

**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 September 30, 2019

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-38263

**ALTAIR ENGINEERING INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**1820 East Big Beaver Road, Troy, Michigan**

(Address of principal executive offices)

**38-2591828**

(I.R.S. Employer Identification No.)

**48083**

(Zip Code)

**(248) 614-2400**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
<b>Class A Common Stock \$0.0001 par value per share</b>	<b>ALTR</b>	<b>The NASDAQ Stock Market</b>

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to section 13(a) of the Exchange Act

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

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

On October 21, 2019 there were 40,473,100 shares of the registrant's Class A common stock outstanding and 31,300,732 shares of the registrant's Class B common stock outstanding.

ALTAIR ENGINEERING INC. AND SUBSIDIARIES  
FORM 10-Q  
FOR THE QUARTER ENDED SEPTEMBER 30, 2019  
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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

ALTAIR ENGINEERING INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(In thousands)	September 30, 2019 (Unaudited)	December 31, 2018
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 246,937	\$ 35,345
Accounts receivable, net	84,062	96,803
Income tax receivable	11,551	4,431
Prepaid expenses and other current assets	18,398	17,455
Total current assets	360,948	154,034
Property and equipment, net	33,720	30,153
Operating lease right of use assets	26,507	—
Goodwill	210,500	210,532
Other intangible assets, net	60,956	69,836
Deferred tax assets	5,870	5,354
Other long-term assets	18,199	17,288
TOTAL ASSETS	\$ 716,700	\$ 487,197
<b>LIABILITIES, MEZZANINE EQUITY AND STOCKHOLDERS' EQUITY</b>		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$ 437	\$ 331
Accounts payable	8,286	8,357
Accrued compensation and benefits	28,839	31,740
Current portion of operating lease liabilities	8,891	—
Other accrued expenses and current liabilities	27,426	27,039
Deferred revenue	69,377	59,765
Total current liabilities	143,256	127,232
Long-term debt, net of current portion	175,624	31,417
Operating lease liabilities, net of current portion	18,831	—
Deferred revenue, non-current	7,666	6,754
Other long-term liabilities	25,630	25,756
TOTAL LIABILITIES	371,007	191,159
Commitments and contingencies		
MEZZANINE EQUITY	2,352	2,352
STOCKHOLDERS' EQUITY:		
Preferred stock (\$0.0001 par value), authorized 45,000 shares, none issued and outstanding	—	—
Common stock (\$0.0001 par value)		
Class A common stock, authorized 513,797 shares, issued and outstanding 40,354 and 38,349 shares as of September 30, 2019 and December 31, 2018, respectively	4	4
Class B common stock, authorized 41,203 shares, issued and outstanding 31,391 and 32,171 shares as of September 30, 2019 and December 31, 2018, respectively	3	3
Additional paid-in capital	436,197	379,832
Accumulated deficit	(80,903)	(74,863)
Accumulated other comprehensive loss	(11,960)	(11,290)
TOTAL STOCKHOLDERS' EQUITY	343,341	293,686
TOTAL LIABILITIES, MEZZANINE EQUITY AND STOCKHOLDERS' EQUITY	\$ 716,700	\$ 487,197

See accompanying notes to consolidated financial statements.

**ALTAIR ENGINEERING INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

(in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
<b>Revenue</b>				
License	\$ 46,853	\$ 40,880	\$ 180,127	\$ 154,515
Maintenance and other services	30,963	23,302	85,388	69,943
Total software	77,816	64,182	265,515	224,458
Software related services	7,956	8,692	25,635	26,872
Total software and related services	85,772	72,874	291,150	251,330
Client engineering services	12,803	12,155	37,265	36,652
Other	1,831	1,722	6,623	5,386
Total revenue	100,406	86,751	335,038	293,368
<b>Cost of revenue</b>				
License	4,371	2,736	13,146	10,534
Maintenance and other services	9,548	7,095	27,509	22,202
Total software	13,919	9,831	40,655	32,736
Software related services	6,013	6,352	19,143	19,573
Total software and related services	19,932	16,183	59,798	52,309
Client engineering services	10,160	9,817	29,993	29,977
Other	1,649	1,204	5,858	3,416
Total cost of revenue	31,741	27,204	95,649	85,702
<b>Gross profit</b>	68,665	59,547	239,389	207,666
<b>Operating expenses:</b>				
Research and development	29,667	24,301	87,012	71,748
Sales and marketing	25,790	19,243	78,462	57,849
General and administrative	20,706	17,234	60,886	51,636
Amortization of intangible assets	3,545	1,739	10,673	5,665
Other operating income, net	(536)	(4,850)	(1,702)	(7,433)
Total operating expenses	79,172	57,667	235,331	179,465
Operating (loss) income	(10,507)	1,880	4,058	28,201
Interest expense	2,726	31	3,586	92
Other income, net	(588)	(970)	(703)	(2,046)
(Loss) income before income taxes	(12,645)	2,819	1,175	30,155
Income tax expense	3,294	1,885	7,215	5,617
Net (loss) income	\$ (15,939)	\$ 934	\$ (6,040)	\$ 24,538
<b>Income per share:</b>				
Net (loss) income per share attributable to common stockholders, basic	\$ (0.22)	\$ 0.01	\$ (0.08)	\$ 0.37
Net (loss) income per share attributable to common stockholders, diluted	\$ (0.22)	\$ 0.01	\$ (0.08)	\$ 0.33
<b>Weighted average shares outstanding:</b>				
Weighted average number of shares used in computing net (loss) income per share, basic	71,770	70,001	71,313	66,429
Weighted average number of shares used in computing net (loss) income per share, diluted	71,770	76,709	71,313	74,182

See accompanying notes to consolidated financial statements.

**ALTAIR ENGINEERING INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
(Unaudited)

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net (loss) income	\$ (15,939)	\$ 934	\$ (6,040)	\$ 24,538
Other comprehensive (loss) income, net of tax:				
Foreign currency translation (net of tax effect of \$0 for all periods)	(2,988)	(1,149)	(1,046)	(4,161)
Retirement related benefit plans (net of tax effect of \$0 \$(9), \$0 and \$(16), respectively)	132	36	376	142
Total other comprehensive loss	(2,856)	(1,113)	(670)	(4,019)
Comprehensive (loss) income	\$ (18,795)	\$ (179)	\$ (6,710)	\$ 20,519

*See accompanying notes to consolidated financial statements.*

**ALTAIR ENGINEERING INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
(Unaudited)

(in thousands)	Common stock				Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss	Total stockholders' equity
	Class A		Class B					
	Shares	Amount	Shares	Amount				
Balance at January 1, 2019	38,349	\$ 4	32,171	\$ 3	\$ 379,832	\$ (74,863)	\$ (11,290)	\$ 293,686
Net income	—	—	—	—	—	13,019	—	13,019
Exercise of stock options	397	—	—	—	458	—	—	458
Vesting of restricted stock	14	—	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	869	—	—	869
Foreign currency translation, net of tax	—	—	—	—	—	—	337	337
Retirement related benefit plans, net of tax	—	—	—	—	—	—	228	228
Balance at March 31, 2019	38,760	4	32,171	3	381,159	(61,844)	(10,725)	308,597
Net loss	—	—	—	—	—	(3,120)	—	(3,120)
Equity component of convertible senior notes, net of issuance costs	—	—	—	—	50,009	—	—	50,009
Exercise of stock options	608	—	—	—	812	—	—	812
Vesting of restricted stock	34	—	—	—	—	—	—	—
Conversion from Class B to Class A common stock	270	—	(270)	—	—	—	—	—
Stock-based compensation	—	—	—	—	1,922	—	—	1,922
Foreign currency translation, net of tax	—	—	—	—	—	—	1,605	1,605
Retirement related benefit plans, net of tax	—	—	—	—	—	—	16	16
Balance at June 30, 2019	39,672	4	31,901	3	433,902	(64,964)	(9,104)	359,841
Net loss	—	—	—	—	—	(15,939)	—	(15,939)
Exercise of stock options	165	—	—	—	169	—	—	169
Vesting of restricted stock	7	—	—	—	—	—	—	—
Conversion from Class B to Class A common stock	510	—	(510)	—	—	—	—	—
Stock-based compensation	—	—	—	—	2,126	—	—	2,126
Foreign currency translation, net of tax	—	—	—	—	—	—	(2,988)	(2,988)
Retirement related benefit plans, net of tax	—	—	—	—	—	—	132	132
Balance at September 30, 2019	<u>40,354</u>	<u>\$ 4</u>	<u>31,391</u>	<u>\$ 3</u>	<u>\$ 436,197</u>	<u>\$ (80,903)</u>	<u>\$ (11,960)</u>	<u>\$ 343,341</u>

See accompanying notes to consolidated financial statements.

**ALTAIR ENGINEERING INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
(Unaudited)

(in thousands)	Common stock				Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss	Total stockholders' equity
	Class A		Class B					
	Shares	Amount	Shares	Amount				
Balance at January 1, 2018	26,725	\$ 2	36,508	\$ 4	\$ 232,156	\$ (168,141)	\$ (5,072)	\$ 58,949
Cumulative effect of an accounting change, net of tax	—	—	—	—	—	77,744	—	77,744
Net income	—	—	—	—	—	24,684	—	24,684
Adjustment for acquisitions	—	—	—	—	(96)	—	—	(96)
Exercise of stock options	632	1	—	—	300	—	—	301
Stock-based compensation	—	—	—	—	216	—	—	216
Foreign currency translation, net of tax	—	—	—	—	—	—	1,255	1,255
Retirement related benefit plans, net of tax	—	—	—	—	—	—	(12)	(12)
Balance at March 31, 2018	27,357	3	36,508	4	232,576	(65,713)	(3,829)	163,041
Net loss	—	—	—	—	—	(1,080)	—	(1,080)
Follow-on public offering, net of offering costs of \$370	5,731	1	(1,675)	(1)	135,201	—	—	135,201
Exercise of stock options	1,768	—	—	—	1,368	—	—	1,368
Conversion from Class B to Class A common stock	1,662	—	(1,662)	—	—	—	—	—
Stock-based compensation	—	—	—	—	434	—	—	434
Foreign currency translation, net of tax	—	—	—	—	—	—	(4,267)	(4,267)
Retirement related benefit plans, net of tax	—	—	—	—	—	—	118	118
Balance at June 30, 2018	36,518	4	33,171	3	369,579	(66,793)	(7,978)	294,815
Net income	—	—	—	—	—	934	—	934
Exercise of stock options	602	—	—	—	260	—	—	260
Conversion from Class B to Class A common stock	1,000	—	(1,000)	—	—	—	—	—
Stock-based compensation	—	—	—	—	563	—	—	563
Foreign currency translation, net of tax	—	—	—	—	—	—	(1,149)	(1,149)
Retirement related benefit plans, net of tax	—	—	—	—	—	—	36	36
Balance at September 30, 2018	<u>38,120</u>	<u>\$ 4</u>	<u>32,171</u>	<u>\$ 3</u>	<u>\$ 370,402</u>	<u>\$ (65,859)</u>	<u>\$ (9,091)</u>	<u>\$ 295,459</u>

See accompanying notes to consolidated financial statements.

**ALTAIR ENGINEERING INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

(In thousands)	Nine Months Ended September 30,	
	2019	2018
<b>OPERATING ACTIVITIES:</b>		
Net (loss) income	\$ (6,040)	\$ 24,538
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	15,836	10,895
Provision for bad debt	472	455
Amortization of debt discount and issuance costs	3,044	18
Stock-based compensation expense	5,584	1,213
Gain on sale of assets held for sale and other	—	(4,544)
Impairment of intangibles	—	608
Deferred income taxes	(741)	706
Other, net	(16)	(134)
Changes in assets and liabilities:		
Accounts receivable	10,185	15,674
Prepaid expenses and other current assets	(8,718)	(6,821)
Other long-term assets	(1,443)	44
Accounts payable	(420)	796
Accrued compensation and benefits	(2,111)	2,650
Other accrued expenses and current liabilities	2,110	(4,781)
Operating lease right-of-use assets and liabilities, net	188	—
Deferred revenue	12,075	(895)
Net cash provided by operating activities	30,005	40,422
<b>INVESTING ACTIVITIES:</b>		
Capital expenditures	(8,120)	(5,333)
Payments for acquisition of developed technology	(473)	(2,738)
Payments for acquisition of businesses, net of cash acquired	(709)	(15,950)
Proceeds from the sale of assets held for sale and other	—	6,613
Other investing activities, net	16	—
Net cash used in investing activities	(9,286)	(17,408)
<b>FINANCING ACTIVITIES:</b>		
Proceeds from issuance of convertible senior notes, net of underwriters' discount and commissions	223,101	—
Payments on revolving commitment	(127,941)	—
Borrowings under revolving commitment	96,991	—
Proceeds from the exercise of stock options	1,441	1,929
Payments for issuance costs of convertible senior notes	(1,233)	—
Payments for follow-on public offering and initial public offering costs	—	(541)
Proceeds from issuance of Class A common stock in follow-on public offering, net of underwriters' discounts and commissions	—	135,572
Other financing activities	(399)	(446)
Net cash provided by financing activities	191,960	136,514
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(1,065)	(1,354)
Net increase in cash, cash equivalents and restricted cash	211,614	158,174
Cash, cash equivalents and restricted cash at beginning of year	35,685	39,578
Cash, cash equivalents and restricted cash at end of period	\$ 247,299	\$ 197,752
<b>Supplemental disclosure of cash flow:</b>		
Interest paid	\$ 385	\$ 70
Income taxes paid	\$ 7,163	\$ 5,900
<b>Supplemental disclosure of non-cash investing and financing activities:</b>		
Finance leases	\$ 588	\$ 995
Property and equipment in accounts payable, other current liabilities and other liabilities	\$ 1,827	\$ 228
Follow-on public offering costs in accounts payable	\$ —	\$ 15
Promissory notes issued and deferred payment obligations for acquisitions	\$ —	\$ 278

See accompanying notes to consolidated financial statements.



**ALTAIR ENGINEERING INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

**1. Organization and description of business**

Altair Engineering Inc. (“Altair” or the “Company”) is incorporated in the state of Delaware. The Company is a global technology company providing software and cloud solutions in the areas of product design and development, high performance computing and data intelligence. Altair enables organizations across broad industry segments to compete more effectively in a connected world while creating a more sustainable future. The Company is headquartered in Troy, Michigan.

**2. Accounting policies**

***Immaterial corrections of prior period financial statements***

In connection with the preparation of its financial statements for the quarter ended June 30, 2019, the Company identified and corrected certain errors that were immaterial to previously-reported consolidated financial statements. No such adjustments are necessary for the quarter ended September 30, 2019, nor does the Company anticipate any further adjustments based on these errors. These historical errors related primarily to i) the cumulative effective adjustment for the income tax effect of intercompany transactions resulting from the adoption of Accounting Standards Codification (“ASC”) No. 606, *Revenue from Contracts with Customers* (ASC 606) on January 1, 2018, and ii) income tax accounting for acquisitions. The Company evaluated the materiality of these errors both qualitatively and quantitatively in accordance with Staff Accounting Bulletin (“SAB”) No. 99, *Materiality*, and SAB No. 108, *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*, and determined the effect of these corrections were not material to the previously issued financial statements. However, the effect of correcting these errors in the current period would be material to the current period financial statements. Therefore, the amounts in the previous periods have been revised to reflect the correction of these errors. These revisions do not impact amounts previously reported in the consolidated statements of operations for the three months ended March 31, 2019 and 2018, the three and six months ended June 30, 2018, the three and nine months ended September 30, 2018, or for total operating, investing, or financing activities on the consolidated statements of cash flows for any previously reported period.

The following table presents the effect of the error corrections on the Company’s consolidated balance sheet for the period indicated (in thousands):

	<b>December 31, 2018</b>		
	<b>As Reported</b>	<b>Adjustments</b>	<b>As Corrected</b>
Deferred tax assets	\$ 1,373	\$ 3,981	\$ 5,354
Total assets	\$ 483,216	\$ 3,981	\$ 487,197
Other accrued expenses and current liabilities	\$ 27,565	\$ (526)	\$ 27,039
Total current liabilities	\$ 127,758	\$ (526)	\$ 127,232
Other long-term liabilities	\$ 28,153	\$ (2,397)	\$ 25,756
Total liabilities	\$ 194,082	\$ (2,923)	\$ 191,159
Accumulated deficit	\$ (82,005)	\$ 7,142	\$ (74,863)
Accumulated other comprehensive loss	\$ (11,052)	\$ (238)	\$ (11,290)
Total stockholders' equity	\$ 286,782	\$ 6,904	\$ 293,686
Total liabilities, mezzanine equity and stockholders' equity	\$ 483,216	\$ 3,981	\$ 487,197

The adjustments for amounts similar to the above were also made to the Company’s consolidated balance sheets as of March 31, 2018, June 30, 2018, September 30, 2018, and March 31, 2019, respectively. Additionally, the Company revised goodwill, total assets, and total liabilities, mezzanine equity and stockholders’ equity on the consolidated balance sheet as of December 31, 2017, to correct these errors, resulting in a decrease of \$1.6 million from the previously reported amounts. The consolidated statements of changes in stockholders’ equity (deficit) for the three month periods ended March 31, 2018 and 2019 have been corrected to reflect the adjustments described herein.

The following tables present the effect of the error corrections on the consolidated statements of operations for the periods indicated (in thousands, except per share data):

	Year Ended December 31, 2018		
	As Reported	Adjustments	As Corrected
Income before income taxes	\$ 27,024	\$ —	\$ 27,024
Income tax expense	\$ 13,309	\$ (1,820)	\$ 11,489
Net income	\$ 13,715	\$ 1,820	\$ 15,535
Net income per share attributable to common stockholders, basic	\$ 0.20	\$ 0.03	\$ 0.23
Net income per share attributable to common stockholders, diluted	\$ 0.18	\$ 0.03	\$ 0.21

	Year Ended December 31, 2017		
	As Reported	Adjustments	As Corrected
Loss before income taxes	\$ (36,411)	\$ —	\$ (36,411)
Income tax expense	\$ 62,996	\$ 2,534	\$ 65,530
Net loss	\$ (99,407)	\$ (2,534)	\$ (101,941)
Net income per share attributable to common stockholders, basic	\$ (1.89)	\$ (0.05)	\$ (1.94)
Net income per share attributable to common stockholders, diluted	\$ (1.89)	\$ (0.05)	\$ (1.94)

Additionally, the Company revised income tax expense, net income, and net income per share attributable to common stockholders (basic and diluted) on the consolidated statement of operations for the year ended December 31, 2016, to correct these errors, resulting in an increase of \$0.2 million, a decrease of \$0.2 million and a decrease of \$0.01, respectively, from the previously reported amounts.

