PTC INC.
Form 10-Q
February 10, 2016

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 January 2, 2016
Commission File Number: 0-18059

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

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

140 Kendrick Street, Needham, MA 02494
(Address of principal executive offices, including zip code)
(781) 370-5000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer þ	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ
There were 114,531,686 shares of our common stock outstanding on February 8, 2016.

Important Update Regarding Quarter-End Results

Our results for the three months ended January 2, 2016 included in this Quarterly Report on Form 10-Q reflect an accrual reversal of $1.6 million related to a legal proceeding which was resolved in our favor after we initially reported our results for the first quarter of 2016 in our Earnings Release on Form 8-K on January 20, 2016. As a result, operating income and net income for the quarter ended January 2, 2016 are $1.6 million higher than initially reported.

PTC Inc.
INDEX TO FORM 10-Q
For the Quarter Ended January 2, 2016

PART I—FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONDENSED FINANCIAL STATEMENTS

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

	January 2, 2016	September 30, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$296,797	$273,417
Accounts receivable, net of allowance for doubtful accounts of $935 and $998 at January 2, 2016 and September 30, 2015, respectively	161,402	197,275
Prepaid expenses	56,536	56,365
Other current assets	144,853	140,819
Deferred tax assets	—	36,803
Total current assets	659,588	704,679
Property and equipment, net	60,878	65,162
Goodwill	1,086,230	1,069,041
Acquired intangible assets, net	317,670	291,301
Deferred tax assets	49,631	38,936
Other assets	41,896	40,794
Total assets	$2,215,893	$2,209,913
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$12,171	$13,361
Accrued expenses and other current liabilities	94,617	97,613
Accrued compensation and benefits	94,726	82,414
Accrued income taxes	4,105	4,010
Deferred tax liabilities	—	1,622
Current portion of long term debt	—	50,000
Deferred revenue	373,768	368,240
Total current liabilities	579,387	617,260
Long term debt, net of current portion	718,125	618,125
Deferred tax liabilities	13,704	42,361
Deferred revenue	15,498	18,610
Other liabilities	53,242	53,386
Total liabilities	1,379,956	1,349,742
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, $0.01 par value; 5,000 shares authorized; none issued	—	—
Common stock, $0.01 par value; 500,000 shares authorized; 114,532 and 113,745 shares issued and outstanding at January 2, 2016 and September 30, 2015, respectively	1,145	1,137
Additional paid-in capital	1,561,795	1,553,390
Accumulated deficit	(626,506)	(602,614)
Accumulated other comprehensive loss	(100,497)	(91,742)

Total stockholders’ equity	835,937	860,171
Total liabilities and stockholders’ equity	$2,215,893	$2,209,913

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

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

	Three months ended	
	January 2, 2016	January 3, 2015
Revenue:		
Subscription	$22,176	$14,223
Support	171,756	181,629
Total recurring software revenue	193,932	195,852
Perpetual license	47,763	64,748
Total software revenue	241,695	260,600
Professional services	49,322	64,842
Total revenue	291,017	325,442
Cost of revenue:		
Cost of software revenue	36,814	34,725
Cost of professional services revenue	43,333	58,217
Total cost of revenue	80,147	92,942
Gross margin	210,870	232,500
Operating expenses:		
Sales and marketing	82,429	89,484
Research and development	57,669	61,097
General and administrative	38,567	35,130
Amortization of acquired intangible assets	8,350	9,413
Restructuring charges	37,147	(255)
Total operating expenses	224,162	194,869
Operating income (loss)	(13,292)	37,631
Interest and other expense, net	(6,253)	(3,224)
Income (loss) before income taxes	(19,545)	34,407
Provision for income taxes	4,347	4,123
Net income (loss)	$(23,892)	$30,284
Earnings (loss) per share—Basic	$(0.21)	$0.26
Earnings (loss) per share—Diluted	$(0.21)	$0.26
Weighted average shares outstanding—Basic	114,151	115,341
Weighted average shares outstanding—Diluted	114,151	117,027

