to Securities and Exchange Commission rules and regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in its annual report on Form 10-K for the year ended December 31, 2002 filed with the Securities and Exchange Commission on March 21, 2003.

The unaudited condensed consolidated financial statements include all adjustments (consisting of normal recurring adjustments), which are, in the opinion of management, necessary for a fair presentation of the results for interim periods. The results of operations for the three-month period ended March 31, 2003 are not necessarily indicative of the results to be expected for the full year.

The preparation of unaudited condensed consolidated financial statements requires Corillian to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, Corillian evaluates its estimates, including those related to revenue recognition, bad debts, investments, intangible assets, income taxes, financing operations, restructuring, and contingencies and litigation. Corillian bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

(2) Principles of Consolidation

The unaudited condensed consolidated financial statements include the financial statements of Corillian Corporation and its wholly-owned subsidiaries, Corillian International, Ltd., Corillian Services, Inc. and Corillian South Asia Sdn Bhd. All significant intercompany balances and transactions have been eliminated in consolidation.

(3) Revenue Recognition

Corillian recognizes revenue from software licensing agreements in accordance with the provisions of Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, *Modification of SOP No. 97-2, Software Revenue Recognition, with Respect to Certain Transactions*. Generally, Corillian s software licenses are functionally dependent on implementation and certain custom software engineering services; therefore, software licenses and implementation services, together with custom software engineering services that are essential to the functionality of the software, are combined and recognized using the percentage-of-completion method of contract accounting in accordance with SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*.

Revenue on software arrangements involving multiple elements, which generally include software licenses, implementation and custom software engineering services, post-contractual customer support, training services and hosting services, is allocated to the elements using the residual method specified in SOP No. 98-9. Corillian has determined that post-contractual customer support, training and hosting services can be separated from software licenses, implementation and custom software engineering services because (a) post-contractual customer support, training and hosting services are not essential to the

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functionality of any other element in the arrangement, and (b) sufficient vendor-specific objective evidence exists to permit the allocation of revenue to these service elements. Vendor-specific objective evidence has been established on post-contractual customer support and hosting services using the price the customer is required to pay when they are sold separately (the renewal rate), and on training based on the price customers are charged when these services are sold separately. Under the residual method, the full fair value of post-contractual customer support, training, and hosting services is deferred and subsequently recognized as the services are performed. The difference between the total software arrangement fee and the amount deferred for post-contractual customer support, hosting and training services is allocated to software license, implementation and custom software engineering services and recognized using contract accounting.

The percentage-of-completion is measured by the percentage of contract hours incurred to date compared to the estimated total contract hours for each contract. Corillian has the ability to make reasonable, dependable estimates relating to the extent of progress towards completion, contract revenues and contract costs. Any estimation process, including that used in preparing contract accounting models, involves inherent risk. Profit estimates are subject to revision as the contract progresses towards completion. Revisions in profit estimates are charged to income in the period that the facts giving rise to the revision become known. Corillian reduces the inherent risk relating to revenue and cost estimates in percentage-of-completion models through corporate policy, approval and monitoring processes. Risks relating to service delivery, usage, productivity and other factors are considered in the estimation process. Cumulative revenues recognized may be less or greater than cumulative costs and profits billed at any point in time during a contract s term. The resulting difference is recognized as deferred revenue or revenue in excess of billing, respectively. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined.

Revenues associated with software developed for others in which Corillian has an obligation to successfully complete specified activities are deferred until acceptance by the customer, whereas agreements in which Corillian is providing services on a best-efforts basis are recognized as services are performed.

Revenues associated with custom software engineering services that are not essential to the core functionality of the software are recognized on a time-and-materials basis as services are performed. Custom software engineering services in which Corillian retains and reserves title and all ownership rights to the software products and anticipates generating revenues from future sales of the resulting product are accounted for following the provisions of the Financial Accounting Standards Board s (FASB) Statement of Financial Accounting Standards No. 68, *Research and Development Arrangements* (Statement No. 68).

Revenues for post-contractual customer support are recognized ratably over the term of the support services period, generally a period of one year. Services provided to customers under customer support and maintenance agreements generally include technical support and unspecified product upgrades. Revenues from hosting services for transactions processed by Corillian are recognized ratably as services are performed.

Customers are billed in accordance with contractual specifications. Corillian records the unrecognized portion of billable fees as deferred revenue. Revenues recognized in excess of contractual billing terms are recorded as revenue in excess of billings.

For certain projects, ultimate recoverability is questionable due to inherent hazards. Pursuant to SOP No. 81-1, Corillian limits revenue recognition in the period to the amount of project costs incurred in the same period, and postpones recognition of profits until results can be estimated more precisely. Under this zero profit methodology, equal amounts of revenue and cost, measured on the basis of performance during the period, are presented in Corillian s condensed consolidated statements of operations. Due to certain triggering events included in a customer s contract, beginning with the three-month period ended September 30, 2002, Corillian applied this zero profit methodology to one existing project. The total project value for this contract is approximately $2.1 million. Revenue and expense recognized from this

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project accounted for under the zero profit methodology during the three-month period ended March 31, 2003, was approximately $288,000.