### ***Basis of presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial information. Accordingly, the accompanying statements do not include all the information and notes required by GAAP for complete financial statements. The accompanying unaudited consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements (and notes thereto) for the year ended December 31, 2018, included in the most recent Annual Report on Form 10-K filed with the SEC. In the opinion of management, all adjustments considered necessary for a fair presentation of the financial statements have been included, and all adjustments are of a normal and recurring nature. The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenue and expenses during the reporting periods. Considerable judgment is often involved in making these determinations; use of different assumptions could result in significantly different results. Management believes its assumptions and estimates are reasonable and appropriate. However, actual results may differ from those estimates. In addition, the results of operations for the nine months ended September 30, 2019, are not necessarily indicative of the results that may be expected for any future period.

The Company adopted Accounting Standards Update (“ASU”) No. 2016-02, *Leases (Topic 842)*, and its related amendments, on January 1, 2019. See Note 3 – Recent accounting guidance and Note 9 – Leases for additional information. There have been no other material changes to Altair’s significant accounting policies as compared to the significant accounting policies described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018.

### ***Adoption of ASC 606, Revenue from Contracts with Customers***

In the fourth quarter of fiscal 2018, the Company adopted ASC 606 effective on January 1, 2018, using the modified retrospective approach for all contracts not completed as of the date of adoption. Results for the three and nine months ended September 30, 2018, have been modified to reflect the adoption of ASC 606 on January 1, 2018.

The Company recorded a decrease to accumulated deficit of \$84.6 million, or \$77.7 million net of tax, on January 1, 2018, due to the cumulative effect of the ASC 606 adoption, with the impact primarily derived from revenue related to software licenses recognized at a point in time under ASC 606 that were historically recognized over time. There was no impact on Client Engineering Services or Other revenue upon the adoption of ASC 606.

The Company has concluded that all material transactions that have occurred that require disclosure or adjustments to the consolidated financial statements have been reported herein.

### **Reclassifications**

Certain prior period amounts included in the 2018 consolidated statement of operations, consolidated balance sheet and consolidated statement of cash flows have been reclassified to conform to the current year presentation.

### **Use of estimates**

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenue and expenses during the reporting periods. On an ongoing basis, management evaluates its significant estimates including the stand alone selling price, or SSP, for each distinct performance obligation included in customer contracts with multiple performance obligations, the incremental borrowing rate used in the valuation of lease liabilities, the determination of the period of benefit for capitalized costs to obtain a contract, fair value of convertible senior notes, provision for doubtful accounts, tax valuation allowances, liabilities for uncertain tax provisions, impairment of goodwill and intangible assets, retirement obligations, useful lives of intangible assets, revenue for fixed price contracts, valuation of common stock, and stock-based compensation. Actual results could differ from those estimates.

### **Cash, cash equivalents and restricted cash**

The Company considers all highly liquid investments with original or remaining maturities of 90 days or less at the date of purchase to be cash equivalents. Cash and cash equivalents are recorded at cost, which approximates fair value.

Restricted cash is included in other long-term assets on the consolidated balance sheets. The following table provides a reconciliation of cash, cash equivalents and restricted cash reported in the consolidated balance sheet that sum to the total of the amounts reported in the consolidated statement of cash flows (in thousands):

	<b>September 30, 2019</b>	<b>December 31, 2018</b>
Cash and cash equivalents	\$ 246,937	\$ 35,345
Restricted cash included in other long-term assets	362	340
Total cash, cash equivalents, and restricted cash	<u>\$ 247,299</u>	<u>\$ 35,685</u>

Restricted cash represents amounts required for a contractual agreement with an insurer for the payment of potential health insurance claims, and term deposits for bank guarantees.

### **Inventory**

Inventory was \$3.4 million and \$2.0 million at September 30, 2019 and December 31, 2018, respectively, and is included in prepaid expenses and other current assets in the consolidated balance sheets. Inventory consist of finished goods and is stated at the lower of cost and net realizable value. Cost is determined using the first-in, first-out method. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonable predictable costs of completion, disposal and transportation. The valuation of inventory requires management to estimate excess inventory as well as inventory that is not of saleable quality. The determination of obsolete or excess inventory requires management to estimate market conditions and future demand for the Company's products.

### **Receivable for French R&D credit**

The French government provides a research and development ("R&D") tax credit known as Credit Impôt Recherche, or CIR, in order to encourage Companies to invest in R&D activities. The tax credit is deductible from French income tax and any excess is carried forward three years. After three years, any unused credit may be reimbursed to the Company by the French government. As of September 30, 2019, the Company had approximately \$11.1 million receivable from the French government related to CIR, of which \$2.4 million was recorded in income tax receivable and the remaining \$8.7 million was recorded in other long-term assets. As of December 31, 2018, the Company had approximately \$11.7 million receivable from the French government related to CIR, of which \$2.6 million was recorded in income tax receivable and the remaining \$9.1 million was recorded in other long-term assets. CIR is subject to customary audit by French tax authorities.

### Mezzanine equity

In 2017, the Company issued 200,000 shares of Class A common stock to a third party as partial consideration for the purchase of developed technology. These shares have a put right that can be exercised by the holder five years from date of purchase at \$12.50 per share that requires the shares to be recorded at fair value at the issuance date and classified as mezzanine equity in the consolidated balance sheet. The put right option is terminated if the shareholders sell their shares. As of December 31, 2017, the Company concluded that it is no longer probable that the put option will be exercised as the put value is substantially below market value and subsequent adjustment is not required.

Classification of the of instrument shall remain as mezzanine equity until one of the following three events take place: (1) shares are sold on the open market; (2) a redemption feature lapses; or (3) there is a modification of the terms of the instrument. As none of these events have taken place as of September 30, 2019, the classification remains as mezzanine equity.

### Leases

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use (“ROU”) assets, current portion of operating lease liabilities, and operating lease liabilities, net of current portion on the Company’s consolidated balance sheets. Finance leases are included in property and equipment, current portion of long-term debt, and long-term debt, net of current portion on the consolidated balance sheets.

### Net (loss) income per share

Basic (loss) income per share attributable to common stockholders is computed using the weighted average number of shares of common stock outstanding for the period, excluding stock options and restricted stock units (“RSUs”). Diluted (loss) income per share attributable to common stockholders is based upon the weighted average number of shares of common stock outstanding for the period and potentially dilutive common shares, including the effect of stock options and RSUs under the treasury stock method. The following table sets forth the computation of the numerators and denominators used in the basic and diluted (loss) income per share amounts (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Numerator:				
Net (loss) income	\$ (15,939)	\$ 934	\$ (6,040)	\$ 24,538
Denominator:				
Denominator for basic (loss) income per share— weighted average shares	71,770	70,001	71,313	66,429
Effect of dilutive securities, stock options and RSUs	—	6,708	—	7,753
Denominator for dilutive (loss) income per share	71,770	76,709	71,313	74,182
Net (loss) income per share attributable to common stockholders, basic	\$ (0.22)	\$ 0.01	\$ (0.08)	\$ 0.37
Net (loss) income per share attributable to common stockholders, diluted	\$ (0.22)	\$ 0.01	\$ (0.08)	\$ 0.33

The computation of diluted (loss) income per share does not include shares that are anti-dilutive under the treasury stock method because their exercise prices are higher than the average fair value of the Company’s stock during the period or due to a net loss in the period. For the three and nine months ended September 30, 2019, respectively, there were 5.3 million and 5.8 million anti-dilutive stock options excluded from the computation of (loss) income per share. For the three and nine months ended September 30, 2018, there were no anti-dilutive shares excluded from the computation of (loss) income per share.

The Company expects to settle the principal amount of the Convertible Notes (as defined in Note 8) in cash, and therefore, the Company uses the treasury stock method for calculating any potential dilutive effect of the Conversion Option (as defined in Note 8) on diluted net (loss) income per share, if applicable. The Conversion Option will have a dilutive impact on net income per share of common stock when the average market price of the Company’s Class A common stock for a given period exceeds the conversion price of the Convertible Notes of \$46.50 per share. During the three and nine months ended September 30, 2019, the Company’s weighted average common stock price was below the conversion price of the Convertible Notes.

### 3. Recent accounting guidance

#### *Accounting standards adopted*

*Leases* — In February 2016, the Financial Accounting Standard Board, or “FASB”, issued Accounting Standards Update, or “ASU”, No. 2016-02, *Leases (ASC 842)*. This standard amends various aspects of existing accounting guidance for leases, including the recognition of a right-of-use (ROU) asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. The Company adopted ASU 2016-02 and its related amendments, on January 1, 2019 and elected the optional transition method and the package of practical expedients on adoption. Accordingly, the prior period comparative information has not been restated and continues to be reported under the accounting guidance in effect for those periods, including the disclosure requirements. The most significant impact of the adoption of ASC 842 was the recognition of ROU assets and lease liabilities for operating leases on the Company’s consolidated balance sheet. On adoption, the Company recognized operating liabilities associated with leases of \$30.1 million and corresponding ROU assets of \$29.1 million, based on the present value of the remaining minimum rental payments under current leasing standards for existing operating leases. See Note 9 – Leases for further discussion. The Company’s accounting for finance leases (previously referred to as capital leases prior to the adoption of ASC 842) remained substantially unchanged. The standard had no impact on the Company’s consolidated net income or cash flows.

*Derivatives and Hedging* – In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. This ASU amends the guidance with the objective of improving the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements. In addition, this ASU amends the current guidance to simplify the application of the hedge accounting guidance. The Company adopted ASU 2017-12 on January 1, 2019. The adoption of this guidance did not have a material effect on the Company’s consolidated financial statements.

*Comprehensive Income* – In February 2018, the FASB issued ASU 2018-02, *Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (AOCI)*, which gives entities the option to reclassify to retained earnings the tax effects resulting from the Tax Cuts and Jobs Act, or the “Tax Act”, related to items in AOCI that the FASB refers to as having been stranded in AOCI. The Company adopted this guidance on January 1, 2019 and elected not to reclassify amounts stranded in AOCI. The Company reclassifies taxes from AOCI to earnings as the items to which the tax effects relate are similarly reclassified. The adoption of ASU 2018-02 did not have a material effect on the Company’s consolidated financial statements.

*Stock Compensation* – In June 2018, the FASB issued ASU 2018-07, *Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. This ASU simplifies the accounting for share-based payments to nonemployees by aligning it with the accounting for share-based payments to employees, with certain exceptions. The Company adopted this guidance on January 1, 2019, which did not have a material effect on the Company’s consolidated financial statements.

#### *Accounting standards not yet adopted*

*Credit Losses* – In June 2016, the FASB issued ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The ASU significantly changes how entities will measure credit losses on most financial assets. This guidance is effective for annual periods beginning after December 15, 2019, and interim periods therein; early adoption is permitted. The Company is currently evaluating the impact of this new guidance on its consolidated financial statements and related disclosures and does not expect this guidance to have a material effect on its consolidated financial statements.

*Goodwill Impairment* — In January 2017, the FASB issued ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, which simplifies accounting for goodwill impairments by eliminating step two from the goodwill impairment test. This guidance is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim and annual goodwill impairment tests performed on testing dates after January 1, 2017. The new standard must be applied on a prospective basis. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.

*Fair Value* – In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU modifies the disclosure requirements for fair value measurements, by removing, modifying, or adding certain disclosures. The amendments are effective for fiscal years, and interim reporting periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for any removed or modified disclosures. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements and related disclosures and does not expect this guidance to have a material effect on its consolidated financial statements.

*Retirement Benefits* – In August 2018, the FASB issued ASU 2018-14, *Compensation – Retirement Benefits- Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans*. This ASU modifies the disclosure requirements for defined benefit pension or other postretirement plans. The amendments are effective for fiscal years ending after December 15, 2020; early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.

*Intangibles* – In August 2018, the FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*. This ASU clarifies and aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years; early adoption is permitted. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements and related disclosures.

#### **4. Revenue from contracts with customers**

##### ***Revenue recognition***

###### *Software revenue*

Revenue is derived principally from the licensing of software products and from related maintenance contracts. The Company enters into contracts that include combinations of products, maintenance and services, which are accounted for as separate performance obligations with differing revenue recognition patterns.

Revenue from term-based software licenses is classified as software revenue. Term-based licenses are sold only as a bundled arrangement that includes the rights to a term software license and post-contract customer support (PCS), which includes unspecified technical enhancements and customer support. Maximizing the use of observable inputs, the Company determined that a majority of the estimated standalone selling prices of the term-based license is attributable to the term license and a minority is attributable to the PCS. The license component is classified as license revenue and recognized as revenue upon the later of delivery of the licensed product or the beginning of the license period. PCS is classified as maintenance and other services and is recognized ratably over the term of the contract, as the Company provides the PCS benefit over time as a stand ready to perform obligation.

In addition to term-based software licenses, the Company sells perpetual licenses. Software revenue is recognized upon the later of delivery of the licensed product or the beginning of the license period. Typically, the Company’s perpetual licenses are sold with PCS. The Company allocates value in bundled perpetual and PCS arrangements based on the value relationship between the software license and maintenance. Revenue from PCS is classified as maintenance and other services and is recognized ratably over the term of the contract, as the Company satisfies the PCS performance obligation over time as a stand ready to perform obligation.

Revenue from training, consulting and other services is recognized as the services are performed, and is classified as maintenance and other services in the consolidated statement of operations. For contracts in which the service consists of a single performance obligation, such as providing a training class to a customer, the Company recognizes revenue upon completion of the performance obligation. For service contracts that are longer in duration and often include multiple performance obligations (for example, point-in-time training and consulting), the Company measures the progress toward completion of the obligations and recognizes revenue accordingly. In measuring progress towards the completion of performance obligations, the Company typically utilizes output-based estimates for services with fixed fee arrangements, and estimates output based on the total tasks completed as compared to the total tasks required for each contract. Input-based estimates are utilized for services that involve general consultations with contractual billing arrangements based on time and materials, utilizing direct labor as the input measure.

The Company also executes arrangements through indirect channel partners in which the channel partners are authorized to market and distribute the Company's software products to end users of the Company's products and services in specified territories. In sales facilitated by channel partners, the channel partner bears the risk of collection from the end-user customer. The Company recognizes revenue from transactions with channel partners when the channel partner submits a purchase commitment, collectability from the channel partner is probable, and the performance obligation is met, at a point in time or over time as appropriate, provided that all other revenue recognition criteria are satisfied. Revenue from channel partner transactions is the amount remitted to the Company by the channel partners. This amount includes a fee for PCS that is compensation for providing technical enhancements and the second level of technical support to the end user, which is recognized over the period that PCS is to be provided. The Company does not offer right of return, product rotation, or price protection to any of its channel partners.

Non-income related taxes collected from customers and remitted to governmental authorities are recorded on the consolidated balance sheet as accounts receivable, net and other accrued expenses and current liabilities. These amounts are reported on a net basis in the consolidated statements of operations and do not impact reported revenues or expenses.

### ***Significant judgments***

#### *Software revenue*

The Company's contracts with customers typically include promises to transfer licenses and services to a customer. Judgment is required to determine if the promises are separate performance obligations within the context of the arrangement, and if so, the allocation of the transaction price to each performance obligation. The Company's determination of standalone selling price for performance obligations is based on the midpoint of the range of historical observable prices for goods and services sold separately. In addition, the Company estimates the standalone selling price for certain performance obligations where observable prices are not directly available or a significant portion of historical prices are not within the range. The Company estimates standalone selling price at contract inception considering all information that is reasonably available and is based on the amount of consideration for which the Company expects to be entitled in exchange for transferring the promised good or service to the customer. The corresponding revenues are recognized as the related performance obligations are satisfied.

The Company's contracts do not include a significant financing component requiring adjustment to the transaction price. Payment terms vary by contract type; however, arrangements typically stipulate a requirement for the customer to pay within 30 days.

The Company rarely enters into agreements to modify previously executed contracts, which constitute contract modifications. The Company assesses each of these contract modifications to determine (i) if the additional products and services are distinct from the products and services in the original arrangement; and (ii) if the amount of consideration expected for the added products and services reflects the stand-alone selling price of those products and services, as adjusted for contract-specific circumstances. A contract modification meeting both criteria is accounted for as a separate contract. A contract modification not meeting both criteria is considered a change to the original contract and is accounted for on either (i) a prospective basis as a termination of the existing contract and the creation of a new contract; or (ii) a cumulative catch-up basis. Generally, the Company's contract modifications meet both criteria and are accounted for as a separate contract, as adjusted for contract-specific circumstances.

#### *Software related services revenue*

Consulting services from product design and development projects are considered distinct performance obligations and are provided to customers on a time-and-materials ("T&M") or fixed-price basis. Altair recognizes software services revenue for T&M contracts based upon hours worked and contractually agreed upon hourly rates using the input method. Revenue from fixed-price engagements is recognized using the output method based on the ratio of costs incurred, to the total estimated project costs.

#### *Client engineering services and Other revenue*

Client engineering services revenue are derived from professional services for staffing primarily representing engineers and data scientists located at a customer site. These professional services are considered distinct performance obligations and are provided to customers on a T&M basis. The Company recognizes this revenue for T&M contracts based upon hours worked and contractually agreed upon hourly rates using the input method. No significant judgments were made for revenue recognition within Other revenue.

