PTC INC.
Form 10-Q
August 11, 2015

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 4, 2015
Commission File Number: 0-18059

PTC Inc.
(Exact name of registrant as specified in its charter)

Massachusetts (State or other jurisdiction of incorporation or organization)	04-2866152 (I.R.S. Employer Identification Number)

140 Kendrick Street, Needham, MA 02494
(Address of principal executive offices, including zip code)
(781) 370-5000
(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 þ 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 þ 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 þ	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 þ
There were 114,168,760 shares of our common stock outstanding on August 10, 2015.

PTC Inc.
INDEX TO FORM 10-Q
For the Quarter Ended July 4, 2015

PART I—FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONDENSED FINANCIAL STATEMENTS

PTC Inc.
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)
(unaudited)

	July 4, 2015	September 30, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$275,060	$293,654
Accounts receivable, net of allowance for doubtful accounts of $1,030 and $1,622 at July 4, 2015 and September 30, 2014, respectively	183,144	235,688
Prepaid expenses and other current assets	148,732	171,526
Deferred tax assets	28,269	31,299
Total current assets	635,205	732,167
Property and equipment, net	65,020	67,783
Goodwill	1,071,796	1,012,527
Acquired intangible assets, net	305,527	336,873
Deferred tax assets	27,938	8,958
Other assets	41,115	41,646
Total assets	$2,146,601	$2,199,954
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$14,561	$19,802
Accrued expenses and other current liabilities	88,732	57,536
Accrued compensation and benefits	112,350	144,875
Accrued income taxes	6,839	9,329
Deferred tax liabilities	102	854
Current portion of long term debt	43,750	25,000
Deferred revenue	371,859	369,271
Total current liabilities	638,193	626,667
Long term debt, net of current portion	580,625	586,875
Deferred tax liabilities	30,610	36,601
Deferred revenue	17,280	13,273
Other liabilities	49,570	82,649
Total liabilities	1,316,278	1,346,065
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, $0.01 par value; 5,000 shares authorized; none issued	—	—
Common stock, $0.01 par value; 500,000 shares authorized; 114,165 and 115,025 shares issued and outstanding at July 4, 2015 and September 30, 2014, respectively	1,142	1,150
Additional paid-in capital	1,556,308	1,597,277
Accumulated deficit	(597,060)	(650,171)
Accumulated other comprehensive loss	(130,067)	(94,367)
Total stockholders' equity	830,323	853,889
Total liabilities and stockholders' equity	$2,146,601	$2,199,954

The accompanying notes are an integral part of the condensed consolidated financial statements.

PTC Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three months ended		Nine months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Revenue:				
License and subscription solutions	$83,926	$97,703	$248,850	$269,114
Support	165,687	172,021	516,042	508,412
Total software revenue	249,613	269,724	764,892	777,526
Professional services	53,500	66,910	177,782	212,733
Total revenue	303,113	336,634	942,674	990,259
Cost of revenue:				
Cost of license and subscription solutions revenue	12,830	11,246	39,349	32,454
Cost of support revenue	20,452	21,118	63,176	62,598
Total cost of software revenue	33,282	32,364	102,525	95,052
Cost of professional services revenue	46,094	58,712	155,847	182,777
Total cost of revenue	79,376	91,076	258,372	277,829
Gross margin	223,737	245,558	684,302	712,430
Operating expenses:				
Sales and marketing	86,454	91,440	256,085	261,612
Research and development	54,078	57,405	175,333	166,109
General and administrative	48,100	33,817	119,342	98,888
Amortization of acquired intangible assets	9,105	7,998	27,691	23,772
Restructuring charges	4,393	514	42,625	1,581
Total operating expenses	202,130	191,174	621,076	551,962
Operating income	21,607	54,384	63,226	160,468
Interest and other income (expense), net	(3,668)	(2,278)	(10,492)	(6,724)
Income before income taxes	17,939	52,106	52,734	153,744
Provision (Benefit) for income taxes	504	14,080	(377)	32,305
Net income	$17,435	$38,026	$53,111	$121,439
Earnings per share—Basic	$0.15	$0.32	$0.46	$1.02
Earnings per share—Diluted	$0.15	$0.32	$0.46	$1.01
Weighted average shares outstanding—Basic	114,764	118,328	115,021	118,753
Weighted average shares outstanding—Diluted	116,025	119,901	116,330	120,573

The accompanying notes are an integral part of the condensed consolidated financial statements.

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PTC Inc.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(unaudited)

	Three months ended		Nine months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Net income	$17,435	$38,026	$53,111	$121,439
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment, net of tax of $0 for each period	1,201	2,364	(41,695)	1,514
Amortization of net actuarial pension loss included in net income, net of tax of $0.1 million and $0.3 million in the third quarter of 2015 and 2014, respectively, and $0.4 million and $0.8 million in the first nine months of 2015 and 2014, respectively	1,003	528	3,081	1,575
Change in unamortized pension loss during the period related to changes in foreign currency	(190)	91	2,915	(114)
Total other comprehensive income (loss)	2,014	2,983	(35,699)	2,975
Comprehensive income	$19,449	$41,009	$17,412	$124,414

The accompanying notes are an integral part of the condensed consolidated financial statements.

PTC Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine months ended	
	July 4, 2015	June 28, 2014
Cash flows from operating activities:		
Net income	$53,111	$121,439
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	63,455	57,299
Stock-based compensation	38,135	37,862
Excess tax benefits from stock-based awards	71	(9,576)
Other non-cash items, net	(53)	(151)
Changes in operating assets and liabilities, excluding the effects of acquisitions:		
Accounts receivable	44,906	14,625
Accounts payable, accrued expenses and other current liabilities	17,433	(3,930)
Accrued compensation and benefits	(27,462)	(24,278)
Deferred revenue	51,393	55,339
Accrued and deferred income taxes	(25,608)	14,545
Other current assets and prepaid expenses	(5,109)	4,125
Other noncurrent assets and liabilities	(17,809)	(13,912)
Net cash provided by operating activities	192,463	253,387
Cash flows from investing activities:		
Additions to property and equipment	(20,637)	(16,721)
Purchases of investments	(11,000)	—
Acquisitions of businesses, net of cash acquired	(98,411)	(111,519)
Net cash used by investing activities	(130,048)	(128,240)
Cash flows from financing activities:		
Borrowings under credit facility	135,000	474,375
Repayments of borrowings under credit facility	(122,500)	(417,500)
Repurchases of common stock	(49,962)	(99,915)
Proceeds from issuance of common stock	38	801
Excess tax benefits from stock-based awards	(71)	9,576
Credit facility origination costs	—	(4,120)
Payments of withholding taxes in connection with vesting of stock-based awards	(29,117)	(26,749)
Net cash used by financing activities	(66,612)	(63,532)
Effect of exchange rate changes on cash and cash equivalents	(14,397)	645
Net (decrease) increase in cash and cash equivalents	(18,594)	62,260
Cash and cash equivalents, beginning of period	293,654	241,913
Cash and cash equivalents, end of period	$275,060	$304,173
Supplemental disclosure of non-cash investing activities:		
Fair value of contingent consideration recorded for acquisition	$3,800	$13,993

The accompanying notes are an integral part of the condensed consolidated financial statements.

PTC Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

General

The accompanying unaudited condensed consolidated financial statements include the accounts of PTC Inc. and its wholly owned subsidiaries and have been prepared by management in accordance with accounting principles generally accepted in the United States of America and in accordance with the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. While we believe that the disclosures presented are adequate in order to make the information not misleading, these unaudited quarterly financial statements should be read in conjunction with our annual consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair statement of our financial position, results of operations and cash flows at the dates and for the periods indicated. Unless otherwise indicated, all references to a year mean our fiscal year, which ends on September 30. The September 30, 2014 Consolidated Balance Sheet included herein is derived from our audited consolidated financial statements.
The results of operations for the nine months ended July 4, 2015 are not necessarily indicative of the results expected for the remainder of the fiscal year.

