

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, 2023

OR

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 1-11859

PEGASYSTEMS INC.

(Exact name of Registrant as specified in its charter)

Massachusetts

04-2787865

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

One Main Street, Cambridge, MA 02142

(Address of principal executive offices, including zip code)

(617) 374-9600

(Registrant's telephone number, including area code)

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

Title of each class

Trading symbol(s)

Name of each exchange on which registered

Common Stock, \$0.01 par value per share

PEGA

NASDAQ Global Select Market

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 x 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 during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). Yes x 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 Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

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

There were 83,555,919 shares of the Registrant's common stock, \$0.01 par value per share, outstanding on October 17, 2023.

PEGASYSTEMS INC.
QUARTERLY REPORT ON FORM 10-Q

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PEGASYSTEMS INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2023	December 31, 2022
Assets		
Current assets:		
Cash and cash equivalents	\$ 169,023	\$ 145,054
Marketable securities	167,286	152,167
Total cash, cash equivalents, and marketable securities	336,309	297,221
Accounts receivable, net	168,795	255,150
Unbilled receivables, net	199,948	213,719
Other current assets	71,438	80,388
Total current assets	776,490	846,478
Unbilled receivables, net	73,795	95,806
Goodwill	81,437	81,399
Other long-term assets	290,807	333,989
Total assets	\$ 1,222,529	\$ 1,357,672
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 20,541	\$ 18,195
Accrued expenses	43,624	50,355
Accrued compensation and related expenses	93,511	127,728
Deferred revenue	297,067	325,212
Other current liabilities	18,038	17,450
Total current liabilities	472,781	538,940
Convertible senior notes, net	498,753	593,609
Operating lease liabilities	68,874	79,152
Other long-term liabilities	14,485	15,128
Total liabilities	1,054,893	1,226,829
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Preferred stock, 1,000 shares authorized; none issued	—	—
Common stock, 200,000 shares authorized; 83,523 and 82,436 shares issued and outstanding at September 30, 2023 and December 31, 2022, respectively	835	824
Additional paid-in capital	343,259	229,602
Accumulated deficit	(151,370)	(76,513)
Accumulated other comprehensive (loss)	(25,088)	(23,070)
Total stockholders' equity	167,636	130,843
Total liabilities and stockholders' equity	\$ 1,222,529	\$ 1,357,672

See notes to unaudited condensed consolidated financial statements.

PEGASYSTEMS INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Revenue				
Subscription services	\$ 201,578	\$ 174,885	\$ 586,192	\$ 516,750
Subscription license	74,342	31,112	200,066	210,245
Consulting	55,976	55,511	167,396	175,451
Perpetual license	2,747	9,223	4,729	18,929
Total revenue	334,643	270,731	958,383	921,375
Cost of revenue				
Subscription services	35,906	34,541	109,553	103,104
Subscription license	629	628	1,971	1,923
Consulting	57,204	57,778	176,262	171,162
Perpetual license	24	103	51	173
Total cost of revenue	93,763	93,050	287,837	276,362
Gross profit	240,880	177,681	670,546	645,013
Operating expenses				
Selling and marketing	131,598	153,517	425,253	472,951
Research and development	74,955	75,342	224,262	221,173
General and administrative	27,321	26,043	73,893	94,530
Restructuring	17,822	—	21,450	—
Total operating expenses	251,696	254,902	744,858	788,654
(Loss) from operations	(10,816)	(77,221)	(74,312)	(143,641)
Foreign currency transaction gain (loss)	1,994	3,826	(3,971)	8,415
Interest income	2,532	520	5,831	1,036
Interest expense	(1,533)	(1,992)	(5,229)	(5,882)
(Loss) on capped call transactions	(2,294)	(6,876)	(449)	(56,381)
Other income (loss), net	6,383	(29)	18,668	6,497
(Loss) before provision for income taxes	(3,734)	(81,772)	(59,462)	(189,956)
Provision for income taxes	3,545	11,748	15,395	190,239
Net (loss)	<u><u>\$ (7,279)</u></u>	<u><u>\$ (93,520)</u></u>	<u><u>\$ (74,857)</u></u>	<u><u>\$ (380,195)</u></u>
(Loss) per share				
Basic	\$ (0.09)	\$ (1.14)	\$ (0.90)	\$ (4.65)
Diluted	\$ (0.09)	\$ (1.14)	\$ (0.90)	\$ (4.65)
Weighted-average number of common shares outstanding				
Basic	83,336	81,996	82,996	81,842
Diluted	83,336	81,996	82,996	81,842

See notes to unaudited condensed consolidated financial statements.

PEGASYSTEMS INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS)
(in thousands)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Net (loss)	\$ (7,279)	\$ (93,520)	\$ (74,857)	\$ (380,195)
Other comprehensive (loss), net of tax				
Unrealized (loss) on available-for-sale securities	(40)	(73)	(281)	(1,000)
Foreign currency translation adjustments	(3,687)	(6,700)	(1,737)	(20,936)
Total other comprehensive (loss), net of tax	<u>(3,727)</u>	<u>(6,773)</u>	<u>(2,018)</u>	<u>(21,936)</u>
Comprehensive (loss)	<u><u>\$ (11,006)</u></u>	<u><u>\$ (100,293)</u></u>	<u><u>\$ (76,875)</u></u>	<u><u>\$ (402,131)</u></u>

See notes to unaudited condensed consolidated financial statements.

PEGASYSTEMS INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except per share amounts)

	Common Stock		Retained Earnings		Accumulated Other Comprehensive (Loss)		Total Stockholders' Equity
	Number of Shares	Amount	Additional Paid-In Capital	(Accumulated Deficit)			
December 31, 2021	81,712	\$ 817	\$ 145,810	\$ 276,449	\$ (6,988)	\$ 416,088	
Repurchase of common stock	(242)	(2)	(22,581)	—	—	—	(22,583)
Issuance of common stock for stock compensation plans	297	3	(12,131)	—	—	—	(12,128)
Issuance of common stock under the employee stock purchase plan	35	—	2,446	—	—	—	2,446
Stock-based compensation	—	—	28,227	—	—	—	28,227
Cash dividends declared (\$ 0.03 per share)	—	—	—	(2,455)	—	—	(2,455)
Other comprehensive (loss)	—	—	—	—	(2,548)	—	(2,548)
Net (loss)	—	—	—	(379)	—	—	(379)
March 31, 2022	81,802	\$ 818	\$ 141,771	\$ 273,615	\$ (9,536)	\$ 406,668	
Repurchase of common stock	(38)	—	(1,925)	—	—	—	(1,925)
Issuance of common stock for stock compensation plans	117	1	(3,252)	—	—	—	(3,251)
Issuance of common stock under the employee stock purchase plan	59	—	2,357	—	—	—	2,357
Stock-based compensation	—	—	31,300	—	—	—	31,300
Cash dividends declared (\$ 0.03 per share)	—	—	—	(2,459)	—	—	(2,459)
Other comprehensive (loss)	—	—	—	—	(12,615)	—	(12,615)
Net (loss)	—	—	—	(286,296)	—	—	(286,296)
June 30, 2022	81,940	\$ 819	\$ 170,251	\$ (15,140)	\$ (22,151)	\$ 133,779	
Issuance of common stock for stock compensation plans	138	2	(2,198)	—	—	—	(2,196)
Issuance of common stock under the employee stock purchase plan	86	1	2,362	—	—	—	2,363
Stock-based compensation	—	—	33,774	—	—	—	33,774
Cash dividends declared (\$ 0.03 per share)	—	—	—	(2,466)	—	—	(2,466)
Other comprehensive (loss)	—	—	—	—	(6,773)	—	(6,773)
Net (loss)	—	—	—	(93,520)	—	—	(93,520)
September 30, 2022	82,164	\$ 822	\$ 204,189	\$ (111,126)	\$ (28,924)	\$ 64,961	

PEGASYSTEMS INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except per share amounts)

	Common Stock		Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive (Loss)	Total Stockholders' Equity
	Number of Shares	Amount				
December 31, 2022	82,436	\$ 824	\$ 229,602	\$ (76,513)	\$ (23,070)	\$ 130,843
Issuance of common stock for stock compensation plans	452	4	668	—	—	672
Issuance of common stock under the employee stock purchase plan	52	1	2,142	—	—	2,143
Stock-based compensation	—	—	42,557	—	—	42,557
Cash dividends declared (\$ 0.03 per share)	—	—	(2,488)	—	—	(2,488)
Other comprehensive income	—	—	—	—	1,543	1,543
Net (loss)	—	—	—	(20,774)	—	(20,774)
March 31, 2023	82,940	\$ 829	\$ 272,481	\$ (97,287)	\$ (21,527)	\$ 154,496
Issuance of common stock for stock compensation plans	225	2	1,824	—	—	1,826
Issuance of common stock under the employee stock purchase plan	47	1	1,980	—	—	1,981
Stock-based compensation	—	—	36,227	—	—	36,227
Cash dividends declared (\$ 0.03 per share)	—	—	(2,496)	—	—	(2,496)
Other comprehensive income	—	—	—	—	166	166
Net (loss)	—	—	—	(46,804)	—	(46,804)
June 30, 2023	83,212	\$ 832	\$ 310,016	\$ (144,091)	\$ (21,361)	\$ 145,396
Issuance of common stock for stock compensation plans	257	3	2,447	—	—	2,450
Issuance of common stock under the employee stock purchase plan	54	—	2,003	—	—	2,003
Stock-based compensation	—	—	31,299	—	—	31,299
Cash dividends declared (\$ 0.03 per share)	—	—	(2,506)	—	—	(2,506)
Other comprehensive (loss)	—	—	—	—	(3,727)	(3,727)
Net (loss)	—	—	—	(7,279)	—	(7,279)
September 30, 2023	83,523	\$ 835	\$ 343,259	\$ (151,370)	\$ (25,088)	\$ 167,636

See notes to unaudited condensed consolidated financial statements.

