Pega's Path to 40

PegaWorld 2018

Ken Stillwell | Chief Administrative Officer, Chief Financial Officer, and SVP

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Certain statements contained in this presentation may be construed as “forward-looking statements” as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current expectations, estimates, forecasts, and projections about the industry and markets in which we operate, and management’s beliefs and assumptions. In addition, other written or oral statements that constitute forward-looking statements may be made by us or on our behalf. Words such as “expect,” “anticipate,” “intend,” “plan,” “believe,” “could,” “estimate,” “may,” “target,” “strategy,” “is intended to,” “project,” “guidance,” “likely,” “usually,” “growth,” “growing,” or variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict.

Factors that could cause the Company’s results to differ materially from those expressed in forward-looking statements are contained in the Company’s press release announcing its Q1 2018 earnings and in the Company’s filings with the Securities and Exchange Commission, including its Annual Report on Form 10-K for the year ended December 31, 2017 and other recent filings with the SEC. Investors are cautioned not to place undue reliance on such forward-looking statements and there are no assurances that the matters contained 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 specifically disclaim any obligation to publicly update or revise these forward-looking statements whether as the result of new information, future events or otherwise.

Non-GAAP Financial Measures

This presentation includes non-GAAP financial measures. Our non-GAAP financial measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures, and should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP. For a detailed explanation of the adjustments made to comparable GAAP measures, the reasons why management uses these measures, the usefulness of these measures, and the material limitations on the usefulness of these measures, see the disclosures included in the appendix of this presentation.

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Adoption of ASC 606

All financial information, post 2015 on an annual basis and post 2016 on a quarterly basis, has been prepared in accordance with the new revenue recognition standard (ASC 606). All previous periods shown were prepared in accordance with the legacy revenue recognition standards that predated ASC 606.

For clarity, 2016 quarterly results and any full year or quarterly results for periods prior to full year 2016 are prepared in accordance with the legacy revenue recognition standards that predated ASC 606.

Refer to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 for additional information on our adoption of ASC 606.

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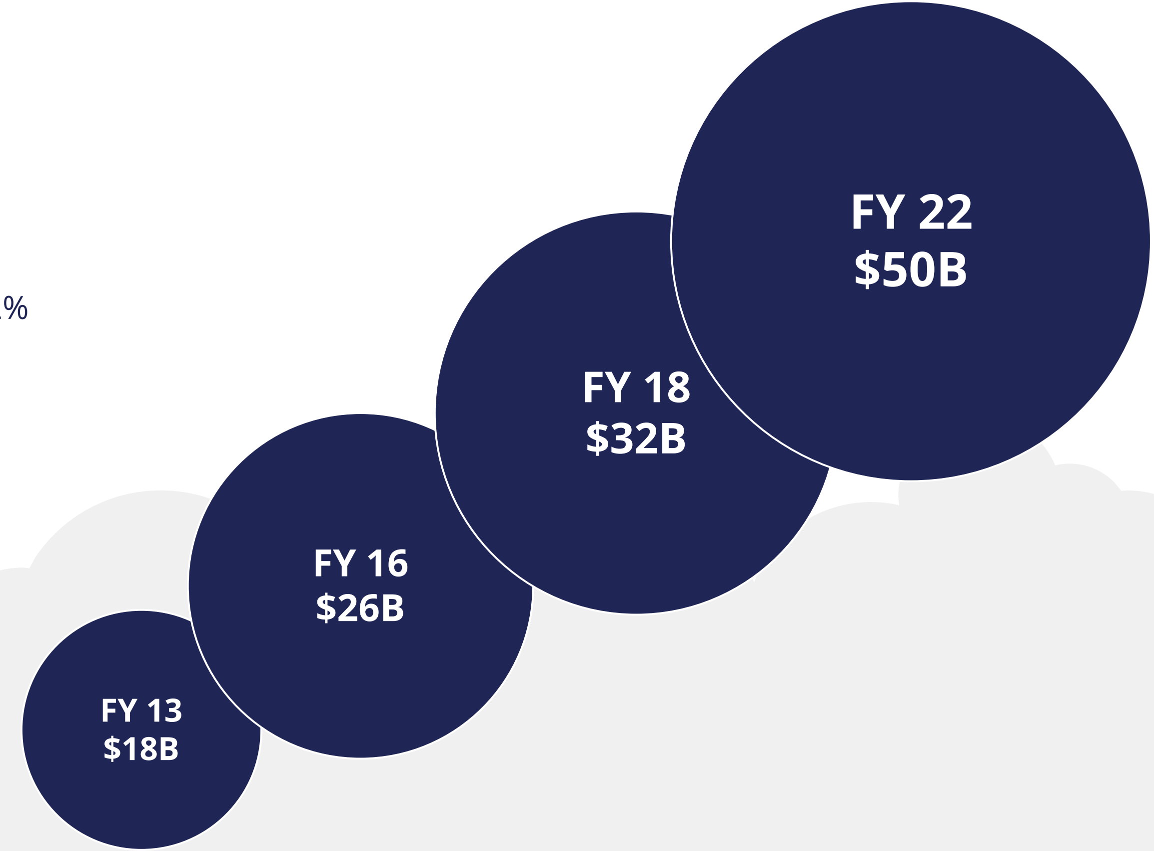
Continuing to Execute Against a Large and Growing Market