Reclassifications

Through 2014, we classified revenue in three categories: 1) license; 2) service; and 3) support. Effective with the beginning of the first quarter of 2015, we are reporting revenue as follows: 1) license and subscription solutions; 2) support; and 3) professional services. License and subscription solutions revenue includes perpetual license revenue, subscription revenue and cloud services revenue. Cloud service offerings were previously reflected in service revenue and cost of service revenue. Consulting and training service revenue and consulting and training cost of service revenue are now referred to as professional services revenue and cost of professional services revenue in the accompanying Consolidated Statements of Operations. The following revenue and costs have been reclassified in the accompanying Consolidated Statements of Operations for the three and nine months ended June 28, 2014 to conform to the current period presentation.

	Three months ended June 28, 2014	Nine months ended June 28, 2014
Reclassifications within revenue	(in millions)	
From Services to L&SS	$3.3	$10.2
From Support to L&SS	1.7	1.8
	$5.0	$12.0
Reclassifications within cost of revenue		
From Services to L&SS	$3.2	$8.9
From Support to L&SS	0.2	0.2
	$3.4	$9.1

Revenue Recognition

Our sources of revenue include: (1) license and subscription solutions, (2) support and (3) professional services. We record revenues in accordance with the guidance provided by ASC 985-605, Software-Revenue Recognition when the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred (generally, FOB shipping point or electronic distribution), (3) the fee is fixed or determinable, and (4) collection is probable. We exercise judgment and use estimates in connection with determining the amounts of software license and services revenues to be recognized in each accounting period. Our primary judgments involve the following:

- determining whether collection is probable;
- assessing whether the fee is fixed or determinable;

- determining whether service arrangements, including modifications and customization of the underlying software, are not essential to the functionality of the licensed software and thus would result in the revenue for license and service elements of an agreement being recorded separately; and

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- determining the fair value of services and support elements included in multiple-element arrangements, which is the basis for allocating and deferring revenue for such services and support.

Our software is distributed primarily through our direct sales force. In addition, we have an indirect distribution channel through alliances with resellers. Revenue arrangements with resellers are recognized on a sell-through basis; that is, when we deliver the product to the end-user customer. We record consideration given to a reseller as a reduction of revenue to the extent we have recorded revenue from the reseller. We do not offer contractual rights of return, stock balancing, or price protection to our resellers, and actual product returns from them have been insignificant to date. As a result, we do not maintain reserves for reseller product returns.

At the time of each sale transaction, we must make an assessment of the collectability of the amount due from the customer. Revenue is only recognized at that time if management deems that collection is probable. In making this assessment, we consider customer credit-worthiness and historical payment experience. At that same time, we assess whether fees are fixed or determinable and free of contingencies or significant uncertainties. In assessing whether the fee is fixed or determinable, we consider the payment terms of the transaction, including transactions with payment terms that extend beyond our customary payment terms, and our collection experience in similar transactions without making concessions, among other factors. We have periodically provided financing to credit-worthy customers with payment terms up to 24 months. If the fee is determined not to be fixed or determinable, revenue is recognized only as payments become due from the customer, provided that all other revenue recognition criteria are met. Our software license arrangements generally do not include customer acceptance provisions. However, if an arrangement includes an acceptance provision, we record revenue only upon the earlier of (1) receipt of written acceptance from the customer or (2) expiration of the acceptance period.

Generally, our contracts are accounted for individually. However, when contracts are closely interrelated and dependent on each other, it may be necessary to account for two or more contracts as one to reflect the substance of the group of contracts.

License and Subscription Solutions

License and subscription solutions revenue includes revenue from three primary sources: (1) sales of perpetual licenses, (2) subscription-based licenses, and (3) cloud services.

Under perpetual license arrangements, we generally recognize license revenue up front upon shipment to the customer. We use the residual method to recognize revenue from perpetual license software arrangements that include one or more elements to be delivered at a future date when evidence of the fair value of all undelivered elements exists, and the elements of the arrangement qualify for separate accounting as described below. Under the residual method, the fair value of the undelivered elements (i.e., support and services) based on our vendor-specific objective evidence (“VSOE”) of fair value is deferred and the remaining portion of the total arrangement fee is allocated to the delivered elements (i.e., perpetual software license). If evidence of the fair value of one or more of the undelivered elements does not exist, all revenues are deferred and recognized when delivery of all of those elements has occurred or when fair values can be established. We determine VSOE of the fair value of services and support revenue based upon our recent pricing for those elements when sold separately. For certain transactions, VSOE is determined based on a substantive renewal clause within a customer contract. Our current pricing practices are influenced primarily by product type, purchase volume, sales channel and customer location. We review services and support sold separately on a periodic basis and update, when appropriate, our VSOE of fair value for such elements to ensure that it reflects our recent pricing experience.

Subscription-based licenses include the right for a customer to use our licenses and receive related support for a specified term and revenue is recognized ratably over the term of the arrangement. When sold in arrangements with other elements, VSOE of fair value is established for the subscription-based licenses through the use of a substantive renewal clause within the customer contract for a combined annual fee that includes the term-based license and related support.

Cloud services reflect recurring revenues that include fees for hosting and application management of customers’ perpetual or subscription-based licenses. Generally, customers have the right to terminate the cloud services contract and take possession of the licenses without a significant penalty. When cloud services are sold as part of a multi-element transaction, revenue is allocated to cloud services based on VSOE, and recognized ratably over the contractual term beginning on the commencement dates of each contract, which is the date the services are made available to the customer. VSOE is established for cloud services either through a substantive stated renewal option or stated contractual overage rates, as these rates represent the value the customer is willing to pay on a standalone basis. In addition, cloud services include set-up fees, which are recognized ratably over the contract term or the expected customer life, whichever is longer.

Support

Support contracts generally include rights to unspecified upgrades (when and if available), telephone and internet-based support, updates and bug fixes. Support revenue is recognized ratably over the term of the support contract on a straight-line basis.

Professional Services

Our software arrangements often include implementation, consulting and training services that are sold under consulting engagement contracts or as part of the software license arrangement. When we determine that such services are not essential to the functionality of the licensed software, we record revenue separately for the license and service elements of these arrangements, provided that appropriate evidence of fair value exists for the undelivered services (i.e. VSOE of fair value). We consider various factors in assessing whether a service is not essential to the functionality of the software, including if the services may be provided by independent third parties experienced in providing such services (i.e. consulting and implementation) in coordination with dedicated customer personnel, and whether the services result in significant modification or customization of the software's functionality. When professional services qualify for separate accounting, professional services revenues under time and materials billing arrangements are recognized as the services are performed. Professional services revenues under fixed-priced contracts are generally recognized as the services are performed using a proportionate performance model with hours or costs as the input method of attribution.

When we provide professional services that are considered essential to the functionality of the software, the arrangement does not qualify for separate accounting of the license and service elements, and the license revenue is recognized together with the consulting services using the percentage-of-completion method of contract accounting. Under such arrangements, consideration is recognized as the services are performed as measured by an observable input. In these circumstances, we separate license revenue from service revenue for income statement presentation by allocating VSOE of fair value of the consulting services as service revenue, and the residual portion as license revenue. Under the percentage-of-completion method, we estimate the stage of completion of contracts with fixed or "not to exceed" fees based on hours or costs incurred to date as compared with estimated total project hours or costs at completion. Adjustments to estimates to complete are made in the periods in which facts resulting in a change become known. When total cost estimates exceed revenues, we accrue for the estimated losses when identified. The use of the proportionate performance and percentage-of-completion methods of accounting require significant judgment relative to estimating total contract costs or hours (hours being a proxy for costs), including assumptions relative to the length of time to complete the project, the nature and complexity of the work to be performed and anticipated changes in salaries and other costs.

Reimbursements of out-of-pocket expenditures incurred in connection with providing consulting services are included in service revenue, with the offsetting expense recorded in cost of service revenue.

Training services include on-site and classroom training. Training revenues are recognized as the related training services are provided.

Recent Accounting Pronouncements

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In July 2015, the FASB approved a one-year delay in the effective date. ASU 2014-09 is effective for us in our first quarter of fiscal 2019 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09. We are currently evaluating the impact of our pending adoption of ASU 2014-09 on our consolidated financial statements.