## Disaggregation of revenue

The Company disaggregates its software revenue by type of performance obligation and timing of revenue recognition as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Software revenue:				
Term licenses	\$ 38,794	\$ 32,688	\$ 149,825	\$ 128,560
Perpetual licenses	8,059	8,192	30,302	25,955
Maintenance	26,898	21,588	74,983	63,285
Professional services and other	4,065	1,714	10,405	6,658
Total software revenue	<u>\$ 77,816</u>	<u>\$ 64,182</u>	<u>\$ 265,515</u>	<u>\$ 224,458</u>

The Company derived approximately 10% of its total revenue through indirect sales channels for the nine months ended September 30, 2019 and 2018.

Software related services revenue, client engineering services revenue, and other revenue were categorized based on the nature and timing of revenue and cash flows.

## Costs to obtain a contract

The Company pays commissions for new software product and PCS sales as well as for renewals of existing software and PCS contracts. Commissions paid to obtain renewal contracts are not commensurate with the commissions paid for new product sales and therefore, a portion of the commissions paid for new contracts relate to future renewals.

The Company accounts for new product sales commissions using a portfolio approach and allocates the cost of commissions in proportion to the allocation of transaction price of license and PCS performance obligations. Commissions allocated to the license and license renewal components are expensed at the time the license revenue is recognized. Commissions allocated to PCS are capitalized and amortized on a straight-line basis over a period of four years, reflecting the Company's estimate of the expected period that it will benefit from those commissions. As of September 30, 2019 and December 31, 2018, capitalized costs to obtain a contract were \$2.2 million and \$2.0 million, respectively, recorded in prepaid and other current assets, and \$0.7 million and \$0.2 million, respectively, recorded in other long-term assets. Amortization expense was \$1.1 million, \$1.1 million, \$3.3 million and \$3.0 million for the three months ended September 30, 2019 and 2018 and nine months ended September 30, 2019 and 2018, respectively, and was included in sales and marketing expense in the Company's consolidated statement of operations.

## Contract assets

At September 30, 2019 and December 31, 2018, contract assets were \$6.0 million and \$3.7 million, respectively, recorded in accounts receivable, and \$3.8 million and \$2.7 million, respectively, recorded in prepaid expenses and other current assets.

## Deferred revenue

Deferred revenue consists of billings made or payments received in advance of revenue recognition from software license, PCS and professional services agreements. The timing of revenue recognition may differ from the timing of billings to customers. Payment terms vary by the type and location of customer and the products or services offered. The term between invoicing and when payment is due is not significant. The Company generally invoices its customers annually for the forthcoming year of software licenses, and more frequently for other products and services. Accordingly, the Company's deferred revenue balance does not include revenue for future years of multiple year non-cancellable contracts that have not yet been billed. Approximately \$53.7 million of revenue recognized during the nine months ended September 30, 2019, was included in the deferred revenue balances at the beginning of the year.



## 5. Acquisitions and disposals

### WEYV

In July 2019, the Company decided to sunset operations of its WEYV business, a consumer music and content service. The Company concluded that this decision was not a strategic shift that has or will have a major effect on its operations and financial results, and therefore did not meet the accounting criteria to be classified as a discontinued operation.

The operations of WEYV terminated in the third quarter of 2019. The loss on disposal was not material, and is included in other operating income in the consolidated statement of operations. WEYV had a loss before income tax of \$0.4 million, \$3.0 million, \$0.9 million and \$4.0 million for the three and nine months ended September 30, 2019 and 2018, respectively. The WEYV business is reported in All Other within the Company's segment information in Note 17.

### Datawatch Corporation

On November 5, 2018, the Company entered into an Agreement and Plan of Merger ("Merger Agreement") with Datawatch Corporation, a Delaware corporation ("Datawatch"), and Dallas Merger Sub, Inc., a Delaware corporation ("Purchaser") and a wholly owned subsidiary of the Company. Pursuant to the Merger Agreement, the Purchaser commenced a tender offer to purchase all of the issued and outstanding shares of Datawatch common stock, (the "Shares") at a purchase price of \$13.10 per share, net to seller in cash, without interest and less any applicable withholding taxes (the "Offer").

On December 13, 2018, the Company accepted and paid for all Shares that were validly tendered and completed the acquisition of Datawatch through the merger of Purchaser with and into Datawatch, with Datawatch surviving as a wholly owned subsidiary of the Company.

Altair completed the acquisition of Datawatch for consideration of approximately \$183.4 million which consisted of consideration paid to former holders of common stock of Datawatch at \$13.10 a share, or \$168.2 million and approximately \$6.7 million to former holders of outstanding Datawatch equity awards. In addition, Altair paid \$8.0 million on the day of closing to settle all of Datawatch's outstanding debt and incurred a liability of approximately \$0.5 million payable to former holders of certain unvested Datawatch equity awards for which service had been rendered at the acquisition date. Altair financed the acquisition with cash on hand and a drawdown from its then existing credit facility.

The financial results of Datawatch have been included in the consolidated financial statements since the acquisition date.

The acquisition of Datawatch has been accounted for as a business combination, under the acquisition method of accounting, which results in acquired assets and assumed liabilities being measured at their estimated fair values as of December 13, 2018, the acquisition date. As of the acquisition date, goodwill is measured as the excess of consideration transferred, which is also generally measured at fair value of the net acquisition date fair values of the assets acquired and liabilities assumed.

The following table summarizes the preliminary purchase consideration transferred to acquire Datawatch and the amounts of identified assets acquired and liabilities assumed at the acquisition date (in thousands):

Fair value of consideration transferred	<u>\$ 183,427</u>
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash	8,278
Accounts receivable	10,384
Other assets	2,522
Property and equipment	980
Trade names	7,400
Developed technology (6-year life)	22,600
Customer relationships (10-year life)	16,700
Accounts payable and other liabilities	(5,041)
Deferred revenue	(3,649)
Other long-term liabilities	(8,340)
Total net identifiable assets acquired and liabilities assumed	<u>51,834</u>
Goodwill (1)	<u>\$ 131,593</u>

(1) Goodwill is primarily attributable to market synergies expected to arise after the acquisition and approximately \$ 0.8 million is deductible for tax purposes. All goodwill is recorded in the Software segment.

The excess of preliminary purchase consideration over the preliminary fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The preliminary fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management's estimates and assumptions. The deferred tax liability established was primarily a result of the difference in the book basis and tax basis related to the identifiable intangible assets. The preliminary estimated fair values of assets acquired and liabilities assumed, including current and noncurrent income taxes payable and deferred taxes, customer contract assets and liabilities and identifiable intangible assets may be subject to change as additional information is received and certain tax returns are finalized. Thus, the provisional measurements of fair value set forth above are subject to change. The primary areas that remain preliminary relate to the fair value of intangible assets acquired, certain tangible assets and liabilities acquired, income taxes and residual goodwill.

#### ***SIMSOLID Corporation***

In October 2018, the Company acquired all of the outstanding capital stock of SIMSOLID Corporation, a Canadian corporation ("SIMSOLID"), for aggregate consideration of \$22.1 million. The allocation of fair value of purchase consideration was finalized in the first quarter of 2019, and there were no changes to the fair value of assets acquired and liabilities assumed, as previously reported.

#### **6. Property and equipment, net**

Property and equipment consisted of the following (in thousands):

	<b>September 30, 2019</b>	<b>December 31, 2018</b>
Land	\$ 7,994	\$ 7,994
Building and improvements	14,447	13,120
Computer equipment and software	36,754	34,582
Office furniture and equipment	7,668	7,958
Leasehold improvements	8,613	6,926
Right-of-use assets under finance leases	2,660	—
Total property and equipment	<u>78,136</u>	<u>70,580</u>
Less: accumulated depreciation and amortization	44,416	40,427
Property and equipment, net	<u>\$ 33,720</u>	<u>\$ 30,153</u>

Depreciation expense, including amortization of ROU assets under finance leases, was \$1.9 million and \$5.2 million for the three and nine months ended September 30, 2019, respectively, and \$1.6 million and \$5.2 million for the three and nine months ended September 30, 2018, respectively.

#### **7. Goodwill and other intangible assets**

##### ***Goodwill***

The changes in the carrying amount of goodwill, which is attributable to the Software reporting segment, were as follows (in thousands):

Balance at December 31, 2018	\$ 210,532
Effects of foreign currency translation and other	(32)
Balance at September 30, 2019	<u>\$ 210,500</u>

### Other intangible assets

A summary of other intangible assets is shown below (in thousands):

	September 30, 2019			
	Weighted average amortization period	Gross carrying amount	Accumulated amortization	Net carrying amount
<i>Definite-lived intangible assets:</i>				
Developed technology	4-6 years	\$ 55,870	\$ 22,679	\$ 33,191
Customer relationships	7-10 years	28,454	10,317	18,137
Other intangibles	10 years	204	57	147
Total definite-lived intangible assets		84,528	33,053	51,475
<i>Indefinite-lived intangible assets:</i>				
Trade names		9,481		9,481
Total other intangible assets		\$ 94,009	\$ 33,053	\$ 60,956

  

	December 31, 2018			
	Weighted average amortization period	Gross carrying amount	Accumulated amortization	Net carrying amount
<i>Definite-lived intangible assets:</i>				
Developed technology	4-6 years	\$ 54,530	\$ 15,517	\$ 39,013
Customer relationships	7-10 years	28,422	7,309	21,113
Other intangibles	10 years	109	56	53
Total definite-lived intangible assets		83,061	22,882	60,179
<i>Indefinite-lived intangible assets:</i>				
Trade names		9,657		9,657
Total other intangible assets		\$ 92,718	\$ 22,882	\$ 69,836

Amortization expense related to intangible assets was \$3.5 million and \$10.7 million for the three and nine months ended September 30, 2019, respectively, and \$1.7 million and \$5.7 million for the three and nine months ended September 30, 2018, respectively.

### 8. Debt

The carrying value of debt is as follows (in thousands):

	September 30, 2019	December 31, 2018
Convertible senior notes	\$ 230,000	\$ —
Revolving credit facility	—	30,950
Obligations for finance leases	1,178	813
Other borrowings	—	75
Total debt	231,178	31,838
Less: unamortized debt discount	49,147	—
Less: unamortized debt issuance costs	5,970	90
Less: current portion of long-term debt	437	331
Long-term debt, net of current portion	\$ 175,624	\$ 31,417

#### Convertible senior notes

In June 2019, the Company issued \$230.0 million aggregate principal amount of 0.25% convertible senior notes due in 2024 (the "Convertible Notes"), which includes the underwriters' exercise in full of their option to purchase an additional \$30.0 million principal amount of the Convertible Notes, in a public offering. The net proceeds from the issuance of the Convertible Notes were \$221.9 million after deducting the underwriting discounts and commissions and estimated issuance costs.

The Company entered into a First Supplemental Indenture relating to the issuance by the Company of the Convertible Notes (the "Supplemental Indenture") supplementing the Indenture, dated June 10, 2019 (the "Base Indenture," and together with the Supplemental Indenture, the "Indenture"), by and between the Company and U.S. Bank National Association, as trustee (the "Trustee"). The Indenture includes customary covenants and sets forth certain events of default after which the Convertible Notes may be declared immediately due and payable and sets forth certain types of bankruptcy or insolvency events of default involving the Company after which the Convertible Notes become automatically due and payable. The Convertible Notes are senior unsecured obligations of the Company.

The Convertible Notes bear interest at a rate of 0.25% per year, payable semi-annually in arrears on June 1 and December 1 of each year, commencing December 1, 2019. The Convertible Notes will mature on June 1, 2024, unless, earlier repurchased or redeemed by the Company or converted pursuant to their terms.

The Convertible Notes have an initial conversion rate of 21.5049 shares of the Company's Class A common stock per \$1,000 principal amount of Convertible Notes, which is equivalent to an initial conversion price of approximately \$46.50 per share of its Class A common stock. The conversion rate will be subject to adjustment upon the occurrence of certain events specified in the Indenture but will not be adjusted for any accrued and unpaid interest. In addition, upon the occurrence of a make whole fundamental change or a redemption period (each as defined in the Indenture), the Company will, in certain circumstances, increase the conversion rate by a specified number of additional shares for a holder who elects to convert its Convertible Notes in connection with such make whole fundamental change or during the relevant redemption period.

Holders of the Convertible Notes may convert all or any portion of their Convertible Notes at any time prior to the close of business on December 1, 2023, in integral multiples of \$1,000 principal amount, only under the following circumstances:

- During any calendar quarter commencing after the calendar quarter ending on September 30, 2019 (and only during such calendar quarter), if the last reported sale price of the Class A Common Stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- During the five business day period after any five consecutive trading day period (the "measurement period") in which the trading price (as defined in the Indenture) per \$1,000 principal amount of Convertible Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Class A Common Stock and the conversion rate on each such trading day;
- If the Company calls any or all of the Convertible Notes for redemption (which the Company may not do prior to June 6, 2022), at any time prior to the close of business on the scheduled trading day immediately preceding the redemption date; or
- Upon the occurrence of specified corporate events.

On or after December 1, 2023 until the close of business on the business day immediately preceding the maturity date, holders may convert their Convertible Notes at any time, regardless of the foregoing circumstances. Upon conversion, the Company may satisfy its conversion obligation by paying and/or delivering, as the case may be, cash, shares of Class A Common Stock or a combination of cash and shares of the Class A Common Stock, at the Company's election, in the manner and subject to the terms and conditions provided in the Indenture.

During the quarter ended September 30, 2019, the conditions allowing holders of the Convertible Notes to convert were not met. Therefore, the Convertible Notes were classified as long-term debt on the consolidated balance sheet as of September 30, 2019.

The Company accounts for the Convertible Notes as separate liability and equity components. The carrying amount of the liability component of the Convertible Notes was calculated by measuring the fair value of similar debt instruments that do not have an associated convertible feature. The Company determined the carrying amount of the liability component as the present value of its cash flows using a discount rate of approximately 5.5%. The estimated interest rate was applied to the Convertible Notes, which resulted in a fair value of the liability component of \$178.2 million upon issuance, calculated as the present value of future contractual payments based on the \$230.0 million aggregate principal amount. The excess of the principal amount of the liability component over its carrying amount, or the debt discount, is amortized to interest expense over the term of the Convertible Notes using the effective interest method. The \$51.8 million difference between the gross proceeds received from issuance of the Convertible Notes of \$230.0 million and the estimated fair value of the liability component represents the equity component, or the "Conversion Option", of the Convertible Notes and was recorded in additional paid-in capital. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

The Company allocated issuance costs related to the issuance of the Convertible Notes to the liability and equity components using the same proportions as the initial carrying value of the Convertible Notes. Issuance costs attributable to the liability component were \$6.3 million and are being amortized to interest expense using the effective interest method over the term of the Convertible Notes. Issuance costs attributable to the equity components were \$1.8 million and are netted with the equity component of the Convertible Notes in stockholders' equity on the condensed consolidated balance sheets.

The net carrying value of the liability component of the Convertible Notes was as follows (in thousands):

	<b>September 30, 2019</b>
Principal	\$ 230,000
Less: unamortized debt discount	49,147
Less: unamortized debt issuance costs	5,970
Net carrying amount	<u>\$ 174,883</u>

The net carrying value of the equity component of the Convertible Notes was as follows (in thousands):

	<b>September 30, 2019</b>
Proceeds allocated to the conversion option (debt discount)	\$ 51,842
Less: issuance costs	1,833
Net carrying amount	<u>\$ 50,009</u>

The interest expense recognized related to the Convertible Notes was as follows (in thousands):

	<b>Three Months Ended September 30, 2019</b>	<b>Nine Months Ended September 30, 2019</b>
Contractual interest expense	\$ 144	\$ 169
Amortization of debt issuance cost and discount	2,577	3,024
Total	<u>\$ 2,721</u>	<u>\$ 3,193</u>

## **Credit agreement**

### ***Revolving credit facility***

The Company has a \$150.0 million credit facility that was amended on June 5, 2019, to permit the issuance of the Convertible Notes and extend the maturity date of the credit facility to December 15, 2023 ("2019 Amended Credit Agreement"). The 2019 Amended Credit Agreement provides for an accordion feature that allows the Company to expand the size of the revolving line of credit by an additional \$50.0 million, subject to certain conditions, by obtaining additional commitments from the existing lenders or by causing a person acceptable to the administrative agent to become a lender (in each case subject to the terms and conditions set forth in the 2019 Amended Credit Agreement).

As of September 30, 2019, the Company had no outstanding borrowings under the 2019 Amended Credit Agreement and there was \$150.0 million available for future borrowing. The 2019 Amended Credit Agreement is available for general corporate purposes, including working capital, capital expenditures, and permitted acquisitions.

Borrowings under the 2019 Amended Credit Agreement bear interest at a rate per annum equal to an agreed upon applicable margin plus, at the Company's option, either the Alternate Base Rate (defined as the greatest of (1) the Prime Rate (as defined in the 2019 Amended Credit Agreement) in effect on such day, (2) the Federal Funds Effective Rate (as defined in the 2019 Amended Credit Agreement) in effect on such day plus 1/2 of 1.00% or (3) the Adjusted LIBO Rate (as defined in the 2019 Amended Credit Agreement) for a one month interest period on such day (or if such day is not a business day, the immediately preceding business day) plus 1.00%) or the Adjusted LIBO Rate. The applicable margin for borrowings under the 2019 Amended Credit Agreement is based on the Company's most recently tested consolidated total net leverage ratio and will vary from (a) in the case of Eurodollar loans, 1.25% to 2.00%, and (b) in the case of ABR loans and swingline loans, 0.25% to 1.00%. The Company pays a commitment fee (based on the Company's most recently tested consolidated total senior secured net leverage ratio) ranging from 0.15% to 0.30% on the unused portion of the 2019 Amended Credit Agreement.

#### ***Collateral and guarantees***

The 2019 Amended Credit Agreement is secured by collateral including (i) substantially all of the Company's properties and assets, and the properties and assets of the Company's direct and indirect domestic subsidiaries but excluding any patents, copyrights, patent applications or copyright applications or any trade secrets or software products and (ii) pledges of the equity interests in all present and future direct and indirect domestic subsidiaries (subject in each case to certain exceptions as provided for under the 2019 Amended Credit Agreement). The Company's direct and indirect domestic subsidiaries are guarantors of all the obligations under the 2019 Amended Credit Agreement.