Total Addressable Market 10 Year CAGR – 12%

- Customer Service 10 Year CAGR – 14%
- Marketing 10 Year CAGR – 13%
- Sales 10 Year CAGR – 10%



Data source: IDC Semiannual Software Tracker Publication Date: May 11, 2018 2017 H2 Forecast Release

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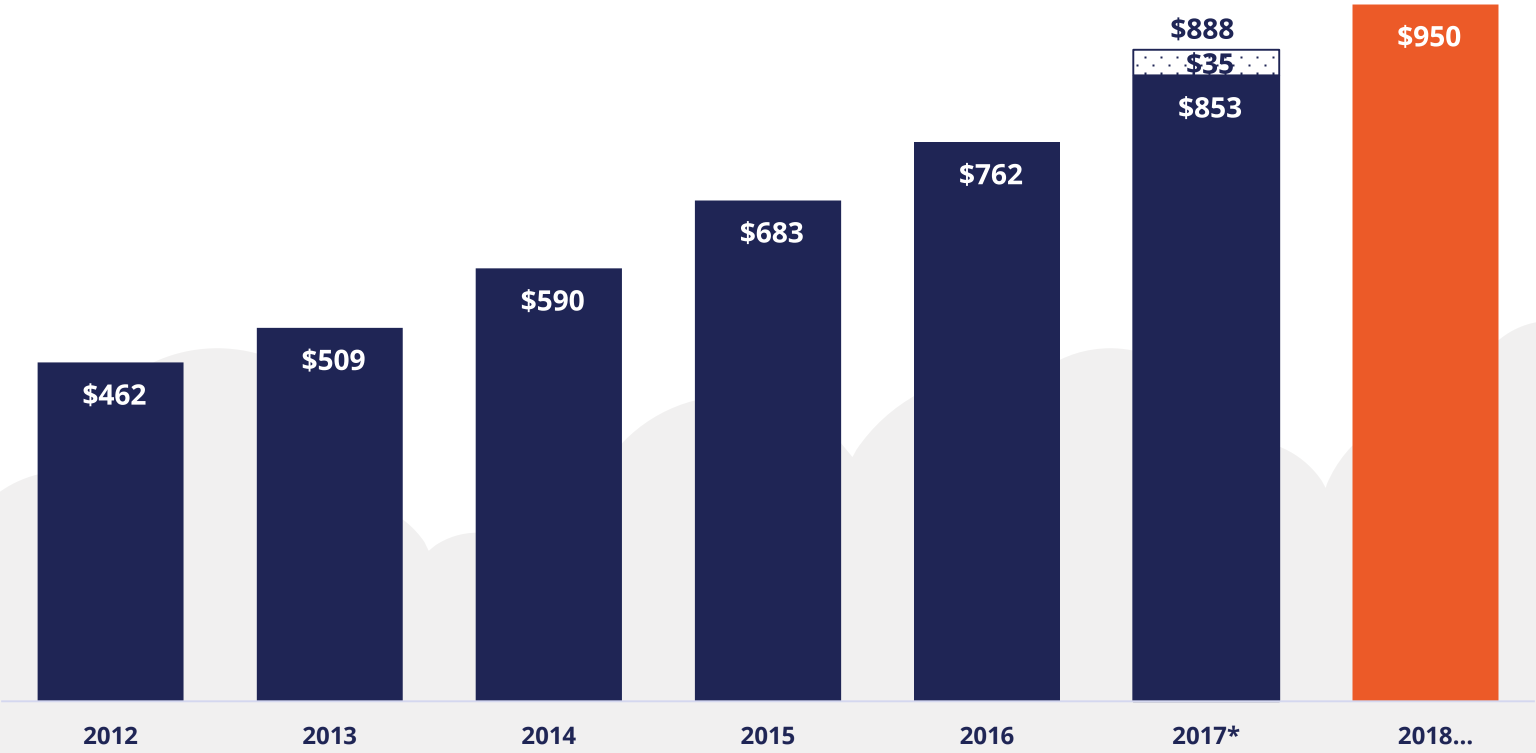
Continuing Top Line Growth