PEGASYSTEMS INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30,	
	2023	2022
Operating activities		
Net (loss)	\$ (74,857)	\$ (380,195)
Adjustments to reconcile net (loss) to cash provided by (used in) operating activities		
Stock-based compensation	110,083	93,301
Deferred income taxes	(188)	169,489
Loss on capped call transactions	449	56,381
Amortization of deferred commissions	43,974	39,752
Lease expense	12,018	11,500
Amortization of intangible assets and depreciation	14,181	12,381
Foreign currency transaction loss (gain)	3,971	(8,415)
Other non-cash	(16,487)	(1,705)
Change in operating assets and liabilities, net	44,776	(5,935)
Cash provided by (used in) operating activities	<u>137,920</u>	<u>(13,446)</u>
Investing activities		
Purchases of investments	(190,466)	(39,056)
Proceeds from maturities and called investments	169,836	53,952
Sales of investments	10,725	18,415
Payments for acquisitions, net of cash acquired	—	(922)
Investment in property and equipment	(14,271)	(22,285)
Cash (used in) provided by investing activities	<u>(24,176)</u>	<u>10,104</u>
Financing activities		
Repurchases of convertible senior notes	(88,989)	—
Dividend payments to stockholders	(7,458)	(7,368)
Proceeds from employee stock purchase plan	6,127	7,166
Proceeds from stock option exercises	6,602	—
Common stock repurchases	(1,654)	(43,282)
Other	341	—
Cash (used in) financing activities	<u>(85,031)</u>	<u>(43,484)</u>
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	<u>(1,621)</u>	<u>(5,513)</u>
Net increase (decrease) in cash, cash equivalents, and restricted cash	27,092	(52,339)
Cash, cash equivalents, and restricted cash, beginning of period	<u>145,054</u>	<u>159,965</u>
Cash, cash equivalents, and restricted cash, end of period	<u>\$ 172,146</u>	<u>\$ 107,626</u>
Cash and cash equivalents	\$ 169,023	\$ 107,626
Restricted cash included in other long-term assets	3,123	—
Total cash, cash equivalents, and restricted cash	<u>\$ 172,146</u>	<u>\$ 107,626</u>

See notes to unaudited condensed consolidated financial statements.

PEGASYSTEMS INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

Pegasystems Inc. (together with its subsidiaries, "the Company") has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC") regarding interim financial reporting. Accordingly, they do not include all the information required by accounting principles generally accepted in the United States of America ("U.S.") for complete financial statements and should be read in conjunction with the Company's audited financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2022.

In the opinion of management, the Company has prepared the accompanying unaudited condensed consolidated financial statements on the same basis as its audited financial statements, and these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented.

All intercompany transactions and balances were eliminated in consolidation. The operating results for the interim periods presented do not necessarily indicate the expected results for 2023.

NOTE 2. MARKETABLE SECURITIES

(in thousands)	September 30, 2023				December 31, 2022			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Government debt	\$ 17,931	\$ —	\$ (18)	\$ 17,913	\$ 2,960	\$ —	\$ (52)	\$ 2,908
Corporate debt	149,927	—	(554)	149,373	151,906	—	(2,647)	149,259
	<u>\$ 167,858</u>	<u>\$ —</u>	<u>\$ (572)</u>	<u>\$ 167,286</u>	<u>\$ 154,866</u>	<u>\$ —</u>	<u>\$ (2,699)</u>	<u>\$ 152,167</u>

As of September 30, 2023, marketable securities' maturities ranged from October 2023 to January 2026, with a weighted average remaining maturity of 0.5 years.

NOTE 3. RECEIVABLES, CONTRACT ASSETS, AND DEFERRED REVENUE

Receivables

(in thousands)	September 30, 2023	December 31, 2022
Accounts receivable, net	\$ 168,795	\$ 255,150
Unbilled receivables, net	199,948	213,719
Long-term unbilled receivables, net	73,795	95,806
	<u>\$ 442,538</u>	<u>\$ 564,675</u>

Unbilled receivables

Unbilled receivables are client-committed amounts for which revenue recognition precedes billing. Billing is solely subject to the passage of time.

Unbilled receivables by expected collection date:

(Dollars in thousands)	September 30, 2023	
1 year or less	\$ 199,948	73 %
1-2 years	58,604	21 %
2-5 years	15,191	6 %
	<u>\$ 273,743</u>	<u>100 %</u>

Unbilled receivables by contract effective date:

(Dollars in thousands)	September 30, 2023	
2023	\$ 90,227	33 %
2022	92,065	34 %
2021	62,729	23 %
2020	19,820	7 %
2019 and prior	8,902	3 %
	<u>\$ 273,743</u>	<u>100 %</u>

PEGASYSTEMS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Contract assets

Contract assets are client-committed amounts for which revenue recognized exceeds the amount billed to the client, and billing is subject to conditions other than the passage of time, such as the completion of a related performance obligation.

(in thousands)

	September 30, 2023	December 31, 2022
Contract assets ⁽¹⁾	\$ 13,263	\$ 17,546
Long-term contract assets ⁽²⁾	10,732	16,470
	<u><u>\$ 23,995</u></u>	<u><u>\$ 34,016</u></u>

(1) Included in other current assets.

(2) Included in other long-term assets.

Deferred revenue

Deferred revenue consists of billings and payments received in advance of revenue recognition.

(in thousands)

	September 30, 2023	December 31, 2022
Deferred revenue	\$ 297,067	\$ 325,212
Long-term deferred revenue ⁽¹⁾	2,605	3,552
	<u><u>\$ 299,672</u></u>	<u><u>\$ 328,764</u></u>

(1) Included in other long-term liabilities.

Deferred revenue decreased in the nine months ended September 30, 2023, primarily due to \$ 292.3 million of revenue recognized during the period included in deferred revenue as of December 31, 2022 exceeded new billings in advance of revenue recognition.

NOTE 4. DEFERRED COMMISSIONS

(in thousands)

	September 30, 2023	December 31, 2022
Deferred commissions ⁽¹⁾	\$ 107,399	\$ 130,195

(1) Included in other long-term assets.

	Three Months Ended		Nine Months Ended	
	September 30,	2023	September 30,	2023
(in thousands)				
Amortization of deferred commissions ⁽¹⁾	\$ 14,947	\$ 11,597	\$ 43,974	\$ 39,752

(1) Included in selling and marketing.

NOTE 5. GOODWILL AND OTHER INTANGIBLES

Goodwill

	Nine Months Ended	
	September 30,	2023
(in thousands)		
January 1,	\$ 81,399	\$ 81,923
Currency translation adjustments	38	(722)
September 30,	<u><u>\$ 81,437</u></u>	<u><u>\$ 81,201</u></u>

Intangibles

Intangible assets are recorded at cost and amortized using the straight-line method over their estimated useful lives.

	Useful Lives	September 30, 2023		
		Cost	Accumulated Amortization	Net Book Value ⁽¹⁾
(in thousands)				
Client-related	4 - 10 years	\$ 63,086	\$ (59,661)	\$ 3,425
Technology	2 - 10 years	68,103	(63,579)	4,524
Other	1 - 5 years	5,361	(5,361)	—
		<u><u>\$ 136,550</u></u>	<u><u>\$ (128,601)</u></u>	<u><u>\$ 7,949</u></u>

(1) Included in other long-term assets.

PEGASYSTEMS INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands)	Useful Lives	December 31, 2022		
		Cost	Accumulated Amortization	Net Book Value ⁽¹⁾
Client-related	4 - 10 years	\$ 63,076	\$ (58,623)	\$ 4,453
Technology	2 - 10 years	68,056	(61,621)	6,435
Other	1 - 5 years	5,361	(5,361)	—
		\$ 136,493	\$ (125,605)	\$ 10,888

(1) Included in other long-term assets.

Future estimated intangibles assets amortization:

(in thousands)	September 30, 2023	
Remainder of 2023	\$	964
2024		3,169
2025		2,615
2026		874
2027		327
	\$	7,949

Amortization of intangible assets:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Cost of revenue	\$ 622	\$ 705	\$ 1,949	\$ 2,017
Selling and marketing	343	343	1,028	1,028
	\$ 965	\$ 1,048	\$ 2,977	\$ 3,045

NOTE 6. OTHER ASSETS AND LIABILITIES

Other current assets

(in thousands)	September 30, 2023	December 31, 2022
Income tax receivables	\$ 19,663	\$ 25,354
Contract assets	13,263	17,546
Other	38,512	37,488
	\$ 71,438	\$ 80,388

Other long-term assets

(in thousands)	September 30, 2023	December 31, 2022
Deferred commissions	\$ 107,399	\$ 130,195
Right of use assets	65,871	76,114
Property and equipment	49,481	55,056
Venture investments	19,348	13,069
Contract assets	10,732	16,470
Intangible assets	7,949	10,888
Capped call transactions	1,792	2,582
Deferred income taxes	5,046	4,795
Restricted cash	3,123	—
Other	20,066	24,820
	\$ 290,807	\$ 333,989

Other current liabilities

(in thousands)

	September 30, 2023	December 31, 2022
Operating lease liabilities	\$ 15,532	\$ 14,976
Dividends payable	2,506	2,474
	<u><u>\$ 18,038</u></u>	<u><u>\$ 17,450</u></u>

PEGASYSTEMS INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Other long-term liabilities

(in thousands)	September 30, 2023	December 31, 2022
Deferred revenue	\$ 2,605	\$ 3,552
Income taxes payable	2,017	3,207
Other	9,863	8,369
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	\$ 14,485	\$ 15,128

NOTE 7. LEASES

Expense

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Fixed lease costs	\$ 4,718	\$ 4,688	\$ 14,979	\$ 14,747
Short-term lease costs	660	916	2,137	2,510
Variable lease costs	2,254	905	6,414	2,395
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	\$ 7,632	\$ 6,509	\$ 23,530	\$ 19,652

Right of use assets and lease liabilities

(in thousands)	September 30, 2023	December 31, 2022
Right of use assets ⁽¹⁾	\$ 65,871	\$ 76,114
Operating lease liabilities ⁽²⁾	\$ 15,532	\$ 14,976
Long-term operating lease liabilities	\$ 68,874	\$ 79,152

(1) Included in other long-term assets.

(2) Included in other current liabilities.

Weighted-average remaining lease term and discount rate for the Company's leases were:

	September 30, 2023	December 31, 2022
Weighted-average remaining lease term	7.0 years	7.5 years
Weighted-average discount rate ⁽¹⁾	4.0 %	4.1 %

(1) The rates implicit in most of the Company's leases are not readily determinable. Therefore, the Company uses its incremental borrowing rate as the discount rate when measuring operating lease liabilities. The incremental borrowing rate represents an estimate of the interest rate the Company would incur to borrow an amount equal to the lease payments on a collateralized basis over the lease term in a similar economic environment.