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

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

	Three months ended	
	January 2, 2016	January 3, 2015
Net income (loss)	$(23,892)	$30,284
Other comprehensive loss, net of tax:		
Unrealized hedge gain arising during the period	1,643	—
Net hedge gain reclassified into earnings	(846)	—
Unrealized gain on hedging instruments	797	—
Foreign currency translation adjustment, net of tax of $0 for each period	(10,504)	(20,432)
Amortization of net actuarial pension loss included in net income, net of tax of $0.2 million and $0.1 million in the first quarter of 2016 and 2015, respectively	402	1,052
Change in unamortized pension loss during the period related to changes in foreign currency	550	921
Total other comprehensive loss	(8,755)	(18,459)
Comprehensive income (loss)	$(32,647)	$11,825

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

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

	Three months ended January 2, 2016	January 3, 2015
Cash flows from operating activities:		
Net income (loss)	$(23,892)	$30,284
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	20,613	21,237
Stock-based compensation	23,189	11,242
Excess tax benefits from stock-based awards	(56)	(163)
Other non-cash items, net	45	(171)
Changes in operating assets and liabilities, excluding the effects of acquisitions:		
Accounts receivable	35,219	25,800
Accounts payable, accrued expenses and other current liabilities	(1,679)	(2,777)
Accrued compensation and benefits	12,054	(48,141)
Deferred revenue	1,262	(8,776)
Accrued and deferred income taxes	(3,355)	(2,953)
Other current assets and prepaid expenses	1,441	(2,108)
Other noncurrent assets and liabilities	(3,587)	(9,842)
Net cash provided by operating activities	61,254	13,632
Cash flows from investing activities:		
Additions to property and equipment	(4,185)	(7,947)
Purchases of investments	—	(1,000)
Acquisitions of businesses, net of cash acquired	(64,780)	180
Net cash used by investing activities	(68,965)	(8,767)
Cash flows from financing activities:		
Borrowings under credit facility	50,000	35,000
Repayments of borrowings under credit facility	—	(41,250)
Proceeds from issuance of common stock	1	3
Excess tax benefits from stock-based awards	56	163
Credit facility origination costs	(1,050)	—
Contingent consideration	(1,250)	—
Payments of withholding taxes in connection with vesting of stock-based awards	(14,833)	(21,669)
Net cash provided (used) by financing activities	32,924	(27,753)
Effect of exchange rate changes on cash and cash equivalents	(1,833)	(9,714)
Net increase (decrease) in cash and cash equivalents	23,380	(32,602)
Cash and cash equivalents, beginning of period	273,417	293,654
Cash and cash equivalents, end of period	$296,797	$261,052

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

PTC Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)
1. Basis of Presentation
General
The accompanying unaudited condensed consolidated financial statements include the accounts of PTC Inc. and its wholly owned subsidiaries and have been prepared by management in accordance with accounting principles generally accepted in the United States of America and in accordance with the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. While we believe that the disclosures presented are adequate in order to make the information not misleading, these unaudited quarterly financial statements should be read in conjunction with our annual consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2015. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair statement of our financial position, results of operations and cash flows at the dates and for the periods indicated. Unless otherwise indicated, all references to a year mean our fiscal year, which ends on September 30. The September 30, 2015 Consolidated Balance Sheet included herein is derived from our audited consolidated financial statements.
The results of operations for the three months ended January 2, 2016 are not necessarily indicative of the results expected for the remainder of the fiscal year.
Income Statement Presentation
In 2015, we classified revenue in three categories: 1) license and subscription solutions; 2) support; and 3) professional services. Effective with the beginning of the first quarter of 2016, we are reporting perpetual license revenue separately from the subscription revenue and are presenting revenue in four categories: 1) subscription; 2) support; 3) perpetual license; and 4) professional services.
Effective with the beginning of the first quarter of 2016, we reclassified certain expenses related to management of our product lines from general and administrative to marketing.
Revenue and costs and expenses in the accompanying Consolidated Statements of Operations have been reclassified to conform to the current period presentation.
Recent Accounting Pronouncements
Deferred Taxes
In November, 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-17, Balance Sheet Classification of Deferred Taxes (Topic 740) , to simplify the presentation of deferred income taxes. The amendments in this Update require that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The guidance does not change the existing requirement that permits offsetting only within a jurisdiction and companies are still prohibited from offsetting deferred tax liabilities from one jurisdiction against deferred tax assets of another jurisdiction. ASU 2015-17 is effective for public companies for fiscal years beginning after December 15, 2016, with early adoption permitted for all entities as of the beginning of an interim or annual reporting period. This guidance may be applied either prospectively or retrospectively (by reclassifying the comparative balance sheet). We adopted this new guidance in our first quarter ended January 2, 2016 and applied this guidance prospectively. As a result, the deferred tax assets and deferred tax liabilities on the Consolidated Balance Sheet as of September 30, 2015 have not been reclassified to conform to the January 2, 2016 presentation.
Revenue Recognition
In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in

doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In July 2015, the FASB approved a one-year delay in the effective date. ASU 2014-09 is effective for us in our first quarter of fiscal 2019 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09. We are currently evaluating the impact of our pending adoption of ASU 2014-09 on our consolidated financial statements.

Debt Issuance Costs

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

2. Deferred Revenue and Financing Receivables

Deferred Revenue

Deferred revenue primarily relates to software support agreements billed to customers for which the services have not yet been provided. The liability associated with performing these services is included in deferred revenue and, if not yet paid, the related customer receivable is included in prepaid expenses and other current assets. Billed but uncollected support and subscription-related amounts included in prepaid expenses and other current assets at January 2, 2016 and September 30, 2015 were $133.9 million and $129.3 million, respectively.

Financing Receivables

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

As of January 2, 2016 and September 30, 2015, amounts due from customers for contracts with original payment terms greater than twelve months (financing receivables) totaled $26.6 million and $27.4 million, respectively. Accounts receivable and prepaid expenses and other current assets in the accompanying Consolidated Balance Sheets included current receivables from such contracts totaling $20.4 million and $21.8 million at January 2, 2016 and September 30, 2015, respectively, and other assets in the accompanying Consolidated Balance Sheets included long-term receivables from such contracts totaling $6.2 million and $5.6 million at January 2, 2016 and September 30, 2015, respectively. As of January 2, 2016 and September 30, 2015, $0.8 million and $0.5 million, respectively, of these receivables were past due. Our credit risk assessment for financing receivables was as follows:

	January 2, 2016	September 30, 2015
	(in thousands)	
S&P bond rating BBB-1 and above-Tier 1	$19,258	$16,841
Internal Credit Assessment-Tier 2	7,339	10,593
Internal Credit Assessment-Tier 3	—	—
Total financing receivables	$26,597	$27,434

We evaluate the need for an allowance for doubtful accounts for estimated losses resulting from the inability of these customers to make required payments. As of January 2, 2016 and September 30, 2015, we concluded that all financing receivables were collectible and no reserve for credit losses was recorded. We did not provide a reserve for credit losses or write off any uncollectible financing receivables in the three months ended January 2, 2016 or January 3,

2015. We write off uncollectible trade and financing receivables when we have exhausted all collection avenues. We periodically transfer future payments under certain of these contracts to third-party financial institutions on a non-recourse basis. We record such transfers as sales of the related accounts receivable when we surrender control of such receivables. We did not sell any financing receivables to third-party financial institutions in the three months ended January 2, 2016 and January 3, 2015.

3. Restructuring Charges

On October 23, 2015, we initiated a plan to restructure our workforce and consolidate select facilities in order to reduce our cost structure and to realign our investments with what we believe to be our higher growth opportunities. The restructuring is expected to result in a charge of up to $50 million, which is primarily attributable to termination benefits. In the first quarter of 2016, we recorded a charge of $36.8 million, attributable to termination benefits associated with 432 employees. The remaining charges are expected to be recorded predominantly in the second and third quarters of 2016.

In the first quarter of 2016, we recorded a charge of $0.2 million related to employee terminations and $0.2 million related to excess facilities associated with our restructuring actions initiated in the second quarter of 2015. As of January 2, 2016, this restructuring plan was substantially completed.

