FAIR ISAAC CORP
Form 10-Q
July 30, 2013
Table of Contents

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 June 30, 2013

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
[NO FEE REQUIRED]

For the transition period from __________ to __________

Commission File Number 1-11689

Fair Isaac Corporation

(Exact name of registrant as specified in its charter)

Delaware	**94-1499887**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
181 Metro Drive, Suite 700 San Jose, California	**95110-1346**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: 408-535-1500

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer	x	Accelerated Filer	¨
Non-Accelerated Filer	¨	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 x No

The number of shares of common stock outstanding on July 19, 2013 was 35,201,057 (excluding 53,655,726 shares held by the Company as treasury stock).

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

FAIR ISAAC CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2013 (Unaudited)	September 30, 2012
	(In thousands, except par value data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 93,019	$ 71,609
Marketable securities available for sale, current portion		22,008
Accounts receivable, net	132,717	142,595
Prepaid expenses and other current assets	21,026	23,113
Total current assets	246,762	259,325
Marketable securities available for sale, less current portion	6,784	5,417
Other investments	11,033	11,083
Property and equipment, net	47,140	41,080
Goodwill	765,587	757,504
Intangible assets, net	59,373	52,299
Deferred income taxes	20,406	22,856
Other assets	7,058	9,047
Total assets	$ 1,164,143	$ 1,158,611
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 25,455	$ 18,958
Accrued compensation and employee benefits	37,944	50,043
Other accrued liabilities	29,324	43,645
Deferred revenue	50,522	47,959
Current maturities on debt	38,000	49,000
Total current liabilities	181,245	209,605
Senior notes	447,000	455,000
Other liabilities	20,661	19,600
Total liabilities	648,906	684,205
Commitments and contingencies		
Stockholders equity:		
Preferred stock ($0.01 par value; 1,000 shares authorized; none issued and outstanding)		
Common stock ($0.01 par value; 200,000 shares authorized, 88,857 shares issued and 35,178 and 34,839 shares outstanding at June 30, 2013 and September 30, 2012, respectively)	352	348
Paid-in-capital	1,106,355	1,103,611
Treasury stock, at cost (53,679 and 54,018 shares at June 30, 2013 and September 30, 2012, respectively)	(1,724,197)	(1,718,570)
Retained earnings	1,164,240	1,104,825

Accumulated other comprehensive loss	(31,513)	(15,808)
Total stockholders equity	515,237	474,406
Total liabilities and stockholders equity	$ 1,164,143	$ 1,158,611

See accompanying notes to condensed consolidated financial statements.

1

Table of Contents

FAIR ISAAC CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Unaudited)

	Quarter Ended June 30,		Nine Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands, except per share data)			
Revenues:				
Transactional and maintenance	$ 129,422	$ 113,708	$ 385,759	$ 342,734
Professional services	32,306	31,993	98,752	91,147
License	22,044	14,777	68,606	56,467
Total revenues	183,772	160,478	553,117	490,348
Operating expenses:				
Cost of revenues (1)	57,655	47,832	172,659	142,620
Research and development	18,570	14,890	49,143	41,925
Selling, general and administrative (1)	68,665	59,123	205,968	173,482
Amortization of intangible assets (1)	3,477	1,465	10,453	4,885
Restructuring and acquisition-related	197		3,486	
Total operating expenses	148,564	123,310	441,709	362,912
Operating income	35,208	37,168	111,408	127,436
Interest income	15	82	45	276
Interest expense	(7,432)	(7,907)	(23,167)	(23,878)
Other income (expense), net	830	911	765	(271)
Income before income taxes	28,621	30,254	89,051	103,563
Provision for income taxes	8,999	9,505	27,513	32,805
Net income	19,622	20,749	61,538	70,758
Other comprehensive income:				
Unrealized losses on investments				(8)
Translation adjustments	(1,284)	(5,720)	(15,705)	(2,266)
Comprehensive income	$ 18,338	$ 15,029	$ 45,833	$ 68,484
Earnings per share:				
Basic	$ 0.55	$ 0.61	$ 1.74	$ 2.01
Diluted	$ 0.54	$ 0.59	$ 1.69	$ 1.95
Shares used in computing earnings per share:				
Basic	35,499	34,004	35,400	35,126
Diluted	36,385	35,293	36,340	36,247

(1) Cost of revenues and selling, general and administrative expenses exclude the amortization of intangible assets. See Note 5 to the accompanying condensed consolidated financial statements.