Maturities of lease liabilities:

(in thousands)	September 30, 2023
Remainder of 2023	\$ 4,775
2024	17,976
2025	14,870
2026	10,853
2027	9,808
2028	9,245
Thereafter	30,054
Total lease payments	97,581
Less: imputed interest ⁽¹⁾	(13,175)
	<hr/> <hr/> <hr/> <hr/> <hr/>
	\$ 84,406

(1) Lease liabilities are measured at the present value of the remaining lease payments using a discount rate determined at lease commencement unless the discount rate is updated due to a lease reassessment event.

Cash flow information

<i>(in thousands)</i>	Nine Months Ended September 30,	
	2023	2022
Cash paid for operating leases, net of tenant improvement allowances	\$ 14,378	\$ 11,628
Right of use assets recognized for new leases and amendments (non-cash)	\$ 1,782	\$ 6,618

PEGASYSTEMS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 8. DEBT

Convertible senior notes and capped calls

Convertible senior notes

In February 2020, the Company issued Convertible Senior Notes (the "Notes") with an aggregate principal of \$ 600 million, due March 1, 2025, in a private placement. No principal payments are due before maturity. The Notes accrue interest at an annual rate of 0.75 %, payable semi-annually in arrears on March 1 and September 1, beginning September 1, 2020.

In the nine months ended September 30, 2023, the Company recognized a gain of \$ 7.9 million in other income (loss), net from repurchases of Notes representing \$ 97.7 million in aggregate principal amount.

Conversion rights

The conversion rate is 7.4045 shares of common stock per \$1,000 principal amount of the Notes, representing an initial conversion price of \$ 135.05 per share of common stock. The conversion rate will be adjusted upon certain events, including spin-offs, tender offers, exchange offers, and certain stockholder distributions. The Company will settle conversions by paying or delivering cash, shares of its common stock, or a combination of cash and shares of its common stock, at the Company's election, based on the applicable conversion rate.

Beginning on September 1, 2024, noteholders may convert their Notes at any time at their election.

Before September 1, 2024, noteholders may convert their Notes in the following circumstances:

- During any calendar quarter beginning after June 30, 2020 (and only during such calendar quarter), if the last reported sale price per share of the Company's common stock exceeds 130 % of the conversion price for each of at least 20 trading days (whether or not consecutive) during the 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter.
- During the five consecutive business days immediately after any five consecutive trading day period (the "Measurement Period"), if the trading price per \$1,000 principal amount of Notes for each trading day of the Measurement Period was less than 98 % of the product of the last reported sale price per share of common stock on such trading day and the conversion rate on such trading day.
- Upon certain corporate events or distributions or if the Company calls any Notes for redemption, noteholders may convert before the close of business on the business day immediately before the related redemption date (or, if the Company fails to pay the redemption price in full on the redemption date until the Company pays the redemption price).

As of September 30, 2023, the Notes were not eligible for conversion.

Repurchase rights

On or after March 1, 2023 and on or before the 40 th scheduled trading day immediately before the maturity date, the Company may redeem for cash all or part of the Notes at a repurchase price equal to 100 % of the principal amount, plus accrued and unpaid interest, if the last reported sale price of the Company's common stock exceeded 130 % of the conversion price then in effect for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading day period ending on, and including, the trading day immediately preceding the date on which the Company provides a redemption notice.

If certain corporate events that constitute a "Fundamental Change" occur, each noteholder will have the right to require the Company to repurchase for cash all of such noteholder's Notes, or any portion of the principal thereof that is equal to \$1,000 or a multiple of \$1,000, at a repurchase price equal to 100 % of the principal amount thereof, plus accrued and unpaid interest. A Fundamental Change relates to mergers, changes in control of the Company, liquidation/dissolution of the Company, or the delisting of the Company's common stock.

Carrying value of the Notes:

(in thousands)	September 30, 2023	December 31, 2022
Principal	\$ 502,270	\$ 600,000
Unamortized issuance costs	(3,517)	(6,391)
Convertible senior notes, net	\$ 498,753	\$ 593,609

Interest expense related to the Notes:

(in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2023	2022	September 30, 2023	2022
Contractual interest expense (0.75 % coupon)	\$ 827	\$ 1,125	\$ 2,949	\$ 3,375
Amortization of issuance costs	613	724	1,988	2,163
	\$ 1,440	\$ 1,849	\$ 4,937	\$ 5,538

PEGASYSTEMS INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The average interest rate on the Notes in the nine months ended September 30, 2023 and 2022 was 1.2 %.

Future payments:

(in thousands)	September 30, 2023		
	Principal	Interest	Total
2024	\$ —	\$ 3,767	\$ 3,767
2025	502,270	1,884	504,154
	\$ 502,270	\$ 5,651	\$ 507,921

Capped call transactions

In February 2020, the Company entered into privately negotiated capped call transactions (the "Capped Call Transactions") with certain financial institutions. The Capped Call Transactions covered approximately 4.4 million shares (representing the number of shares for which the Notes were initially convertible) of the Company's common stock.

In the nine months ended September 30, 2023, Capped Call Transactions covering approximately 0.7 million shares were settled for proceeds of \$ 0.3 million. As of September 30, 2023, Capped Call Transactions covering approximately 3.7 million shares were outstanding.

The Capped Call Transactions are expected to reduce common stock dilution and/or offset any potential cash payments the Company must make, other than for principal and interest, upon conversion of the Notes, with such reduction and/or offset subject to a cap of \$ 196.44 . The cap price of the Capped Call Transactions is subject to adjustment upon specified extraordinary events affecting the Company, including mergers and tender offers.

The Capped Call Transactions are accounted for as derivative instruments and do not qualify for the Company's own equity scope exception in ASC 815 since, in some cases of early settlement, the settlement value calculated following the governing documents may not represent a fair value measurement. The Capped Call Transactions are classified as other long-term assets and remeasured to fair value each reporting period, resulting in a non-operating gain or loss.

Change in capped call transactions:

(in thousands)	Nine Months Ended September 30,	
	2023	2022
January 1,	\$ 2,582	\$ 59,964
Settlements	(341)	—
Fair value adjustment	(449)	(56,381)
September 30,	\$ 1,792	\$ 3,583

Credit facility

In November 2019, and as since amended, the Company entered into a five-year \$ 100 million senior secured revolving credit agreement (the "Credit Facility") with PNC Bank, National Association. The Company may use borrowings for general corporate purposes and to finance working capital needs. Subject to specific conditions and the agreement of the financial institutions lending the additional amount, the aggregate commitment may be increased to \$ 200 million. The commitments expire on November 4, 2024, and any outstanding loans will be payable on such date. The Credit Facility, as amended, contains customary covenants, including, but not limited to, those relating to additional indebtedness, liens, asset divestitures, and affiliate transactions.

The Company is required to comply with financial covenants, including:

- Through December 31, 2023, the parent company must maintain at least \$ 200 million in cash, investments, and availability under the Credit Facility and the Company must maintain:

(in thousands)	Year to Date			
	March 31, 2023	June 30, 2023	September 30, 2023	December 31, 2023
Minimum Consolidated EBITDA (as defined in the Credit Facility)	\$ 38,862	\$ 59,894	\$ 95,597	\$ 214,590

- Beginning with the fiscal quarter ended March 31, 2024, a maximum net consolidated leverage ratio of 3.5 to 1.0 (with a step-up for certain acquisitions) and a minimum consolidated interest coverage ratio of 3.5 to 1.0.

As of September 30, 2023 and December 31, 2022, the Company had \$ 27.3 million in outstanding letters of credit, which reduced the Company's available borrowing capacity under the Credit Facility and no outstanding cash borrowings under the Credit Facility.

PEGASYSTEMS INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 9. RESTRUCTURING

The Company has undertaken the following restructuring activities as it optimizes its go-to-market strategy and reassesses its office space needs:

	Three months ended	Expense
Employee severance and related benefits and closure of a US office	December 31, 2022	\$ 21,743
Office space reduction	March 31, 2023	\$ 1,241
Employee severance and related benefits	June 30, 2023	\$ 1,581
Employee severance and related benefits and closure of a foreign office	September 30, 2023	\$ 17,236

Accrued employee severance and related benefits:

Change for all restructuring actions:

	Nine Months Ended	September 30,
		2023
(in thousands)		
January 1,	\$ 18,573	
Costs incurred		19,921
Cash disbursements		(21,576)
Currency translation adjustments		(203)
September 30,	\$ 16,715	

Note: Accrued employee severance and related benefits is included in accrued compensation and related expenses.

NOTE 10. FAIR VALUE MEASUREMENTS

Assets and liabilities measured at fair value on a recurring basis

The Company records its cash equivalents, marketable securities, Capped Call Transactions, and venture investments at fair value on a recurring basis. Fair value is an exit price, representing the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants based on assumptions that market participants would use in pricing an asset or liability.

As a basis for classifying the fair value measurements, a three-tier fair value hierarchy, which classifies the fair value measurements based on the inputs used in measuring fair value, was established as follows:

- Level 1 - observable inputs, such as quoted prices in active markets for identical assets or liabilities;
- Level 2 - significant other inputs that are observable either directly or indirectly; and
- Level 3 - significant unobservable inputs with little or no market data, which require the Company to develop its own assumptions.

This hierarchy requires the Company to use observable market data when available and minimize unobservable inputs when determining fair value.

The fair value of the Capped Call Transactions at the end of each reporting period is determined using a Black-Scholes option-pricing model. The valuation model uses various market-based inputs, including stock price, remaining contractual term, expected volatility, risk-free interest rate, and expected dividend yield. The Company applies judgment when determining expected volatility. The Company considers the underlying equity security's historical and implied volatility levels. The Company's venture investments are recorded at fair value based on multiple valuation methods, including observable public companies and transaction prices and unobservable inputs, including the volatility, rights, and obligations of the securities the Company holds.

Assets and liabilities measured at fair value on a recurring basis:

	September 30, 2023				December 31, 2022			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
(in thousands)								
Cash equivalents	\$ 22,686	\$ —	\$ —	\$ 22,686	\$ 2,526	\$ —	\$ —	\$ 2,526
Marketable securities	\$ —	\$ 167,286	\$ —	\$ 167,286	\$ —	\$ 152,167	\$ —	\$ 152,167
Capped Call Transactions ⁽¹⁾	\$ —	\$ 1,792	\$ —	\$ 1,792	\$ —	\$ 2,582	\$ —	\$ 2,582
Venture investments ⁽¹⁾⁽²⁾	\$ —	\$ —	\$ 19,348	\$ 19,348	\$ —	\$ —	\$ 13,069	\$ 13,069

(1) Included in other long-term assets.