Total GAAP Revenues (millions)



Revenue for years 2016-2018 are under ASC 606, all other periods are under ASC 605

*Includes $35M Renewal

2017 GAAP Revenue – Recast Under ASC 606

Term revenue represents the most significant change between 606 and 605

(In millions)	Q1	Q2	Q3	Q4	FY 17
Perpetual	$38	$31	$13	$51	$133
Term	89 *	20	40	57	206
Cloud	10	13	13	15	51
Maintenance	59	59	62	62	242
Consulting & Training	60	63	63	70	256
Total GAAP Revenue	**$256**	**$186**	**$192**	**$255**	**$888**

*Includes $35M Renewal

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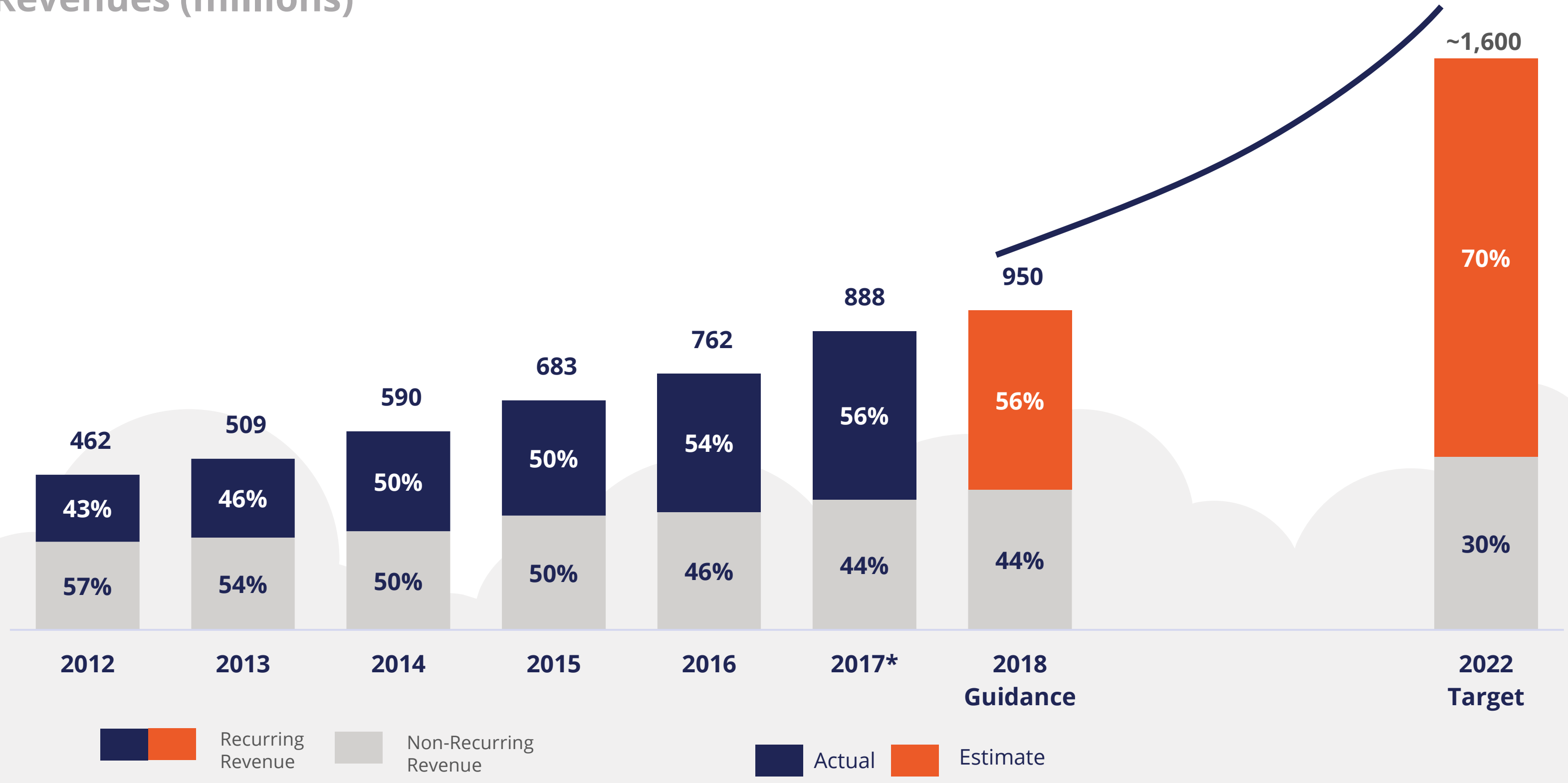
Tracking with Market movement to recurring over the Next 5 Years

Total Revenues (millions)



*Includes $35M Renewal

Revenue for years 2016-2018 are under ASC 606, all other periods are under ASC 605