The following table summarizes restructuring accrual activity for the three months ended January 2, 2016:

	Employee Severance and Related Benefits	Facility Closures and Related Costs	Total
	(in thousands)		
October 1, 2015	$14,086	$1,168	$15,254
Charge to operations	36,961	186	37,147
Cash disbursements	(16,269)	(433)	(16,702)
Foreign exchange impact	(81)	(36)	(117)
Accrual, January 2, 2016	$34,697	$885	$35,582

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

4. Stock-based Compensation

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

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

Restricted stock unit activity for the three month ended January 2, 2016	Shares	Weighted Average Grant Date Fair Value (Per Share)
	(in thousands)	
Balance of outstanding restricted stock units October 1, 2015	3,654	$33.64
Granted	1,753	$38.22
Vested	(1,209)	$28.67
Forfeited or not earned	(215)	$35.78
Balance of outstanding restricted stock units January 2, 2016	3,983	$37.04

	Restricted Stock Units		
Grant Period	TSR Units (1)	Performance-based RSUs (2)	Service-based RSUs (2)
	(Number of Units in thousands)		

First three months of 2016	326	343	1,083

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(1) The TSR units were granted to our executive officers pursuant to the terms described below.

(2) The service-based RSUs were issued to both employees and our executive officers. In addition, executive officers may earn up to one or, for our CEO, two times the number of time-based RSUs (up to a maximum of 343,000 shares) if certain performance conditions are met. Of the service-based RSUs, approximately 110,000 shares will vest in two substantially equal annual installments on or about the anniversary of the date of grant. All other service-based RSUs will vest in three substantially equal annual installments on or about the anniversary of the date of grant. The performance-based RSUs will vest in three substantially equal installments on the later of November 15, 2016, November 15, 2017 and November 15, 2018, or the date the Compensation Committee determines the extent to which the applicable performance criteria have been achieved.

In the first three months of 2016, we granted the target performance-based TSR units ("target RSUs") shown in the table above to our executive officers. These RSUs are eligible to vest based upon our total shareholder return relative to a peer group (the "TSR units"), measured annually over a three-year period. The number of TSR units to vest over the three year period will be determined based on the performance of PTC stock relative to the stock performance of an index of PTC peer companies established as of the grant date, as determined at the end of three measurement periods ending on September 30, 2016, 2017 and 2018, respectively. The shares earned for each period will vest on November 15 following each measurement period, up to a maximum of two times the number of target RSUs (up to a maximum of 652,000 shares). No vesting will occur in a period unless an annual threshold requirement is achieved. The employee must remain employed by PTC through the applicable vest date for any RSUs to vest. If the return to PTC shareholders is negative but still meets or exceeds the peer group indexed return, a maximum of 100% of the target RSUs shall vest for the measurement period. TSR units not earned in the first two year measurement periods are eligible to be earned in the third measurement period.

The weighted average fair value of the TSR units was $46.96 per target RSU on the grant date. The fair value of the TSR units was determined using a Monte Carlo simulation model, a generally accepted statistical technique used to simulate a range of possible future stock prices for PTC and the peer group. The method uses a risk-neutral framework to model future stock price movements based upon the risk-free rate of return, the volatility of each entity, and the pairwise correlations of each entity being modeled. The fair value for each simulation is the product of the payout percentage determined by PTC's TSR rank against the peer group, the projected price of PTC stock, and a discount factor based on the risk-free rate.

The significant assumptions used in the Monte Carlo simulation model were as follows:

Average volatility of peer group	28.1	%
Risk free interest rate	1.05	%
Dividend yield	—	%

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

	Three months ended	
	January 2, 2016	January 3, 2015
	(in thousands)	
Cost of software revenue	$1,905	$918
Cost of professional services revenue	1,451	1,689
Sales and marketing	4,282	3,201
Research and development	2,513	3,086
General and administrative	13,038	2,348
Total stock-based compensation expense	$23,189	$11,242

The stock-based compensation expense in the first quarter of 2016 included $10 million of expense related to modifications of certain performance-based RSUs previously granted under our long-term incentive programs. The Compensation Committee of our Board of Directors amended these equity awards due to the impact of changes in our business model and strategy and foreign currency on our financial results.