(2) Investments in privately-held companies.

PEGASYSTEMS INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Changes in venture investments:

(in thousands)	Nine Months Ended September 30,	
	2023	2022
January 1,	\$ 13,069	\$ 7,648
New investments	400	400
Sales of investments	(2,773)	(3,954)
Changes in foreign exchange rates	27	(675)
Changes in fair value:		
included in other income (loss), net	10,886	5,989
included in other comprehensive (loss)	(2,261)	2,502
September 30,	\$ 19,348	\$ 11,910

The carrying value of certain financial instruments, including receivables and accounts payable, approximates fair value due to their short maturities.

Fair value of the Notes

The fair value of the Notes outstanding (including the embedded conversion feature) was \$ 460.3 million as of September 30, 2023 and \$ 521.1 million as of December 31, 2022. In the nine months ended September 30, 2023 the Company repurchased Notes representing \$ 97.7 million in aggregate principal amount.

The fair value was determined based on the Notes' quoted price in an over-the-counter market on the last trading day of the reporting period and classified within Level 2 in the fair value hierarchy.

NOTE 11. REVENUE

Geographic revenue

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
U.S.	\$ 154,741	47 %	\$ 148,200	55 %
Other Americas	23,497	7 %	18,546	7 %
United Kingdom ("U.K.")	41,622	12 %	24,074	9 %
Europe (excluding U.K.), Middle East, and Africa	67,880	20 %	46,212	17 %
Asia-Pacific	46,903	14 %	33,699	12 %
	\$ 334,643	100 %	\$ 270,731	100 %
	\$ 958,383	100 %	\$ 921,375	100 %

Revenue streams

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Perpetual license	\$ 2,747	\$ 9,223	\$ 4,729	\$ 18,929
Subscription license	74,342	31,112	200,066	210,245
Revenue recognized at a point in time	77,089	40,335	204,795	229,174
Maintenance	83,538	77,526	245,210	235,568
Pega Cloud	118,040	97,359	340,982	281,182
Consulting	55,976	55,511	167,396	175,451
Revenue recognized over time	257,554	230,396	753,588	692,201
Total revenue	\$ 334,643	\$ 270,731	\$ 958,383	\$ 921,375

PEGASYSTEMS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Pega Cloud	\$ 118,040	\$ 97,359	\$ 340,982	\$ 281,182
Maintenance	83,538	77,526	245,210	235,568
Subscription services	201,578	174,885	586,192	516,750
Subscription license	74,342	31,112	200,066	210,245
Subscription	275,920	205,997	786,258	726,995
Consulting	55,976	55,511	167,396	175,451
Perpetual license	2,747	9,223	4,729	18,929
	<u><u>\$ 334,643</u></u>	<u><u>\$ 270,731</u></u>	<u><u>\$ 958,383</u></u>	<u><u>\$ 921,375</u></u>

Remaining performance obligations ("Backlog")

Expected future revenue from existing non-cancellable contracts:

As of September 30, 2023:

(Dollars in thousands)	Subscription services		Subscription			Total
	Maintenance	Pega Cloud	license	Perpetual license	Consulting	
1 year or less	\$ 202,610	\$ 391,324	\$ 48,427	\$ 4,567	\$ 39,335	\$ 686,263 54 %
1-2 years	58,610	239,787	4,356	2,696	3,662	309,111 24 %
2-3 years	28,585	121,778	8,518	—	1,100	159,981 13 %
Greater than 3 years	17,478	89,870	2,664	—	—	110,012 9 %
	<u><u>\$ 307,283</u></u>	<u><u>\$ 842,759</u></u>	<u><u>\$ 63,965</u></u>	<u><u>\$ 7,263</u></u>	<u><u>\$ 44,097</u></u>	<u><u>\$ 1,265,367 100 %</u></u>

As of September 30, 2022:

(Dollars in thousands)	Subscription services		Subscription			Total
	Maintenance	Pega Cloud	license	Perpetual license	Consulting	
1 year or less	\$ 191,045	\$ 328,111	\$ 69,753	\$ 814	\$ 27,968	\$ 617,691 53 %
1-2 years	55,141	213,304	4,113	4,505	6,699	283,762 25 %
2-3 years	24,496	115,416	1,420	2,252	1,648	145,232 13 %
Greater than 3 years	16,198	82,807	1,734	—	508	101,247 9 %
	<u><u>\$ 286,880</u></u>	<u><u>\$ 739,638</u></u>	<u><u>\$ 77,020</u></u>	<u><u>\$ 7,571</u></u>	<u><u>\$ 36,823</u></u>	<u><u>\$ 1,147,932 100 %</u></u>

NOTE 12. STOCK-BASED COMPENSATION

Expense

(in thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Cost of revenue	\$ 6,410	\$ 6,797	\$ 22,497	\$ 19,754
Selling and marketing	10,401	12,933	43,410	36,524
Research and development	7,375	7,724	24,286	22,425
General and administrative	7,113	6,320	19,890	14,598
	<u><u>\$ 31,299</u></u>	<u><u>\$ 33,774</u></u>	<u><u>\$ 110,083</u></u>	<u><u>\$ 93,301</u></u>
Income tax benefit	\$ (316)	\$ (600)	\$ (1,569)	\$ (1,505)

As of September 30, 2023, the Company had \$ 137.5 million of unrecognized stock-based compensation expense, net of estimated forfeitures, which is expected to be recognized over a weighted-average period of 1.8 years.

PEGASYSTEMS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Grants

	Nine Months Ended September 30, 2023	
(in thousands)	Shares	Total Fair Value
Restricted stock units	1,514	\$ 70,962
Non-qualified stock options	911	\$ 19,142
Performance stock options ⁽¹⁾	906	\$ 18,265
Common stock	13	\$ 600

(1) Performance stock options allow the holder to purchase a specified number of common stock shares at an exercise price equal to or greater than the shares' fair market value at the grant date. The options usually vest over two years and expire ten years from the grant date, subject to specific performance conditions.

NOTE 13. INCOME TAXES

Effective income tax rate

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Provision for income taxes	\$ 3,545	\$ 11,748	\$ 15,395	\$ 190,239
Effective income tax rate			(26)%	(100)%

The Company's effective income tax rate in the nine months ended September 30, 2023 was primarily driven by the valuation allowance on the Company's deferred tax assets in the U.S. and U.K. and projected taxable income in the U.S., partially offset by available tax credits and losses in the U.S.

The Company recognizes deferred tax assets to the extent that it believes that these assets are more likely than not to be realized. A deferred tax valuation allowance requires significant judgment and uncertainties, including assumptions about future taxable income. Quarterly, the Company reassesses the need for a valuation allowance on its net deferred tax assets by weighting all available and objectively verifiable negative and positive evidence, including projected future reversals of existing taxable temporary differences, committed contractual backlog ("Backlog"), projected future taxable income, including the impact of enacted legislation, tax-planning strategies, and recent operating results.

The Company intends to maintain a valuation allowance on the Company's U.S. and U.K. net deferred tax assets until sufficient evidence exists to support the realization of these deferred tax assets.

NOTE 14. (LOSS) PER SHARE

Basic (loss) per share is calculated using the weighted-average number of common shares outstanding during the period. Diluted (loss) per share is calculated using the weighted-average number of common shares outstanding during the period, plus the dilutive effect of outstanding stock options, RSUs, and convertible senior notes.

Calculation of (loss) per share:

(in thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Net (loss)	\$ (7,279)	\$ (93,520)	\$ (74,857)	\$ (380,195)
Weighted-average common shares outstanding	83,336	81,996	82,996	81,842
(Loss) per share, basic	\$ (0.09)	\$ (1.14)	\$ (0.90)	\$ (4.65)
Net (loss)	\$ (7,279)	\$ (93,520)	\$ (74,857)	\$ (380,195)
Weighted-average common shares outstanding, assuming dilution ^{(1) (2) (3)}	83,336	81,996	82,996	81,842
(Loss) per share, diluted	\$ (0.09)	\$ (1.14)	\$ (0.90)	\$ (4.65)
Outstanding anti-dilutive stock options and RSUs ⁽⁴⁾	2,255	3,019	1,652	3,589

(1) All dilutive securities are excluded in periods of loss as their inclusion would be anti-dilutive.

(2) The shares underlying the conversion options in the Company's Notes are included using the if-converted method, if dilutive in the period. If the outstanding conversion options were fully exercised, the Company would issue approximately 3.7 million shares as of September 30, 2023.

(3) The Company's Capped Call Transactions represent the equivalent of approximately 3.7 million shares of the Company's common stock (representing the number of shares for which the Notes are convertible) as of September 30, 2023. The Capped Call Transactions are expected to reduce common stock dilution and/or offset any potential cash payments the Company must make, other than for principal and interest, upon conversion of the Notes, with such reduction and/or offset subject to a cap of \$ 196.44 . The Capped Call Transactions are excluded from weighted-average common shares outstanding, assuming dilution, in all periods as their effect would be anti-dilutive.

PEGASYSTEMS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(4) Outstanding stock options and RSUs that were anti-dilutive under the treasury stock method in the period were excluded from the computation of diluted (loss) per share. These awards may be dilutive in the future.

NOTE 15. COMMITMENTS AND CONTINGENCIES

Commitments

See "Note 7. Leases" for additional information.

Legal proceedings

In addition to the matters below, the Company is or may become involved in a variety of claims, demands, suits, investigations, and proceedings that arise from time to time relating to matters incidental to the ordinary course of the Company's business, including actions concerning contracts, intellectual property, employment, benefits, and securities matters. Regardless of the outcome, legal disputes can have a material effect on the Company because of defense and settlement costs, diversion of management resources, and other factors.

In addition, as the Company is a party to ongoing litigation, it is at least reasonably possible that the Company's estimates will change in the near term, and the effect may be material.

The Company had no accrued losses for litigation as of September 30, 2023 and December 31, 2022.