Corillian recognizes non-refundable license fees paid by a reseller that has not demonstrated a history of its ability to successfully install Corillian Voyager in an end customer environment over the estimated implementation period for the end customer s project. Once a reseller has successfully demonstrated its ability to implement Corillian Voyager, Corillian recognizes subsequent non-refundable license fees from the reseller on future contracts as a separate element in the period in which the cash was received, assuming all other SOP No. 97-2 revenue recognition criteria are met.

(4) Concentration of Credit Risk

Results of operations are substantially derived from United States operations and substantially all significant assets reside in the United States. Banks and other financial institutions accounted for a majority of Corillian s revenue during the three-month periods ended March 31, 2002 and 2003. A majority of Corillian s revenue is generated from the financial services industry. Accordingly, Corillian s near-term and long-term prospects depend on its ability to attract the technology expenditures of these companies. The market for Internet-based financial services is new, intensely competitive, highly fragmented and rapidly changing. Additionally, the sale and implementation of Corillian s products and services are often subject to delays because of Corillian s customers internal budgets and procedures for approving large capital expenditures and deploying new technologies within their networks. Corillian s financial condition, results of operations and liquidity could be materially affected if adverse conditions in the industry developed, such as a reduction in technology expenditures or a delay in the sales or implementation timeline. An inability of Corillian to generate demand for its product, whether as a result of competition, technological change, economic, or other factors, could have a material adverse result on Corillian s financial condition, results of operations or liquidity.

Corillian is exposed to concentration of credit risk principally from accounts receivable and revenue in excess of billing. As of March 31, 2002, one customer accounted for 15% of consolidated accounts receivable. Two customers individually accounted for more than 10% of Corillian s consolidated revenue in excess of billing balance as of March 31, 2002. These customers, in total, accounted for approximately 79% of Corillian s consolidated revenue in excess of billing balance as of March 31, 2002.

As of March 31, 2003, three customers individually accounted for more than 10% of consolidated accounts receivable. These customers, in total, accounted for approximately 66% of Corillian s consolidated accounts receivable balance as of March 31, 2003. Two customers individually accounted for more than 10% of Corillian s consolidated revenue in excess of billing balance as of March 31, 2003. These customers, in total, accounted for approximately 56% of Corillian s consolidated revenue in excess of billing balance as of March 31, 2003.

Corillian is also subject to concentrations of credit risk from its cash and cash equivalents and investments. Corillian limits its exposure to credit risk associated with cash and cash equivalents and investments by placing its cash, cash equivalents and investments with major financial institutions and by investing in investment-grade securities.

(5) Comprehensive Income

Corillian has adopted the provisions of Statement No. 130, *Reporting on Comprehensive Income*. Comprehensive income is defined as changes in shareholders equity (deficit) exclusive of transactions with owners. To date, only foreign currency translation adjustments are required to be reported in comprehensive income for Corillian and have not been material to Corillian s financial position or results of operations.

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(6) Supplemental Disclosures of Cash Flow Information

	For the Three-Month Period Ended	
	March 31, 2002	**March 31, 2003**
	(in thousands)	
Cash paid during the period for:		
Interest	$165	$83
Taxes	7	
Supplemental diclosures of non-cash investing and financing activities:		
Property and equipment acquired through capital leases	112	

(7) Stock-Based Compensation

As of March 31, 2003, Corillian had various stock-based compensation plans, including stock option plans and an employee stock purchase plan. The Company continues to apply the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* as allowed by Statement No. 123, *Accounting for Stock-Based Compensation*. Under APB No. 25, no stock-based compensation expense is recognized for stock awards granted with an exercise price at or above fair market value on the date of grant. Deferred stock-based compensation is recorded for those situations where the exercise price of an option was lower than the fair value of the underlying common stock. Corillian recorded no deferred stock-based compensation during the three-month periods ended March 31, 2002 and 2003. Expense associated with stock-based compensation recorded in prior periods is amortized on an accelerated basis over the vesting period of the individual stock option awards consistent with the method prescribed in FASB Interpretation No. 28.

The following table illustrates the effect on net loss and net loss per share if Corillian had applied the fair value recognition provisions of Statement No. 123, to stock-based employee compensation.

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	For the Three-Month Period Ended	
	March 31, 2002	March 31, 2003
	(in thousands, except per share data)	
Net loss, as reported	$(4,030)	$ (441)
Add: Stock-based compensation expense determined under APB No. 25	325	35
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(2,148)	(884)
Proforma net loss	$(5,853)	$(1,290)
Net loss per share:		
Basic & diluted as reported	$ (0.11)	$ (0.01)
Basic & diluted pro forma	$ (0.17)	$ (0.04)

(8) Net Loss Per Share

Corillian computes net loss per share in accordance with Statement No. 128, *Earnings Per Share*, and SEC Staff Accounting Bulletin No. 98 (SAB No. 98). Under the provisions of Statement No. 128 and SAB No. 98, basic and diluted net loss per share is computed by dividing the net loss for the period by the weighted-average number of shares of common stock outstanding during the period.