See accompanying notes to condensed consolidated financial statements.

2

Table of Contents

FAIR ISAAC CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(Unaudited)

	Common Stock Shares	Common Stock Par Value	Paid-in-Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
			(In thousands, except per share data)				
Balance at September 30, 2012	**34,839**	**$ 348**	**$ 1,103,611**	**$ (1,718,570)**	**$ 1,104,825**	**$ (15,808)**	**$ 474,406**
Share-based compensation			18,897				18,897
Issuance of treasury stock under employee stock plans	1,325	14	(18,398)	42,174			23,790
Tax effect from share-based payment arrangements			2,245				2,245
Repurchases of common stock	(986)	(10)		(47,801)			(47,811)
Dividends paid ($0.02 per share)					(2,123)		(2,123)
Net income					61,538		61,538
Translation adjustments						(15,705)	(15,705)
Balance at June 30, 2013	**35,178**	**$ 352**	**$ 1,106,355**	**$ (1,724,197)**	**$ 1,164,240**	**$ (31,513)**	**$ 515,237**

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FAIR ISAAC CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended June 30, 2013	2012
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 61,538	$ 70,758
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	25,160	14,555
Share-based compensation	18,897	15,466
Deferred income taxes	(5,515)	(1,864)
Tax effect from share-based payment arrangements	2,245	3,708
Excess tax benefits from share-based payment arrangements	(5,073)	(4,402)
Net amortization of premium on marketable securities	8	200
Benefit from provision for doubtful accounts, net	293	
Net loss on sales of property and equipment	393	2
Changes in operating assets and liabilities:		
Accounts receivable	9,977	(6,149)
Prepaid expenses and other assets	1,841	1,080
Accounts payable	4,987	6,970
Accrued compensation and employee benefits	(12,897)	(230)
Other liabilities	(1,213)	(10,099)
Deferred revenue	(464)	16,413
Net cash provided by operating activities	100,177	106,408
Cash flows from investing activities:		
Purchases of property and equipment	(20,435)	(19,616)
Purchases of marketable securities		(48,067)
Proceeds from maturities of marketable securities	22,000	121,659
Cash paid for acquisitions, net of cash acquired	(32,874)	(18,192)
Distribution from (purchase of) cost method investees	50	(149)
Net cash provided by (used in) investing activities	(31,259)	35,635
Cash flows from financing activities:		
Proceeds from revolving line of credit and other short-term loans	30,000	
Payments on revolving line of credit and other short-term loans	(3,676)	
Payments on Senior Notes	(49,000)	(8,000)
Proceeds from issuance of treasury stock under employee stock plans	23,790	39,609
Dividends paid	(2,123)	(2,111)
Repurchases of common stock	(47,811)	(191,056)
Excess tax benefits from share-based payment arrangements	5,073	4,402
Net cash used in financing activities	(43,747)	(157,156)
Effect of exchange rate changes on cash	(3,761)	(1,958)
Increase (decrease) in cash and cash equivalents	21,410	(17,071)
Cash and cash equivalents, beginning of year	71,609	135,752

Cash and cash equivalents, end of year	$ 93,019	$ 118,681
Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net of refunds	$ 23,139	$ 30,415
Cash paid for interest	$ 24,480	$ 24,955

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FAIR ISAAC CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Business

Fair Isaac Corporation

Incorporated under the laws of the State of Delaware, Fair Isaac Corporation (FICO) is a provider of analytic, software and data management products and services that enable businesses to automate, improve and connect decisions. FICO provides a range of analytical solutions, credit scoring and credit account management products and services to banks, credit reporting agencies, credit card processing agencies, insurers, retailers and healthcare organizations.

In these condensed consolidated financial statements, FICO is referred to as we, us, our, or FICO .