Debt Issuance Costs

In April 2015, the FASB issued ASU No. 2015-03, Interest-Imputation of Interest (Subtopic 835-30), to simplify the required presentation of debt issuance costs. The amended guidance requires that debt issuance costs be presented in the balance sheet as a direct reduction from the carrying amount of the related debt liability rather than as an asset. It is effective for financial statements issued for fiscal years beginning after December 15, 2015, our fiscal 2017, with early adoption permitted. The new guidance will be applied retrospectively to each prior period presented. We are currently evaluating the impact of the new guidance on our consolidated financial statements.

2. Deferred Revenue and Financing Receivables

Deferred Revenue

Deferred revenue primarily relates to software support agreements billed to customers for which the services have not yet been provided. The liability associated with performing these services is included in deferred revenue and, if not yet paid, the related customer receivable is included in prepaid expenses and other current assets. Billed but uncollected support and subscription-related amounts included in prepaid expenses and other current assets at July 4, 2015 and September 30, 2014 were $88.8 million and $116.2 million, respectively.

Financing Receivables

We periodically provide extended payment terms to credit-worthy customers for software purchases with payment terms up to 24 months. The determination of whether to offer such payment terms is based on the size, nature and credit-worthiness of the customer, and the history of collecting amounts due, without concession, from the customer and customers generally. This determination is based on an internal credit assessment. In making this assessment, we use the Standard & Poor's (S&P) credit rating as our primary credit quality indicator, if available. If a customer, whether commercial or the U.S. Federal government, has an S&P bond rating of BBB- or above, we designate the customer as Tier 1. If a customer does not have a S&P bond rating, or has an S&P bond rating below BBB-, we base our assessment on an internal credit assessment which considers selected balance sheet, operating and liquidity measures, historical payment experience, and current business conditions within the industry or region. We designate these customers as Tier 2 or Tier 3, with Tier 3 being lower credit quality than Tier 2.

As of July 4, 2015 and September 30, 2014, amounts due from customers for contracts with original payment terms greater than twelve months (financing receivables) totaled $28.1 million and $58.1 million, respectively. Accounts receivable and prepaid expenses and other current assets in the accompanying Consolidated Balance Sheets included current receivables from such contracts totaling $24.8 million and $44.6 million at July 4, 2015 and September 30, 2014, respectively, and other assets in the accompanying Consolidated Balance Sheets included long-term receivables from such contracts totaling $3.3 million and $13.5 million at July 4, 2015 and September 30, 2014, respectively. None of these receivables were past due as of either July 4, 2015 or September 30, 2014. Our credit risk assessment for financing receivables was as follows:

	July 4, 2015	September 30, 2014
	(in thousands)	
S&P bond rating BBB-1 and above-Tier 1	$17,143	$41,152
Internal Credit Assessment-Tier 2	11,002	16,989
Internal Credit Assessment-Tier 3	—	—
Total financing receivables	$28,145	$58,141

We evaluate the need for an allowance for doubtful accounts for estimated losses resulting from the inability of these customers to make required payments. As of July 4, 2015 and September 30, 2014, we concluded that all financing receivables were collectible and no reserve for credit losses was recorded. We did not provide a reserve for credit losses or write off any uncollectible financing receivables in the nine months ended July 4, 2015 or June 28, 2014. We write off uncollectible trade and financing receivables when we have exhausted all collection avenues.

We periodically transfer future payments under certain of these contracts to third-party financial institutions on a non-recourse basis. We record such transfers as sales of the related accounts receivable when we surrender control of such receivables. We sold $3.0 million of financing receivables to third-party financial institutions in the nine months ended July 4, 2015. We sold $16.5 million of financing receivables to third-party financial institutions in the nine months ended June 28, 2014.

3. Restructuring Charges

On April 4, 2015, we committed to a plan to restructure our workforce and consolidate select facilities to realign our global workforce to increase investment in our Internet of Things business and to reduce our cost structure through organizational efficiencies in the face of significant foreign currency depreciation relative to the U.S. Dollar and a more cautious outlook on global macroeconomic conditions. The restructuring actions are expected to result in restructuring charges of up to $45 million, primarily attributable to termination benefits. In the second and third quarters of 2015, we recorded charges of $38.5 million and $3.3 million respectively, attributable to termination benefits associated with 443 employees. Additionally, in the third quarter of 2015, we recorded a charge of $1.1 million related to the closure of excess facilities. The facility charge reflects estimated costs including gross lease commitments of approximately $2.0 million, net of estimated sublease income of $0.9 million.

In September 2014, in support of integrating businesses acquired in 2014 and the continued evolution of our business model, we committed to a plan to restructure our workforce. As a result, we recorded a restructuring charge of $26.8 million in the fourth quarter of 2014 associated with severance and related costs associated with 283 employees.

The following table summarizes restructuring accrual activity for the nine months ended July 4, 2015:

	Employee Severance and Related Benefits	Facility Closures and Related Costs	Total
	(in thousands)		
October 1, 2014	$25,835	$535	$26,370
Charge to operations	41,483	1,142	42,625
Cash disbursements	(47,249)	(528)	(47,777)
Foreign exchange impact	(938)	(30)	(968)
Accrual, July 4, 2015	$19,131	$1,119	$20,250

The accrual for facility closures and related costs is included in accrued expenses and other liabilities in the Consolidated Balance Sheets, and the accrual for employee severance and related benefits is included in accrued compensation and benefits in the Consolidated Balance Sheets.

4. Stock-based Compensation

We measure the cost of employee services received in exchange for restricted stock unit (RSU) awards based on the fair value of RSU awards on the date of grant. That cost is recognized over the period during which an employee is required to provide service in exchange for the award.

Our equity incentive plan provides for grants of nonqualified and incentive stock options, common stock, restricted stock, RSUs and stock appreciation rights to employees, directors, officers and consultants. We award RSUs as the principal equity incentive awards, including certain performance-based awards that are earned based on achievement of performance criteria established by the Compensation Committee of our Board of Directors. Each RSU represents the contingent right to receive one share of our common stock.

Our equity incentive plans are described more fully in Note K to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

Restricted stock unit activity for the nine months ended July 4, 2015	Shares	Weighted Average Grant Date Fair Value (Per Share)
	(in thousands)	
Balance of outstanding restricted stock units October 1, 2014	4,379	$26.87
Granted	1,860	$38.25
Vested	(2,190)	$24.65
Forfeited or not earned	(374)	$30.52
Balance of outstanding restricted stock units July 4, 2015	3,675	$33.58

Grant Period	Restricted Stock Units Performance-based (1)	Service-based (2)
	(Number of Units in thousands)	
First nine months of 2015	313	1,547

(1) The performance-based RSUs were granted to employees pursuant to the terms described below.

(2) The service-based RSUs were issued to employees, including our executive officers, and our directors. Of these RSUs, approximately 212,000 will vest one year from the date of grant. Substantially all other service-based RSUs will vest in three substantially equal annual installments on or about the anniversary of the date of grant.

In the first nine months of 2015, we granted the target performance-based restricted stock units ("target RSUs") shown in the table above to senior level employees, including our executive officers. These RSUs are eligible to vest based upon our total shareholder return relative to a peer group (the “TSR units”), measured annually over a three-year period.

The number of TSR units to vest over the three year period will be determined based on the performance of PTC stock relative to the stock performance of an index of PTC peer companies established as of the grant date, as determined at the end of three measurement

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periods ending on September 30, 2015, 2016 and 2017, respectively. The shares earned for each period will vest on November 15 following each measurement period, up to a maximum of two times or one and one half times, as applicable, the number of target RSUs (up to a maximum of 590,000 shares). No vesting will occur in a period unless an annual threshold requirement is achieved. The employee must remain employed by PTC through the applicable vest date for any RSUs to vest. If the return to PTC shareholders is negative but still meets or exceeds the peer group indexed return, a maximum of 100% of the target RSUs shall vest for the measurement period. TSR units not earned in the first two year measurement periods are eligible to be earned in the third measurement period.
The weighted average fair value of the TSR units was $41.32 per target RSU on the grant date. The fair value of the TSR units was determined using a Monte Carlo simulation model, a generally accepted statistical technique used to simulate a range of possible future stock prices for PTC and the peer group. The method uses a risk-neutral framework to model future stock price movements based upon the risk-free rate of return, the volatility of each entity, and the pairwise correlations of each entity being modeled. The fair value for each simulation is the product of the payout percentage determined by PTC's TSR rank against the peer group, the projected price of PTC stock, and a discount factor based on the risk-free rate.
The significant assumptions used in the Monte Carlo simulation model were as follows:

Average volatility of peer group	29.8	%
Risk free interest rate	0.85	%
Dividend yield	—	%

Compensation expense recorded for our stock-based awards was classified in our Consolidated Statements of Operations as follows:

	Three months ended		Nine months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
	(in thousands)			
Cost of license and subscription solutions revenue	$121	$63	$381	$209
Cost of support revenue	1,012	898	2,777	2,711
Cost of professional services revenue	1,317	1,549	4,510	4,436
Sales and marketing	3,430	3,065	9,383	8,583
Research and development	2,928	2,231	9,015	7,067
General and administrative	5,263	4,726	12,069	14,856
Total stock-based compensation expense	$14,071	$12,532	$38,135	$37,862

5. Earnings per Share (EPS) and Common Stock

EPS

Basic EPS is calculated by dividing net income by the weighted average number of shares outstanding during the period. Unvested restricted stock, although legally issued and outstanding, is not considered outstanding for purposes of calculating basic EPS. Diluted EPS is calculated by dividing net income by the weighted average number of shares outstanding plus the dilutive effect, if any, of outstanding stock options, restricted shares and RSUs using the treasury stock method. The calculation of the dilutive effect of outstanding equity awards under the treasury stock method includes consideration of proceeds from the assumed exercise of stock options, unrecognized compensation expense and any tax benefits as additional proceeds.

Calculation of Basic and Diluted EPS	Three months ended July 4, 2015	Three months ended June 28, 2014	Nine months ended July 4, 2015	Nine months ended June 28, 2014
	(in thousands, except per share data)			
Net income	$17,435	$38,026	$53,111	$121,439
Weighted average shares outstanding—Basic	114,764	118,328	115,021	118,753
Dilutive effect of employee stock options, restricted shares and restricted stock units	1,261	1,573	1,309	1,820
Weighted average shares outstanding—Diluted	116,025	119,901	116,330	120,573
Earnings per share—Basic	$0.15	$0.32	$0.46	$1.02
Earnings per share—Diluted	$0.15	$0.32	$0.46	$1.01

RSUs of 0.1 million were outstanding during the first nine months of 2014 but were not included in the calculation of diluted EPS because the share impact of the assumed proceeds related to the weighted unamortized compensation expense exceeded the weighted average RSUs outstanding. These RSUs were excluded from the computation of diluted EPS as the effect would have been anti-dilutive.

Common Stock Repurchases

Our Articles of Organization authorize us to issue up to 500 million shares of our common stock. Our Board of Directors authorized us to repurchase up to $100 million worth of shares with cash from operations in the period October 1, 2013 through September 30, 2014. On August 4, 2014, our Board of Directors authorized us to repurchase up to an additional $600 million of our common stock from August 4, 2014 through September 30, 2017. In the third quarter and first nine months of 2014, respectively, we repurchased 1.6 million and 2.8 million shares at a cost of $60.0 million and $99.9 million. In the third quarter of 2015, we repurchased 1.2 million shares at a cost of $50.0 million. All shares of our common stock repurchased are automatically restored to the status of authorized and unissued.

On August 14, 2014, we entered into an accelerated share repurchase ("ASR") agreement with a major financial institution ("Bank"). The ASR allowed us to buy a large number of shares immediately at a purchase price determined by an average market price over a period of time. Under the ASR, we agreed to purchase $125 million of our common stock, in total, with an initial delivery to us in August 2014 of 2.3 million shares. We settled the ASR in December 2014 and the Bank delivered to us 1.1 million shares.

6. Acquisitions

In 2014, we completed the acquisitions of Axeda (on August 11, 2014), Atego (on June 30, 2014) and ThingWorx (on December 30, 2013). In 2015, we completed the acquisition of ColdLight (on May 7, 2015). The results of operations of these acquired businesses have been included in our consolidated financial statements beginning on their respective acquisition dates.

Acquisition-related costs were $2.8 million and $8.7 million for the third quarter and first nine months of 2015, respectively, and $1.3 million and $6.4 million for the third quarter and first nine months of 2014, respectively. Acquisition-related costs include direct costs of potential and completed acquisitions (e.g., investment banker fees, professional fees, including legal and valuation services) and expenses related to acquisition integration activities (e.g., professional fees, severance, and retention bonuses). In addition, subsequent adjustments to our initial estimated amount of contingent consideration associated with specific acquisitions are included within acquisition-related charges. These costs have been classified in general and administrative expenses in the accompanying Consolidated Statements of Operations.

ColdLight

On May 7, 2015, we acquired all of the ownership interest of ColdLight Solutions, LLC, a company that offered solutions for data machine learning and predictive analytics, for approximately $98.6 million in cash (net of cash acquired of $1.3 million). Up to $5 million of contingent consideration may become payable to the former owners of ColdLight if certain technology milestones are achieved within two years of the acquisition (the earn-out). If an earn-out milestone is achieved, a portion of the contingent consideration becomes earned and payable in cash after each six-month period. Up to $3.0 million of the contingent consideration can be earned in the first year and up to $2.0 million can be earned in the second year. We borrowed $100.0 million under our existing credit facility to fund the acquisition.

The acquisition of the ColdLight automated predictive analytics platform will expand our technology portfolio in the Internet of Things (IoT) market. At the time of the acquisition, ColdLight had approximately 60 employees and annualized revenues of $8.0 million. The results of operations of ColdLight have been included in our consolidated financial statements beginning on the acquisition date. Revenue and earnings of ColdLight since the acquisition date were not material.

The acquisition of ColdLight has been accounted for as a business combination. Assets acquired and liabilities assumed have been recorded at their estimated fair values as of the acquisition date. The fair values of intangible assets were based on valuations using an income approach, with estimates and assumptions provided by management of ColdLight and PTC. The process for estimating the fair values of identifiable intangible assets and the contingent consideration liability requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill. In connection with accounting for the business combination, we recorded a liability of $3.8 million, representing the fair value of the contingent consideration. The liability was valued using a discounted cash flow method and a probability weighted estimate of achievement of the technology milestones. The estimated undiscounted range of outcomes for the contingent consideration is $3.8 million to $5.0 million. We will assess the probability that the milestones will be met and at what level each reporting period. Any subsequent changes in the estimated fair value of the liability will be reflected in earnings until the liability is fully settled.

Based upon a preliminary valuation, the total purchase price allocation was as follows:

Purchase price allocation:	(in thousands)	
Goodwill	$85,288	
Identifiable intangible assets	17,620	
Cash	1,313	
Other assets and liabilities, net	(516	)
Total allocation of purchase price consideration	103,705	
Less: cash acquired	(1,313	)
Total purchase price allocation, net of cash acquired	$102,392	
Less: contingent consideration	(3,800	)
Net cash used to acquire ColdLight	$98,592	

The preliminary purchase price allocation resulted in $85.3 million of goodwill, which will be deductible for income tax purposes. All of the acquired goodwill was allocated to our software products segment. Intangible assets of $17.6 million includes purchased software of $13.6 million, customer relationships of $3.5 million and trademarks of $0.5 million, which are being amortized over weighted average useful lives of 10 years, 9 years and 7 years, respectively, based upon the pattern in which economic benefits related to such assets are expected to be realized.

The resulting amount of goodwill reflects our expectations of the following benefits: (1) ColdLight provides a differentiated machine learning platform for critical data analytics in our solution portfolio; (2) ColdLight’s Neuron® product suite can automate the analytics process, reducing the dependency on manual processes; (3) ColdLight is addressing challenging aspects of data analytics aligned with the PTC / ThingWorx analytics vision; (4) ColdLight has a presence in industries outside of PTC's traditional markets which create a foundation for us to pursue opportunities in non-traditional vertical markets.