#### ***Debt covenants***

The 2019 Amended Credit Agreement requires the Company to maintain the following financial covenants:

- *Maximum Net Leverage Ratio:* On the last day of each fiscal quarter, the Company on a consolidated basis will not permit the ratio of total indebtedness (net of unrestricted domestic cash in excess of \$20.0 million) to EBITDA, as such terms are defined in the 2019 Amended Credit Agreement, for the rolling four quarter period ending on such date to be greater than 5.00 to 1.00 as of the last day of any such fiscal quarter.
- *Senior Secured Leverage Ratio:* On the last day of each fiscal quarter, the Company on a consolidated basis will not permit the ratio of total indebtedness secured by a lien (net of unrestricted domestic cash in excess of \$20.0 million) to EBITDA, as such terms are defined in the 2019 Amended Credit Agreement, for the rolling four quarter period ending on such date to be greater than 3.00 to 1.00 as of the last day of any such fiscal quarter.
- *Consolidated Interest Coverage Ratio:* On the last day of each fiscal quarter, the Company on a consolidated basis will not permit the ratio of (x) EBITDA to (y) cash Consolidated Interest Expense, as such terms are defined in the 2019 Amended Credit Agreement, in each case for the rolling four quarter period ending on such date, to be less than 3.00 to 1.00 as of the last day of any such fiscal quarter.

At September 30, 2019, the Company was in compliance with all the financial covenants.

#### **9. Leases**

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease assets and operating lease obligations on the Company's consolidated balance sheets. Finance leases are included in property and equipment, current portion of long-term debt, and long-term debt on the consolidated balance sheets.

ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments under the lease. Operating lease ROU assets and operating lease liabilities are recognized based on the present value of the future minimum lease payments over the lease term at commencement date. At commencement date, the ROU asset also includes adjustments for lease prepayments, lease incentives received and the lessee's initial direct costs, if applicable. As most of the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of future payments. The incremental borrowing rates are determined using rates specific to the term of the lease, economic environments where lease activity is concentrated, value of lease portfolio, and assuming full collateralization of the loans. Subsequent to the commencement date, the operating ROU asset is equal to the remeasured lease liability adjusted for cumulative prepaid or accrued rent if the lease payments are uneven throughout the lease term, unamortized lease incentives, unamortized initial direct costs and any impairment of the ROU assets. The lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease cost for minimum lease payments is recognized on a straight-line basis over the lease term.

The Company has elected not to recognize a lease liability or ROU asset for short-term leases (leases with a term of twelve months or less). For contracts with lease and non-lease components, the Company has elected not to allocate the contract consideration, and account for the lease and non-lease components as a single lease component.

The Company's operating leases consist of office facilities, office equipment and cars and the Company's finance leases consist of office equipment and cars. The Company's leases have remaining terms of less than one year to 8.1 years, some of which include one or more options to renew, with renewal terms up to six years and some of which include options to terminate the leases within the next four years.

The components of lease cost were as follows (in thousands):

	<b>Three Months Ended September 30,</b>	<b>Nine Months Ended September 30,</b>
	<b>2019</b>	<b>2019</b>
Operating lease cost	\$ 3,287	\$ 10,070
<b>Finance lease cost:</b>		
Amortization of ROU assets	\$ 145	\$ 392
Interest on lease liabilities	6	16
Total finance lease cost	\$ 151	\$ 408

Operating lease cost includes short-term leases and variable lease costs, which are immaterial. Rent cost related to operating leases for office facilities was \$3.0 million and \$9.0 million for the three and nine months ended September 30, 2019, respectively, and \$2.4 million and \$7.0 million for the three and nine months ended September 30, 2018, respectively.

Supplemental balance sheet information related to lease liabilities at September 30, 2019, was as follows:

(in thousands, except lease term and discount rate)

**Operating leases:**

Operating lease ROU assets	\$ 26,507
Current portion of operating lease liabilities	\$ 8,891
Operating lease liabilities, net of current portion	18,831
Total operating lease liabilities	\$ 27,722
Weighted average remaining lease term	4.1 years
Weighted average discount rate	5.5%

**Finance leases:**

Property and equipment	\$ 2,660
Accumulated depreciation	(1,287)
Property and equipment, net	\$ 1,373
Current portion of long-term debt	\$ 437
Long-term debt, net of current portion	741
Total finance lease liabilities	\$ 1,178
Weighted average remaining lease term	2.9
Weighted average discount rate	3.5%

Supplemental cash flow information related to leases for the nine months ended September 30, 2019, was as follows (in thousands):

**Cash paid for amounts included in the measurement of lease liabilities:**

Operating cash flows from operating leases	\$	(8,489)
Operating cash flows from finance leases	\$	(36)
Financing cash flows from finance leases	\$	(323)

**ROU assets obtained in exchange for lease obligations:**

Operating leases	\$	7,304
Finance leases	\$	588

Maturities of operating lease liabilities at September 30, 2019, were as follows (in thousands):

Year ending December 31,		
2019 (excluding the nine months ended September 30, 2019)	\$	2,809
2020		9,483
2021		7,202
2022		4,954
2023		2,964
Thereafter		3,291
Total lease payments		30,703
Less: imputed interest		2,981
Total operating lease liabilities	\$	<u>27,722</u>

Total obligations for finance leases, previously referred to as capital leases prior to the adoption of Topic 842 on January 1, 2019, were \$0.8 million at December 31, 2018.

**10. Other liabilities**

The following table provides the details of other accrued expenses and current liabilities (in thousands):

	September 30, 2019	December 31, 2018
Income taxes payable	\$ 8,400	\$ 3,932
Accrued professional fees	4,232	3,165
Accrued VAT	2,907	4,536
Accrued royalties	1,888	2,613
Defined contribution plan liabilities	1,389	1,376
Non-income tax liabilities	1,024	853
Government grants	806	915
Billings in excess of cost	436	1,504
Other current liabilities	6,344	8,145
Total	<u>\$ 27,426</u>	<u>\$ 27,039</u>

The following table provides details of other long-term liabilities (in thousands):

	September 30, 2019	December 31, 2018
Pension and other post retirement liabilities	\$ 9,766	\$ 9,111
Deferred tax liabilities	5,598	5,339
Other liabilities	10,266	11,306
Total	<u>\$ 25,630</u>	<u>\$ 25,756</u>

**11. Fair value measurements**



The accounting guidance for fair value, among other things, defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The framework for measuring fair value consists of a three-level valuation hierarchy that prioritizes the inputs to valuation techniques used to measure fair value based upon whether such inputs are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect market assumptions made by the reporting entity. The three-level hierarchy for the inputs to valuation techniques is briefly summarized as follows:

Level 1 – Quoted prices in active markets for identical assets and liabilities at the measurement date;

Level 2 – Observable inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3 – Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

An asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to their short maturities. Interest on the Company's long-term debt is at a variable rate, and as such the debt obligation outstanding approximates fair value.

As of September 30, 2019, the fair value of the Convertible Notes was \$32.0 million. The estimated fair values of the Convertible Notes, which the Company has classified as Level 2 financial instruments, were determined based on quoted bid prices of the Convertible Notes on the last trading day of each reporting period. The Company carries the convertible senior notes at face value less unamortized debt discount and issuance costs on its consolidated balance sheet, and it presents the fair value for required disclosure purposes only. For further information on the Convertible Notes see Note 8. – Debt.

## 12. Stock-based compensation

### 2001 stock-based compensation plans

#### Nonqualified stock option plan

In 2001, the Company established the Nonqualified Stock Option Plan ("NSO Plan") under which 3,736,947 stock options with an exercise price of \$0.000025 remain outstanding at September 30, 2019. The NSO Plan was terminated in 2003. Stock options under the NSO plan were immediately vested and have a contractual term of 35 years from the date of grant. The outstanding awards will continue to be governed by their existing terms under the NSO Plan. The NSO Plan is accounted for as an equity plan.

The following table summarizes the stock option activity under the NSO Plan for the period:

	Number of options	Weighted average exercise price per share	Weighted average remaining contractual term (years)	Aggregate intrinsic value (in millions)
Outstanding at January 1, 2019	4,337,856	\$ 0.000025	18.0	\$ 119.6
Exercised	(600,909)	\$ 0.000025		
Forfeited	—	—		
Outstanding and exercisable at September 30, 2019	<u>3,736,947</u>	\$ 0.000025	17.3	\$ 129.4

The total intrinsic value of the NSO Plan stock options exercised during the nine months ended September 30, 2019, was \$2.8 million.

### *Incentive and nonqualified stock-based plan*

Also in 2001, the Company established the Incentive and Nonqualified Stock-based Plan (“ISO Plan”) which was terminated in 2011 and was authorized to issue nonqualified stock options (“NQSO”) and incentive stock options (“ISO”) covering 11,153,872 shares of Class A common stock. The NQSO grants could be issued at less than the fair market value at date of grant under the terms of the ISO Plan, while ISO grants were issued at a price equal to or greater than the fair market value at date of grant. Options generally vested over a two to three-year period. All options have a contractual term of ten years from the date of grant.

The following table summarizes the stock option activity under the 2001 stock-based compensation plans for the period:

	<u>Number of options</u>	<u>Weighted average exercise price per share</u>	<u>Weighted average remaining contractual term (years)</u>	<u>Aggregate intrinsic value (in millions)</u>
Outstanding at January 1, 2019	532,220	\$ 0.65	1.4	\$ 14.3
Exercised	(271,278)	\$ 0.66		
Forfeited	—	—		
Outstanding and exercisable at September 30, 2019	<u>260,942</u>	\$ 0.64	0.6	\$ 8.9

The total intrinsic value of the ISO Plan stock options exercised during the nine months ended September 30, 2019, was \$9.3 million.

### *2012 stock-based compensation plans*

During 2012, the Company established the 2012 Incentive and Nonqualified Stock Option Plan (“2012 Plan”) which permits the issuance of 5,200,000 shares of Class A common stock for the grant of nonqualified stock options and incentive stock options for management, other employees, and board members of the Company. The options are issued at a price equal to or greater than fair market value at date of grant. All options have a contractual term of 10 years from date of grant.

The 2012 Plan is accounted for as an equity plan. For those options expected to vest, compensation expense is recognized on a straight-line basis over a four-year period, the total requisite service period of the awards. Total compensation cost related to nonvested awards not yet recognized as of September 30, 2019, totaled \$0.5 million, and is expected to be recognized over a weighted average period of 1.3 years.

The following table summarizes the stock option activity under the 2012 Plan for the period:

	<u>Number of options</u>	<u>Weighted average exercise price per share</u>	<u>Weighted average remaining contractual term (years)</u>	<u>Aggregate intrinsic value (in millions)</u>
Outstanding at January 1, 2019	1,541,165	\$ 4.12	6.9	\$ 36.2
Granted	—	—		
Exercised	(299,089)	\$ 3.76		
Forfeited	(6,772)	\$ 4.56		
Outstanding at September 30, 2019	<u>1,235,304</u>	\$ 4.21	6.3	
Exercisable at September 30, 2019	<u>859,107</u>	\$ 3.95	5.9	\$ 26.4

The total intrinsic value of the 2012 Plan stock options exercised during the nine months ended September 30, 2019, was \$9.7 million.

### *Other*

In connection with the acquisition of Datawatch, all outstanding unvested Datawatch RSUs were converted into a right to receive cash (the “Replacement Awards”). The payment to the holders of unvested Datawatch RSUs will be payable on or after the date that such RSUs would have otherwise vested in accordance with its original terms.

The accounting treatment for the outstanding unvested Datawatch RSUs in the context of the business combination was to allocate the fair value of the RSUs at the date of consummation attributable to pre-combination service to the aggregate merger consideration. The difference between the fair value of the Replacement Awards and the amount allocable to pre-combination service was considered a post-combination expense to the Company after the consummation date.

The estimated post combination expense to the Company as a result of the business combination was approximately \$3.4 million which will be recognized on a straight-line basis over the remaining service period that was stipulated in each holder's original RSU agreement. The weighted average remaining service period is 1.25 years. Once the vesting conditions of the service period are met, Altair will cash-settle the Replacement Awards. The liability related to the Datawatch RSUs as of September 30, 2019 and December 31, 2018, was \$0.3 million and \$0.6 million, respectively, and is recorded in other accrued expenses and current liabilities.

#### **2017 stock-based compensation plan**

In 2017, the Company's board of directors adopted the 2017 Equity Incentive Plan ("2017 Plan"), which was approved by the Company's stockholders. The 2017 Plan provides for the grant of incentive stock options to the Company's employees and any parent and subsidiary corporations' employees, and for the grant of nonstatutory stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, performance shares, other cash-based awards and other stock-based awards to the Company's employees, directors and consultants and the Company's parent, subsidiary, and affiliate corporations' employees and consultants. The 2017 Plan has 8,104,971 authorized shares of the Company's Class A common stock reserved for issuance.

The following table summarizes the restricted stock units, or RSUs, awarded under the 2017 Plan for the period:

	<b>Number of RSUs</b>
Outstanding at January 1, 2019	206,061
Granted	689,642
Vested	(54,388)
Forfeited	(39,330)
Outstanding at September 30, 2019	<u>801,985</u>

The weighted average grant date fair value of the RSUs was \$36.23 and the RSUs generally vest in four equal annual installments. Total compensation cost related to nonvested awards not yet recognized as of September 30, 2019, totaled \$25.4 million, and is expected to be recognized over a weighted average period of approximately four years.

The following table summarizes the stock option activity under the 2017 Plan for the period:

	<b>Number of options</b>	<b>Weighted average exercise price per share</b>	<b>Weighted average remaining contractual term (years)</b>	<b>Aggregate intrinsic value (in millions)</b>
Outstanding at January 1, 2019	—	\$ —		
Granted	20,000	\$ 38.11		
Exercised	—	\$ —		
Forfeited	—	\$ —		
Outstanding at September 30, 2019	<u>20,000</u>	\$ 38.11	9.5	
Exercisable at September 30, 2019	<u>—</u>	\$ —	—	\$ —

The Company measures the fair value of its equity awards on the date of grant using the Black-Scholes option pricing model. This valuation model requires the Company to make certain estimates and assumptions, including assumptions related to the expected price volatility of the Company's stock, the period under which the options will be outstanding, the rate of return on risk-free investments, and the expected dividend yield for the Company's stock.

The fair values of the Company's stock options granted during the nine months ended September 30, 2019, were estimated using the following assumptions:

	2019 grants
Weighted average grant date fair value per share	\$ 38.11
Expected volatility	42%
Expected term (in years)	6.25
Risk-free interest rate	1.80%
Expected dividend yield	0%

These assumptions and estimates are as follows:

- *Fair Value of Common Stock.* The Company used the publicly quoted price as reported on the Nasdaq Global Select Market as the fair value of its common stock.
- *Expected Term.* The Company used the simplified method to determine the expected term.
- *Risk-Free Interest Rate.* The Company based the risk-free interest rate on U.S. Treasury zero-coupon yield curves with a remaining term equal to the expected term of the option.
- *Expected Volatility.* As the Company does not have an extensive trading history for its common stock, the expected volatility was derived using the historical volatility of the returns of comparable publicly traded companies combined with the brief trading history of the Company's common stock.

### *Stock-based compensation expense*

The stock-based compensation expense was recorded as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Cost of revenue – software	\$ 384	\$ 8	\$ 727	\$ 24
Research and development	674	175	1,611	330
Sales and marketing	625	140	1,562	315
General and administrative	609	240	1,684	544
Total stock-based compensation expense	<u>\$ 2,292</u>	<u>\$ 563</u>	<u>\$ 5,584</u>	<u>\$ 1,213</u>

### **13. Other income, net**

Other income, net consists of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Foreign exchange loss (gain)	\$ 514	\$ (152)	\$ 694	\$ (732)
Other	(1,102)	(818)	(1,397)	(1,314)
Other income, net	<u>\$ (588)</u>	<u>\$ (970)</u>	<u>\$ (703)</u>	<u>\$ (2,046)</u>

#### 14. Income taxes

At the end of each interim period, the Company makes its best estimate of the annual expected effective income tax rate and applies that rate to its ordinary year-to-date income (loss) before income taxes. The income tax provision or benefit related to unusual or infrequent items, if applicable, that will be separately reported or reported net of their related tax effects are individually computed and recognized in the interim period in which those items occur. In addition, the effect of changes in enacted tax laws or rates, tax status, judgment on the realizability of a beginning-of-the-year deferred tax asset in future years or income tax contingencies is recognized in the interim period in which the change occurs.

The computation of the annual expected effective income tax rate at each interim period requires certain estimates and assumptions including, but not limited to, the expected income (loss) before income taxes for the year, projections of the proportion of income (and/or loss) earned and taxed in respective tax jurisdictions, including applicable foreign taxes withheld at the source, permanent and temporary differences, and the likelihood of the realizability of deferred tax assets generated in the current year. Jurisdictions with a projected loss for the year or a year-to-date loss for which no tax benefit can be recognized due to a valuation allowance are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter, based upon the composition and timing of actual earnings compared to annual projections. The estimates used to compute the provision or benefit for income taxes may change as new events occur, additional information is obtained or the Company's tax environment changes. To the extent that the expected annual effective income tax rate changes, the effect of the change on prior interim periods is included in the income tax provision in the period in which the change in estimate occurs.

The Company's income tax expense and effective tax rate for the three and nine months ended September 30, 2019 and 2018, were as follows (in thousands, except percentages):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Income tax expense	\$ 3,294	\$ 1,885	\$ 7,215	\$ 5,617
Effective tax rate	(26%)	67%	614%	19%

The tax rate is affected by the Company being a U.S. resident taxpayer, the tax rates in the U.S. and other jurisdictions in which the Company operates, the relative amount of income earned by jurisdiction and the relative amount of losses or income for which no benefit or expense is recognized. The effective tax rate was impacted by the geographic income mix in 2019 as compared to 2018, primarily related to United States pre-tax loss of \$17.5 million and \$12.3 million, respectively, for the three and nine months ended September 30, 2019, for which a tax benefit was not recognized due to the valuation allowance, compared to United States pre-tax income of \$2.8 million and \$14.8 million for the three and nine months ended September 30, 2018, for which tax expense was not recognized due to the valuation allowance. Partially offsetting the impact to the tax expense and the effective tax rate for September 30, 2019, was a reversal of a reserve recorded for uncertain tax positions of \$1.1 million.