Principles of Consolidation and Basis of Presentation

We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with the instructions to Form 10-Q and the applicable accounting guidance. Consequently, we have not necessarily included in this Form 10-Q all information and footnotes required for audited financial statements. In our opinion, the accompanying unaudited interim condensed consolidated financial statements in this Form 10-Q reflect all adjustments (consisting only of normal recurring adjustments, except as otherwise indicated) necessary for a fair presentation of our financial position and results of operations. These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with our audited consolidated financial statements and notes thereto presented in our Annual Report on Form 10-K for the year ended September 30, 2012. The interim financial information contained in this report is not necessarily indicative of the results to be expected for any other interim period or for the entire fiscal year.

The condensed consolidated financial statements include the accounts of FICO and its subsidiaries. All intercompany accounts and transactions have been eliminated.

Use of Estimates

We make estimates and assumptions that affect the amounts reported in the financial statements and the disclosures made in the accompanying notes. For example, we use estimates in determining the collectibility of accounts receivable; the appropriate levels of various accruals; labor hours in connection with fixed-fee service contracts; the amount of our tax provision and the realizability of deferred tax assets. We also use estimates in determining the remaining economic lives and carrying values of acquired intangible assets, property and equipment, and other long-lived assets. In addition, we use assumptions to estimate the fair value of reporting units and share-based compensation. Actual results may differ from our estimates.

New Accounting Pronouncements Recently Issued or Adopted

On December 16, 2011 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11). ASU 2011-11 provides for additional disclosures of both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. ASU 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013, which means that it will be effective for our fiscal year beginning October 1, 2013. Retrospective adoption is required. We do not believe that adoption of ASU 2011-11 will have a significant impact on our condensed consolidated financial statements.

On February 5, 2013 the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.* (ASU 2013-02). ASU 2013-02 requires reporting entities to provide information about the amounts reclassified from accumulated other comprehensive income by component. In addition, reporting entities will be required to present, either on the face of the statement of income and comprehensive income or in the footnotes to the financial statements, significant amounts reclassified from accumulated other comprehensive income by statement of operations line item. ASU 2013-02 is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2012, which means that it will be effective for our fiscal year beginning October 1, 2013. Early adoption is permitted. We do not believe that adoption of ASU 2013-02 will have a significant impact on our condensed consolidated financial statements.

Table of Contents

2. Acquisitions

On April 1, 2013, we acquired 100% of the common stock of Infoglide Software, Inc. (Infoglide) for $4.4 million in cash. Infoglide is a provider of entity resolution and social network analysis solutions used primarily to improve fraud detection, security and compliance. Infoglide s solutions expedite fraud investigations and will further differentiate FICO s fraud solutions in banking, insurance, retail and healthcare, as well as enabling FICO analytics to be applied to fraud, security and compliance challenges across multiple industries, including telecommunications and cyber-security. The pro forma impact of this acquisition was not deemed material to our results of operations.

3. Fair Value Measurements

Fair value is defined as the price that would be received from the sale of an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The accounting guidance establishes a three-level hierarchy for disclosure that is based on the extent and level of judgment used to estimate the fair value of assets and liabilities.

Level 1 uses unadjusted quoted prices that are available in active markets for identical assets or liabilities. Our Level 1 securities are comprised of money market funds and certain equity securities.

Level 2 uses inputs other than quoted prices included in Level 1 that are either directly or indirectly observable through correlation with market data. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and inputs to valuation models or other pricing methodologies that do not require significant judgment because the inputs used in the model, such as interest rates and volatility, can be corroborated by readily observable market data. Our Level 2 securities are comprised of U.S. government and corporate debt obligations that are generally held to maturity.

Level 3 uses one or more significant inputs that are unobservable and supported by little or no market activity, and that reflect the use of significant management judgment. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, and significant management judgment or estimation. We do not have any assets or liabilities that are valued using inputs identified under a Level 3 hierarchy.