Appian Corp. v. Pegasystems Inc. & Youyong Zou

As previously reported, the Company is a defendant in litigation brought by Appian in the Circuit Court of Fairfax County, Virginia (the "Court") titled Appian Corp. v. Pegasystems Inc. & Youyong Zou, No. 2020-07216 (Fairfax Cty. Ct.). On May 9, 2022, the jury rendered its verdict finding that the Company had misappropriated one or more of Appian's trade secrets, that the Company had violated the Virginia Computer Crimes Act, and that the trade secret misappropriation was willful and malicious. The jury awarded damages of \$ 2,036,860,045 for trade secret misappropriation and \$ 1.00 for violating the Virginia Computer Crimes Act. On September 15, 2022, the circuit court of Fairfax County entered judgment of \$ 2,060,479,287 , consisting of the damages previously awarded by the jury plus attorneys' fees and costs, and stating that the judgment is subject to post-judgment interest at a rate of 6.0 % per annum, from the date of the jury verdict (May 9, 2022) as to the amount of the jury verdict and from September 15, 2022 as to the amount of the award of attorneys' fees and costs. On September 15, 2022, the Company filed a notice of appeal from the judgment. On September 29, 2022, the circuit court of Fairfax County approved a \$ 25,000,000 letter of credit obtained by the Company to secure the judgment and entered an order suspending the judgment during the pendency of the Company's appeal. Appellate briefing in the Court of Appeals of Virginia is completed. The Court of Appeals of Virginia has set November 15, 2023 as the date for oral arguments in the appeal. Although it is not possible to predict timing, this appeals process could potentially take years to complete. The Company continues to believe that it did not misappropriate any alleged trade secrets and that its sales of the Company's products at issue were not caused by, or the result of, any alleged misappropriation of trade secrets. The Company is unable to reasonably estimate possible damages because of, among other things, uncertainty as to the outcome of appellate proceedings and/or any potential new trial resulting from the appellate proceedings.

City of Fort Lauderdale Police and Firefighters' Retirement System, Individually and on Behalf of All Others Similarly Situated v. Pegasystems Inc., Alan Trefler, and Kenneth Stillwell

On May 19, 2022, a lawsuit was filed against the Company, the Company's chief executive officer and the Company's chief operating and financial officer in the United States District Court for the Eastern District of Virginia Alexandria Division, captioned City of Fort Lauderdale Police and Firefighters' Retirement System, Individually and on Behalf of All Others Similarly Situated v. Pegasystems Inc., Alan Trefler, and Kenneth Stillwell (Case 1:22-cv-00578-LMB-IDD). The complaint generally alleges, among other things, that the defendants violated Section 10(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and Rule 10b-5 promulgated thereunder and that the individual defendants violated Section 20(a) of the Exchange Act, in each case by allegedly making materially false and/or misleading statements, as well as allegedly failing to disclose material adverse facts about the Company's business, operations, and prospects, which caused the Company's securities to trade at artificially inflated prices. The complaint seeks unspecified damages on behalf of a class of purchasers of the Company's securities between May 29, 2020 and May 9, 2022. The litigation has since been transferred to the United States District Court for the District of Massachusetts (Case 1:22-cv-11220-WGY), and lead plaintiff class representatives—Central Pennsylvania Teamsters Pension Fund - Defined Benefit Plan, Central Pennsylvania Teamsters Pension Fund - Retirement Income Plan 1987, and Construction Industry Laborers Pension Fund—have been appointed. On October 18, 2022, a consolidated amended complaint was filed that does not add any new parties or legal claims, is based upon the same general factual allegations as the original complaint, and now seeks unspecified damages on behalf of a class of purchasers of the Company's securities between June 16, 2020 and May 9, 2022. The Company moved to dismiss the consolidated amended complaint on December 19, 2022. The hearing on the Company's motion to dismiss took place on May 17, 2023. After hearing argument from both sides, the Court denied the Company's motion from the bench and stated that a written opinion would follow. On June 30, 2023, the Company filed its Answer to the complaint. On July 24, 2023, the Court issued its written opinion denying the motion to dismiss as to the Company and Defendant Trefler but granting the motion without prejudice as to Mr. Stillwell. The Company believes it has strong defenses to the claims brought against the defendants and intends to defend against these claims vigorously. The Company is unable to reasonably estimate possible damages or a range of possible damages in this matter given the stage of the lawsuit, the Company's belief that it has strong defenses to the claims asserted, its intent to defend against these claims, and there being no specified quantum of damages sought in the complaint.

PEGASYSTEMS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

In re Pegasystems Inc., Derivative Litigation

On November 21, 2022, a lawsuit was filed against the members of the Company's board of directors, the Company's chief operating and financial officer and the Company in the United States District Court for the District of Massachusetts, captioned Mary Larkin, derivatively on behalf of nominal defendant Pegasystems Inc. v. Peter Gyenes, Richard Jones, Christopher Lafond, Dianne Ledingham, Sharon Rowlands, Alan Trefler, Larry Weber, and Kenneth Stillwell, defendants, and Pegasystems Inc., nominal defendant (Case 1:22-cv-11985). The complaint generally alleges the defendants sold shares of the Company while in possession of material nonpublic information relating to (i) the litigation brought by Appian in the Circuit Court of Fairfax County, Virginia, described above, and (ii) alleged misconduct by Company employees alleged in that litigation. On April 28, 2023, a lawsuit was filed in the United States District Court for the District of Massachusetts by Dag Sagfors, derivatively on behalf of nominal defendant Pegasystems Inc. asserting breach of fiduciary duty and related claims relating to the Virginia Appian litigation against the same defendants as the Larkin lawsuit. On May 17, 2023, the *Larkin* and *Sagfors* cases were consolidated and a joint motion to stay the consolidated case is pending before the Court. The Company also has received confidential demand letters raising substantially the same allegations set forth in the foregoing derivative complaints. On April 12, 2023, the Company's board of directors (other than Mr. Trefler, who recused himself), formed a committee consisting solely of independent directors, to review, analyze, and investigate the matters raised in the demands and to determine in good faith what actions (if any) are reasonably believed to be appropriate under similar circumstances and reasonably believed to be in the best interests of the Company in response to the demand letters. The Company is unable to reasonably estimate possible damages or a range of possible damages in this matter given the stage of the lawsuit and there being no specified quantum of damages sought in the complaint.

SEC Inquiry

Beginning in March 2023, the U.S. Securities and Exchange Commission ("SEC") has requested certain information relating to, among other things, the accounting treatment of the Company's above-described litigation with Appian Corporation. The Company is fully cooperating with the SEC's requests.

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

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q ("Quarterly Report") contains or incorporates forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Words such as expects, anticipates, intends, plans, believes, will, could, should, estimates, may, targets, strategies, intends to, projects, forecasts, guidance, likely, and usually or variations of such words and other similar expressions identify forward-looking statements, which speak only as of the date the statement was made and are based on current expectations and assumptions.

Forward-looking statements deal with future events and are subject to risks and uncertainties that are difficult to predict, including, but not limited to:

- our future financial performance and business plans;
- the adequacy of our liquidity and capital resources;
- the continued payment of our quarterly dividends;
- the timing of revenue recognition;
- management of our transition to a more subscription-based business model;
- variation in demand for our products and services, including among clients in the public sector;
- reliance on key personnel;
- global economic and political conditions and uncertainty, including impacts from public health emergencies and the war in Ukraine;
- reliance on third-party service providers, including hosting providers;
- compliance with our debt obligations and covenants;
- the potential impact of our convertible senior notes and Capped Call Transactions;
- foreign currency exchange rates;
- the potential legal and financial liabilities and damage to our reputation due to cyber-attacks;
- security breaches and security flaws;
- our ability to protect our intellectual property rights, costs associated with defending such rights, intellectual property rights claims, and other related claims by third parties against us, including related costs, damages, and other relief that may be granted against us;
- our ongoing litigation with Appian Corp.;
- our client retention rate; and
- management of our growth.

These risks and others that may cause actual results to differ materially from those expressed in such forward-looking statements are described further in Part I of our Annual Report on Form 10-K for the year ended December 31, 2022, Part II of this Quarterly Report on Form 10-Q, and other filings we make with the U.S. Securities and Exchange Commission ("SEC").

Investors are cautioned not to place undue reliance on such forward-looking statements, and there are no assurances that the results included in such statements will be achieved. Although subsequent events may cause our view to change, except as required by applicable law, we do not undertake and expressly disclaim any obligation to publicly update or revise these forward-looking statements whether as the result of new information, future events, or otherwise.

The forward-looking statements in this Quarterly Report represent our views as of October 25, 2023.

NON-GAAP MEASURES

Our non-GAAP financial measures should only be read in conjunction with our consolidated financial statements prepared in accordance with GAAP. We believe that these measures help investors understand our core operating results and prospects, consistent with how management measures and forecasts our performance without the effect of often one-time charges and other items outside our normal operations. They are not a substitute for financial measures prepared under U.S. GAAP. A reconciliation of GAAP and non-GAAP measures is located with each non-GAAP measure.

BUSINESS OVERVIEW

We develop, market, license, host, and support enterprise software that helps organizations build agility into their business so they can adapt to change. Our powerful low-code platform for workflow automation and artificial intelligence-powered decisioning enables the world's leading brands and government agencies to hyper-personalize customer experiences, streamline customer service, and automate mission-critical business processes and workflows. With Pega, our clients can leverage our intelligent technology and scalable architecture to accelerate their digital transformation. In addition, our client success teams, world-class partners, and clients leverage our Pega Express™ methodology to design and deploy mission-critical applications quickly and collaboratively.

Our target clients are Global 2000 organizations and government agencies that require solutions to distinguish themselves in the markets they serve. Our solutions achieve and facilitate differentiation by increasing business agility, driving growth, improving productivity, attracting and retaining customers, and reducing risk. Along with our partners, we deliver solutions tailored to the specific industry needs of our clients.