ThingWorx

In the second quarter of 2014, we acquired ThingWorx, Inc. for $111.5 million (net of cash acquired of $0.1 million). The former shareholders of ThingWorx are eligible to receive additional consideration of up to $18.0 million if certain profitability and bookings targets are achieved within two years of the acquisition (the earn-out). The earn-out is payable in cash in two installments, half of which was earned and paid in July 2015 and the remainder of which, if earned, will become payable in 2016 after the second year measurement period. In connection with accounting for the business combination, we recorded a liability representing the fair value of the contingent consideration. The liability was valued using a discounted cash flow method and a probability weighted estimate of achievement of the financial targets. We assess the probability that the targets will be met each reporting period. At July 4, 2015, we estimate that the full amount of the contingent consideration of $18.0 million will be earned. Any subsequent changes in the estimated fair value of the liability are reflected in earnings until the liability is fully settled (an increase of $2.8 million in the contingent consideration liability in the first nine months of 2015, see Note 8).

7. Goodwill and Intangible Assets

We have two operating segments: (1) Software Products and (2) Services. We assess goodwill for impairment at the reporting unit level. Our reporting units are determined based on the components of our operating segments that constitute a business for which discrete financial information is available and for which operating results are regularly reviewed by segment management. Our reporting units are the same as our operating segments. As of July 4, 2015 and September 30, 2014, goodwill and acquired intangible assets in the aggregate attributable to our software products segment were $1,314.2 million and $1,283.0 million, respectively, and attributable to our services segment were $63.1 million and $66.4 million, respectively. Acquired intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. We evaluate goodwill for impairment in the third quarter of our fiscal year, or on an interim basis if an event occurs or circumstances change that would, more likely than not, reduce the fair value of a reporting segment below its carrying value. Factors we consider important, on an overall company basis and segment basis, when applicable, that could trigger an impairment review include significant under-performance relative to historical or projected future operating results, significant changes in our use of the acquired assets or the strategy for our overall business, significant negative industry or economic trends, a significant decline in our stock price for a sustained period and a reduction of our market capitalization relative to net book value. We completed our annual goodwill impairment review as of July 4, 2015 and concluded that no impairment charge was required as of that date.

To conduct these tests of goodwill, the fair value of the reporting unit is compared to its carrying value. If the reporting unit's carrying value exceeds its fair value, we record an impairment loss equal to the difference between the carrying value of goodwill and its implied fair value. We estimate the fair values of our reporting units using discounted cash flow valuation models. Those models require estimates of future revenues, profits, capital expenditures, working capital, terminal values based on revenue multiples, and discount rates for each reporting unit. We estimate these amounts by evaluating historical trends, current budgets, operating plans and industry data. The estimated fair value of each reporting unit was more than double its carrying value as of July 4, 2015.

Goodwill and acquired intangible assets consisted of the following:

	July 4, 2015			September 30, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
	(in thousands)					
Goodwill (not amortized)			$1,071,796			$1,012,527
Intangible assets with finite lives (amortized) (1):						
Purchased software	$284,427	$169,903	$114,524	$278,012	$162,259	$115,753
Capitalized software	22,877	22,877	—	22,877	22,877	—
Customer lists and relationships	350,845	166,527	184,318	360,530	147,469	213,061
Trademarks and trade names	18,573	12,221	6,352	18,479	10,964	7,515
Other	3,938	3,605	333	4,117	3,573	544
	$680,660	$375,133	$305,527	$684,015	$347,142	$336,873
Total goodwill and acquired intangible assets			$1,377,323			$1,349,400

(1) The weighted average useful lives of purchased software, customer lists and relationships, trademarks and trade names and other intangible assets with a remaining net book value are 9 years, 10 years, 9 years, and 3 years, respectively.

Goodwill

Changes in goodwill presented by reportable segment were as follows:

	Software Products Segment	Services Segment	Total
	(in thousands)		
Balance, October 1, 2014	$959,768	$52,759	$1,012,527
Acquisition of Axeda	(180)	—	(180)
Acquisition of ColdLight	85,288	—	85,288
Foreign currency translation adjustments	(25,627)	(212)	(25,839)

Balance, July 4, 2015	$1,019,249	$52,547	$1,071,796

Amortization of Intangible Assets

The aggregate amortization expense for intangible assets with finite lives was classified in our Consolidated Statements of Operations as follows:

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	Three months ended		Nine months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
	(in thousands)			
Amortization of acquired intangible assets	$9,105	$7,998	$27,691	$23,772
Cost of license and subscriptions solutions revenue	4,957	4,415	14,438	13,319
Total amortization expense	$14,062	$12,413	$42,129	$37,091

8. Fair Value Measurements

Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance. Generally accepted accounting principles prescribe a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Three levels of inputs that may be used to measure fair value:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; or
- Level 3: unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Our significant financial assets and liabilities measured at fair value on a recurring basis as of July 4, 2015 and September 30, 2014 were as follows:

	July 4, 2015			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Financial assets:				
Cash equivalents (1)	$52,916	$—	$—	$52,916
Forward contracts	—	851	—	851
	$52,916	$851	$—	$53,767
Financial liabilities:				
Contingent consideration related to acquisitions	$—	$—	$21,800	$21,800
Forward contracts	—	888	—	888
	$—	$888	$21,800	$22,688

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Financial assets:				
Cash equivalents (1)	$101,113	$—	$—	$101,113
Forward contracts	—	339	—	339
	$101,113	$339	$—	$101,452
Financial liabilities:				
Contingent consideration related to acquisitions	$—	$—	$15,191	$15,191
Forward contracts	—	911	—	911
	$—	$911	$15,191	$16,102

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(1) Money market funds and time deposits.

Changes in the fair value of Level 3 contingent consideration liability associated with our acquisition of ThingWorx and ColdLight were as follows:

	Contingent Consideration	
	(in thousands)	
	ThingWorx	ColdLight
Balance, October 1, 2014	$15,191	$—
Change in present value of contingent consideration	2,809	3,800
Balance, July 4, 2015	$18,000	$3,800

In connection with accounting for the ThingWorx and ColdLight business combinations, we recorded a liability representing the fair value of contingent consideration payable upon achievement of certain financial targets and technology milestones. The liabilities that we recorded were valued using a discounted cash flow method and a probability weighted estimate of achievement of the targets based on inputs that are not observable in the market, which represents a level 3 measurement within the fair value hierarchy. Changes in the fair value of the contingent consideration liabilities will be reflected in acquisition-related charges in general and administrative expense until the liabilities are fully settled. Of the total, $20.5 million of the contingent consideration liabilities are included in accrued expenses and other current liabilities, with the remaining $1.3 million in other liabilities in the Consolidated Balance Sheet as of July 4, 2015.

9. Derivative Financial Instruments

Our foreign currency risk management strategy is principally designed to mitigate the future potential financial impact of changes in the value of transactions and balances denominated in foreign currency resulting from changes in foreign currency exchange rates. We enter into derivative transactions, specifically foreign currency forward contracts with maturities of up to approximately three months, to manage our exposure to fluctuations in foreign exchange rates that arise primarily from our foreign currency-denominated receivables and payables.

Generally, we do not designate foreign currency forward contracts as hedges for accounting purposes, and changes in the fair value of these instruments are recognized immediately in earnings. Because we enter into forward contracts only as an economic hedge, any gain or loss on the underlying foreign-denominated balance would be offset by the loss or gain on the forward contract. Gains and losses on forward contracts and foreign denominated receivables and payables are included in other income (expense), net.

As of July 4, 2015 and September 30, 2014, we had outstanding forward contracts with notional amounts equivalent to the following:

Currency Hedged	July 4, 2015	September 30, 2014
	(in thousands)	
Canadian Dollar / U.S. Dollar	$19,971	$25,583
Euro / U.S. Dollar	77,987	61,751
British Pound / Euro	9,713	14,259
Israeli New Sheqel / U.S. Dollar	5,681	6,144
Japanese Yen / Euro	24,080	—
Swiss Franc /Euro	8,516	—
All other	10,990	9,251
Total	$156,938	$116,988

As of July 4, 2015 and September 30, 2014, the accompanying Consolidated Balance Sheets include a net asset of $0.9 million and $0.3 million, respectively, in prepaid expenses and other current assets, and a net liability of $0.9 million for both periods, in accrued expenses related to the fair value of our forward contracts.