The following table represents financial assets that we measured at fair value on a recurring basis at June 30, 2013 and September 30, 2012, respectively:

June 30, 2013	**Active Markets for Identical Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Fair Value as of June 30, 2013**
		(In thousands)	
Assets:			
Cash equivalents (1)	$ 672	$	$ 672
Marketable securities (3)	6,784		6,784
Total	$ 7,456	$	$ 7,456

Table of Contents

September 30, 2012	Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2) (In thousands)	Fair Value as of September 30, 2012
Assets:			
Cash equivalents (1)	$ 644	$	$ 644
U.S. corporate debt (2)		2,008	2,008
U.S. government obligations (2)		20,000	20,000
Marketable securities (3)	5,417		5,417
Total	$ 6,061	$ 22,008	$ 28,069

(1) Included in cash and cash equivalents on our balance sheet at June 30, 2013 and September 30, 2012. Not included in this table are cash deposits of $92.3 million and $71.0 million at June 30, 2013 and September 30, 2012, respectively.
(2) Included in current marketable securities on our balance sheet at September 30, 2012.
(3) Represents securities held under a supplemental retirement and savings plan for certain officers and senior management employees, which are distributed upon termination or retirement of the employees. Included in long-term marketable securities on our balance sheet at June 30, 2013 and September 30, 2012.

Where applicable, we use quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing applies to our Level 1 investments. To the extent quoted prices in active markets for assets or liabilities are not available, the valuation techniques used to measure the fair values of our financial assets incorporate market inputs, which include reported trades, broker/dealer quotes, benchmark yields, issuer spreads, benchmark securities and other inputs derived from or corroborated by observable market data. This methodology applies to our Level 2 investments. We have not changed our valuation techniques in measuring the fair value of any financial assets and liabilities during the period.

For the fair value of our derivative instruments, see Note 4 to the condensed consolidated financial statements.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities measured at fair value on a nonrecurring basis primarily include goodwill and definite-lived intangible assets which are measured at fair value for the purposes of our annual impairment assessment.

4. Derivative Financial Instruments

We use derivative instruments to manage risks caused by fluctuations in foreign exchange rates. The primary objective of our derivative instruments is to protect the value of foreign currency denominated accounts receivable and cash balances from the effects of volatility in foreign exchange rates that might occur prior to conversion to their functional currency. We principally utilize foreign currency forward contracts, which enable us to buy and sell foreign currencies in the future at fixed exchange rates and economically offset changes in foreign currency exchange rates. We routinely enter into contracts to offset exposures denominated in the British pound, Euro and Canadian dollar.

Foreign currency denominated accounts receivable and cash balances are re-measured at foreign currency rates in effect on the balance sheet date with the effects of changes in foreign currency rates reported in other income (expense), net. The forward contracts are not designated as hedges and are marked to market through other income (expense), net. Fair value changes in the forward contracts help mitigate the changes in the value of the re-measured accounts receivable and cash balances attributable to changes in foreign currency exchange rates. The forward contracts are short-term in nature and typically have average maturities at inception of less than three months.

The following tables summarize our outstanding forward foreign currency contracts, by currency, at June 30, 2013 and September 30, 2012, respectively:

Table of Contents

	June 30, 2013 Contract Amount		Fair Value
	Foreign Currency	US$	US$
		(In thousands)	
Sell foreign currency:			
Canadian dollar (CAD)	CAD 6,550	$ 6,253	$
Euro (EUR)	EUR 5,150	$ 6,771	$
Buy foreign currency:			
British pound (GBP)	GBP 7,068	$ 10,800	$

	September 30, 2012 Contract Amount		Fair Value
	Foreign Currency	US$	US$
		(In thousands)	
Sell foreign currency:			
Canadian dollar (CAD)	CAD 2,750	$ 2,794	$
Euro (EUR)	EUR 4,060	$ 5,255	$
Buy foreign currency:			
British pound (GBP)	GBP 6,131	$ 9,950	$

The forward foreign currency contracts were all entered into on June 30, 2013 and September 30, 2012, respectively; therefore, their fair value was $0.

Gains (losses) on derivative financial instruments are recorded in our condensed consolidated statements of income and comprehensive income as a component of other income (expense), net, and consisted of the following:

	Quarter Ended June 30,		Nine Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands)			
Foreign currency forward contracts	$ 131	$ 116	$ (728)	$ 259

5. Goodwill and Intangible Assets

Amortization expense associated with our intangible assets, which has been reflected as a separate operating expense caption within the accompanying condensed consolidated statements of income and comprehensive income, consisted of the following:

Table of Contents

	Quarter Ended June 30, 2013	Quarter Ended June 30, 2012	Nine Months Ended June 30, 2013	Nine Months Ended June 30, 2012
	(In thousands)			
Cost of revenues	$ 1,739	$ 92	$ 4,883	$ 789
Selling, general and administrative expenses	1,738	1,373	5,570	4,096
	$ 3,477	$ 1,465	$ 10,453	$ 4,885

Cost of revenues reflects our amortization of completed technology and selling, general and administrative expenses reflects our amortization of other intangible assets. Intangible assets, gross were $170.5 million and $175.3 million as of June 30, 2013 and September 30, 2012, respectively.