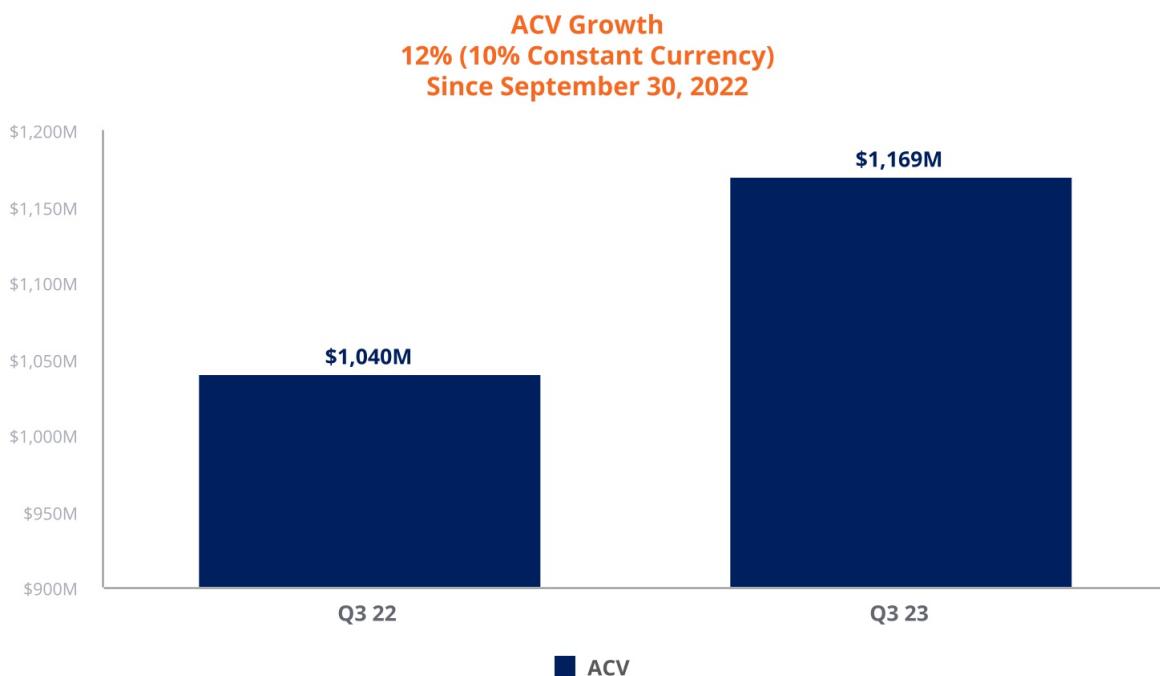
Performance metrics

We use performance metrics to analyze and assess our overall performance, make operating decisions, and forecast and plan for future periods, including:

Annual contract value ("ACV")

ACV represents the annualized value of our active contracts as of the measurement date. The contract's total value is divided by its duration in years to calculate ACV. ACV is a performance measure that we believe provides useful information to our management and investors.

In 2023, the Company revised its ACV methodology for maintenance and all contracts less than 12 months as its overall client renewal rate exceeds 90%. The impact of the change was \$3 million and 0.3% of Total ACV or less for all quarters in 2022. Previously disclosed ACV amounts have been updated to allow for comparability. This simplification, made possible by improvements to the Company's financial systems, ensures that ACV for all contract types and lengths is consistently calculated as the total contract value divided by the duration in years. Previously, ACV for maintenance was calculated as the maintenance revenue for the quarter then ended, multiplied by four, and ACV for contracts less than 12 months was equal to the contract's total value. The Company believes the simplified methodology better represents the current value of its contracts and better aligns its definition with comparable companies.

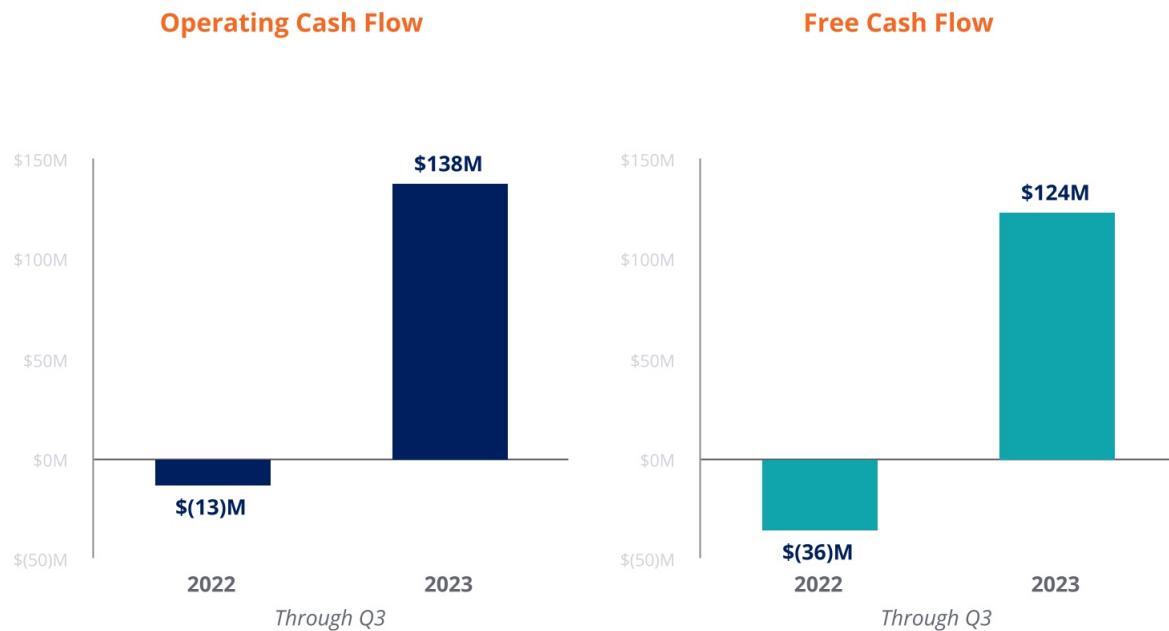


Reconciliation of ACV and Constant Currency ACV

(in millions, except percentages)	Q3 22	Q3 23	1-Year Change
ACV	\$ 1,040	\$ 1,169	12 %
Impact of changes in foreign exchange rates	—	(22)	
Constant Currency ACV	\$ 1,040	\$ 1,147	10 %

Note: Constant currency ACV is calculated by applying the Q3 2022 foreign exchange rates to all periods shown.

Cash flow ⁽¹⁾



Note: Starting in the third quarter of 2023, the Company has calculated free cash flow as cash provided by (used in) operating activities less investments in property and equipment. To ensure comparability, previously disclosed amounts have been updated.

(Dollars in thousands)	Nine Months Ended September 30,			
	2023		2022	
	Margin ⁽²⁾	Margin ⁽²⁾	Margin ⁽²⁾	Margin ⁽²⁾
Cash provided by (used in) operating activities	\$ 137,920	14 %	\$(1,446)	(1) %
Investment in property and equipment	(14,271)		(22,285)	
Free cash flow	\$ 123,649	13 %	\$(35,731)	(4) %
Additional information ⁽³⁾				
Legal fees	\$ 5,867		\$ 37,944	
Restructuring	21,576		—	
Interest on convertible senior notes	4,134		4,500	
Other	—		3,266	
	\$ 31,577		\$ 45,710	

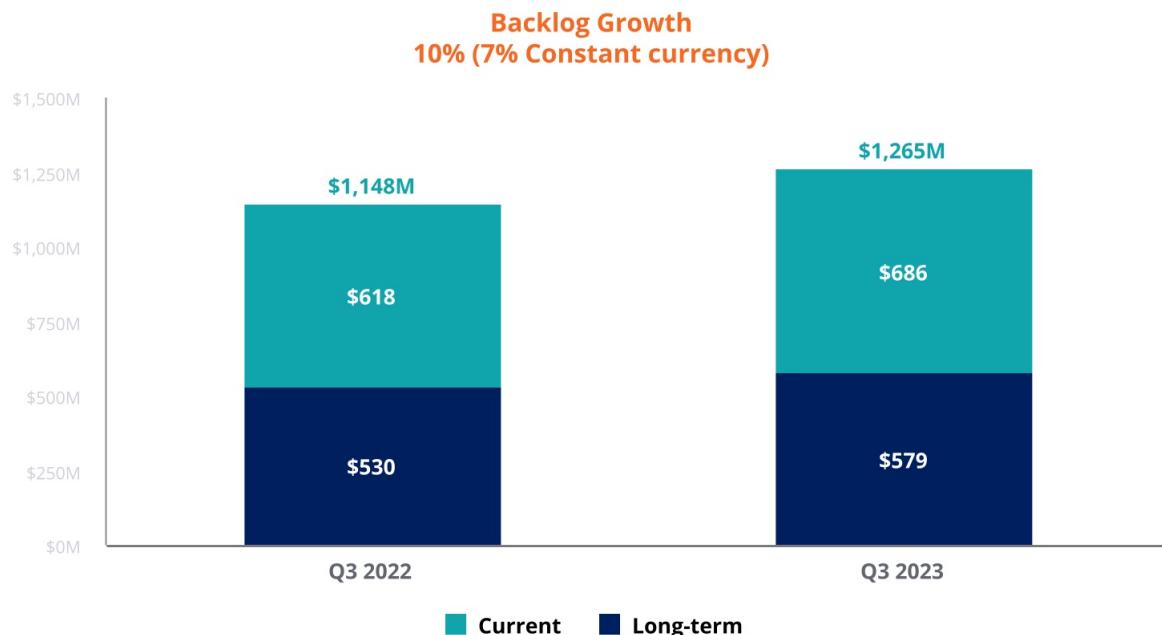
(1) Our non-GAAP free cash flow is defined as cash provided by (used in) operating activities less investment in property and equipment. Investment in property and equipment fluctuates in amount and frequency and are significantly affected by the timing and size of investments in our facilities. We provide information on free cash flow to enable investors to assess our ability to generate cash without incurring additional external financings. This information is not a substitute for financial measures prepared under U.S. GAAP.

(2) Operating and Free Cash Flow Margin are calculated by comparing the respective cash flow to Total Revenue.

(3) The additional information discloses items that affect our cash flows and are considered by management not to be representative of our core business operations and ongoing operational performance.

- **Legal fees:** Includes legal and related fees arising from proceedings outside the ordinary course of business.
- **Restructuring:** Restructuring fluctuates in amount and frequency and is significantly affected by the timing and size of our restructuring activities.
- **Interest on convertible senior notes:** In February 2020, we issued convertible senior notes, due March 1, 2025, in a private placement. The Notes accrue interest at an annual rate of 0.75%, payable semi-annually in arrears on March 1 and September 1, beginning September 1, 2020.
- **Other:** Includes fees related to capital advisory services, canceled in-person sales and marketing events, and incremental costs incurred integrating acquisitions.

Remaining performance obligations ("Backlog")



Reconciliation of Backlog and Constant Currency Backlog (Non-GAAP)

(in millions, except percentages)	Q3 22	Q3 2023	1-Year Growth Rate
Backlog - GAAP	\$ 1,148	\$ 1,265	10 %
Impact of changes in foreign exchange rates	—	(33)	
Constant currency backlog	\$ 1,148	\$ 1,232	7 %

Note: Constant currency Backlog is calculated by applying the Q3 2022 foreign exchange rates to all periods shown.