5. Earnings per Share (EPS) and Common Stock

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EPS

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

Calculation of Basic and Diluted EPS	Three months ended January 2, 2016	January 3, 2015
	(in thousands, except per share data)	
Net income (loss)	$(23,892)	$30,284
Weighted average shares outstanding—Basic	114,151	115,341
Dilutive effect of employee stock options, restricted shares and restricted stock units	—	1,686
Weighted average shares outstanding—Diluted	114,151	117,027
Earnings (loss) per share—Basic	$(0.21)	$0.26
Earnings (loss) per share—Diluted	$(0.21)	$0.26

For the three months ended January 2, 2016, diluted net loss per share is the same as basic net loss per share as the effects of our potential common stock equivalents are antidilutive. Total antidilutive shares were 2.0 million for the three months ended January 2, 2016.

Common Stock Repurchases

Our Articles of Organization authorize us to issue up to 500 million shares of our common stock. Our Board of Directors has periodically authorized the repurchase of shares of our common stock. On August 4, 2014, our Board of Directors authorized us to repurchase up to $600 million of our common stock through September 30, 2017. In the first quarter of 2016, we did not repurchase any shares. In the first quarter of 2015, we received 1.1 million shares as the final settlement of the accelerated share repurchase ("ASR") agreement described below. All shares of our common stock repurchased are automatically restored to the status of authorized and unissued.

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

6. Acquisitions

Acquisition-related costs were $1.2 million and $4.0 million for the first quarter of 2016 and 2015, respectively. Acquisition-related costs include direct costs of potential and completed acquisitions (e.g., investment banker fees, professional fees, including legal and valuation services) and expenses related to acquisition integration activities (e.g., professional fees, severance, and retention bonuses). In addition, subsequent adjustments to our initial estimated amount of contingent consideration associated with specific acquisitions are included within acquisition-related charges. These costs have been classified in general and administrative expenses in the accompanying Consolidated Statements of Operations.

Vuforia

On November 3, 2015, pursuant to an Asset Purchase Agreement, PTC acquired the Vuforia business from Qualcomm Connected Experiences, Inc., a subsidiary of Qualcomm Incorporated, for $64.8 million in cash (net of cash acquired of $4.5 million). We borrowed $50 million under our credit facility to finance this acquisition. At the time of the acquisition, Vuforia had approximately 80 employees and historical annualized revenues were not material. The results of operations of Vuforia have been included in our consolidated financial statements beginning on the acquisition date. Vuforia added $0.3 million to our revenue and $4.1 million in costs and expenses in the first quarter of 2016.

The acquisition of Vuforia has been accounted for as a business combination. Assets acquired and liabilities assumed have been recorded at their estimated fair values as of the acquisition date. The fair values of intangible assets were based on valuations using a cost approach which requires the use of significant estimates and assumptions, including estimating costs to reproduce an asset. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill.

The purchase price allocation resulted in $23.3 million of goodwill, $41.2 million of technology and $4.7 million of net tangible assets. The acquired technology is being amortized over weighted average useful lives of 6 years. All of the acquired goodwill was allocated to our software products segment and will be deductible for income tax purposes. The resulting amount of goodwill reflects the value of the synergies created by integrating Vuforia's augmented technology platform into PTC's Technology Platform solutions.

ColdLight

In the third quarter of 2015, we acquired ColdLight Solutions, LLC, for approximately $98.6 million in cash (net of cash acquired of $1.3 million). The former shareholders of ColdLight are eligible to receive additional consideration (the earn-out) of up to $5 million which is contingent upon achievement of certain technology milestones within two years of the acquisition. If an earn-out milestone is achieved, a portion of the contingent consideration becomes earned and payable in cash after each six-month period. In connection with accounting for the business combination, we recorded a liability $3.8 million, representing the fair value of the contingent consideration. The liability was valued using a discounted cash flow method and a probability weighted estimate of achievement of the technology milestones. The estimated undiscounted range of outcomes for the contingent consideration was $3.8 million to $5.0 million at the acquisition date. As of January 2, 2016, our estimate of the liability was $2.8 million, after a payment of $1.3 million made in December 2015. The payment was included in financing activities in the Consolidated Statements of Cash Flows. We will continue to assess the probability that the unearned milestones will be met and at what level each reporting period. Changes in the estimated fair value of the liability are reflected in earnings until the liability is fully settled.