Net gains and losses on foreign currency exposures are recorded in other income (expense), net and include realized and unrealized gains and losses on forward contracts. Net gains and losses on foreign currency exposures for the three and nine months ended July 4, 2015 and June 28, 2014 were as follows:

	Three months ended		Nine months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
	(in thousands)			
Net foreign currency losses	$449	$746	$1,362	$2,739
Net realized and unrealized loss (gain) on forward contracts (excluding the underlying foreign currency exposure being hedged)	$741	$1,320	$1,122	$(377)

10. Segment Information

We operate within a single industry segment—computer software and related services. Operating segments as defined under GAAP are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision maker is our President and Chief Executive Officer. We have two operating and reportable segments: (1) Software Products, which includes license and related support revenue (including updates and technical support) for all our products except training-related products; and (2) Services, which includes consulting, implementation, training, cloud services, computer-based training products, including support on these products, and other services revenue. We do not allocate sales and marketing or administrative expenses to our operating segments as these activities are managed on a consolidated basis.

The revenue and operating income attributable to our operating segments are summarized as follows:

	Three months ended		Nine months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
	(in thousands)			
Revenue:				
Total Software Products segment revenue	$235,371	$258,805	$723,313	$748,482
Total Services segment revenue	67,742	77,829	219,361	241,777
Total revenue	$303,113	$336,634	$942,674	$990,259
Operating income: (1)				
Software Products segment	$145,016	$166,639	$428,533	$479,736
Services segment	13,378	13,516	29,868	42,566
Sales and marketing expenses	(88,715)	(91,440)	(271,257)	(262,085)
General and administrative expenses	(48,072)	(34,331)	(123,918)	(99,749)
Total operating income	21,607	54,384	63,226	160,468
Interest and other income (expense), net	(3,668)	(2,278)	(10,492)	(6,724)
Income before income taxes	$17,939	$52,106	$52,734	$153,744

(1) We recorded restructuring charges of $4.4 million and $42.6 million in the third quarter and first nine months of 2015, respectively. Software Products included $1.5 million and $11.5 million respectively; Services included $0.6 million and $11.4 million, respectively; sales and marketing expenses included $2.3 million and $15.1 million, respectively; and general and administrative expenses included $(28) thousand and $4.6 million, respectively, of these restructuring charges. We recorded restructuring charges of $0.5 million in the third quarter of 2014, all of which were included in general and administrative expenses. We recorded restructuring charges of $1.6 million in the first nine months of 2014. Software Products included $0.1 million; Services included $0.2 million; sales and marketing expenses included $0.5 million; and general and administrative expenses included $0.8 million of these restructuring charges.

11. Income Taxes

In the third quarter and first nine months of 2015, our effective tax rate was a provision of 3% on pre-tax income of $17.9 million and a benefit of 1% on pre-tax income of $52.7 million, respectively, compared to a provision of 27% on pre-tax income of $52.1 million and 21% on pre-tax income of $153.7 million in the third quarter and first nine months of 2014, respectively. In the third quarter and first nine months of 2015 and 2014, our effective tax rate was lower than the 35% statutory federal income tax rate due to our corporate structure in which our foreign taxes are at a net effective tax rate lower than the U.S. rate. A significant amount of our foreign earnings is generated by our subsidiaries organized in Ireland. In 2015 and 2014, the foreign rate differential predominantly relates to these Irish earnings. Our foreign rate differential in 2015 includes a rate benefit from a business realignment completed on September 30, 2014 in which intellectual property was transferred between two wholly-owned foreign subsidiaries. The realignment allows us to more efficiently manage the distribution of our products to European customers. This realignment resulted in a tax benefit of approximately $6 million and $14 million in the third quarter and first nine months of 2015, respectively. In addition, in the first nine months of 2015, we recorded a tax benefit of $3.1 million related to the reassessment of our reserve requirements, and a benefit of $1.4 million in conjunction with the reorganization of our Atego U.S. subsidiaries. Additionally, our provision reflects a $2.1 million tax benefit related to a retroactive extension of the U.S. research and development tax credit enacted in the first quarter of 2015. This benefit was offset by a corresponding provision to increase our U.S. valuation allowance.
Additionally, in the first nine months of 2014, our effective tax rate was lower than the 35% statutory federal income tax rate due to the reversal of a portion of our valuation allowance against net deferred tax assets. In the second quarter of 2014, our acquisition of ThingWorx was accounted for as a business combination and we recorded the fair value of assets and liabilities acquired, including finite-lived acquired intangible assets totaling $32.1 million and net deferred tax liabilities of $8.9 million, primarily related to the tax effect of the acquired intangible assets that are not deductible for income tax purposes. These net deferred tax liabilities reduced our net deferred tax asset balance and resulted in a

tax benefit of $8.9 million recorded in the second quarter of 2014 to decrease our valuation allowance in the U.S. As the decrease in the valuation allowance was not part of the accounting for the business combination (the fair value of the assets acquired and liabilities assumed), it was recorded as an income tax benefit.
As of July 4, 2015 and September 30, 2014, we had unrecognized tax benefits of $11.9 million and $15.0 million, respectively. If all of our unrecognized tax benefits as of July 4, 2015 were to become recognizable in the future, we would

record a benefit to the income tax provision of $10.3 million which would be partially offset by an increase in the U.S. valuation allowance of $3.9 million.

Although we believe our tax estimates are appropriate, the final determination of tax audits and any related litigation could result in favorable or unfavorable changes in our estimates. We believe it is reasonably possible that within the next 12 months the amount of unrecognized tax benefits related to the resolution of multi-jurisdictional tax positions could be reduced by up to $4 million as audits close and statutes of limitations expire.

We follow the with-and-without approach for the direct effects of windfall tax deductions to determine the timing of the recognition of benefits for windfall tax deductions. In the third quarter and first nine months of 2014, we recorded windfall tax benefits of $1.5 million and $9.6 million, respectively, to additional paid-in capital.

12. Debt

Credit Agreement

In September 2014, we entered into a multi-currency credit facility with a syndicate of sixteen banks for which JPMorgan Chase Bank, N.A. acts as Administrative Agent. We expect to use the credit facility for general corporate purposes, including acquisitions of businesses, share repurchases and working capital requirements. As of July 4, 2015, the fair value of our credit facility approximates our book value.

The credit facility consists of a $500 million term loan and a $1 billion revolving loan commitment, and may be increased by an additional $250 million (in the form of revolving loans or term loans, or a combination thereof) if the existing or additional lenders are willing to make such increased commitments. The revolving loan commitment does not require amortization of principal. The term loan requires prepayment of principal at the end of each calendar quarter. The revolving loan and term loan may be repaid in whole or in part prior to the scheduled maturity dates at our option without penalty or premium. The credit facility matures on September 15, 2019, when remaining amounts outstanding will be due and payable in full. We are required to make principal payments under the term loan of $25 million, $50 million, $50 million, $75 million and $300 million in 2015, 2016, 2017, 2018 and 2019, respectively.

PTC is the sole borrower under the credit facility. The obligations under the credit facility are guaranteed by PTC's material domestic subsidiaries and 65% of the voting equity interests of PTC's material first-tier foreign subsidiaries are pledged as collateral for the obligations.

As of July 4, 2015, we had $624.4 million outstanding under the credit facility comprised of a $481.3 million term loan and a $143.1 million revolving loan. Loans under the credit facility bear interest at variable rates which reset every 30 to 180 days depending on the rate and period selected by PTC as described below. As of July 4, 2015, the annual rate on the term and revolving loan was 1.6875% (which will reset on September 17, 2015 for the term loan and $43.1 million of the revolving loan, and on August 6, 2015 for the remaining $100 million of the revolving loan). Interest rates on borrowings outstanding under the credit facility range from 1.25% to 1.5% above an adjusted LIBO rate for Eurodollar-based borrowings or would range from 0.25% to 0.5% above the defined base rate (the greater of the Prime Rate, the Federal Funds Effective Rate plus 0.005%, or an adjusted LIBO rate plus 1%) for base rate borrowings, in each case based upon PTC's leverage ratio. Additionally, PTC may borrow certain foreign currencies at rates set in the same range above the respective London interbank offered interest rates for those currencies, based on PTC's leverage ratio. A quarterly commitment fee on the undrawn portion of the credit facility is required, ranging from 0.175% to 0.25% per annum, based upon PTC's leverage ratio.