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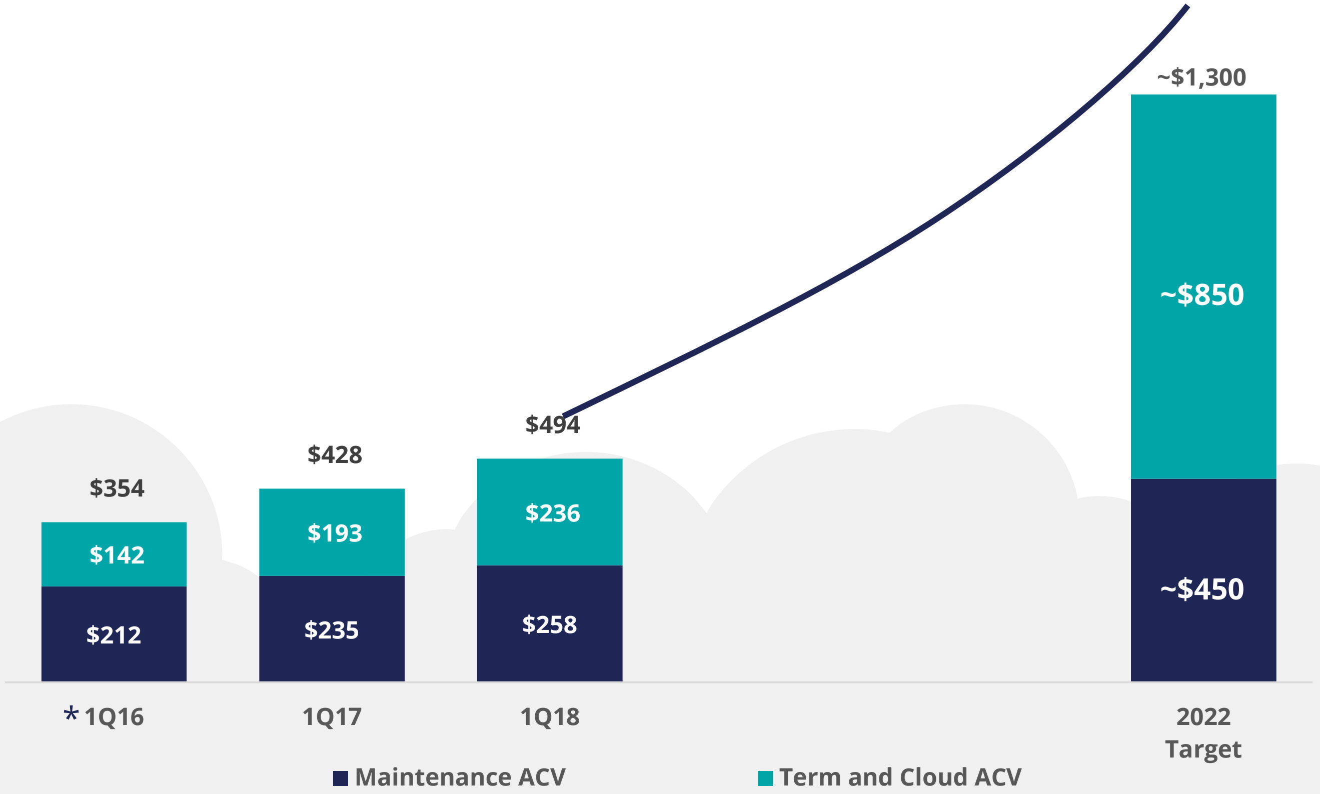
Continuing ACV Growth – Q1 Compare

In Millions



*2016 Maintenance ACV is calculated using ASC 605 Maintenance Revenue

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Q1 ACV Equivalent Growth

In millions

	Q1 17	Q1 18	YoY
Change in Term and Cloud ACV	$8	$20	132%
Perpetual ACV Equivalent Growth	$11	$7	(39%)
ACV Equivalent Growth*	**$19**	**$27**	**36%**

Change in Term and Cloud ACV – For a given quarter, the increase in ACV as of the end of such quarter as compared to ACV at the end of the immediately preceding quarter.

Perpetual ACV Equivalent – Quarterly perpetual revenue divided by a conversion factor of 3.5, which approximates the value of an equivalent term arrangement.

*ACV Equivalent Growth is the sum of the Change in Term and Cloud ACV plus the Perpetual ACV Equivalent Growth