#### 15. Accumulated other comprehensive loss

The components of accumulated other comprehensive loss were as follows (in thousands):

	Foreign currency translation	Retirement related benefit plans	Total
Balance at January 1, 2019	\$ (8,823)	\$ (2,467)	\$ (11,290)
Other comprehensive (loss) income before reclassification	(1,046)	87	(959)
Amounts reclassified from accumulated other comprehensive loss	—	289	289
Tax effects	—	—	—
Other comprehensive (loss) income	(1,046)	376	(670)
Balance at September 30, 2019	<u>\$ (9,869)</u>	<u>\$ (2,091)</u>	<u>\$ (11,960)</u>

## **16. Commitments and contingencies**

### ***Swedish Tax Litigation***

The Swedish Tax Authorities, or STA, have assessed tax (net of utilization of tax attributes), penalties and interest in the amount of \$6.6 million related to the acquisition of Panopticon AB by Datawatch Corporation, in 2013 for the years 2013, 2014 and 2015. The STA, upon auditing the acquisition transaction, reached a conclusion that post acquisition, certain assets were removed from Sweden, triggering the tax obligation. The STA is also of the opinion that some services related to product development provided to the new parent company in the U.S. were performed by Panopticon AB at a price below market price triggering tax obligations. Datawatch contested the findings by the STA throughout the audit process including contesting the STA position in the first level of administrative courts. An Administrative Court hearing was held on May 16, 2019. On May 29, 2019, the Administrative Court issued its ruling in favor of Datawatch AB. On July 4, 2019, the STA filed an appeal of the Administrative Court ruling with the Administrative Court of Appeal in Stockholm, effectively continuing to assert that the assessments are in fact appropriate. The Company continues to contest the assessment through the appeals process and in late September 2019, submitted its filing in response to the STA appeal with the Administrative Court of Appeal in Stockholm. The Company has determined that these events do not cause a change in the assessment of uncertain tax positions.

### ***Potential Export Violation***

As previously disclosed on Form 8-K on May 10, 2019, the Company discovered potential violations of U.S. economic sanctions and export control laws and immediately filed preliminary self-disclosure notices with the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") and the U.S. Commerce Department's Bureau of Industry & Security ("BIS").

The Company subsequently conducted an internal investigation into these issues under the direction of outside legal counsel and filed voluntary self-disclosures with both agencies on July 25, 2019. These disclosures describe the unintentional transfer of commercial software and trial software licenses to various individuals located in Iran and other restricted countries. These transfers involved freeware, trial software licenses, and volunteer software testing communities. The Company did not discover any evidence indicating any commercial transactions with restricted parties or countries.

In addition to filing voluntary self-disclosures with OFAC and BIS, the Company has implemented a series of additional compliance measures to prevent unintentional transfers of the sort described above. These measures will further enhance the Company's international trade compliance program, which is designed to assure that the Company does not conduct business directly or indirectly with any countries or parties subject to U.S. economic sanctions and export control laws.

On August 30, 2019, BIS notified the Company that it had completed its investigation of the potential violation of U.S. export control laws by the Company and concluded that no criminal or administrative prosecution was warranted and closed the matter.

Although OFAC has not notified the Company of its findings or the completion of its investigations, the Company does not currently have any reason to believe that its voluntary self-disclosures (or any related U.S. Government investigations) will have a meaningful impact on its operations, results of operations for any future period, or financial condition.

### ***Other legal proceedings***

From time to time, the Company may be subject to legal proceedings and claims in the ordinary course of business. The Company has received, and may in the future continue to receive, claims from third parties asserting, among other things, infringement of their intellectual property rights. Future litigation may be necessary to defend the Company, its partners and its customers by determining the scope, enforceability and validity of third party proprietary rights, or to establish and enforce the Company's proprietary rights. The results of any current or future litigation cannot be predicted with certainty and regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources and other factors.

## **17. Segment information**

The Company defines its operating segments as components of its business where separate financial information is available and used by the chief operating decision maker ("CODM") in deciding how to allocate resources to its segments and in assessing performance. The Company's CODM is its Chief Executive Officer.

The Company has identified two reportable segments for financial reporting purposes: Software and Client Engineering Services, or “CES”. The primary measure of segment operating performance is Adjusted EBITDA, which is defined as net income (loss) adjusted for income tax expense (benefit), interest expense, interest income and other, depreciation and amortization, stock-based compensation expense, restructuring charges, asset impairment charges and other special items as determined by management. Adjusted EBITDA includes an allocation of corporate headquarters costs.

The Software reportable segment derives revenue from the sale and subscription of licenses for software products focused on the development and application of simulation, high performance computing, and data intelligence technology to synthesize and optimize designs, processes and decisions for improved business performance. The Software segment also derives revenue from software support, upgrades, training and consulting services focused on product design and development expertise, high performance computing, data intelligence, and analysis support throughout product lifecycles. To a much lesser extent, the Software segment also includes revenue from the sale of hardware products, primarily as a result of recent business acquisitions.

The Client Engineering Services reportable segment provides support to its customers with long-term ongoing product design and development expertise in its market segments of Solvers & Optimization, Modeling & Visualization, Industrial & Concept Design, and High Performance Computing. The Company hires simulation specialists, industrial designers, design engineers, materials experts, development and test specialists, manufacturing engineers, data scientists and information technology specialists for placement at customer sites for specific customer-directed assignments.

The “All other” represents innovative services and products, including toggled®, the Company’s LED lighting business. toggled® is focused on developing and selling next-generation solid state lighting technology along with communication and control protocols based on intellectual property for the direct replacement of fluorescent light tubes with LED lamps. Other businesses combined within Other include the Company’s WEYV business, which was terminated in the third quarter of 2019, and potential services and product concepts that are still in development stages. See Note 5 for further information about the termination of the WEYV business.

Inter-segment sales are not significant for any period presented. The CODM does not review asset information by segment when assessing performance; therefore, no asset information is provided for reportable segments.

The following tables are in thousands:

<b>Three Months Ended September 30, 2019</b>	<b>Software</b>	<b>CES</b>	<b>All other</b>	<b>Total</b>
Revenue	\$ 85,772	\$ 12,803	\$ 1,831	\$ 100,406
Adjusted EBITDA	\$ (2,834)	\$ 1,707	\$ (1,208)	\$ (2,335)

<b>Three Months Ended September 30, 2018</b>	<b>Software</b>	<b>CES</b>	<b>All other</b>	<b>Total</b>
Revenue	\$ 72,874	\$ 12,155	\$ 1,722	\$ 86,751
Adjusted EBITDA	\$ 1,858	\$ 1,407	\$ (866)	\$ 2,399

<b>Nine Months Ended September 30, 2019</b>	<b>Software</b>	<b>CES</b>	<b>All other</b>	<b>Total</b>
Revenue	\$ 291,150	\$ 37,265	\$ 6,623	\$ 335,038
Adjusted EBITDA	\$ 26,415	\$ 4,280	\$ (3,881)	\$ 26,814

<b>Nine Months Ended September 30, 2018</b>	<b>Software</b>	<b>CES</b>	<b>All other</b>	<b>Total</b>
Revenue	\$ 251,330	\$ 36,652	\$ 5,386	\$ 293,368
Adjusted EBITDA	\$ 35,604	\$ 3,971	\$ (2,323)	\$ 37,252

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
<b>Reconciliation of Adjusted EBITDA to U.S. GAAP (Loss) income before income taxes:</b>				
Adjusted EBITDA	\$ (2,335)	\$ 2,399	\$ 26,814	\$ 37,252
Stock-based compensation expense	(2,292)	(563)	(5,584)	(1,213)
Interest expense	(2,726)	(31)	(3,586)	(92)
Interest income and other (1)	76	4,384	(633)	5,103
Depreciation and amortization	(5,368)	(3,370)	(15,836)	(10,895)
(Loss) income before income taxes	\$ (12,645)	\$ 2,819	\$ 1,175	\$ 30,155

(1) Included in 2019 are a) nonrecurring severance expenses of \$ 0.4 million and nonrecurring acquisition related costs of \$ 0.6 million, for both the three and nine months ended September 30, 2019, and b) impairment charges for royalty contracts resulting in \$1.0 million of expense for the nine months ended September 30, 2019.

Included in 2018 are a) a gain on the sale of a building of \$ 4.4 million for the three and nine months ended September 30, 2018, b) impairment charges for royalty contracts and trade names resulting in \$0.8 million and \$ 2.6 million of expense for the three and nine months ended September 30, 2018, respectively, and c) a non-recurring adjustment for a change in estimated legal expenses resulting in \$2.0 million of income for the nine months ended September 30, 2018.

## 18. Subsequent events

### *Acquisition of Polliwog*

In October 2019, the Company entered into a stock purchase agreement (the “Stock Purchase Agreement”) and simultaneously acquired 97% of the outstanding capital stock of Polliwog Co. Ltd. (“Polliwog”), a software company based near Seoul, Korea, for aggregate consideration of \$26.2 million. Simultaneously, the Company entered into a separate stock purchase agreement (the “Second Stock Purchase Agreement”) with one of Polliwog’s stockholders to acquire the remaining 3% of the outstanding Polliwog shares in October 2022. Polliwog is a supplier of Electronic Design Automation software to the global electronics industry, which will expand Altair’s ability to provide software for system-level design decisions. The Company believes Polliwog’s printed circuit board solvers and verification tools will integrate well with Altair’s existing HyperWorks software solutions.

The consideration consisted of cash in the amount of \$10.7 million, subject to a customary working capital adjustment, and an aggregate of 459,539 shares of the Company’s Class A Common Stock, par value \$0.0001 per share (the “SPA Stock Consideration”). Forty percent of the SPA Stock Consideration (183,815 shares) was issued at closing (which occurred concurrently with the execution of the Stock Purchase Agreement) and is subject to customary securities law restrictions on transferability for the first six months after the closing. The remaining sixty percent (an aggregate of 275,724 shares) of the SPA Stock Consideration will be issuable in equal installments of 91,908 shares on each of the one, two and three year anniversaries of the closing subject to potential reduction in certain circumstances. The Company will pay an additional \$0.3 million in cash and issue an additional 14,213 shares of its Class A Common Stock at the closing under the Second Stock Purchase Agreement, representing three percent of the aggregate consideration to be paid by Altair to acquire all of Polliwog’s outstanding capital stock.

### *Acquisition of DEM Solutions Limited*

In November 2019, the Company entered into a stock purchase agreement and simultaneously acquired 100% of the outstanding capital stock of DEM Solutions Limited, a company that provides market-leading Discrete Element Method (DEM) software for bulk material simulation, based in Edinburgh, UK.



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this quarterly report and with our audited consolidated financial statements (and notes thereto) for the year ended December 31, 2018, included in our Annual Report on Form 10-K filed with the SEC. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below.*

### CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 under Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions and future performance, and involve known and unknown risks, uncertainties and other factors, which may be beyond our control, and which may cause our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be forward-looking statements. You can identify these forward-looking statements through our use of words such as “may,” “can,” “anticipate,” “assume,” “should,” “indicate,” “would,” “believe,” “contemplate,” “expect,” “seek,” “estimate,” “continue,” “plan,” “point to,” “project,” “predict,” “could,” “intend,” “target,” “potential” and other similar words and expressions of the future.

There are a number of important factors that could cause the actual results to differ materially from those expressed in any forward-looking statement made by us. These factors include, but are not limited to:

- our ability to acquire new customers because of the difficulty in predicting our software sales cycles;
- reduced spending on product design and development activities by our customers;
- our dependence on annual renewals of our software licenses;
- our ability to maintain or protect our intellectual property;
- our ability to retain key executive members;
- our ability to internally develop new inventions and intellectual property;
- our ability to successfully integrate and realize the benefits of our past or future strategic acquisitions or investments;
- demand for our software by customers other than simulation engineering specialists and in additional industry verticals;
- acceptance of our business model by investors;
- our ability to integrate companies that we have acquired or may acquire in the future;
- our susceptibility to factors affecting the automotive and financial services industries where we derive a substantial portion of our revenues;
- the accuracy of our estimates regarding expenses and capital requirements;
- our susceptibility to foreign currency risks that arise because of our substantial international operations; and
- the significant quarterly fluctuations of our results.

The foregoing does not represent an exhaustive list of matters that may be covered by the forward-looking statements contained herein or risk factors that we are faced with that may cause our actual results to differ from those anticipated in our forward-looking statements. For additional risks which could adversely impact our business and financial performance please see “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the SEC, on March 1, 2019, and in Item 1A, Part II of this Quarterly Report on Form 10-Q and other information appearing elsewhere in our Annual Report on Form 10-K, this report on Form 10-Q and our other filings with the SEC.

All forward-looking statements are expressly qualified in their entirety by this cautionary notice. You are cautioned not to place undue reliance on any forward-looking statements, which speak only as of the date of this report or the date of the document incorporated by reference into this report. We have no obligation, and expressly disclaim any obligation, to update, revise or correct any of the forward-looking statements, whether as a result of new information, future events or otherwise. We have expressed our expectations, beliefs and projections in good faith, and we believe they have a reasonable basis. However, we cannot assure you that our expectations, beliefs or projections will result or be achieved or accomplished.

## **Overview**

We are a global technology company providing software and cloud solutions in the areas of product design and development, high performance computing, or HPC, and data intelligence. We enable organizations across broad industry segments to compete more effectively in a connected world while creating a more sustainable future.

Our simulation-driven approach to innovation is powered by our broad portfolio of high-fidelity and high-performance physics solvers. Our integrated suite of software optimizes design performance across multiple disciplines encompassing structures, motion, fluids, thermal management, electromagnetics, system modeling, and embedded systems, while also providing data intelligence and true-to-life visualization and rendering.

Altair’s software products represent a comprehensive, open architecture solution for simulation, data intelligence and cloud computing to empower decision making for improved product development, manufacturing, energy management and exploration, financial services, health care, and retail operations. We believe our products offer a comprehensive set of technologies to design and optimize high performance, efficient, innovative and sustainable products and processes in an increasingly connected world. Our products are categorized by:

- Design, Modeling & Visualization;
- Physics Simulation;
- Data Intelligence;
- High Performance Cloud Computing; and
- Internet of Things, or IoT.

Altair also provides client engineering services, or CES, to support our customers with long-term ongoing expertise. This has the benefit of embedding us within customers, deepening our understanding of their processes, and allowing us to more quickly perceive trends in the overall market. Our presence at our customers’ sites helps us to better tailor our software products’ research and development, or R&D, and sales initiatives.

## **Acquisition of Polliwog**

In October 2019, the Company entered into a stock purchase agreement (the “Stock Purchase Agreement”) and simultaneously acquired 97% of the outstanding capital stock of Polliwog Co. Ltd. (“Polliwog”), a software company based near Seoul, Korea, for aggregate consideration of \$26.2 million. Simultaneously, the Company entered into a separate stock purchase agreement (the “Second Stock Purchase Agreement”) with one of Polliwog’s stockholders to acquire the remaining 3% of the outstanding Polliwog shares in October 2022. Polliwog is a supplier of Electronic Design Automation software to global electronics industry customers, which will expand Altair’s ability to provide software for system-level design decisions. The Company believes Polliwog’s printed circuit board solvers and verification tools will integrate well with Altair’s existing HyperWorks software solutions.

The consideration consisted of cash in the amount of \$10.7 million, subject to a customary working capital adjustment, and an aggregate of 459,539 shares of the Company's Class A Common Stock, par value \$0.0001 per share (the "SPA Stock Consideration"). Forty percent of the SPA Stock Consideration (183,815 shares) was issued at closing (which occurred concurrently with the execution of the Stock Purchase Agreement) and is subject to customary securities law restrictions on transferability for the first six months after the closing. The remaining sixty percent (an aggregate of 275,724 shares) of the SPA Stock Consideration will be issuable in equal installments of 91,908 shares on each of the one, two and three year anniversaries of the closing, subject to potential reduction in certain circumstances. The Company will pay an additional \$0.3 million in cash and issue an additional 14,213 shares of its Class A Common Stock at the closing under the Second Stock Purchase Agreement, representing three percent of the aggregate consideration to be paid by Altair to acquire all of Polliwog's outstanding capital stock.

#### **Convertible Senior Notes**

In June 2019, we issued \$230.0 million aggregate principal amount of 0.25% convertible senior notes due in 2024 (the "Notes"), which includes the underwriters' exercise in full of their option to purchase an additional \$30.0 million principal amount of the Convertible Notes, in a public offering. The net proceeds from the issuance of the Convertible Notes were \$221.9 million after deducting the underwriting discounts and commissions and estimated issuance costs.

In conjunction with the issuance of the Convertible Notes, we entered into a base indenture and a supplemental indenture by and between the Company and U.S. Bank National Association (collectively, the "Indenture"). The Indenture includes customary covenants and sets forth certain events of default after which the Convertible Notes may be declared immediately due and payable and sets forth certain types of bankruptcy or insolvency events of default involving the Company after which the Convertible Notes become automatically due and payable. The Convertible Notes are senior unsecured obligations of the Company.

The Convertible Notes bear interest at a rate of 0.25% per year, payable semi-annually in arrears on June 1 and December 1 of each year, commencing December 1, 2019. The Convertible Notes will mature on June 1, 2024, unless, earlier repurchased or redeemed by us or converted pursuant to their terms.

The Convertible Notes have an initial conversion rate of 21.5049 shares of our Class A common stock per \$1,000 principal amount of Convertible Notes, which is equivalent to an initial conversion price of approximately \$46.50 per share of our Class A common stock. The conversion rate will be subject to adjustment upon the occurrence of certain events specified in the Indenture but will not be adjusted for any accrued and unpaid interest. In addition, upon the occurrence of a make whole fundamental change or a redemption period (each as defined in the Indenture), we will, in certain circumstances, increase the conversion rate by a specified number of additional shares for a holder who elects to convert its Convertible Notes in connection with such make whole fundamental change or during the relevant redemption period.

Holders of the Convertible Notes may convert all or any portion of their Convertible Notes at any time prior to the close of business on December 1, 2023, in integral multiples of \$1,000 principal amount, only under the following circumstances:

- During any calendar quarter commencing after the calendar quarter ending on September 30, 2019 (and only during such calendar quarter), if the last reported sale price of the Class A Common Stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- During the five business day period after any five consecutive trading day period (the "measurement period") in which the trading price (as defined in the Indenture) per \$1,000 principal amount of Convertible Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Class A Common Stock and the conversion rate on each such trading day;
- If we call any or all of the Convertible Notes for redemption (which the Company may not do prior to June 6, 2022), at any time prior to the close of business on the scheduled trading day immediately preceding the redemption date; or
- Upon the occurrence of specified corporate events.

On or after December 1, 2023 until the close of business on the business day immediately preceding the maturity date, holders may convert their Convertible Notes at any time, regardless of the foregoing circumstances. Upon conversion, we may satisfy our conversion obligation by paying and/or delivering, as the case may be, cash, shares of Class A Common Stock or a combination of cash and shares of the Class A Common Stock, at our election, in the manner and subject to the terms and conditions provided in the Indenture.

#### **Credit agreement**

In June 2019, we amended our \$150.0 million credit facility to, among other things, permit the issuance of the Convertible Notes and extend the maturity date of the credit facility to December 15, 2023.

#### **Factors Affecting our Performance**

We believe that our future success will depend on many factors, including those described below. While these areas present significant opportunity, they also present risks that we must manage to achieve successful results. If we are unable to address these challenges, our business, operating results and prospects could be harmed. Please see “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2018, as filed with the SEC on March 1, 2019, and in Item 1A, Part II of this Quarterly Report on Form 10-Q.

#### ***Seasonality and quarterly results***

Our billings have historically been highest in the first and fourth quarters of any calendar year and may vary in future quarters. The timing of recording billings and the corresponding effect on our cash flows may vary due to the seasonality of the purchasing patterns of our customers. In addition, the timing of the recognition of revenue, the amount and timing of operating expenses, including employee compensation, sales and marketing activities, and capital expenditures, may vary from quarter-to-quarter which may cause our reported results to fluctuate significantly. In addition, we may choose to grow our business for the long-term rather than to optimize for profitability or cash flows for a particular shorter-term period. This seasonality or the occurrence of any of the factors above may cause our results of operations to vary and our financial statements may not fully reflect the underlying performance of our business.

#### ***Integration of recent acquisitions***

We believe that our recent acquisitions result in certain benefits, including expanding our portfolio of software and products and enabling us to better serve our customer’s requests for data intelligence and simulation technology. However, to realize some of these anticipated benefits, the acquired businesses must be successfully integrated. The success of these acquisitions will depend in part on our ability to realize these anticipated benefits. We may fail to realize the anticipated benefits of these acquisitions for a variety of reasons.

#### ***Foreign currency fluctuations***

Because of our substantial international operations, we are exposed to foreign currency risks that arise from our normal business operations, including in connection with our transactions that are denominated in foreign currencies, including the Euro, British Pound Sterling, Indian Rupee, Japanese Yen, and Chinese Yuan. To present the changes in our underlying business without regard to the impact of currency fluctuations, we evaluate certain of our operating results both on an as reported basis, as well as on a constant currency basis.

Constant currency amounts exclude the effect of foreign currency fluctuations on our reported results. Our comparative financial results were impacted by fluctuations in the value of the United States dollar relative to other currencies during the three and nine months ended September 30, 2019, as compared to the three and nine months ended September 30, 2018. To present this information, the results for 2019 for entities whose functional currency is a currency other than the United States dollar were converted to United States dollars at rates that were in effect for 2018. These adjusted amounts are then compared to our current period reported amounts to provide operationally driven variances in our results.

The effects of currency fluctuations on our Revenue, Adjusted EBITDA, and Billings are reflected in the table below. Amounts in brackets indicate a net adverse impact from currency fluctuations.

(in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2019		September 30, 2019	
Revenue	\$	(1,354)	\$	(8,278)
Adjusted EBITDA	\$	(180)	\$	(1,687)
Billings	\$	(1,825)	\$	(7,881)

#### *Expanded use of our software applications*

Our ability to grow our revenue is affected, in part, by the pace at which our customers continue to expand their use of our design, simulation, optimization and analysis applications, our suite of data intelligence products and the degree to which prospective customers realize the benefit of using our software applications. To grow our presence within our customers and attract new customers, we devote substantial sales and marketing resources to drive increased adoption across our existing customers and encourage new customers to commence using our software. As a result of this “land and expand” business model, we expect to generate additional revenue from our current and future customer base. To the extent our sales and marketing efforts do not translate into customer retention or expansion, or if we do not allocate those expenses efficiently, our financial performance may be adversely affected. Therefore, our financial performance will depend in part on the degree to which our “land and expand” strategies are successful.

#### *Investments for growth*

We have made and plan to continue to make investments for long-term growth, including investments in our ongoing research and development activities seeking to create new software and to enhance our existing applications to address emerging technology trends and additional customer needs. Generally, the development of new or improved applications in our software can result in the expansion of our user base within an organization and a potential increase in revenue over time, although the expenditures associated with such developments may adversely affect our performance in the near term. We intend to continue to invest resources in sales and marketing, by further expanding our sales teams and increasing our marketing activities. Our ability to continue to grow revenue from our current and potential customer base is dependent, in part, upon the success of our current and future research and development and sales and marketing activities.

#### Business Segments

We have identified two reportable segments: Software and Client Engineering Services:

- *Software* —Our Software segment includes software and software related services. The software component of this segment includes our portfolio of software products including our solvers and optimization technology products, modeling and visualization tools, data intelligence and analysis products, high performance computing, or HPC, software applications and hardware products, IoT platform and analytics tools as well as support and the complementary software products we offer through our Altair Partner Alliance, or APA. The APA includes technologies ranging from computational fluid dynamics and fatigue to manufacturing process simulation and cost estimation. The software related services component of this segment includes consulting, implementation services, and training focused on product design and development expertise and analysis from the component level up to complete product engineering at any stage of the lifecycle.
- *Client Engineering Services* —Our client engineering services, or CES, segment provides client engineering services to support our customers with long-term, ongoing expertise. We operate our CES business by hiring engineers and data scientists for placement at a customer site for specific customer-directed assignments. We employ and pay them only for the duration of the placement.

Our other businesses which do not meet the criteria to be separate reportable segments are combined and reported as “Other” which represents innovative services and products, including toggled, our LED lighting business. toggled is focused on developing and selling next-generation solid state lighting technology along with communication and control protocols based on our intellectual property for the direct replacement of fluorescent light tubes with LED lamps. Other businesses combined within Other include our WEYV business, which was terminated in the third quarter of 2019, and potential services and product concepts that are still in development stages. See Note 5 in the Notes to consolidated financial statements for further information about the termination of the WEYV business.

For additional information about our reportable segments and other businesses, see Note 17 in the Notes to consolidated financial statements in Item 1, Part I of this Quarterly Report on Form 10-Q.

## Results of operations

### Comparison of the three months ended September 30, 2019 and 2018

The following table sets forth the results of operations and the period-over-period percentage change in certain financial data for the three and nine months ended September 30, 2019 and 2018:

(in thousands)	Three Months Ended September 30,		Increase / (decrease) %	Nine Months Ended September 30,		Increase / (decrease) %
	2019	2018		2019	2018	
<b>Revenue:</b>						
Software	\$ 77,816	\$ 64,182	21%	\$ 265,515	\$ 224,458	18%
Software related services	7,956	8,692	(8%)	25,635	26,872	(5%)
Total software and related services	85,772	72,874	18%	291,150	251,330	16%
Client engineering services	12,803	12,155	5%	37,265	36,652	2%
Other	1,831	1,722	6%	6,623	5,386	23%
Total revenue	100,406	86,751	16%	335,038	293,368	14%
<b>Cost of revenue:</b>						
Software	13,919	9,831	42%	40,655	32,736	24%
Software related services	6,013	6,352	(5%)	19,143	19,573	(2%)
Total software and related services	19,932	16,183	23%	59,798	52,309	14%
Client engineering services	10,160	9,817	3%	29,993	29,977	—%
Other	1,649	1,204	37%	5,858	3,416	71%
Total cost of revenue	31,741	27,204	17%	95,649	85,702	12%
Gross profit	68,665	59,547	15%	239,389	207,666	15%
<b>Operating expenses:</b>						
Research and development	29,667	24,301	22%	87,012	71,748	21%
Sales and marketing	25,790	19,243	34%	78,462	57,849	36%
General and administrative	20,706	17,234	20%	60,886	51,636	18%
Amortization of intangible assets	3,545	1,739	104%	10,673	5,665	88%
Other operating income, net	(536)	(4,850)	(89%)	(1,702)	(7,433)	(77%)
Total operating expenses	79,172	57,667	37%	235,331	179,465	31%
Operating (loss) income	(10,507)	1,880	NM	4,058	28,201	(86%)
Interest expense	2,726	31	NM	3,586	92	NM
Other income, net	(588)	(970)	(39%)	(703)	(2,046)	(66%)
(Loss) income before income taxes	(12,645)	2,819	NM	1,175	30,155	(96%)
Income tax expense	3,294	1,885	75%	7,215	5,617	28%
Net (loss) income	\$ (15,939)	\$ 934	NM	\$ (6,040)	\$ 24,538	NM
<b>Other financial information:</b>						
Billings <sup>(1)</sup>	\$ 103,643	\$ 84,926	22%	\$ 345,562	\$ 290,490	19%
Adjusted EBITDA <sup>(2)</sup>	\$ (2,335)	\$ 2,399	NM	\$ 26,814	\$ 37,252	(28%)
Net cash (used in) provided by operating activities	\$ (1,863)	\$ 3,109	NM	\$ 30,005	\$ 40,422	(26%)
Free cash flow <sup>(3)</sup>	\$ (3,316)	\$ 906	NM	\$ 21,885	\$ 35,089	(38%)

NM Not meaningful.

- (1) Billings consists of our total revenue plus the change in our deferred revenue, excluding deferred revenue from acquisitions. For more information about Billings and our other non-GAAP financial measures and reconciliations of our non-GAAP financial measures to the most directly comparable financial measures calculated and presented in accordance with GAAP, see "Non-GAAP financial measures" contained herein.
- (2) We define Adjusted EBITDA as net income (loss) adjusted for income tax expense (benefit), interest expense, interest income and other, depreciation and amortization, stock-based compensation expense, restructuring charges, asset impairment charges and other special items as determined by management. For more information about Adjusted EBITDA and our other non-GAAP financial measures and reconciliations of our non-GAAP financial measures to the most directly comparable financial measure calculated and presented in accordance with GAAP, see "Non-GAAP financial measures" contained herein.
- (3) We define Free Cash Flow as net cash provided by operating activities less capital expenditures. For a reconciliation of Free Cash Flow, see "Non-GAAP financial measures" contained herein.

The following table sets forth our revenue growth on a constant currency basis for the three and nine months ended September 30, 2019, compared to the three and nine months ended September 30, 2018:

(dollars in thousands)	Three Months Ended September 30,		Change %	Constant currency change(1) %	Nine Months Ended September 30,		Change %	Constant currency change(1) %
	2019	2018			2019	2018		
<b>Revenue:</b>								
Software	\$ 77,816	\$ 64,182	21%	23%	\$ 265,515	\$ 224,458	18%	21%
Software related services	7,956	8,692	(8%)	(6%)	25,635	26,872	(5%)	—%
Total software and related services	85,772	72,874	18%	19%	291,150	251,330	16%	19%
Client engineering services	12,803	12,155	5%	5%	37,265	36,652	2%	2%
Other	1,831	1,722	6%	6%	6,623	5,386	23%	23%
Total revenue	<u>\$ 100,406</u>	<u>\$ 86,751</u>	16%	17%	<u>\$ 335,038</u>	<u>\$ 293,368</u>	14%	17%

(1) The results for entities whose functional currency is a currency other than the United States dollar were converted to United States dollars at rates that were in effect for the corresponding period of the prior year.

### Three months ended September 30, 2019 and 2018

#### Revenue

Total revenue increased by \$13.7 million, or 16%, for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. The increase was primarily attributable to an increase in software revenue.

#### Software

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Software revenue	\$ 77,816	\$ 64,182	\$ 13,634	21%
As a percent of software segment revenue	91%	88%		
As a percent of consolidated revenue	78%	74%		

The 21% increase in our software revenue for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018, was primarily the result of an expansion in the number of units licensed by our existing customers under renewed software license agreements and licensing of units to new customers pursuant to new software license agreements. Also contributing to the increase in the current year, was revenue attributable to recent acquisitions. Our performance for the three months ended September 30, 2019, was affected by adverse shifts in certain foreign currencies. On a constant currency basis, our software revenue increased by 23% for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018.

#### Software related services

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Software related services revenue	\$ 7,956	\$ 8,692	\$ (736)	(8%)
As a percent of software segment revenue	9%	12%		
As a percent of consolidated revenue	8%	10%		

Software related services revenue decreased 8% for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. This decrease was primarily the result of a decline in revenue from consulting services. On a constant currency basis, our software related services revenue decreased by 6% for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018.

*Client engineering services*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Client engineering services revenue	\$ 12,803	\$ 12,155	\$ 648	5%
As a percent of consolidated revenue	13%	14%		

The 5% increase in CES revenue for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018, was primarily due to an increase in our ability to fulfill demand for our client engineering services. Our CES business is primarily affected by customer demand and our ability to fill customers' open positions.

*Other*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Other revenue	\$ 1,831	\$ 1,722	\$ 109	6%
As a percent of consolidated revenue	2%	2%		

The 6% increase in other revenue for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018, was due to increased revenue from toggled, our LED lighting business, driven by increased product unit sales.

**Cost of revenue***Software*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Cost of software revenue	\$ 13,919	\$ 9,831	\$ 4,088	42%
As a percent of software revenue	18%	15%		
As a percent of consolidated revenue	14%	11%		

Cost of software revenue increased by \$4.1 million, or 42%, for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. This increase in the current year period was due to increased employee compensation and related costs of \$1.8 million, increased hardware costs of \$1.2 million, increased third party royalty costs of \$0.4 million and increased stock-based compensation expense of \$0.4 million.

*Software related services*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Cost of software related services revenue	\$ 6,013	\$ 6,352	\$ (339)	(5%)
As a percent of software related services revenue	76%	73%		
As a percent of consolidated revenue	6%	7%		

Cost of software related services revenue decreased 5% for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. The decrease in the current year period was primarily due to fluctuations in foreign currency.

*Client engineering services*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Cost of client engineering services revenue	\$ 10,160	\$ 9,817	\$ 343	3%
As a percent of client engineering services revenue	79%	81%		
As a percent of consolidated revenue	10%	11%		



Cost of CES revenue increased 3% for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018, due to compensation expenses associated with a larger number of placements to meet customer demand.

*Other*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Cost of other revenue	\$ 1,649	\$ 1,204	\$ 445	37%
As a percent of other revenue	90%	70%		
As a percent of consolidated revenue	2%	1%		

Cost of other revenue increased \$0.4 million, or 37%, for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. This increase is due to greater unit sales volumes at lower selling prices in excess of cost reductions for products sold for our LED lighting business.

*Gross profit*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Gross profit	\$ 68,665	\$ 59,547	\$ 9,118	15%
As a percent of consolidated revenue	68%	69%		

Gross profit increased by \$9.1 million, or 15%, for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. This increase in gross profit was primarily attributable to the growth of our software revenue of \$13.6 million driven by the factors described above. The increase in revenue was partially offset by the increase in cost of revenue as described above and resulted in the 1% decrease of gross margin in the current year.

*Operating expenses*

Operating expenses, as discussed below, support all the products and services that we provide to our customers and, as a result, they are reported and discussed here in the aggregate.

*Research and development*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Research and development	\$ 29,667	\$ 24,301	\$ 5,366	22%
As a percent of consolidated revenue	30%	28%		

Research and development expenses increased by \$5.4 million, or 22%, for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. This increase was primarily attributable to higher employee costs of \$3.1 million from an increase in our headcount, primarily due to acquisitions, an \$0.9 million increase in outsourced development fees as a result of acquisitions, a \$0.5 million increase in stock-based compensation expense and a \$0.3 million increase in software maintenance expense.

*Sales and marketing*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Sales and marketing	\$ 25,790	\$ 19,243	\$ 6,547	34%
As a percent of consolidated revenue	26%	22%		

Sales and marketing expenses increased by \$6.5 million, or 34%, for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. Employee compensation and related expense increased \$4.5 million, primarily due to acquisitions. Travel and trade show related expense increased \$0.9 million and stock-based compensation expense increased by \$0.5 million in the three months ended September 30, 2019, as compared to the three months ended September 30, 2018.

*General and administrative*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
General and administrative	\$ 20,706	\$ 17,234	\$ 3,472	20%
As a percent of consolidated revenue	21%	20%		

General and administrative expenses increased by \$3.5 million, or 20%, for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. This increase was primarily attributable to a \$1.4 million increase in employee compensation and related expenses, a \$0.4 million increase in rent expense, a \$0.4 million increase in stock-based compensation expense, a \$0.3 million increase in professional fees and a \$0.2 million increase in software maintenance expense.

*Amortization of intangible assets*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Amortization of intangible assets	\$ 3,545	\$ 1,739	\$ 1,806	104%
As a percent of consolidated revenue	4%	2%		

Amortization of intangible assets increased by \$1.8 million for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. This was attributable to an increase in the amortization of developed technology and customer relationships in the current year period as a result of 2018 acquisitions.