Estimated future intangible asset amortization expense associated with intangible assets existing at June 30, 2013, was as follows (in thousands):

Fiscal year	
Remainder of fiscal 2013	$ 3,071
2014	11,342
2015	11,193
2016	10,964
2017	9,843
Thereafter	12,960
	$ 59,373

The following table summarizes changes to goodwill during the nine months ended June 30, 2013, both in total and as allocated to our segments.

	Applications	Scores	Tools	Total
	(In thousands)			
Balance at September 30, 2012	$ 542,943	$ 146,648	$ 67,913	$ 757,504
Addition from acquisitions	17,457			17,457
Foreign currency translation adjustment	(7,848)		(1,526)	(9,374)
Balance at June 30, 2013	$ 552,552	$ 146,648	$ 66,387	$ 765,587

6. Composition of Certain Financial Statement Captions

The following table summarizes property and equipment, and the related accumulated depreciation and amortization.

	June 30, 2013	September 30, 2012
	(In thousands)	
Property and equipment	$ 187,022	$ 189,519
Less: accumulated depreciation and amortization	(139,882)	(148,439)
	$ 47,140	$ 41,080

Table of Contents

7. Revolving Line of Credit

We have a $200 million unsecured revolving line of credit with a syndicate of banks that expires on September 28, 2016. Proceeds from the credit facility can be used for working capital and general corporate purposes and may also be used for the refinancing of existing debt, acquisitions, and the repurchase of our common stock. Interest on amounts borrowed under the credit facility is based on (i) a base rate, which is the greater of (a) the prime rate and (b) the Federal Funds rate plus 0.50% or (ii) LIBOR plus an applicable margin. The margin on LIBOR borrowings ranges from 1.000% to 1.625% and is determined based on our consolidated leverage ratio. In addition, we must pay utilization fees if borrowings and commitments under the credit facility exceed 50% of the total credit facility commitment, as well as facility fees. The credit facility contains certain restrictive covenants including maintaining a maximum consolidated leverage ratio of 3.0 and a minimum fixed charge ratio of 2.5, and also contains other covenants typical of unsecured facilities. As of June 30, 2013, we had $30.0 million borrowings outstanding at an interest rate of 1.375% and were in compliance with all financial covenants under this credit facility.

8. Senior Notes

In May 2008, we issued $275 million of Senior Notes in a private placement to a group of institutional investors (the 2008 Senior Notes). The 2008 Senior Notes were issued in four series with maturities ranging from 5 to 10 years. The Series A note matured on May 7, 2013 and the entire $41 million principal balance was repaid. The remaining 2008 Senior Notes weighted average interest rate is 7.0% and the weighted average maturity is 8.8 years. In July 2010, we issued $245 million of Senior Notes in a private placement to a group of institutional investors (the 2010 Senior Notes and, with the 2008 Senior Notes, the Senior Notes). The 2010 Senior Notes were issued in four series with maturities ranging from 6 to 10 years. The 2010 Senior Notes weighted average interest rate is 5.2% and the weighted average maturity is 8.0 years. The Senior Notes require interest payments semi-annually and also include certain restrictive covenants. As of June 30, 2013, we were in compliance with all financial covenants which include the maintenance of consolidated net debt to consolidated EBITDA ratio and a fixed charge coverage ratio. The issuance of the Senior Notes also required us to make certain covenants typical of unsecured facilities. The carrying value of the Senior Notes was $455.0 million and $504.0 million as of June 30, 2013 and September 30, 2012, respectively. The fair value of the Senior Notes was $462.3 million and $519.1 million as of June 30, 2013 and September 30, 2012, respectively. These estimated fair values are based on Level 2 inputs.