CRITICAL ACCOUNTING POLICIES

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our unaudited condensed consolidated financial statements, which have been prepared following accounting principles generally accepted in the United States of America ("U.S.") and the rules and regulations of the SEC for interim financial reporting. Preparing these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses, and the related disclosure of contingent assets and liabilities. We base our estimates and judgments on historical experience, knowledge of current conditions, and expectations of what could occur in the future, given the available information. For more information about our critical accounting policies, we encourage you to read the discussion in the following locations in our Annual Report on Form 10-K for the year ended December 31, 2022:

- "Critical Accounting Estimates and Significant Judgments" in Item 7; and
- "Note 2. Significant Accounting Policies" in Item 8.

There have been no other significant changes to our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2022.

RESULTS OF OPERATIONS

Revenue

(Dollars in thousands)	Three Months Ended September 30,						Nine Months Ended September 30,					
	2023		2022		Change		2023		2022		Change	
Pega Cloud	\$ 118,040	35 %	\$ 97,359	36 %	\$ 20,681	21 %	\$ 340,982	36 %	\$ 281,182	31 %	\$ 59,800	21 %
Maintenance	83,538	25 %	77,526	29 %	6,012	8 %	245,210	25 %	235,568	25 %	9,642	4 %
Subscription services	201,578	60 %	174,885	65 %	26,693	15 %	586,192	61 %	516,750	56 %	69,442	13 %
Subscription license	74,342	22 %	31,112	11 %	43,230	139 %	200,066	21 %	210,245	23 %	(10,179)	(5)%
Subscription	275,920	82 %	205,997	76 %	69,923	34 %	786,258	82 %	726,995	79 %	59,263	8 %
Consulting	55,976	17 %	55,511	21 %	465	1 %	167,396	18 %	175,451	19 %	(8,055)	(5)%
Perpetual license	2,747	1 %	9,223	3 %	(6,476)	(70)%	4,729	— %	18,929	2 %	(14,200)	(75)%
	\$ 334,643	100 %	\$ 270,731	100 %	\$ 63,912	24 %	\$ 958,383	100 %	\$ 921,375	100 %	\$ 37,008	4 %

- The increases in Pega Cloud revenue for the three and nine months ended September 30, 2023 were primarily due to the growth of the hosted client base as our clients continued to expand their use of Pega Cloud.
- The increases in maintenance revenue in the three and nine months ended September 30, 2023 were primarily due to continued demand for our subscription license offerings which are generally bundled with maintenance.
- The increase in subscription license revenue in the three months ended September 30, 2023 was primarily due to increased license deliveries in the three months ended September 30, 2023. The decrease in subscription license revenue in the nine months ended September 30, 2023 was primarily due to several large multi-year contracts recognized in revenue in the nine months ended September 30, 2022.
- The decrease in consulting revenue in the nine months ended September 30, 2023 was primarily due to lower consultant realization rates in the Americas.
- The decreases in perpetual license revenue in the three and nine months ended September 30, 2023 reflects our strategy of promoting subscription-based arrangements.

Gross profit

(Dollars in thousands)	Three Months Ended September 30,						Nine Months Ended September 30,					
	2023		2022		Change		2023		2022		Change	
Pega Cloud	\$ 88,553	75 %	\$ 68,673	71 %	\$ 19,880	29 %	\$ 250,943	74 %	\$ 194,350	69 %	\$ 56,593	29 %
Maintenance	77,119	92 %	71,671	92 %	5,448	8 %	225,696	92 %	219,296	93 %	6,400	3 %
Subscription services	165,672	82 %	140,344	80 %	25,328	18 %	476,639	81 %	413,646	80 %	62,993	15 %
Subscription license	73,713	99 %	30,484	98 %	43,229	142 %	198,095	99 %	208,322	99 %	(10,227)	(5)%
Subscription	239,385	87 %	170,828	83 %	68,557	40 %	674,734	86 %	621,968	86 %	52,766	8 %
Consulting	(1,228)	(2)%	(2,267)	(4)%	1,039	46 %	(8,866)	(5)%	4,289	2 %	(13,155)	*
Perpetual license	2,723	99 %	9,120	99 %	(6,397)	(70)%	4,678	99 %	18,756	99 %	(14,078)	(75)%
	\$ 240,880	72 %	\$ 177,681	66 %	\$ 63,199	36 %	\$ 670,546	70 %	\$ 645,013	70 %	\$ 25,533	4 %

* not meaningful

- The increases in Pega Cloud gross profit percent in the three and nine months ended September 30, 2023 were primarily due to increased cost efficiency, particularly for hosting services, as Pega Cloud continues to grow and scale.
- The decrease in maintenance gross profit percent in the nine months ended September 30, 2023 was primarily due to an increase in compensation and benefits as a result of increased headcount.
- The increase in consulting gross profit percent in the three months ended September 30, 2023 was primarily due to higher consultant utilization in the Americas. The decrease in consulting profit percent in the nine months ended September 30, 2023, was primarily due to lower consultant realization rates in the Americas.

Operating expenses

(Dollars in thousands)	Three Months Ended			Nine Months Ended				
	September 30,	2023	2022	Change	September 30,	2023	2022	Change
Selling and marketing	\$ 131,598	\$ 153,517	\$ (21,919)	(14)%	\$ 425,253	\$ 472,951	\$ (47,698)	(10)%
% of Revenue	39 %	57 %			44 %	51 %		
Research and development	\$ 74,955	\$ 75,342	\$ (387)	(1)%	\$ 224,262	\$ 221,173	\$ 3,089	1 %
% of Revenue	22 %	28 %			23 %	24 %		
General and administrative	\$ 27,321	\$ 26,043	\$ 1,278	5 %	\$ 73,893	\$ 94,530	\$ (20,637)	(22)%
% of Revenue	8 %	10 %			8 %	10 %		
Restructuring	\$ 17,822	\$ —	\$ 17,822	100 %	\$ 21,450	\$ —	\$ 21,450	100 %
% of Revenue	5 %	— %			2 %	— %		

- The decreases in selling and marketing during the three and nine months ended September 30, 2023 were primarily due to decreases in compensation and benefits of \$18.6 million and \$45.0 million, respectively. The decreases were due to reduced headcount as we optimize our go-to-market strategy. For additional information, see "Note 9. Restructuring" in Part I, Item 1 of this Quarterly Report.
- The increase in research and development for the nine months ended September 30, 2023 was primarily due to additional investments in our products and services.
- The changes in general and administrative in the three and nine months ended September 30, 2023 were primarily due to an increase of \$2.3 million in the three months ended September 30, 2023 and a decrease of \$21.4 million in the nine months ended September 30, 2023 in legal fees and related expenses arising from proceedings outside the ordinary course of business. We expect to continue to incur additional costs for these proceedings. See "Note 15. Commitments and Contingencies" in Part I, Item 1 of this Quarterly Report and "Risk Factors" in Part I, Item 1A of our Annual Report for the year ended December 31, 2022 for additional information.
- The increases in restructuring expenses during the three and nine months ended September 30, 2023 were primarily due to our efforts to optimize our go-to-market organization. For additional information, see "Note 9. Restructuring" in Part I, Item 1 of this Quarterly Report.

Other income and expenses

(Dollars in thousands)	Three Months Ended			Nine Months Ended				
	September 30,	2023	2022	Change	September 30,	2023	2022	Change
Foreign currency transaction gain (loss)	\$ 1,994	\$ 3,826	\$ (1,832)	(48)%	\$ (3,971)	\$ 8,415	\$ (12,386)	*
Interest income	2,532	520	2,012	387 %	5,831	1,036	4,795	463 %
Interest expense	(1,533)	(1,992)	459	23 %	(5,229)	(5,882)	653	11 %
(Loss) on capped call transactions	(2,294)	(6,876)	4,582	67 %	(449)	(56,381)	55,932	99 %
Other income (loss), net	6,383	(29)	6,412	*	18,668	6,497	12,171	187 %
	\$ 7,082	\$ (4,551)	\$ 11,633	*	\$ 14,850	\$ (46,315)	\$ 61,165	*

* not meaningful

- The changes in foreign currency transaction gain (loss) in the three and nine months ended September 30, 2023 were primarily due to the impact of fluctuations in foreign currency exchange rates associated with foreign currency-denominated cash and receivables held by our subsidiary in the United Kingdom.
- The increases in interest income in the three and nine months ended September 30, 2023 were primarily due to increases in market interest rates.
- The decreases in interest expense in the three and nine months ended September 30, 2023 were due to our repurchases of Convertible Senior Notes in the nine months ended September 30, 2023. For additional information, see "Note 8. Debt" in Part I, Item 1 of this Quarterly Report.
- The changes in (loss) on capped call transactions in the three and nine months ended September 30, 2023 were due to fair value adjustments for our capped call transactions.
- The increase in other income (loss), net in the three months ended September 30, 2023 was due to a \$6.4 million increase in the value of equity securities held in our venture investments portfolio. The increase in other income (loss), net in the nine months ended September 30, 2023, was due to a \$7.9 million gain from repurchases of our convertible senior notes and a \$10.9 million increase in the value of equity securities held in our venture investments portfolio. For additional information, see "Note 8. Debt" and "Note 10. Fair Value Measurements" in Part I, Item 1 of this Quarterly Report.

Provision for income taxes

(Dollars in thousands)	Nine Months Ended September 30,	
	2023	2022
Provision for income taxes	\$ 15,395	\$ 190,239
Effective income tax rate	(26)%	(100)%

The effective income tax rate in the nine months ended September 30, 2023 was primarily driven by the valuation allowance on our deferred tax assets in the U.S. and U.K. and projected taxable income in the U.S., partially offset by available tax credits and losses in the U.S.

LIQUIDITY AND CAPITAL RESOURCES

(in thousands)	Nine Months Ended September 30,	
	2023	2022
Cash provided by (used in):		
Operating activities	\$ 137,920	\$ (13,446)
Investing activities	(24,176)	10,104
Financing activities	(85,031)	(43,484)
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	(1,621)	(5,513)
Net increase (decrease) in cash, cash equivalents, and restricted cash	\$ 27,092	\$ (52,339)
(in thousands)		
Held by U.S. entities	\$ 217,735	\$ 248,389
Held by foreign entities	118,574	48,832
Total cash, cash equivalents, and marketable securities	\$ 336,309	\$ 297,221

We believe that our current cash, cash flow provided by operations, borrowing capacity, and ability to engage in capital market transactions will be sufficient to fund our operations, stock repurchases, and quarterly cash dividends for at least the next 12 months and to meet our known long-term cash requirements. Whether these resources are adequate to meet our liquidity needs beyond that period will depend on our future growth, operating results, and the investments needed to support our operations. We may utilize available funds or seek external financing if we require additional capital resources.