*Other operating income, net*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Other operating income, net	\$ (536)	\$ (4,850)	\$ (4,314)	(89%)
As a percent of consolidated revenue	(1%)	(6%)		

Other operating income decreased \$4.3 million for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. The prior year period includes of a gain on the sale of a building for \$4.4 million, offset in part by impairment of trade names for \$0.6 million as a result of rebranding certain products.

*Interest expense*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Interest expense	\$ 2,726	\$ 31	\$ 2,695	NM
As a percent of consolidated revenue	3%	—%		

Interest expense increased \$2.7 million for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. The increase in interest expense was primarily the result of amortization of the debt discount and issuance costs on the Convertible Notes in the current year.

*Other income, net*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Other income, net	\$ (588)	\$ (970)	\$ (382)	39%
As a percent of consolidated revenue	(1%)	(1%)		

Other income, net decreased by \$0.4 million for the three months ended September 30, 2019, as compared to the three months ended September 30, 2018. This decrease was due to a \$0.7 million increase in foreign currency due to fluctuations in the United States dollar relative to other functional currencies offset by a \$0.3 million increase in interest income during the three months ended September 30, 2019, compared to the three months ended September 30, 2018.

#### *Income tax expense*

(in thousands)	Three Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Income tax expense	\$ 3,294	\$ 1,885	\$ 1,409	75%

The effective tax rate was (26)% and 67% for the three months ended September 30, 2019 and 2018, respectively. The tax rate is affected by the Company being a U.S. resident taxpayer, the tax rates in the U.S. and other jurisdictions in which the Company operates, the relative amount of income earned by jurisdiction and the relative amount of losses or income for which no benefit or expense is recognized. The effective tax rate was impacted by the geographic income mix in 2019 as compared to 2018, primarily related to a United States pre-tax loss of \$17.5 million for the three months ended September 30, 2019, for which a tax benefit was not recognized due to the valuation allowance, compared to a United States pre-tax income of \$2.8 million for the three months ended September 30, 2018, for which tax expense was not recognized due to the valuation allowance.

#### **Nine months ended September 30, 2019 and 2018**

##### *Revenue*

Total revenue increased by \$41.7 million, or 14%, for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. The increase was primarily attributable to an increase in software revenue.

##### *Software*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Software revenue	\$ 265,515	\$ 224,458	\$ 41,057	18%
As a percent of software segment revenue	91%	89%		
As a percent of consolidated revenue	79%	77%		

The 18% increase in our software revenue for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018, was primarily the result of an expansion in the number of units licensed by our existing customers under renewed software license agreements, contributions from recent acquisitions and licensing of units to new customers pursuant to new software license agreements.

##### *Software related services*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Software related services revenue	\$ 25,635	\$ 26,872	\$ (1,237)	(5%)
As a percent of software segment revenue	9%	11%		
As a percent of consolidated revenue	8%	9%		

The 5% decrease in our software related services revenue for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018, was primarily the result of fluctuations in foreign currencies. On a constant currency basis, our software related services revenue was relatively consistent with the prior year.

##### *Client engineering services*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Client engineering services revenue	\$ 37,265	\$ 36,652	\$ 613	2%
As a percent of consolidated revenue	11%	12%		

The 2% increase in CES revenue for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018, was primarily due to an increase in demand for our consulting services. Our CES business is primarily affected by customer demand and our ability to fill customers' open positions.

*Other*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Other revenue	\$ 6,623	\$ 5,386	\$ 1,237	23%
As a percent of consolidated revenue	2%	2%		

The 23% increase in other revenue for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018, was due to increased revenue from toggled, our LED lighting business, driven by increased product unit sales.

**Cost of revenue**

*Software*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Cost of software revenue	\$ 40,655	\$ 32,736	\$ 7,919	24%
As a percent of software revenue	15%	15%		
As a percent of consolidated revenue	12%	11%		

Cost of software revenue increased by \$7.9 million, or 24%, for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. This increase in the current year was due to increased employee compensation and related costs of \$3.7 million, increased third party royalty costs of \$0.8 million for software programs, \$1.8 million in hardware costs, \$0.7 million in stock-based compensation expense and \$0.3 million in software maintenance.

*Software related services*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Cost of software related services revenue	\$ 19,143	\$ 19,573	\$ (430)	(2%)
As a percent of software related services revenue	75%	73%		
As a percent of consolidated revenue	6%	7%		

Cost of software related services revenue decreased \$0.4 million, or 2%, for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. The decrease was primarily the result of fluctuations in foreign currencies.

*Client engineering services*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Cost of client engineering services revenue	\$ 29,993	\$ 29,977	\$ 16	0%
As a percent of client engineering services revenue	80%	82%		
As a percent of consolidated revenue	9%	10%		

Cost of CES revenue was relatively consistent for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018.

*Other*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Cost of other revenue	\$ 5,858	\$ 3,416	\$ 2,442	71%
As a percent of other revenue	88%	63%		
As a percent of consolidated revenue	2%	1%		

The cost of other revenue increase of \$2.4 million, or 71%, for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018, was primarily due to greater unit sales volumes at lower selling prices in excess of cost reductions for products sold for our LED lighting business, partially offset by decreased third party royalty income of \$0.5 million..

***Gross profit***

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Gross profit	\$ 239,389	\$ 207,666	\$ 31,723	15%
As a percent of consolidated revenue	71%	71%		

Gross profit increased by \$31.7 million, or 15%, for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. This increase in gross profit was primarily attributable to the growth of our software revenue of \$41.1 million driven by the factors described above. The increase in revenue was partially offset by the increase in cost of revenue as described above.

***Operating expenses***

Operating expenses, as discussed below, support all the products and services that we provide to our customers and, as a result, they are reported and discussed here in the aggregate.

*Research and development*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Research and development	\$ 87,012	\$ 71,748	\$ 15,264	21%
As a percent of consolidated revenue	26%	24%		

Research and development expenses increased by \$15.3 million, or 21%, for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. This increase was primarily attributable to higher employee costs of \$9.6 million resulting from annual compensation adjustments and an increase in our headcount, primarily due to acquisitions. In addition, there was an increase in outsourced development fees of \$2.5 million as a result of acquisitions, an increase in stock-based compensation expense of \$1.3 million and an increase in software maintenance expense of \$0.8 million for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018.

*Sales and marketing*

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Sales and marketing	\$ 78,462	\$ 57,849	\$ 20,613	36%
As a percent of consolidated revenue	23%	20%		

Sales and marketing expenses increased by \$20.6 million, or 36%, for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. This increase was primarily attributable to higher employee costs of \$13.5 million resulting from annual compensation adjustments and an increase in our headcount, primarily due to acquisitions. Travel and trade show related expense increased \$2.7 million and sales and marketing campaigns to support our direct sales force increased \$0.8 million. In addition, stock-based compensation expense and consulting fees increased by \$1.3 million and \$0.5 million, respectively.

#### General and administrative

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
General and administrative	\$ 60,886	\$ 51,636	\$ 9,250	18%
As a percent of consolidated revenue	18%	18%		

General and administrative expenses increased by \$9.3 million, or 18%, for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. This increase was primarily attributable to higher employee costs of \$3.8 million resulting from annual compensation adjustments and an increase in our headcount, primarily due to acquisitions, higher facility costs of \$1.6 million, higher professional fees of \$1.6 million, higher stock-based compensation expense of \$1.1 million, and higher software maintenance expense of \$0.6 million.

#### Amortization of intangible assets

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Amortization of intangible assets	\$ 10,673	\$ 5,665	\$ 5,008	88%
As a percent of consolidated revenue	3%	2%		

Amortization of intangible assets increased by \$5.0 million for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. This was attributable to an increase in the amortization of developed technology and customer relationships in the current year as a result of 2018 acquisitions.

#### Other operating income, net

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Other operating income, net	\$ (1,702)	\$ (7,433)	\$ 5,731	(77%)
As a percent of consolidated revenue	(1%)	(3%)		

Other operating income decreased \$5.7 million for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. The prior year period includes of a gain on the sale of a building for \$4.4 million, a non-recurring adjustment for a change in estimated legal expenses of \$2.0 million of income, offset in part by impairment of trade names for \$0.6 million as a result of rebranding certain products.

#### Interest expense

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Interest expense	\$ 3,586	\$ 92	\$ 3,494	NM
As a percent of consolidated revenue	1%	—%		

Interest expense increased \$3.5 million for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. The increase in interest expense was a result of the \$2.9 million amortization of debt discount related to the Convertible Notes and \$0.4 million of increased interest expense due to increased borrowings under the line of credit during the nine months ended September 30, 2019.

### Other income, net

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Other income, net	\$ (703)	\$ (2,046)	\$ 1,343	(66%)
As a percent of consolidated revenue	(—%)	(1%)		

Other income, net decreased by \$1.3 million for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018. This decrease was due to fluctuations in the United States dollar relative to other functional currencies during the nine months ended September 30, 2019, compared to the nine months ended September 30, 2018.

### Income tax expense

(in thousands)	Nine Months Ended September 30,		Period-to-period change	
	2019	2018	\$	%
Income tax expense	\$ 7,215	\$ 5,617	\$ 1,598	28%

The effective tax rate was 614% and 19% for the nine months ended September 30, 2019 and 2018, respectively. The tax rate is affected by the Company being a U.S. resident taxpayer, the tax rates in the U.S. and other jurisdictions in which the Company operates, the relative amount of income earned by jurisdiction and the relative amount of losses or income for which no benefit or expense is recognized. The effective tax rate was impacted by the geographic income mix in 2019 as compared to 2018, primarily related to a United States pre-tax loss of \$12.3 million for the nine months ended September 30, 2019, for which a tax benefit was not recognized due to the valuation allowance, compared to a United States pre-tax income of \$14.8 million for the nine months ended September 30, 2018, for which tax expense was not recognized due to the valuation allowance. Offsetting the impact to the tax expense and the effective tax rate for September 30, 2019, was a reversal of reserve adjustments recorded for uncertain tax positions of \$1.1 million.

### Non-GAAP financial measures

In analyzing and planning for our business, we supplement our use of GAAP financial measures with non-GAAP financial measures, including Billings as a liquidity measure, Adjusted EBITDA and Modified Adjusted EBITDA as performance measures and Free Cash Flow as a liquidity measure.

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
<b>Other financial data:</b>				
Billings	\$ 103,643	\$ 84,926	\$ 345,562	\$ 290,490
Adjusted EBITDA	\$ (2,335)	\$ 2,399	\$ 26,814	\$ 37,252
Modified Adjusted EBITDA	\$ (85)	\$ 2,399	\$ 33,564	\$ 37,252
Free Cash Flow	\$ (3,316)	\$ 906	\$ 21,885	\$ 35,089

*Billings.* Billings consists of our total revenue plus the change in our deferred revenue, excluding deferred revenue from acquisitions during the period. Given that we generally bill our customers at the time of sale, but typically recognize a portion of the related revenue ratably over time, management believes that Billings is a meaningful way to measure and monitor our ability to provide our business with the working capital generated by upfront payments from our customers. See the table below for information regarding the impact of ASC 606 on Billings for the nine months ended September 30, 2018.

*Adjusted EBITDA.* We define Adjusted EBITDA as net income (loss) adjusted for income tax expense (benefit), interest expense, interest income and other, depreciation and amortization, stock-based compensation expense, restructuring charges, asset impairment charges and other special items as determined by management. Our management team believes that Adjusted EBITDA is a meaningful measure of performance as it is commonly utilized by management and the investment community to analyze operating performance in our industry.

*Modified Adjusted EBITDA.* Modified adjusted EBITDA is consistent with our definition of Adjusted EBITDA; however, it includes the revenue not recognized under GAAP due to acquisition accounting adjustments associated with accounting for deferred revenue in significant business combinations.

*Free Cash Flow.* Free Cash Flow is a non-GAAP measure that we calculate as cash flow provided by operating activities less capital expenditures. Management believes that Free Cash Flow is useful in analyzing our ability to service and repay debt, when applicable, and return value directly to stockholders.

These non-GAAP financial measures reflect an additional way of viewing aspects of our business that, when viewed with our GAAP results and the accompanying reconciliations to the corresponding GAAP financial measures included in the tables below, may provide a more complete understanding of factors and trends affecting our business. These non-GAAP financial measures should not be relied upon to the exclusion of GAAP financial measures and are by definition an incomplete understanding of the Company and must be considered in conjunction with GAAP measures.

We believe that the non-GAAP measures disclosed herein are only useful as an additional tool to help management and investors make informed decisions about our financial and operating performance and liquidity. By definition, non-GAAP measures do not give a full understanding of the Company. To be truly valuable, they must be used in conjunction with the comparable GAAP measures. In addition, non-GAAP financial measures are not standardized. It may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names. We strongly encourage investors to review our consolidated financial statements and the notes thereto in their entirety and not rely on any single financial measure.

The following table provides a reconciliation of Billings to revenue, the most comparable GAAP financial measure, for each of the periods presented:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Revenue	\$ 100,406	\$ 86,751	\$ 335,038	\$ 293,368
Ending deferred revenue	77,043	53,975	77,043	53,975
Adoption of ASC 606 on beginning deferred revenue	—	—	—	82,909
Beginning deferred revenue	(73,806)	(55,800)	(66,519)	(139,762)
Billings	\$ 103,643	\$ 84,926	\$ 345,562	\$ 290,490

The following table provides a reconciliation of Modified Adjusted EBITDA and Adjusted EBITDA to net income (loss), the most comparable GAAP financial measure, for each of the periods presented:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net (loss) income	\$ (15,939)	\$ 934	\$ (6,040)	\$ 24,538
Income tax expense	3,294	1,885	7,215	5,617
Stock-based compensation expense	2,292	563	5,584	1,213
Interest expense	2,726	31	3,586	92
Interest income and other (1)	(76)	(4,384)	633	(5,103)
Depreciation and amortization	5,368	3,370	15,836	10,895
Adjusted EBITDA	(2,335)	2,399	26,814	37,252
Acquisition related deferred revenue (2)	2,250	—	6,750	—
Modified Adjusted EBITDA	\$ (85)	\$ 2,399	\$ 33,564	\$ 37,252



- (1) Included in 2019 are a) nonrecurring severance expenses of \$0.4 million and nonrecurring acquisition related costs of \$0.6 million, for both the three and nine months ended September 30, 2019, and b) impairment charges for royalty contracts resulting in \$1.0 million of expense for the nine months ended September 30, 2019.
- Included in 2018 are a) a gain on the sale of a building of \$4.4 million for the three and nine months ended September 30, 2018, b) impairment charges for royalty contracts and trade names resulting in \$0.8 million and \$2.6 million of expense for the three and nine months ended September 30, 2018, respectively, and c) a non-recurring adjustment for a change in estimated legal expenses resulting in \$2.0 million of income for the nine months ended September 30, 2018.
- (2) Represents revenue not recognized under GAAP due to acquisition accounting adjustments associated with the accounting for deferred revenue in significant business combinations.

The following table provides a reconciliation of Free Cash Flow to net cash provided by operating activities, the most comparable GAAP financial measure, for each of the periods presented:

(in thousands)	Nine Months Ended September 30,	
	2019	2018
Net cash provided by operating activities	\$ 30,005	\$ 40,422
Capital expenditures	(8,120)	(5,333)
Free cash flow	\$ 21,885	\$ 35,089

*Recurring Software License Rate.* A key factor to our success is our recurring software license rate which we measure through Billings, primarily derived from annual renewals of our existing subscription customer agreements. We calculate our recurring software license rate for a particular period by dividing (i) the sum of software term-based license Billings, software license maintenance Billings, and 20% of software perpetual license Billings which we believe approximates maintenance as an element of the arrangement by (ii) the total software license Billings including all term-based subscriptions, maintenance, and perpetual license billings from all customers for that period. For the nine months ended September 30, 2019, our recurring software license rate was 88%.

### Liquidity and capital resources

Our principal sources of liquidity have been the net payments received from global customers using our software and services and proceeds from our initial public offering, follow-on offering and more recently our convertible debt offering, as well as periodic draws on our credit facilities, when needed. We believe that funds generated from operations, with cash and cash equivalents and the amounts available to us to borrow under our credit facility, will be sufficient to meet our anticipated cash needs for at least the next 12 months.

In June 2019, we issued \$230.0 million aggregate principal amount of Convertible Notes. See Note 8 in the Notes to consolidated financial statements in Item 1, Part I of this Quarterly Report on Form 10-Q.

We have commenced the initial planning to update zoning to allow for future expansion of our corporate headquarters facilities on the adjacent property we own to enable development consistent with our long-term needs. We have not yet determined the nature and scope of the overall timeline and investment beyond the immediate rezoning efforts necessary for our potential use in the future. Over the next 12 months, we expect to continue to advance this project.

### Revolving credit facility

We have a \$150.0 million credit facility that was amended on June 5, 2019, to permit the issuance of the Convertible Notes and extend the maturity date of the credit facility to December 15, 2023 ("2019 Amended Credit Agreement"). The 2019 Amended Credit Agreement allows us to request that the aggregate commitments under the 2019 Amended Credit Agreement be increased by up to \$50.0 million for a total of \$200.0 million, subject to certain conditions.

As of September 30, 2019, we had no outstanding borrowings under the 2019 Amended Credit Agreement and there was \$150.0 million available for future borrowing. The 2019 Amended Credit Agreement is available for general corporate purposes, including working capital, capital expenditures and permitted acquisitions. At September 30, 2019, we were in compliance with the financial covenants.

For additional information about the 2019 Amended Credit Agreement, see Note 8 in the Notes to consolidated financial statements in Item 1, Part I of this Quarterly Report on Form 10-Q.

## Cash flows

As of September 30, 2019, we had aggregate cash and cash equivalents of \$246.9 million available for working capital purposes, acquisitions, and capital expenditures; \$210.3 million of this aggregate amount was held in the United States and \$31.6 million was held in the APAC and EMEA regions.