The credit facility limits PTC's and its subsidiaries' ability to, among other things: incur additional indebtedness; incur liens or guarantee obligations; pay dividends (other than to PTC) and make other distributions; make investments and enter into joint ventures; dispose of assets; and engage in transactions with affiliates, except on an arms-length basis. Under the credit facility, PTC and its material domestic subsidiaries may not invest cash or property in, or loan to, PTC's foreign subsidiaries in aggregate amounts exceeding $75 million for any purpose and an additional $150 million for acquisitions of businesses. In addition, under the credit facility, PTC and its subsidiaries must maintain the following financial ratios:

- a leverage ratio, defined as consolidated funded indebtedness to consolidated trailing four quarters EBITDA, of no greater than 3.00 to 1.00 at any time; and
- a fixed charge coverage ratio, defined as the ratio of consolidated trailing four quarters EBITDA less consolidated capital expenditures to consolidated fixed charges, of no less than 3.50 to 1.00 at any time.

As of July 4, 2015, our leverage ratio was 2.31 to 1.00, our fixed charge coverage ratio was 7.25 to 1.00 and we were in compliance with all financial and operating covenants of the credit facility. As of July 4, 2015, we had $190 million available to borrow under the revolving loan portion of our credit facility, the availability of which is limited based on financial covenants in the facility.

Any failure to comply with the financial or operating covenants of the credit facility would prevent PTC from being able to borrow additional funds, and would constitute a default, permitting the lenders to, among other things, accelerate the amounts outstanding, including all accrued interest and unpaid fees, under the credit facility and to terminate the credit facility. A change in control of PTC, as defined in the agreement, also constitutes an event of default, permitting the lenders to accelerate the indebtedness and terminate the credit facility.

13. Commitments and Contingencies

Legal and Regulatory Matters

China Investigation

We have, since making a voluntary disclosure to the U.S. Securities and Exchange Commission (SEC) and the Department of Justice (DOJ), been cooperating to provide information to those agencies concerning expenditures by our business partners and our China business, including for travel and entertainment, that apparently benefited employees of customers regarded as state owned enterprises in China. This matter involves issues regarding compliance with laws, including the U.S. Foreign Corrupt Practices Act. Negotiations with the SEC and DOJ to reach a resolution of the investigation have begun but have not been concluded. Resolution of this matter is likely to include fines and penalties. In the third quarter, we recorded a liability of $13.6 million associated with pending discussions with these agencies to resolve this matter. This is the minimum amount of liability we expect to incur if we are able to reach a settlement in this matter, and does not include any amounts associated with potential fines that might be imposed by either or both of the SEC and DOJ, which amounts would increase our liability and could be significant. There can be no assurance that we will reach a settlement with these agencies or that the cost of such settlements, if reached, would not materially exceed the existing accrual. Further, any settlement or other resolution of this matter could have collateral effects on our business in China, the United States and elsewhere.

Legal Proceedings

We are subject to various other legal proceedings and claims that arise in the ordinary course of business. We do not believe that resolving the legal proceedings and claims that we are currently subject to will have a material adverse impact on our financial condition, results of operations or cash flows. However, the results of legal proceedings cannot be predicted with certainty. Should any of these legal proceedings and claims be resolved against us, the operating results for a particular reporting period could be adversely affected.

Accruals

With respect to legal proceedings and claims, we record an accrual for a contingency when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. For legal proceedings and claims for which the likelihood that a liability has been incurred is more than remote but less than probable, we estimate the range of possible outcomes. As of July 4, 2015, we had a legal proceedings and claims accrual of $15.9 million, including an accrual of $13.6 million for the China investigation.

Guarantees and Indemnification Obligations

We enter into standard indemnification agreements in the ordinary course of our business. Pursuant to such agreements with our business partners or customers, we indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally in connection with patent, copyright or other intellectual property infringement claims by any third party with respect to our products, as well as claims relating to property damage or personal injury resulting from the performance of services by us or our subcontractors. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. Historically, our costs to defend lawsuits or settle claims relating to such indemnity agreements have been minimal and we accordingly believe the estimated fair value of liabilities under these agreements is immaterial.

We warrant that our software products will perform in all material respects in accordance with our standard published specifications in effect at the time of delivery of the licensed products for a specified period of time. Additionally, we generally warrant that our consulting services will be performed consistent with generally accepted industry standards. In most cases, liability for these warranties is capped. If necessary, we would provide for the estimated cost of product and service warranties based on specific warranty claims and claim history; however, we have not incurred significant cost under our product or services warranties. As a result, we believe the estimated fair value of these liabilities is immaterial.

14. Pension Plans
Our pension plans are described in more detail in Note M to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014. In the first nine months of 2015, we contributed $20 million to a non-U.S. pension plan.

Termination of U.S. Pension Plan

We maintain a U.S. defined benefit pension plan (the Plan) that covers certain persons who were employees of Computervision Corporation (acquired by us in 1998). Benefits under the Plan were frozen in 1990. In the second quarter of 2014, we began the process of terminating the Plan. In the third quarter of 2014, we provided notice to plan participants of our intent to terminate the plan effective August 1, 2014 and in the second quarter of 2015 we provided a notice of plan benefits to participants. In March 2015, we received a favorable determination letter from the Internal Revenue Service with respect to the termination, and we expect to complete the termination process by September 30, 2015. In August 2015, lump sum distributions totaling $45 million were made to selected participants from plan assets in settlement of their liabilities and we purchased annuity contracts with an insurer for approximately $90 million to cover remaining liabilities of the plan including benefits for retirees currently receiving payments and vested participants who did not elect to receive a lump sum. In connection with settling the liabilities, we contributed $26 million to fully fund the Plan.

In the fourth quarter, upon settlement of the liabilities, we expect to recognize a settlement loss of $66 million, $47 million net of tax, including unamortized losses in accumulated other comprehensive income, based on the projected benefit obligations and assets measured as of the dates the settlements occur.

15. Subsequent Events

Contingent Earn-Out Payment

The ThingWorx contingent earn-out first year payment criteria were attained in the third quarter of fiscal 2015. As such, $9 million of the total contingent consideration was paid on July 17, 2015.

Termination of U.S. Pension Plan

In August 2015, lump sum distributions totaling $45 million were made to selected participants from plan assets in settlement of their liabilities and we purchased annuity contracts with an insurer for approximately $90 million to cover remaining liabilities of the plan. In connection with settling the liabilities, we contributed $26 million to fully fund the Plan.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

Statements in this Quarterly Report on Form 10-Q that are not historic facts, including statements about our future financial and growth expectations, the development of our products and markets and adoption of our solutions and future purchases by customers, are forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from those projected. These risks include the possibility that the macroeconomic and/or global manufacturing climates may not improve or may deteriorate, the possibility that customers may not purchase our solutions when or at the rates we expect, the possibility that our businesses, including our Internet of Things (IoT) and SLM businesses, may not expand and/or generate the revenue we expect, the possibility that market size and growth estimates may be incorrect and that we may be unable to grow our business at or in excess of market growth rates, the possibility that new products released and planned products, including IoT enabled core products, may not generate the revenue we expect or be released as we expect, the possibility that foreign currency exchange rates may vary from our expectations and thereby affect our reported revenue and expense, the possibility that we may not achieve the license and subscription solutions (L&SS), support or professional services revenue that we expect, which could result in a different mix of revenue between L&SS, support and professional services and could impact our EPS results, the possibility that our customers may purchase more of our solutions as subscriptions than we expect, which would adversely affect near-term revenue, operating margins and EPS, the possibility that sales of our solutions as subscriptions may not have the longer-term positive effect on revenue that we expect, the possibility that we may be unable to expand our services partner ecosystem or improve services margins as we expect, the possibility that our workforce realignment may adversely affect our operations, the possibility that we may be unable to generate sufficient operating cash flow to return 40% of free cash flow to shareholders or that other uses of cash could preclude share repurchases, and the possibility that amounts in excess of the current accrual may be assessed against PTC in connection with the resolution of our investigation in China and that any such resolution may have collateral effects on our business in China, the U.S. or elsewhere; as well as other risks and uncertainties described below throughout or referenced in Part II, Item 1A. Risk Factors of this report.

Business Overview

PTC Inc. develops and delivers technology solutions, comprised of software and services, that transform the way our customers create, operate and service their products for a smart, connected world.