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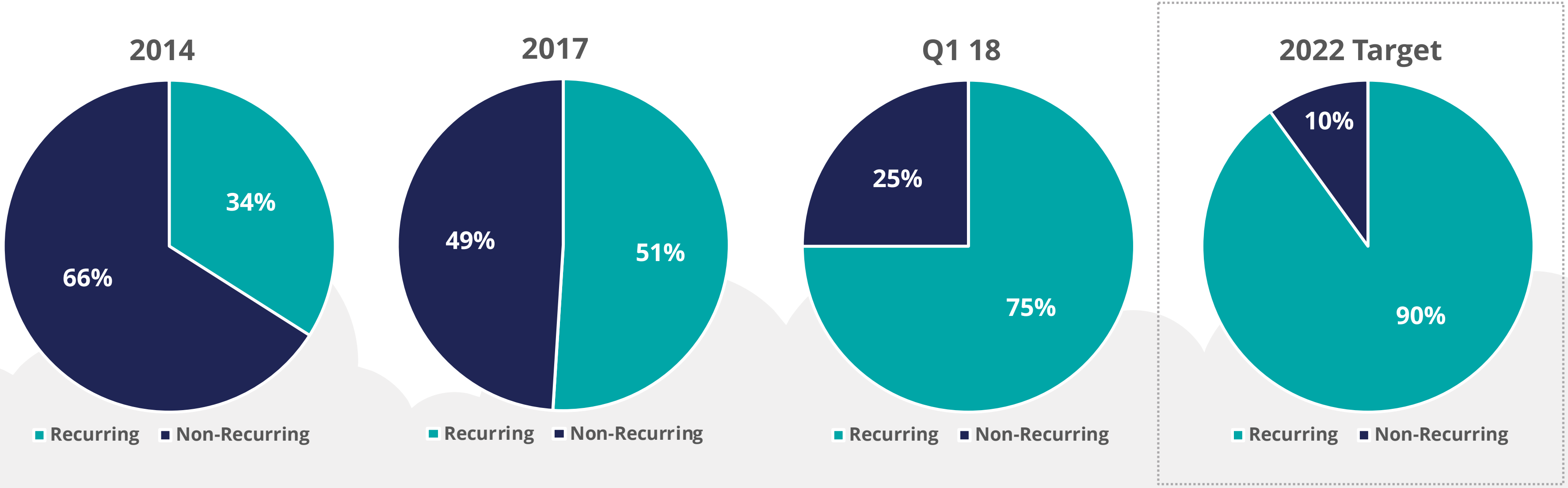
Growing Recurring Contribution

Mix of ACV Equivalents



Years 2016-2018 are under ASC 606, all other periods are under ASC 605

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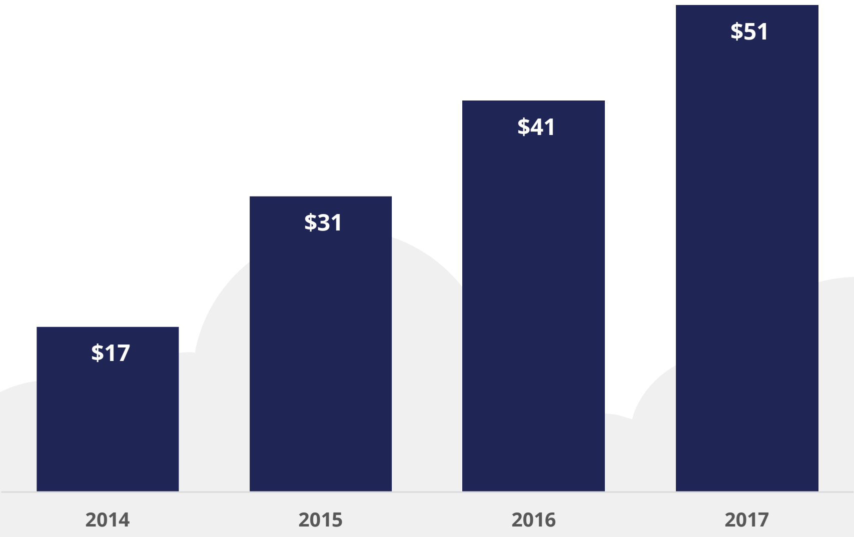
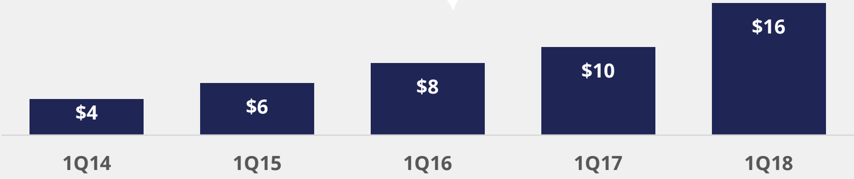
Growing Cloud Business – Full Year and Q1 Compares

Revenues (millions)





Years 2016-2018, and Quarters 1Q17 and 1Q18 are under ASC 606, all other periods are under ASC 605

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Still Tracking to "Rule of 40"

	2017	2022 Target
Revenue Growth	16%	~15-17%
GAAP Operating Margin	10%	
Non-GAAP Operating Margin	18%	~23-25%
Cloud Revenue Growth	~25%	~35%
Cloud Margin	~50%	~70%

Rule of 40": Trailing Twelve Month Non-GAAP Operating Margin excluding GAAP Depreciation expense plus Trailing Twelve Month Non-GAAP Revenue Growth with a goal for the Company to meet or exceed 40.

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New Revenue Standard (ASC 606)

Principles-based model

Step 1

Identify the contract with the customer

Step 2

Identify the separate performance obligations in the contract

Step 3

Determine the transaction price

Step 4

Allocate the transaction price to the separate performance obligations

Step 5

Recognize revenue when (or as) the entity satisfies a performance obligation

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Revenue and Sales Commission Treatment Comparison

	ASC 605	ASC 606
Perpetual	Upfront	Upfront
Term	As Invoices Due	Upfront
Cloud	Ratable	Ratable
Sales Commission	Upfront	Over time

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Example:

Three Year Term License – $1M per Year

	ASC 605		
	2017	2018	2019
Revenue	$ 1,000	$ 1,000	$ 1,000
Billings	$ 1,000	$ 1,000	$ 1,000
ACV	$ 1,000	$ 1,000	$ 1,000

	ASC 606		
	2017	2018	2019
Revenue	$ 3,000	$ -	$ -
Billings	$ 1,000	$ 1,000	$ 1,000
ACV	$ 1,000	$ 1,000	$ 1,000

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Mix Impact Example

Total Contract Deal values $300, assumes 3 year duration for term and cloud deals

Impact of Cloud Shift

33% → **50%**

	Deal Value	Revenue Y1
Perpetual	100	100
Term	100	100
Cloud	100	33
Total	300	233

	Deal Value	Revenue Y1
Perpetual	50	50
Term	100	100
Cloud	150	50
Total	300	200

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APPENDIX

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Glossary

Recurring Revenue: Includes Term License, Maintenance and Cloud Revenue

Non-Recurring Revenue: Includes Perpetual License, Consulting and Training Revenue

ACV, as of a given date, is the sum of the following two components:

- The sum of the annual value of each term and cloud contract in effect on such date, with the annual value of a term or cloud contract being equal to the total value of the contract divided by the total number of years of the contract.
- Maintenance revenue reported for the quarter ended on such date, multiplied by four.

ACV Equivalent Growth, is the sum of the following two components:

- Change in Term and Cloud ACV: For a given quarter, the increase in ACV as of the end of such quarter as compared to ACV as of the end of the immediately preceding quarter.
- Perpetual ACV Equivalent: Quarterly perpetual revenue divided by a conversion factor of 3.5, which approximates the value of an equivalent term arrangement.

"Rule of 40": Trailing Twelve Month Non-GAAP Operating Margin excluding GAAP Depreciation expense plus Trailing Twelve Month Non-GAAP Revenue Growth with a goal for the Company to meet or exceed 40.

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Appendix - ASC 606 Recast Results (millions)

	Three Months Ended:					
	Previously Reported	Adjustments	As Adjusted	Previously Reported	Adjustments	As Adjusted
	March 31, 2017			June 30, 2017		
Perpetual	$38,680	($781)	$37,899	$30,255	$1,042	$31,297
Term	53,710	35,399	89,109	30,782	(10,929)	19,853
Maintenance	58,965	(252)	58,713	59,590	(166)	59,424
Cloud	10,827	(425)	10,402	12,733	(208)	12,525
Consulting and training	61,065	(879)	60,186	64,620	(1,123)	63,497
Total Revenue	**$223,247**	**$33,062**	**$256,309**	**$197,980**	**($11,384)**	**$186,596**

	September 30, 2017			December 31, 2017		
Perpetual	$20,115	($7,492)	$12,623	$52,769	($1,705)	$51,064
Term	21,678	18,933	40,611	40,345	16,493	56,838
Maintenance	62,204	(392)	61,812	63,588	(1,217)	62,371
Cloud	13,354	(74)	13,280	14,978	(88)	14,890
Consulting and training	62,464	167	62,631	67,860	1,582	69,442
Total Revenue	**$179,815**	**$11,142**	**$190,957**	**$239,540**	**$15,065**	**$254,605**

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Appendix - ASC 606 Recast Results (millions)

	Twelve Months Ended:					
	Previously Reported	Adjustments	As Adjusted	Previously Reported	Adjustments	As Adjusted
	December 31, 2017			**December 31, 2016**		
Perpetual	$141,819	($8,936)	$132,883	$147,529	($2,476)	$145,053
Term	146,515	59,896	206,411	132,466	19,765	152,231
Maintenance	244,347	(2,027)	242,320	220,336	(1,701)	218,635
Cloud	51,892	(795)	51,097	41,438	(791)	40,647
Consulting and training	256,009	(253)	255,756	208,497	(2,834)	205,663
Total Revenue	**$840,582**	**$47,885**	**$888,467**	**$750,266**	**$11,963**	**$762,229**

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Appendix - Reconciliation of Selected GAAP Measures to Non-GAAP Measures (millions)

	FY 2017
GAAP revenue	**$888**
Large term license renewal	(35)
Revenue excluding large renewal (Non-GAAP)	$853

	FY 2017	
GAAP Revenue	**$888**	**% of Revenue**
GAAP income from operations	**$94**	**10%**
Amortization of Intangibles	12	
Stock-based compensation	53	
Non-GAAP income from operations	$159	18%

To supplement our financial results presented in accordance with generally accepted accounting principles in the U.S. ("GAAP"), the Company provides non-GAAP measures, including in this presentation. Pegasystems' management utilizes a number of different financial measures, both GAAP and non-GAAP, in analyzing and assessing the overall performance of the business, for making operating decisions, and for forecasting and planning for future periods. The Company's annual financial plan is prepared on both a GAAP and non-GAAP basis, and both are approved by our board of directors. In addition, and as a consequence of the importance of these measures in managing the business, the Company uses non-GAAP measures and financial performance results in the evaluation process to establish management's compensation. The non-GAAP measures exclude the effects of certain business combination accounting entries, stock-based compensation expense, amortization of intangible assets, acquisition-related and restructuring expenses, and certain other adjustments. The Company believes these non-GAAP measures are helpful in understanding its past financial performance and its anticipated future results. These non-GAAP financial measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures and should be read only in conjunction with the Company's consolidated financial statements prepared in accordance with GAAP.

Our non-GAAP financial measures reflect adjustments based on the following items:

- Amortization of intangible assets: We have excluded the amortization expense of intangible assets from our non-GAAP operating expenses and profitability measures. Amortization of intangible assets is inconsistent in amount and frequency and is significantly affected by the timing and size of our acquisitions. Investors should note that the use of intangible assets contributed to our revenues earned during the periods presented and are expected to contribute to our future period revenues as well. Amortization of intangible assets will recur in future periods.
- Stock-based compensation: We have excluded stock-based compensation expense from our non-GAAP operating expenses and profitability measures. Although stock-based compensation is a key incentive offered to our employees, and we believe such compensation contributed to the revenues earned during the periods presented and will contribute to the generation of future period revenues, we continue to evaluate our business performance excluding stock-based compensation expense.

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