Other than statutory limitations, there are no significant restrictions on the ability of our subsidiaries to pay dividends or make other distributions to Altair. Based on our current liquidity needs and repatriation strategies, we expect that we can manage our global liquidity needs without material adverse tax implications. The 2017 changes in U.S. tax law could materially affect our tax obligations. For further discussion, please see our 2018 Annual Report on Form 10-K, "Item 1A. Risk Factors – New legislations or tax-reform policies that would change U.S. or foreign taxation of international business activities, including uncertainties in the interpretation and application of the 2017 Tax Cuts and Jobs Act, could materially affect our tax obligations and effective tax rate."

The following table summarizes our cash flows for the periods indicated:

(in thousands)	Nine Months Ended September 30,	
	2019	2018
Net cash provided by operating activities	\$ 30,005	\$ 40,422
Net cash used in investing activities	(9,286)	(17,408)
Net cash provided by financing activities	191,960	136,514
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(1,065)	(1,354)
Net increase in cash, cash equivalents and restricted cash	\$ 211,614	\$ 158,174

### Net cash provided by operating activities

Net cash provided by operating activities for the nine months ended September 30, 2019 was \$30.0 million, which reflects a decrease of \$10.4 million compared to the nine months ended September 30, 2018. This decrease was the result of the reduction in net income and changes to our working capital position for the nine months ended September 30, 2019, as compared to the nine months ended September 30, 2018.

### Net cash used in investing activities

Net cash used in investing activities for the nine months ended September 30, 2019 was \$9.3 million, which reflects a decrease of \$8.1 million compared to the nine months ended September 30, 2018. This decrease was primarily the result of a decrease in cash payments for business acquisitions in the nine months ended September 30, 2019, offset by cash received from the sale of a building in the nine months ended September 30, 2018.

### Net cash provided by financing activities

Net cash provided by financing activities for the nine months ended September 30, 2019 was \$192.0 million, which reflects an increase in cash provided of \$55.4 million compared with the nine months ended September 30, 2018. For the nine months ended September 30, 2019, we received aggregate proceeds of \$223.1 million from our Convertible Notes offering, net of underwriters' discounts and commissions, and we had net cash payments on our revolving commitment of \$31.0 million. For the nine months ended September 30, 2018, we received aggregate proceeds of \$135.6 million from our follow-on public offering, net of underwriters' discounts and commissions, and we did not have any borrowings.

### Effect of exchange rate changes on cash, cash equivalents and restricted cash

There were adverse effects of exchange rate changes on cash, cash equivalents and restricted cash of \$1.1 million for the nine months ended September 30, 2019, and \$1.4 million for the nine months ended September 30, 2018.

### Contractual obligations and commitments

Our principal commitments and contractual obligations consist of our Convertible Notes due in 2024, and obligations under operating leases for office facilities. The following summarizes our non-cancelable contractual obligations as of September 30, 2019:

(in thousands)	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Convertible senior notes	\$ 230,000	\$ —	\$ —	\$ 230,000	\$ —
Aggregate interest obligations (1)	2,875	575	1,725	575	—
Operating lease obligations	30,845	10,239	13,402	4,852	2,352
Royalties	644	239	405	—	—
Finance lease obligations	1,239	467	672	100	—
Other long-term liabilities	3,106	1,493	1,269	344	—
Total	<u>\$ 268,709</u>	<u>\$ 13,013</u>	<u>\$ 17,473</u>	<u>\$ 235,871</u>	<u>\$ 2,352</u>

(1) Represents estimated aggregate interest obligations for our outstanding convertible senior notes that are payable in cash.

### Off-balance sheet arrangements

Through September 30, 2019, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

### Recently issued accounting pronouncements

See Note 3 in the Notes to consolidated financial statements in Item 1, Part I of this Quarterly Report on Form 10-Q for a full description of the recent accounting pronouncements and our expectation of their impact, if any, on our results of operations and financial condition.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain global market risks, including foreign currency exchange risk and interest rate risk associated with our debt.

#### Foreign Currency Exchange Risk

As a result of our substantial international operations, we are exposed to foreign currency risks that arise from our normal business operations, including in connection with our transactions that are denominated in foreign currencies. In addition, we translate sales and financial results denominated in foreign currencies into United States dollars for purposes of our consolidated financial statements. As a result, appreciation of the United States dollar against these foreign currencies generally will have a negative impact on our reported revenue and operating income while depreciation of the United States dollar against these foreign currencies will generally have a positive effect on reported revenue and operating income.

To date, we have not entered into any foreign currency hedging contracts, since exchange rate fluctuations have not had a material impact on our operating results and cash flows. Based on our current international structure, we do not plan on engaging in hedging activities in the near future.

#### Market Risk and Market Interest Risk

In June 2019, we issued \$230.0 million aggregate principal amount of 0.250% Convertible Notes. Our Convertible Notes have fixed annual interest rates at 0.250% and, therefore, we do not have economic interest rate exposure on our Convertible Notes. However, the value of the Convertible Notes is exposed to interest rate risk. Generally, the fair market value of our fixed interest rate Convertible Notes will increase as interest rates fall and decrease as interest rates rise. In addition, the fair values of the Convertible Notes are affected by our stock price. The fair value of the Convertible Notes will generally increase as our Class A common stock price increases in value and will generally decrease as our Class A common stock price declines in value. Additionally, we carry the Convertible Notes at face value less unamortized discount and issuance costs on our balance sheet, and we present the fair value for required disclosure purposes only.

As of September 30, 2019, we had cash, cash equivalents and restricted cash of \$247.3 million, consisting primarily of bank deposits and money market funds. As of September 30, 2019, we had no outstanding borrowings under our 2019 Amended Credit Agreement. Such interest-bearing instruments carry a degree of interest rate risk; however, historical fluctuations of interest expense have not been significant.

Interest rate risk relates to the gain/increase or loss/decrease we could incur on our debt balances and interest expense associated with changes in interest rates. It is our policy not to enter into derivative instruments for speculative purposes, and therefore, we hold no derivative instruments for trading purposes.

#### **Item 4. Controls and Procedures**

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as defined in Rule 13(a)-15(e) under the Exchange Act as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were not effective as of September 30, 2019, due to a material weakness identified in connection with the audit of our fiscal year 2018 financial statements.

The material weakness pertained to controls over accounting for income taxes. We determined that management's review controls over income taxes are not operating effectively to detect a material misstatement in the financial statements related to income tax accounting around acquisitions, as well as routine and non-routine transactions. We have taken steps to remediate this material weakness by enhancing our preparation and review procedures around income tax accounting, which includes supplementing our resources by using an independent consultant with technical expertise in tax accounting for acquisitions and routine and non-routine transactions.

Effective internal control over financial reporting is necessary for us to provide reliable and timely financial reports and, together with adequate disclosure controls and procedures, are designed to reasonably detect and prevent fraud. Any failure to implement required new or improved controls, or difficulties encountered in their implementation could cause us to fail to meet our reporting obligations.

#### **Changes in Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2019, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

As previously disclosed, on May 10, 2019, the Company discovered potential violations of U.S. economic sanctions and export control laws and immediately filed preliminary self-disclosure notices with the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") and the U.S. Commerce Department's Bureau of Industry & Security ("BIS").

The Company subsequently conducted an internal investigation into these issues under the direction of outside legal counsel and filed voluntary self-disclosures with both agencies on July 25, 2019. These disclosures describe the unintentional transfer of commercial software and trial software licenses to various individuals located in Iran and other restricted countries. These transfers involved freeware, trial software licenses, and volunteer software testing communities. The Company did not discover any evidence indicating any commercial transactions with restricted parties or countries.

In addition to filing voluntary self-disclosures with OFAC and BIS, the Company has implemented a series of additional compliance measures to prevent unintentional transfers of the sort described above. These measures will further enhance the Company's international trade compliance program, which is designed to assure that the Company does not conduct business directly or indirectly with any countries or parties subject to U.S. economic sanctions and export control laws.

On August 30, 2019, BIS notified the Company that it had completed its investigation of the potential violation of U.S. export control laws by the Company and concluded that no criminal or administrative prosecution was warranted and closed the matter.

Although OFAC has not notified the Company of its findings or the completion of its investigations, the Company does not currently have any reason to believe that its voluntary self-disclosures (or any related U.S. Government investigations) will have a meaningful impact on its operations, results of operations for any future period, or financial condition.

As previously described in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, the Company is subject to other legal proceedings. Except as set forth above, there were no material changes in such matters during the nine months ended September 30, 2019.

### Item 1A. Risk Factors

The risk factors set forth below supplement the risk factors previously disclosed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2018.

#### Risks Related to Our Indebtedness

*Our 0.250% Convertible Senior Notes due 2024, or the Convertible Notes, are effectively subordinated to our secured debt and any liabilities of our subsidiaries.*

The Convertible Notes rank senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the Convertible Notes; equal in right of payment to any of our liabilities that are not so subordinated; effectively junior in right of payment to any of our secured indebtedness (including all amounts outstanding under our revolving credit facility) to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of our subsidiaries. In the event of our bankruptcy, liquidation, reorganization or other winding up, our assets that secure debt ranking senior or equal in right of payment to the Convertible Notes (including all amounts outstanding under our revolving credit facility) will be available to pay obligations on the Convertible Notes only after the secured debt has been repaid in full from these assets, and the assets of our subsidiaries will be available to pay obligations on the Convertible Notes only after all claims senior to the Convertible Notes have been repaid in full. There may not be sufficient assets remaining to pay amounts due on any or all of the Convertible Notes then outstanding. The indenture governing the Convertible Notes will not prohibit us from incurring additional senior debt or secured debt, nor does it prohibit any of our subsidiaries from incurring additional liabilities.

***The Convertible Notes are our obligations only and a substantial portion of our operations are conducted through, and a substantial portion of our consolidated assets are held by, our subsidiaries.***

The Convertible Notes are our obligations exclusively and are not guaranteed by any of our operating subsidiaries. A substantial portion of our operations is conducted through, and a substantial portion of our consolidated assets is held by, our subsidiaries. Accordingly, our ability to service our debt, including the Convertible Notes, depends in part on the results of operations of our subsidiaries and upon the ability of such subsidiaries to provide us with cash, whether in the form of dividends, loans or otherwise, to pay amounts due on our obligations, including the Convertible Notes. Our subsidiaries are separate and distinct legal entities and have no obligation, contingent or otherwise, to make payments on the Convertible Notes or to make any funds available for that purpose. In addition, dividends, loans or other distributions to us from such subsidiaries may be subject to contractual and other restrictions and are subject to other business considerations.

***Servicing our debt will require a significant amount of cash, and we may not have sufficient cash flow from our business to pay our substantial debt.***

Our ability to make scheduled payments of the principal of, to pay interest on, or to refinance our future indebtedness, including the amounts payable under our revolving credit facility and the Convertible Notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations. In addition, any of our future debt agreements may contain restrictive covenants that may prohibit us from adopting any of these alternatives. Our failure to comply with these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of our debt.

***We may still incur substantially more debt or take other actions which would intensify the risks discussed above.***

We and our subsidiaries may be able to incur substantial additional debt in the future, subject to the restrictions contained in our debt instruments, some of which may be secured debt. We will not be restricted under the terms of the indenture governing the Convertible Notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture governing the Convertible Notes that could have the effect of diminishing our ability to make payments on the Convertible Notes when due. Our existing revolving credit facility restricts our ability to incur additional indebtedness, including secured indebtedness, but if the facility matures or is repaid, we may not be subject to such restrictions under the terms of any subsequent indebtedness.

***We may not have the ability to raise the funds necessary to settle conversions of the Convertible Notes in cash or to repurchase the Convertible Notes upon a fundamental change, and our current debt contains, and our future debt may contain, limitations on our ability to pay cash upon conversion or repurchase of the Convertible Notes.***

Holders of the Convertible Notes will have the right to require us to repurchase their Convertible Notes upon the occurrence of a fundamental change at a defined repurchase price equal to 100% of the principal amount of the Convertible Notes to be repurchased, plus accrued and unpaid interest, if any. In addition, upon conversion of the Convertible Notes, unless we elect to deliver solely shares of our Class A common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the Convertible Notes being converted. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Convertible Notes surrendered therefor or Convertible Notes being converted.

In addition, our ability to repurchase the Convertible Notes or to pay cash upon conversions of the Convertible Notes may be limited by law, by regulatory authority or by agreements governing our indebtedness including our existing revolving credit facility. Our failure to repurchase Convertible Notes at a time when the repurchase is required by the indenture or to pay any cash payable on future conversions of the Convertible Notes as required by the indenture would constitute a default under the indenture. A default under the indenture or the occurrence of a fundamental change itself would likely also lead to a default under our revolving credit facility, and may lead to a default under agreements governing our future indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Convertible Notes or make cash payments upon conversions thereof.

***Our revolving credit facility limits our ability to pay any cash amount upon the conversion or repurchase of the Convertible Notes.***

Our existing revolving credit facility prohibits us from making any cash payments on the conversion or repurchase of the Convertible Notes if a default under such credit facility exists or would be created thereby. In addition, our ability to make cash payments on the conversion or repurchase of the Convertible Notes will be limited to the extent we do not satisfy certain financial covenant tests after giving effect to such payments. Any new credit facility that we may enter into may have similar restrictions. Our failure to make cash payments upon the conversion or repurchase of the Convertible Notes as required under the terms of the Convertible Notes would permit holders of the Convertible Notes to accelerate our obligations under the Convertible Notes.

***The conditional conversion feature of the Convertible Notes, if triggered, may adversely affect our financial condition and operating results.***

In the event the conditional conversion feature of the Convertible Notes is triggered, holders of Convertible Notes will be entitled to convert the Convertible Notes at any time during specified periods at their option. If one or more holders elect to convert their Convertible Notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our Class A common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders of the Convertible Notes do not elect to convert their Convertible Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Convertible Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

***The accounting method for convertible debt securities that may be settled in cash, such as the Convertible Notes, could have a material effect on our reported financial results.***

Under Financial Accounting Standards Board Accounting Standards Codification 470-20, Debt with Conversion and Other Options (“ASC 470-20”), an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Convertible Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer’s economic interest cost. The effect of ASC 470-20 on the accounting for the Convertible Notes is that the equity component is required to be included in the additional paid-in capital section of stockholders’ equity on our consolidated balance sheet, and the value of the equity component would be treated as debt discount for purposes of accounting for the debt component of the Convertible Notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the Convertible Notes to their face amount over the term of the Convertible Notes. We will report larger net losses (or lower net income) in our financial results because ASC 470-20 will require interest to include both the current period’s amortization of the debt discount and the instrument’s coupon interest, which could adversely affect our reported or future financial results, the trading price of our Class A common stock and the trading price of the Convertible Notes.

In addition, under certain circumstances, convertible debt instruments (such as the Convertible Notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the Convertible Notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the Convertible Notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of Class A common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the Convertible Notes, then our diluted earnings per share would be adversely affected.

***Transactions relating to the Convertible Notes may affect the value of our Class A common stock.***

The conversion of some or all of the Convertible Notes would dilute the ownership interests of existing stockholders to the extent we satisfy our conversion obligation by delivering shares of our Class A common stock upon any conversion of the Convertible Notes. If holders of our Convertible Notes elect to convert their notes, we may settle our conversion obligation by delivering to them a significant number of shares of our Class A common stock, which would cause dilution to our existing stockholders.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****Unregistered Sales of Equity Securities**

On October 7, 2019, in connection with the acquisition of Polliwog Co. Ltd. (“Polliwog”), the Company issued, or agreed to issue, to shareholders of Polliwog an aggregate of 459,539 shares of the Company’s Class A Common Stock, par value \$0.0001 per share (the “SPA Stock Consideration”). Forty percent of the SPA Stock Consideration (183,815 shares) was issued at closing and is subject to customary securities law restrictions on transferability for the first six months after the closing. The remaining sixty percent (an aggregate of 275,724 shares) of the SPA Stock Consideration will be issuable in equal installments of 91,908 shares on each of the one, two and three year anniversaries of the closing, subject to potential reduction in certain circumstances. All shares of Class A Common Stock issued or to be issued as the SPA Stock Consideration were or will be issued without registration under the Securities Act of 1933, as amended (the “Securities Act”), pursuant to Section 4(a)(2) of the Securities Act. Polliwog’s existing stockholders provided customary representations for a private placement of securities and agreed to customary restrictions on transferability.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Not applicable.



## Item 6. Exhibits

No.	Description
31.1*	<a href="#">Certification of the Chief Executive Officer of Altair Engineering Inc. pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended</a>
31.2*	<a href="#">Certification of the Chief Financial Officer of Altair Engineering Inc. pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended</a>
32.1**	<a href="#">Certification of the Chief Executive Officer and Chief Financial Officer of Altair Engineering Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
101.INS*	Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH*	Inline XBRL Taxonomy Extension Schema Document
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibits 101).

\* Filed herewith.

\*\* The certifications furnished in Exhibit 32.1 hereto are deemed to accompany this Quarterly Report on Form 10-Q and will not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, except to the extent that the registrant specifically incorporates it by reference.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

### ALTAIR ENGINEERING INC.

Date: November 7, 2019

By: /s/ James Scapa

\_\_\_\_\_  
James R. Scapa

Chief Executive Officer (Principal Executive Officer)

Date: November 7, 2019

By: /s/ Howard N. Morof

\_\_\_\_\_  
Howard N. Morof

Chief Financial Officer (Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO  
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James R. Scapa, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Altair Engineering Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ James Scapa

James R. Scapa  
Chief Executive Officer  
(Principal Executive Officer)

November 7, 2019

**CERTIFICATION PURSUANT TO  
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Howard N. Morof, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Altair Engineering Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; (paragraph omitted pursuant to the transition period exemption for newly public companies);
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Howard N. Morof

Howard N. Morof

Chief Financial Officer

*(Principal Financial and Accounting Officer)*

November 7, 2019

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Altair Engineering Inc. (the "Company"), on Form 10-Q for the period ended September 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned officers of the Company certify to their knowledge and in their respective capacities, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James Scapa

James R. Scapa  
Chief Executive Officer  
*(Principal Executive Officer)*

/s/ Howard N. Morof

Howard N. Morof  
Chief Financial Officer  
*(Principal Financial and Accounting Officer)*

November 7, 2019