Our solutions and software products address the challenges our customers face in the following areas:

- Computer-Aided Design (CAD)

Effective and collaborative product design across the globe.

- Product Lifecycle Management (PLM)

Efficient and consistent management of product development from concept to retirement across functional processes and distributed teams.

- Application Lifecycle Management (ALM)

Management of global software development from concept to delivery.

- Service Lifecycle Management (SLM)

Planning and delivery of service, and analysis of product intelligence at the point of service.

- Internet of Things (IoT)

Enabling connectivity and development of software applications for smart, connected products.

Executive Overview

Results for the third quarter

Revenue was down year over year due to changes within our business as well as external factors, including a challenging macroeconomic environment and an increase in the strength of the U.S. Dollar relative to international currencies, most notably the Euro and the Yen.

Revenue	Three Months Ended July 4, 2015	June 28, 2014	Change	Constant Currency Change
	(in millions)			
License and Subscription Solutions	$83.9	$97.7	(14%)	(7%)
Support	165.7	172.0	(4%)	6%
Total Software	249.6	269.7	(7%)	2%
Professional Services	53.5	66.9	(20%)	(10%)
Total	$303.1	$336.6	(10%)	(1%)

- Software revenue declined due to unfavorable currency movements and fewer large deals in the quarter than in the prior year. We believe that challenging macroeconomic conditions, particularly in the Americas and China, impacted our ability to close large deals in our core business.
- Professional services revenue declined primarily due to a shift of services to our partners in accordance with our margin improvement strategy.
- We delivered strong growth in our Internet of Things business, closing a number of significant deals with large, industrial companies that are adopting our platform for their IoT initiatives. Three of our eight largest deals in the quarter were IoT deals and IoT license revenue represented more than 20% of our total license and subscription solutions (L&SS) revenue.
- Subscription solutions bookings in the quarter comprised 16% of our L&SS bookings, and included three large IoT deals that came in as perpetual license transactions, compared to 21% in the third quarter of 2014 when we had two significant subscription bookings, including one mega deal, in our core business.
- Approximately 60% of our revenue in the third quarter of 2015 came from recurring revenue streams (subscription solutions and support), compared to approximately 53% in the year-ago period.
- We had 8 large deals (which we define as a L&SS booking greater than $1 million from an individual customer in a quarter) in the third quarter of 2015, compared to 21 in the third quarter of 2014. Many of our largest customers are multinational companies that rely heavily on exports, so the strengthening of the U.S. Dollar could be negatively impacting their businesses and their willingness to spend.

From a geographic perspective, we believe macroeconomic challenges in the Americas are impacting our ability to close large CAD and ePLM deals, which, given the maturity of these markets, tend to be more cyclical. However, strong performance in our IoT business and solid performance in our SLM business more than offset our weaker results in CAD and ePLM and enabled us to deliver 13% software revenue growth in the Americas. In Europe, we saw modest software revenue growth on a constant currency basis, again driven by IoT and SLM with declines in CAD and ePLM against a tough third quarter of 2014 comparison when we had more large deals in the region. Pacific Rim software revenue declined modestly due to weak results in CAD and SLM, which we believe were primarily due to the overall economic slowdown in China. Japan software revenue was down from the third quarter of 2014 due to weak results in CAD, ePLM and SLM, also owing to a tough comparison with the prior year.

Other Operating Measures	Three Months Ended July 4, 2015	June 28, 2014	Change	Constant Currency Change
Operating Margin	7.1%	16.2%		
EPS	$0.15	$0.32	(53%)	(19%)
Non-GAAP Operating Margin[1]	24.1%	24.2%		
Non-GAAP EPS[1]	$0.53	$0.53	-	21%

(1) Non-GAAP measures are reconciled to GAAP results under Results of Operations - Non-GAAP Measures below.

GAAP and non-GAAP operating income reflect lower revenue, offset by reductions in operating expenses driven by cost savings from restructuring and by lower incentive compensation accruals. Additionally, our GAAP earnings include a $14 million accrual associated with the pending China matter and restructuring charges of $4 million.

Currency movements reduced GAAP EPS by approximately $0.11. Both GAAP and non-GAAP EPS benefited from a lower tax rate.

We ended the quarter with a cash balance of $275 million. We generated $87 million of cash from operations in the third quarter of 2015 and we drew down $94 million (net of $6 million of repayments) on our credit facility to fund the acquisition of ColdLight for $99 million (net of cash acquired). Additionally, we repurchased $50 million of shares in the quarter. At July 4, 2015, the balance outstanding under our credit facility was $624 million and we had $190 million available to borrow under the revolving loan portion of our credit facility.

Future Expectations, Strategies and Risks

Uncertainty about the economic environment, volatility in foreign currency exchange rates and our transition to subscription-based sales continue to be headwinds for revenue growth. Due to deterioration in currency exchange rates and uncertainty regarding macroeconomic conditions beyond our initial expectations for 2015, we expect 2015 revenue and non-GAAP earnings will be below our previous guidance.

If economic conditions deteriorate further, or if foreign currency exchange rates relative to the U.S. Dollar differ significantly from our current assumed rates, future results could differ materially from our targets. Additionally, if a greater percentage of our customers purchase our solutions as subscriptions than we expect, it may have an adverse impact on revenue, operating margin, cash flow and EPS growth relative to our targets and historical results.

Our 2015 targets exclude settlement losses related to the termination of our U.S. pension plan. While we expect to complete the termination process by September 30, 2015, the amount of the losses will vary based on the timing of the settlement payments and the projected benefit obligations and assets in the plan measured as of the dates the settlements occur. We currently estimate the pre-tax settlement losses to be approximately $66 million.

Our results have been impacted, and we expect will continue to be impacted, by our ability to close large transactions. The amount of revenue, particularly L&SS revenue, attributable to large transactions, and the number of such transactions, varies significantly from quarter to quarter based on customer purchasing decisions and macroeconomic conditions. Our growth rates have become increasingly dependent on adoption of our solutions by large direct customers. Such transactions tend to be larger in size and may have long lead times as they often follow a lengthy product selection and evaluation process. This may cause volatility in our results.

Impact of an Investigation in China

We have, since making a voluntary disclosure to the U.S. Securities and Exchange Commission (SEC) and the Department of Justice, been cooperating to provide information to those agencies concerning expenditures by our business partners and our China business, including for travel and entertainment, that apparently benefited employees of customers regarded as state owned enterprises in China. This matter involves issues regarding compliance with laws, including the U.S. Foreign Corrupt Practices Act.

In the third quarter of 2015, we recorded a liability of $13.6 million associated with pending discussions with the SEC and the Department of Justice to resolve this matter. This is the minimum amount of liability we expect to incur if we are able to reach a settlement in this matter, and does not include any amounts associated with potential fines that might be imposed by either or both of the SEC and DOJ, which amounts would increase our liability and could be significant. There can be no assurance that we will reach a settlement with these agencies or that the cost of such settlements, if reached, would not materially exceed the existing accrual. Further, any settlement or other resolution of this matter could have collateral effects on our business in China, the United States and elsewhere.

Results of Operations

The following table shows the financial measures that we consider the most significant indicators of the performance of our business. In addition to operating income, operating margin, and diluted earnings per share as calculated under generally accepted accounting principles (“GAAP”), the table also includes non-GAAP operating income, operating margin, and diluted earnings per share for the reported periods. We discuss the non-GAAP measures in detail, including items excluded from the measures, and provide a reconciliation to the comparable GAAP measures under Non-GAAP Measures below.

	Three months ended		Percent Change 2014 to 2015		Nine months ended		Percent Change 2014 to 2015	
	July 4, 2015	June 28, 2014	Actual	Constant Currency	July 4, 2015	June 28, 2014	Actual	Constant Currency
	(Dollar amounts in millions, except per share data)							
License and subscriptions solutions	$83.9	$97.7	(14)%	(7)%	$248.9	$269.1	(8)%	(1)%
Support	165.7	172.0	(4)%	6 %	516.0	508.4	2 %	9 %
Total software revenue	249.6	269.7	(7)%	2 %	764.9	777.5	(2)%	5 %
Professional services	53.5	66.9	(20)%	(10)%	177.8	212.7	(16)%	(9)%
Total revenue	303.1	336.6	(10					