If it becomes necessary or desirable to repatriate foreign funds, we may have to pay federal, state, and local income taxes as well as foreign withholding taxes upon repatriation. However, estimating the taxes we would have to pay is impracticable due to the complexity of income tax laws and regulations.

Operating activities

The change in cash provided by (used in) operating activities in the nine months ended September 30, 2023 was primarily due to growth in client collections, the impact of our cost-efficiency initiatives, and lower legal fees and related costs arising from proceedings outside the ordinary course of business. We expect to continue to incur additional costs for these proceedings. For additional information, see "Note 9. Restructuring" and "Note 15. Commitments and Contingencies" in Part I, Item 1 of this Quarterly Report.

Investing activities

The change in cash (used in) provided by investing activities in the nine months ended September 30, 2023 was primarily due to our investments in financial instruments and reduced investment in property and equipment as we optimize our office space.

Financing activities

Debt financing

In February 2020, we issued \$600 million in aggregate principal amount of convertible senior notes, which mature on March 1, 2025. In the nine months ended September 30, 2023, we paid \$89 million to repurchase \$97.7 million in aggregate principal amount of convertible senior notes. As of September 30, 2023, we had \$502 million in aggregate principal amount of convertible senior notes outstanding due on March 1, 2025. For additional information, see "Note 8. Debt" in Part I, Item 1 of this Quarterly Report.

In November 2019, and as since amended, we entered into a five-year \$100 million senior secured revolving credit agreement (the "Credit Facility") with PNC Bank, National Association. As of September 30, 2023 and December 31, 2022, we had \$27.3 million in outstanding letters of credit, which reduced the Company's available borrowing capacity under the Credit Facility and no outstanding cash borrowings under the Credit Facility. For additional information, see "Note 8. Debt" in Part I, Item 1 of this Quarterly Report.

Stock repurchase program

Changes in the remaining stock repurchase authority:

(in thousands)	Nine Months Ended September 30, 2023
December 31, 2022	\$ 58,075
Authorizations ⁽¹⁾	1,925
September 30, 2023	<u><u>\$ 60,000</u></u>

(1) On April 25, 2023, our Board of Directors extended the expiration date of our current share repurchase program from June 30, 2023 to June 30, 2024, and the amount of stock we are authorized to repurchase was increased to \$60 million.

Common stock repurchases

(in thousands)	Nine Months Ended September 30,			
	2023		2022	
	Shares	Amount	Shares	Amount
Stock repurchase program	—	—	279	24,508
Tax withholdings for net settlement of equity awards	39	1,654	253	17,575
	<u><u>39</u></u>	<u><u>\$ 1,654</u></u>	<u><u>532</u></u>	<u><u>\$ 42,083</u></u>

In the nine months ended September 30, 2023 and 2022, instead of receiving cash from the equity holders, we withheld shares with a value of \$1.0 million and \$11.5 million, respectively, for the exercise price of options. These amounts are not included in the table above.

Dividends

We intend to pay a quarterly cash dividend of \$0.03 per share. However, the Board of Directors may terminate or modify the dividend program without prior notice.

(in thousands)	Nine Months Ended September 30,	
	2023	2022
Dividend payments to stockholders	\$ 7,458	\$ 7,368

Contractual obligations

As of September 30, 2023, our contractual obligations were:

(in thousands)	Payments due by period								
	Remainder of								
	2023	2024	2025	2026	2027	2028 and after	Other	Total	
Convertible senior notes ⁽¹⁾	\$ —	\$ 3,767	\$ 504,154	\$ —	\$ —	\$ —	\$ —	\$ 507,921	
Purchase obligations ⁽²⁾	43,491	134,122	126,065	120,745	134,060	177	—	558,660	
Operating lease obligations	4,775	17,976	14,870	10,853	9,808	39,299	—	97,581	
Venture investment commitments ⁽³⁾	500	500	—	—	—	—	—	1,000	
Liability for uncertain tax positions ⁽⁴⁾	—	—	—	—	—	—	2,017	2,017	
	<u><u>\$ 48,766</u></u>	<u><u>\$ 156,365</u></u>	<u><u>\$ 645,089</u></u>	<u><u>\$ 131,598</u></u>	<u><u>\$ 143,868</u></u>	<u><u>\$ 39,476</u></u>	<u><u>\$ 2,017</u></u>	<u><u>\$ 1,167,179</u></u>	

(1) Includes principal and interest.

(2) Represents the fixed amount owed for purchase obligations of software licenses, hosting services, and sales and marketing programs.

(3) Represents the maximum funding under existing venture investment agreements. Our venture investment agreements generally allow us to withhold unpaid funds at our discretion.

(4) We cannot reasonably estimate the timing of this cash outflow due to uncertainties in the timing of the effective settlement of tax positions.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss from adverse changes in financial market prices and rates.

Foreign currency exposure

Translation risk

Our international operations' operating expenses are primarily denominated in foreign currencies. However, our international sales are also primarily denominated in foreign currencies, partially offsetting our foreign currency exposure.

A hypothetical 10% strengthening in the U.S. dollar against other currencies would have resulted in the following:

	Nine Months Ended September 30,	
	2023	2022
(Decrease) in revenue	(4)%	(4)%
(Decrease) increase in net income	(5)%	2 %

Remeasurement risk

We incur transaction gains and losses from the remeasurement of monetary assets and liabilities denominated in currencies other than the functional currency of the entities in which they are recorded.

We are primarily exposed to changes in foreign currency exchange rates associated with the Australian dollar, Euro, and U.S. dollar-denominated cash, cash equivalents, receivables, and intercompany balances held by our U.K. subsidiary, a British pound functional entity.

A hypothetical 10% strengthening in the British pound exchange rate in comparison to the Australian dollar, Euro, and U.S. dollar would have resulted in the following impact:

	Nine Months Ended September 30,	
	2023	2022
(in thousands)		
Foreign currency (loss)	\$ (11,351)	\$ (6,335)

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures

Our management, with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act")) as of September 30, 2023. In designing and evaluating our disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and our management necessarily applied its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of September 30, 2023.

(b) Changes in internal control over financial reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2023 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth in "Note 15. Commitments and Contingencies", in Part I, Item 1 of this Quarterly Report is incorporated herein by reference.

ITEM 1A. RISK FACTORS

We encourage you to carefully consider the risk factors identified in Item 1A. "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2022, filed with the U.S. Securities and Exchange Commission. These risk factors could materially affect our business, financial condition, and future results and may cause our actual business and financial results to differ materially from those contained in forward-looking statements made in this Quarterly Report on Form 10-Q or elsewhere by management.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer purchases of equity securities ⁽¹⁾

Common stock repurchased in the three months ended September 30, 2023:

(in thousands, except per share amounts)	Total Number of Shares Purchased ⁽²⁾	Average Price Paid per Share ⁽²⁾	Total Number of Shares Purchased as Part of Publicly Announced Share Repurchase Program	Approximate Dollar Value of Shares That May Yet Be Purchased at Period End Under Publicly Announced Share Repurchased Programs
			Publicly Announced Share Repurchase Program	May Yet Be Purchased at Period End Under Publicly Announced Share Repurchased Programs
July 1, 2023 - July 31, 2023	3	\$ 55.81	—	\$ 60,000
August 1, 2023 - August 31, 2023	—	—	—	\$ 60,000
September 1, 2023 - September 30, 2023	4	48.92	—	\$ 60,000
	7	\$ 51.65	—	

(1) For additional information, see "Liquidity and Capital Resources" in Part I, Item 2 of this Quarterly Report.

(2) Includes shares withheld to cover the option exercise price and tax withholding obligations for stock compensation awards subject to net settlement provisions.

ITEM 5. OTHER INFORMATION

Rule 10b5-1 and non-rule 10b5-1 trading arrangements

During the three months ended September 30, 2023, no director or officer of the Company adopted or terminated a "Rule 10b5-1 trading arrangement" or "non-Rule 10b5-1 trading arrangement," as each term is defined in Item 408(a) of Regulation S-K.

ITEM 6. EXHIBITS

Exhibit No.	Description	Incorporation by Reference			
		Form	Exhibit	Filing Date	Filed Herewith
3.1	Restated Articles of Organization of the Registrant and Amendments thereto	10-Q	3.1	November 4, 2014	
3.2	Amended and Restated Bylaws of Pegasytems Inc.	8-K	3.2	June 15, 2020	
31.1	Certification pursuant to Exchange Act Rules 13a-14 and 15d-14 of the Chief Executive Officer.				X
31.2	Certification pursuant to Exchange Act Rules 13a-14 and 15d-14 of the Chief Financial Officer.				X
32	Certification pursuant to 18 U.S.C. Section 1350 of the Chief Executive Officer and the Chief Financial Officer.				+
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.				X
101.SCH	Inline XBRL Taxonomy Extension Schema Document.				X
101.CAL	Inline XBRL Taxonomy Calculation Linkbase Document.				X
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document.				X
101.LAB	Inline XBRL Taxonomy Label Linkbase Document.				X
101.PRE	Inline XBRL Taxonomy Presentation Linkbase Document.				X
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)				X

+ Indicates that the exhibit is being furnished with this report and is not filed as a part of it.

SIGNATURE

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.

Pegasystems Inc.

Dated: October 25, 2023

By: _____ /s/ KENNETH STILLWELL

Kenneth Stillwell

Chief Operating Officer and Chief Financial Officer

(Principal Financial Officer)

CERTIFICATION

I, Alan Trefler, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pegasystems 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 the 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.

Dated: October 25, 2023

/s/ ALAN TREFLER

Alan Trefler
Chairman and Chief Executive Officer
(Principal Executive Officer)

CERTIFICATION

I, Kenneth Stillwell, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pegasystems 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 the 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.

Dated: October 25, 2023

/s/ KENNETH STILLWELL

Kenneth Stillwell

Chief Operating Officer and Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION PURSUANT TO SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Pegasystems Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2023 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Alan Trefler, Chairman and Chief Executive Officer of Pegasystems Inc., and Kenneth Stillwell, Chief Operating Officer and Chief Financial Officer of Pegasystems Inc., each certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

Dated: October 25, 2023

/s/ ALAN TREFLER

Alan Trefler

Chairman and Chief Executive Officer
(Principal Executive Officer)

/s/ KENNETH STILLWELL

Kenneth Stillwell

Chief Operating Officer and Chief Financial Officer
(Principal Financial Officer)