The following table sets forth the weighted-average shares of common stock issuable under stock options using the treasury stock method, which have exercise prices that are less than the average fair market value of the underlying common stock for the periods presented below, but which are not included in calculating net loss per share due to their antidilutive effect for the periods indicated:

	For the Three-Month Period Ended	
	March 31, 2002	March 31, 2003
Shares issuable under stock options	713,100	97,384

The following shares issuable under stock options and a warrant would not result in additional dilutive shares under the treasury stock method as the exercise price of the stock options and warrant exceeded the average fair market value of the underlying common stock for the periods presented below:

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	For the Three-Month Period Ended	
	March 31, 2002	March 31, 2003
Shares issuable under stock options	4,277,495	3,494,045
Shares issuable under a warrant	250,000	250,000
	4,527,495	3,744,045

(9) Stock-Based Compensation

The amortization of deferred stock-based compensation relates to the following items in the accompanying condensed consolidated statements of operations:

	For the Three-Month Period Ended	
	March 31, 2002	March 31, 2003
	(in thousands)	
Cost of revenues	$ 55	$ 7
Sales and marketing	151	14
Research and development	25	5
General and administrative	94	9
	$ 325	$ 35

(10) Segment Information

Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for reporting information related to operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to shareholders. Statement No. 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are defined as components of an enterprise about which separate, discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, in making decisions how to allocate resources and assess performance. Corillian s chief operating decision maker, as defined under Statement No. 131, is its chief executive officer.

(a) Geographic Information

Results of operations are substantially derived from United States operations and substantially all assets reside in the United States. Corillian s results of operations for the three-month periods ended March 31, 2002 and 2003 include approximately $2.2 million and $178,000, respectively, of direct operating expenses related to its international operations, primarily Europe. Corillian s international operations generated a total of approximately $323,000 and $132,000, respectively, of its consolidated revenues during the three-month periods ended March 31, 2002 and 2003. In 2002, Corillian closed its office in London, England, and elected to pursue international sales primarily through resellers and selective direct sales efforts.

(b) Revenues

Corillian derives its revenue from a single operating segment, providing electronic finance software and services. Revenue is generated in this segment through software license and professional service arrangements. Revenues derived from Corillian s licenses and services are as follows:

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	For the Three-Month Period Ended	
	March 31, 2002	March 31, 2003
	(in thousands)	
License and professional services	$ 8,141	$ 8,251
Post-contractual customer support	1,459	2,135
Hosting	463	462
	$ 10,063	$ 10,848

(11) Commitments and Contingencies

(a) Litigation

Other than the proceedings described below, Corillian is engaged in legal proceedings incidental to the normal course of business. Although the ultimate outcome of these matters cannot be determined, management believes that the final disposition of these proceedings will not have a material adverse effect on the consolidated financial position, results of operations or liquidity of Corillian.

In October 2002, Corillian and KeyBank settled a legal dispute. As part of this settlement, Corillian agreed to pay KeyBank approximately $1.8 million in cash and issue to KeyBank 500,000 shares of common stock, valued at approximately $745,000. Corillian paid $1.4 million of the cash to KeyBank during the fourth fiscal quarter of 2002. Corillian will pay $250,000 and $175,000 to KeyBank on November 16, 2003 and 2004, respectively. Corillian issued the shares of common stock during the fourth fiscal quarter of 2002. Corillian agreed to allow KeyBank to include its shares in any registration statements Corillian may file with the Securities and Exchange Commission during the 12 months following the date of the settlement. Corillian recorded a charge of approximately $2.6 million during the three-month period ended September 30, 2002 related to this settlement.

(b) Ted Spooner severance

In connection with Ted Spooner s departure as Chief Executive Officer in October 2002, Corillian entered into an agreement with Mr. Spooner that required Corillian to pay Mr. Spooner a severance payment of approximately $600,000. $300,000 of expense related this severance agreement was recognized as general and administrative expense during the three-month period ended March 31, 2003. The remaining $300,000 of expense related to this severance agreement was recognized as general and administrative expense during the three-month period ended December 31, 2002. In April 2003, Corillian paid the severance payment to Mr. Spooner. Effective May 7, 2003, Mr. Spooner is neither a director nor employee of Corillian.

(c) Restricted cash and escrow receivable

During the third quarter of 2002, Corillian deposited $1.6 million into an escrow account pending successful completion of a customer project. Of this amount, $1.2 million was funded by a receivable from this customer. This escrow

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receivable was recorded as a component of other current assets as of March 31, 2003. Corillian also agreed to deposit $1.0 million in cash in a corporate bank account with this customer, which was deposited in October 2002 and was classified as restricted cash as of March 31, 2003. These funds will become unrestricted upon the successful completion of this customer s project. If Corillian fails to meet specified milestones for this customer project, Corillian will be obligated to deposit an additional $1.7 million into the escrow account. The customer has informed Corillian that it believes that Corillian has failed to meet certain of the applicable milestones and has demanded that Corillian deposit an additional $1.7 million into the escrow account. Corillian believes it has met, and will continue to meet, the re