ThingWorx

In the second quarter of 2014, we acquired ThingWorx, Inc. for $111.5 million (net of cash acquired of $0.1 million). The former shareholders of ThingWorx are eligible to receive additional consideration of up to $18.0 million if certain profitability and bookings targets are achieved within two years of the acquisition from December 30, 2013 to January 1, 2016. The earn-out is payable in cash in two installments after each measurement period. In connection with accounting for the business combination, we recorded a liability representing the fair value of the contingent consideration. The liability was valued using a discounted cash flow method and a probability weighted estimate of achievement of the financial targets. We assess the probability that the targets will be met each reporting period. Any subsequent changes in the estimated fair value of the liability are reflected in earnings until the liability is fully settled. The first year payment criteria were attained and we paid $9 million of the total contingent consideration in July 2015. As of January 2, 2016, the remaining $9.0 million of the total contingent consideration is fully earned and becomes payable in the second quarter of 2016.

7. Goodwill and Intangible Assets

We have two operating segments: (1) Software Products and (2) Services. We assess goodwill for impairment at the reporting unit level. Our reporting units are determined based on the components of our operating segments that constitute a business for which discrete financial information is available and for which operating results are regularly reviewed by segment management. Our reporting units are the same as our operating segments. As of January 2, 2016 and September 30, 2015, goodwill and acquired intangible assets in the aggregate attributable to our software products segment were $1,342.0 million and $1,297.9 million, respectively, and attributable to our services segment were $61.9 million and $62.4 million, respectively. Acquired intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. We evaluate goodwill for impairment in the third quarter of our fiscal year, or on an interim basis if an event occurs or circumstances change that would, more likely than not, reduce the fair value of a reporting segment below its carrying value. Factors we consider important, on an overall company basis and segment basis, when applicable, that could trigger an impairment review include significant under-performance relative to historical or projected future operating results, significant changes in our use of the acquired assets or the strategy for our overall business, significant negative industry or economic trends, a significant decline in our stock price for a sustained period and a reduction of our market capitalization relative to net book value. We completed our annual goodwill impairment review as of July 4, 2015 and concluded that no impairment charge was required as of that date.

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

Goodwill and acquired intangible assets consisted of the following:

	January 2, 2016			September 30, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
	(in thousands)					
Goodwill (not amortized)			$1,086,230			$1,069,041
Intangible assets with finite lives (amortized) (1):						
Purchased software	$323,762	$178,483	$145,279	$284,257	$174,887	$109,370
Capitalized software	22,877	22,877	—	22,877	22,877	—
Customer lists and relationships	347,011	180,417	166,594	349,938	174,017	175,921
Trademarks and trade names	18,432	12,814	5,618	18,534	12,759	5,775
Other	3,905	3,726	179	3,946	3,711	235
	$715,987	$398,317	$317,670	$679,552	$388,251	$291,301
Total goodwill and acquired intangible assets			$1,403,900			$1,360,342

(1) The weighted average useful lives of purchased software, customer lists and relationships, trademarks and trade names and other intangible assets with a remaining net book value are 8 years, 10 years, 10 years, and 3 years, respectively.

Goodwill

Changes in goodwill presented by reportable segment were as follows:

	Software Products Segment	Services Segment	Total
	(in thousands)		
Balance, October 1, 2015	$1,016,413	$52,628	$1,069,041
Acquisition of Vuforia	23,316	—	23,316
Foreign currency translation adjustments	(6,082)	(45)	(6,127)
Balance, January 2, 2016	$1,033,647	$52,583	$1,086,230

Amortization of Intangible Assets

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

	Three months ended	
	January 2, 2016	January 3, 2015
	(in thousands)	
Amortization of acquired intangible assets	$8,350	$9,413
Cost of software revenue	5,127	4,767
Total amortization expense	$13,477	$14,180

8. Fair Value Measurements

Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance. Generally accepted accounting principles prescribe a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair

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value. A financial instrument’s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Three levels of inputs that may be used to measure fair value:

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

Our significant financial assets and liabilities measured at fair value on a recurring basis as of January 2, 2016 and September 30, 2015 were as follows: