PEGASYSTEMS INC
Form 10-Q
May 03, 2012
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended March 31, 2012**

**or**

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

**For the transition period from ________ to ________**

**Commission File Number: 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.)*** |
| **101 Main Street Cambridge, MA** | **02142-1590** |
| ***(Address of principal executive offices)*** | ***(Zip Code)*** |

**(617) 374-9600**

***(Registrant s telephone number including area code)***

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

| | | | |
|---|---|---|---|
| Large accelerated filer x | Accelerated filer ¨ | Non-accelerated filer ¨<br>(Do not check if smaller reporting company) | Smaller reporting company ¨ |

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

There were 37,865,884 shares of the Registrant s common stock, $.01 par value per share, outstanding on April 25, 2012.

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**PEGASYSTEMS INC.**

**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

**(in thousands)**

| | As of March 31, 2012 | As of December 31, 2011 |
|---|---|---|
| ***ASSETS*** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 33,473 | $ 60,353 |
| Marketable securities | 54,587 | 51,079 |
| Total cash, cash equivalents, and marketable securities | 88,060 | 111,432 |
| Trade accounts receivable, net of allowance of $1,256 and $926 | 106,852 | 98,293 |
| Deferred income taxes | 9,829 | 9,826 |
| Income taxes receivable | 8,270 | 7,545 |
| Other current assets | 5,989 | 4,865 |
| Total current assets | 219,000 | 231,961 |
| Property and equipment, net | 18,852 | 14,458 |
| Long-term deferred income taxes | 43,100 | 43,286 |
| Long-term other assets | 2,676 | 2,186 |
| Intangible assets, net | 66,564 | 69,369 |
| Goodwill | 20,451 | 20,451 |
| Total assets | $ 370,643 | $ 381,711 |
| ***LIABILITIES AND STOCKHOLDERS EQUITY*** | | |
| Current liabilities: | | |
| Accounts payable | $ 6,069 | 10,899 |
| Accrued expenses | 20,565 | 18,336 |
| Accrued compensation and related expenses | 18,340 | 39,170 |
| Deferred revenue | 80,568 | 73,840 |
| Total current liabilities | 125,542 | 142,245 |
| Income taxes payable | 9,590 | 9,547 |
| Long-term deferred revenue | 13,609 | 15,367 |
| Other long-term liabilities | 7,013 | 5,796 |
| Total liabilities | 155,754 | 172,955 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock, 1,000 shares authorized; no shares issued and outstanding | | |
| Common stock, 70,000 shares authorized; 37,854 shares and 37,712 issued and outstanding | 379 | 377 |
| Additional paid-in capital | 131,564 | 129,701 |
| Retained earnings | 79,951 | 77,029 |
| Accumulated other comprehensive income | 2,995 | 1,649 |

| | | | | |
|---|---|---|---|---|
| Total stockholders equity | | 214,889 | | 208,756 |
| Total liabilities and stockholders equity | $ | 370,643 | $ | 381,711 |

See notes to unaudited condensed consolidated financial statements.

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**PEGASYSTEMS INC.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

**(in thousands, except per share amounts)**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2012** | **2011** |
| Revenue: | | |
| Software license | $ 35,943 | $ 33,462 |
| Maintenance | 30,845 | 27,448 |
| Professional services | 44,379 | 41,450 |
| Total revenue | 111,167 | 102,360 |
| Cost of revenue: | | |
| Cost of software license | 1,599 | 1,674 |
| Cost of maintenance | 3,609 | 3,374 |
| Cost of professional services | 36,326 | 34,968 |
| Total cost of revenue | 41,534 | 40,016 |
| Gross profit | 69,633 | 62,344 |
| Operating expenses: | | |
| Selling and marketing | 38,395 | 34,036 |
| Research and development | 19,004 | 15,133 |
| General and administrative | 6,315 | 7,132 |
| Acquisition-related costs | | 338 |
| Restructuring costs | | 141 |
| Total operating expenses | 63,714 | 56,780 |
| Income from operations | 5,919 | 5,564 |
| Foreign currency transaction gain | 740 | 1,016 |
| Interest income, net | 111 | 86 |
| Other (expense) income, net | (839) | 28 |
| Income before provision for income taxes | 5,931 | 6,694 |
| Provision for income taxes | 1,874 | 1,963 |
| Net income | $ 4,057 | $ 4,731 |
| Earnings per share | | |
| Basic | $ 0.11 | $ 0.13 |
| Diluted | $ 0.10 | $ 0.12 |

| | | | | |
|---|---|---|---|---|
| Weighted-average number of common shares outstanding | | | | |
| Basic | | 37,756 | | 37,276 |
| Diluted | | 38,889 | | 38,803 |
| Cash dividends declared per share | $ | 0.03 | $ | 0.03 |

See notes to unaudited condensed consolidated financial statements.

**PEGASYSTEMS INC.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(in thousands)**

| | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| Net income: | $ 4,057 | $ 4,731 |
| Other comprehensive income, net of tax: | | |
| Unrealized gain (loss) on securities, net of tax | 72 | (16) |
| Foreign currency translation adjustments | 1,274 | 1,288 |
| Total other comprehensive income | 1,346 | 1,272 |
| Comprehensive income | $ 5,403 | $ 6,003 |

See notes to unaudited condensed consolidated financial statements.

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**PEGASYSTEMS INC.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(in thousands)**

| | Three Months Ended March 31, 2012 | | Three Months Ended March 31, 2011 | |
|---|---|---|---|---|
| Operating activities: | | | | |
| Net income | $ | 4,057 | $ | 4,731 |
| Adjustment to reconcile net income to cash (used in) provided by operating activities: | | | | |
| Excess tax benefits from exercise or vesting of equity awards | | (1,622) | | (1,077) |
| Deferred income taxes | | 214 | | 142 |
| Depreciation and amortization | | 4,525 | | 4,011 |
| Stock-based compensation expense | | 2,852 | | 2,535 |
| Foreign currency transaction loss | | 395 | | 66 |
| Other | | 382 | | 87 |
| Change in operating assets and liabilities: | | | | |
| Trade accounts receivable | | (8,130) | | (28,221) |
| Income taxes receivable and other current assets | | (156) | | (399) |
| Accounts payable and accrued expenses | | (25,800) | | (7,011) |
| Deferred revenue | | 4,696 | | 17,223 |
| Other long-term assets and liabilities | | 813 | | (202) |

Cash used in operating activities

No Prospectus (as defined in Directive 2003/71/EC (as amended, the “Prospectus Directive”)) will be prepared in connection with the notes. Accordingly, the notes may not be offered to the public in any member state of the European Economic Area (the “EEA”), and any purchaser of the notes who subsequently sells any of the notes in any EEA member state must do so only in accordance with the requirements of the Prospectus Directive, as implemented in that member state.

The notes are not intended to be offered, sold or otherwise made available to, and should not be offered, sold or otherwise made available to, any retail investor in the EEA. For these purposes, the expression “offer" includes the communication in any form and by any means of sufficient information on the terms of the offer and the notes to be offered so as to enable an investor to decide to purchase or subscribe the notes, and a “retail investor” means a person who is one (or more) of: (a) a retail client, as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, “MiFID II”); or (b) a customer, within the meaning of Insurance Distribution Directive 2016/97/EU, as amended, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or (c) not a qualified investor as defined in the Prospectus Directive. Consequently, no key information document required by Regulation (EU) No 1286/2014 (as amended, the “PRIIPs

Regulation") for offering or selling the notes or otherwise making them available to retail investors in the EEA has been prepared, and therefore, offering or selling the notes or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPs Regulation.

**Additional Information Relating to the Estimated Initial Value of the Notes**

Our estimated initial value of each of the notes that is set forth on the cover page of this pricing supplement equals the sum of the values of the following hypothetical components:

- a fixed-income debt component with the same tenor as the notes, valued using our internal funding rate for structured notes; and
- one or more derivative transactions relating to the economic terms of the notes.

The internal funding rate used in the determination of the initial estimated value generally represents a discount from the credit spreads for our conventional fixed-rate debt. The value of these derivative transactions are derived from our internal pricing models. These models are based on factors such as the traded market prices of comparable derivative instruments and on other inputs, which include volatility, dividend rates, interest rates and other factors. As a result, the estimated initial value of each of the notes on the Pricing Date was determined based on market conditions on the Pricing Date.

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**The Reference Stocks**

We have derived the following information from publicly available documents. We have not independently verified the accuracy or completeness of the following information. We are not affiliated with the applicable Reference Stock Issuer and the applicable Reference Stock Issuer will have no obligations with respect to the notes. This pricing supplement relates only to the notes and does not relate to the shares of the applicable Reference Stock or any securities included in the applicable Underlying Index. Neither we nor any of our affiliates participates in the preparation of the publicly available documents described below. Neither we nor any of our affiliates has made any due diligence inquiry with respect to the applicable Reference Stock in connection with the offering of the notes. There can be no assurance that all events occurring prior to the date of this pricing supplement, including events that would affect the accuracy or completeness of the publicly available documents described below and that would affect the trading price of the shares of the applicable Reference Stock, have been or will be publicly disclosed. Subsequent disclosure of any events or the disclosure of or failure to disclose material future events concerning the applicable Reference Stock could affect the price of the shares of the applicable Reference Stock during the Monitoring Period, on each Observation Date and on the Valuation Date, and therefore could affect the payments on the notes.

We encourage you to review recent prices of the applicable Reference Stock prior to making an investment decision.

The selection of the applicable Reference Stock is not a recommendation to buy or sell the shares of the applicable Reference Stock. Neither we nor any of our affiliates make any representation to you as to the performance of the shares of the applicable Reference Stock. Information provided to or filed with the SEC under the Securities Exchange Act of 1934 and the Investment Company Act of 1940 relating to the applicable Reference Stock may be obtained through the SEC's website at http://www.sec.gov.

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**SPDR® S&P® Oil & Gas Exploration & Production ETF**

In this section, Reference Stock Issuer refers to the SPDR® S&P® Oil & Gas Exploration & Production ETF (the “XOP”), Reference Stock refers to the shares of the XOP, and Underlying Index refers to the S&P® Oil & Gas Exploration & Production Select Industry® Index.

The Reference Stock is an investment portfolio maintained and managed by SSFM. The Reference Stock trades on the NYSE Arca under the ticker symbol “XOP.” The inception date of the Reference Stock is June 19, 2006. Prior to January 8, 2007, the Reference Stock was known as the SPDR® Oil & Gas Exploration & Production ETF.

Information provided to or filed with the SEC by the SPDR® Series Trust (“SPDR”) under the Securities Exchange

Act of 1934 can be located by reference to its Central Index Key, or CIK, 1064642 through the SEC's website at http://www.sec.gov. Additional information about SSFM and the Reference Stock may be obtained from other sources including, but not limited to, press releases, newspaper articles and other publicly disseminated documents. We have not made any independent investigation as to the accuracy or completeness of such information.

The Reference Stock seeks to provide investment results that correspond generally to the price and yield performance, before fees and expenses, of the Underlying Index. The Underlying Index represents the oil and gas exploration and production sub-industry portion of the S&P Total Market Index ("S&P TMI"), an index that measures the performance of the U.S. equity market. The Reference Stock is composed of companies that are in the oil and gas sector exploration and production.

The Reference Stock utilizes a sampling strategy, which means that it is not required to purchase all of the securities represented in its Underlying Index. Instead, it may purchase a subset of the securities in the Underlying Index in an effort to hold a portfolio of securities with generally the same risk and return characteristics of the Underlying Index. Under normal market conditions, the Reference Stock will invest at least 80% of its total assets in common stocks that comprise the Underlying Index.

The information above was compiled from the SPDR® website. We have not independently investigated the accuracy of that information. Information contained in the SPDR® website is not incorporated by reference in, and should not be considered a part of, this document.

**The Underlying Index: S&P® Oil & Gas Exploration & Production Select Industry® Index**

We have derived all information contained in this document regarding the Underlying Index, including, without limitation, its make-up, method of calculation and changes in its components, from publicly available information. Such information reflects the policies of, and is subject to change by, S&P.

The Underlying Index is an equal-weighted index that is designed to measure the performance of the oil and gas exploration and production sub-industry portion of the S&P TMI. The S&P TMI includes all U.S. common equities listed on the NYSE (including NYSE Arca), the NYSE American, the Nasdaq Global Select Market, and the Nasdaq Capital Market.

To be eligible for inclusion in the Underlying Index, companies must be in the S&P TMI and must be included in the relevant Global Industry Classification Standard (GICS) sub-industry. The GICS was developed to establish a global standard for categorizing companies into sectors and industries. In addition to the above, companies must satisfy one of the three following combined size and liquidity criteria:

- float-adjusted market capitalization above US$500 million and float-adjusted liquidity ratio above 90%;

- float-adjusted market capitalization above US$400 million and float-adjusted liquidity ratio above 150%; or

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- for current constituents, float adjusted market capitalization above US$300 million and float-adjusted liquidity ratio greater than or equal to 50%.

All U.S. companies satisfying these requirements are included in the Underlying Index. The total number of companies in the Underlying Index should be at least 35. If there are fewer than 35 stocks, stocks from a supplementary list of highly correlated sub-industries that meet the market capitalization and liquidity thresholds above are included in order of their float-adjusted market capitalization to reach 35 constituents. Minimum market capitalization requirements may be relaxed to ensure there are at least 22 companies in the Underlying Index as of each rebalancing effective date.

Eligibility factors include:

- Market Capitalization: Float-adjusted market capitalization should be at least US$400 million for inclusion in the Underlying Index. Existing index components must have a float-adjusted market capitalization of US$300 million to remain in the Underlying Index at each rebalancing.

- Liquidity: The liquidity measurement used is a liquidity ratio, defined as dollar value traded over the previous 12-months divided by the float-adjusted market capitalization as of the Underlying Index rebalancing reference date. Stocks having a float-adjusted market capitalization above US$500 million must have a liquidity ratio greater than 90% to be eligible for addition to the Underlying Index. Stocks having a float-adjusted market capitalization between US$400 and US$500 million must have a liquidity ratio greater than 150% to be eligible for addition to the Underlying Index. Existing index constituents must have a liquidity ratio greater than 50% to remain in the Underlying Index at the quarterly rebalancing. The length of time to evaluate liquidity is reduced to the available trading period for IPOs or spin-offs that do not have 12 months of trading history.

- Takeover Restrictions: At the discretion of S&P, constituents with shareholder ownership restrictions defined in company bylaws may be deemed ineligible for inclusion in the Underlying Index. Ownership restrictions preventing entities from replicating the index weight of a company may be excluded from the eligible universe or removed from the Underlying Index.

- Turnover: S&P believes turnover in index membership should be avoided when possible. At times, a company may appear to temporarily violate one or more of the addition criteria. However, the addition criteria are for addition to the Underlying Index, not for continued membership. As a result, an index constituent that appears to violate the criteria for addition to the Underlying Index will not be deleted unless ongoing conditions warrant a change in the composition of the Underlying Index.

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**The VanEck Vectors$^{TM}$ Gold Miners ETF**

In this section, Reference Stock Issuer refers to the VanEck Vectors$^{TM}$ Gold Miners ETF (the "GDX"), Reference Stock refers to the shares of the GDX, and the Underlying Index refers to the NYSE Arca Gold Miners Index.

The Reference Stock is an investment portfolio maintained, managed and advised by Van Eck. The VanEck Vectors$^{TM}$ ETF Trust is a registered open-end investment company that consists of numerous separate investment portfolios, including the Reference Stock.

The Reference Stock is an exchange traded fund that trades on NYSE Arca under the ticker symbol "GDX."

The Reference Stock seeks to provide investment results that correspond generally to the price and yield performance, before fees and expenses, of the Underlying Index. The Underlying Index was developed by the NYSE Amex and is calculated, maintained and published by NYSE Arca. The Underlying Index is a modified market capitalization-weighted index comprised of publicly traded companies involved primarily in mining for gold or silver.

The Reference Stock utilizes a "passive" or "indexing" investment approach in attempting to track the performance of the Underlying Index. The Reference Stock will invest in all of the securities which comprise the Underlying Index. The Reference Stock will normally invest at least 95% of its total assets in common stocks that comprise the Underlying Index.

The notes are not sponsored, endorsed, sold or promoted by Van Eck. Van Eck makes no representations or warranties to the owners of the notes or any member of the public regarding the advisability of investing in the notes. Van Eck has no obligation or liability in connection with the operation, marketing, trading or sale of the notes.

*The Underlying Index*

We have derived all information contained in this pricing supplement regarding the Underlying Index, including, without limitation, its make-up, method of calculation and changes in its components, from publicly available information and information supplied by NYSE Arca. Such information reflects the policies of, and is subject to change by, NYSE Arca. The Underlying Index was developed by the NYSE Amex (formerly the American Stock Exchange) and is calculated, maintained and published by the NYSE Arca. The NYSE Arca has no obligation to continue to publish, and may discontinue the publication of, the Underlying Index.

The Underlying Index includes common stocks, ADRs and GDRs of selected companies that are involved primarily in mining for gold or silver and that are listed for trading and electronically quoted on a major stock market that is accessible by foreign investors. Generally, this will include exchanges in most developed markets and major emerging markets, and will include companies that are cross-listed, e.g., both U.S. and Canadian listings. NYSE Arca will use its discretion to avoid exchanges and markets that are considered "frontier" in nature or have major restrictions to foreign ownership. The Underlying Index includes companies that derive at least 50% of their revenues from gold mining and related activities (40% for companies that were included in the Underlying Index prior to September 23, 2013). Also, the Underlying Index maintains exposure to companies with a significant revenue exposure to silver mining in addition to gold mining, which will not exceed 20% of the Underlying Index weight at each rebalance.

Only companies with market capitalizations greater than $750 million that have an average daily volume of at least 50,000 shares over the past three months and an average daily value traded of at least $1 million over the past three months are eligible for inclusion in the Underlying Index. Starting in December 2013, for companies that were included in the Underlying Index prior to September 23, 2013, the market capitalization requirement at each rebalance became $450 million, the average daily volume requirement will be at least 30,000 shares over the past three months and the average daily value traded requirement will be at least $600,000 over the past three months. NYSE Arca has the discretion to not include all companies that meet the minimum criteria for inclusion. The Underlying Index's benchmark value was 500.00 at the close of trading on December 20, 2002.

*Calculation of the Underlying Index*. The Underlying Index is calculated by NYSE Arca on a price return basis. The calculation is based on the current modified market capitalization divided by a divisor. The divisor was determined on the initial capitalization base of the Underlying Index and the base level and may be adjusted as a result of corporate actions and composition changes, as described below.

*Index Maintenance*. The Underlying Index is reviewed quarterly to ensure that at least 90% of the index weight is accounted for by index components that continue to meet the initial eligibility requirements. NYSE Arca may at any time and from time to time change the number of securities comprising the group by adding or deleting one or more securities, or replacing one or more securities contained in the group with one or more substitute securities of its choice, if in NYSE Arca's discretion such addition, deletion or substitution is necessary or appropriate to maintain the quality and/or character of the Underlying Index. Components will be removed from the Underlying Index during the quarterly review if (1) the market capitalization falls below $450 million, or (2) the traded average daily shares for the previous three months is lower than 30,000 shares and the traded average daily value for the previous three months is less than $600,000.

At the time of the quarterly rebalance, the component security quantities will be modified to conform to the following asset diversification requirements:

(1) the weight of any single component security may not account for more than 20% of the total value of the Underlying Index;

(2) the component securities are split into two subgroups–large and small, which are ranked by market capitalization weight

in the Underlying Index. Large securities are defined as having a starting index weight greater than or equal to 5%. Small securities are defined as having a starting index weight below 5%; and

(3) the final aggregate weight of those component securities which individually represent more than 4.5% of the total value of the Underlying Index may not account for more than 45% of the total index value.

The weights of the components securities (taking into account expected component changes and share adjustments) are modified in accordance with the Underlying Index's diversification rules.

Changes to the index composition and/or the component security weights in the Underlying Index are determined and announced prior to taking effect, which typically occurs after the close of trading on the third Friday of each calendar quarter month in connection with the quarterly index rebalance. The share quantities of each component security in the index portfolio remains fixed between quarterly reviews except in the event of certain types of corporate actions such as stock splits, reverse stock splits, stock dividends, or similar events. The share quantities used in the index calculation are not typically adjusted for shares issued or repurchased between quarterly reviews. However, in the event of a merger between two components, the share quantity of the surviving entity may be adjusted to account for any stock issued in the acquisition. NYSE Arca may substitute securities or change the number of securities included in the Underlying Index, based on changing conditions in the industry or in the event of certain types of corporate actions, including mergers, acquisitions, spin-offs, and reorganizations. In the event of component or share quantity changes to the index portfolio, the payment of dividends other than ordinary cash dividends, spin-offs, rights offerings, re-capitalization, or other corporate actions affecting a component security of the Underlying Index, the index divisor may be adjusted to ensure that there are no changes to the index level as a result of nonmarket forces.

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**Validity of the Notes**

In the opinion of Osler, Hoskin & Harcourt LLP, the issue and sale of the notes has been duly authorized by all necessary corporate action of the Bank in conformity with the Senior Indenture, and when this pricing supplement has been attached to, and duly notated on, the master note that represents the notes, the notes will have been validly executed and issued and, to the extent validity of the notes is a matter governed by the laws of the Province of Ontario, or the laws of Canada applicable therein, and will be valid obligations of the Bank, subject to the following limitations (i) the enforceability of the Senior Indenture may be limited by the Canada Deposit Insurance Corporation Act (Canada), the Winding-up and Restructuring Act (Canada) and bankruptcy, insolvency, reorganization, receivership, moratorium, arrangement or winding-up laws or other similar laws affecting the enforcement of creditors' rights generally; (ii) the enforceability of the Senior Indenture may be limited by equitable principles, including the principle that equitable remedies such as specific performance and injunction may only be granted in the discretion of a court of competent jurisdiction; (iii) pursuant to the Currency Act (Canada) a judgment by a Canadian court must be awarded in Canadian currency and that such judgment may be based on a rate of exchange in existence on a day other than the day of payment; and (iv) the enforceability of the Senior Indenture will be subject to the limitations contained in the Limitations Act, 2002 (Ontario), and such counsel expresses no opinion as to whether a court may find any provision of the Senior Debt Indenture to be unenforceable as an attempt to vary or exclude a limitation period under that Act. This opinion is given as of the date hereof and is limited to the laws of the Provinces of Ontario and the federal laws of Canada applicable thereto. In addition, this opinion is subject to customary assumptions about the trustee's authorization, execution and delivery of the Indenture and the genuineness of signatures and certain factual matters, all as stated in the letter of such counsel dated September 23, 2018, which has been filed as Exhibit 5.3 to Bank of Montreal's Form 6-K filed with the SEC and dated September 23, 2018.

In the opinion of Morrison & Foerster LLP, when the pricing supplement has been attached to, and duly notated on, the master note that represents the notes, and the notes have been issued and sold as contemplated by the prospectus supplement and the prospectus, the notes will be valid, binding and enforceable obligations of Bank of Montreal, entitled to the benefits of the Senior Indenture, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally, concepts of reasonableness and equitable principles of general applicability (including, without limitation, concepts of good faith, fair dealing and the lack of bad faith). This opinion is given as of the date hereof and is limited to the laws of the State of New York. This opinion is subject to customary assumptions about the trustee's authorization, execution and delivery of the Senior Indenture and the genuineness of signatures and to such counsel's reliance on Bank of Montreal and other sources as to certain factual matters, all as stated in the legal opinion dated September 23, 2018, which has been filed as Exhibit 5.4 to Bank of Montreal's Form 6-K dated September 23, 2018.