9. Restructuring Expenses

The following table summarizes our restructuring accruals and certain FICO facility closures. The current portion and non-current portion is recorded in other accrued current liabilities and other long-term liabilities, respectively, within the accompanying condensed consolidated balance sheets. These balances are expected to be paid by the end of fiscal 2018.

	Accrual at September 30, 2012	Expense Additions	Cash Payments	Expense Reversals	Accrual at June 30, 2013
			(In thousands)		
Facilities charges	$ 3,333	$ 1,624	$ (2,647)	$	$ 2,310
Employee separation	2,471	1,095	(3,313)	(253)	
	5,804	$ 2,719	$ (5,960)	$ (253)	2,310
Less: current portion	(4,944)				(2,116)
Non-current	$ 860				$ 194

10. Income Taxes

Effective Tax Rate

The effective income tax rate was 31.4% during the quarters ended June 30, 2013 and 2012, and 30.9% and 31.7% during the nine months ended June 30, 2013 and 2012, respectively.

The provision for income taxes during interim quarterly reporting periods is based on our estimates of the effective tax rates for the respective full fiscal year. The effective tax rate in any quarter can also be affected positively or negatively by adjustments that are required to be reported in the specific quarter of resolution. The slight decrease in our effective tax rate year over year was primarily

Table of Contents

due to the re-enactment of the U.S. Federal Research and Development credit in January 2013, as well as a one-time benefit of a tax adjustment in one state, partially offset by an adjustment to our income tax valuation allowance in another state. The 2012 effective tax rate was also negatively impacted by a one-time tax impact of a legal entity restructuring charge.

The total unrecognized tax benefit for uncertain tax positions at June 30, 2013 and September 30, 2012 is estimated to be approximately $8.8 million and $7.5 million, respectively. We recognize interest expense related to unrecognized tax benefits and penalties as part of the provision for income taxes in our condensed consolidated statements of income and comprehensive income. As of June 30, 2013 and September 30, 2012, we have accrued interest of $0.9 million and $0.7 million, respectively related to the unrecognized tax benefits.

11. Earnings Per Share

The following reconciles the numerators and denominators of basic and diluted earnings per share (EPS):

	Quarter Ended June 30,		Nine Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands, except per share data)			
Numerator for diluted and basic earnings per share:				
Net Income	$ 19,622	$ 20,749	$ 61,538	$ 70,758
Denominator share:				
Basic weighted-average shares	35,499	34,004	35,400	35,126
Effect of dilutive securities	886	1,289	940	1,121
Diluted weighted-average shares	36,385	35,293	36,340	36,247
Earnings per share:				
Basic	$ 0.55	$ 0.61	$ 1.74	$ 2.01
Diluted	$ 0.54	$ 0.59	$ 1.69	$ 1.95

We exclude the options to purchase shares of common stock in the computation of the diluted EPS where the options exercise prices exceed the average market price of our common stock as their inclusion would be antidilutive. There were no options excluded for the quarter ended June 30, 2013. There were approximately 890,000 options excluded for the quarter ended June 30, 2012. There were approximately 145,000 and 1,669,000 options excluded for the nine months ended June 30, 2013 and 2012, respectively.

12. Segment Information

We are organized into the following three reportable segments to align with internal management of our worldwide business operations based on product offerings.

Applications. Our Applications products are pre-configured Decision Management applications and associated professional services, designed for a specific type of business problem or process, such as marketing, account origination, customer management, fraud and insurance claims management.

Scores. This segment includes our business-to-business scoring solutions, our myFICO® solutions for consumers and associated professional services. Our scoring solutions give our clients access to analytics that can be easily integrated into their transaction streams and decision-making processes. Our scoring solutions are distributed through major credit reporting agencies, as well as services through which we provide our scores to clients directly.

Tools. The Tools segment is composed of software tools and associated professional services that clients can use to create their own custom Decision Management applications.

Table of Contents

Our Chief Executive Officer evaluates segment financial performance based on segment revenues and segment operating income. Segment operating expenses consist of direct and indirect costs principally related to personnel, facilities, consulting, travel and depreciation. Indirect costs are allocated to the segments generally based on relative segment revenues, fixed rates established by management based upon estimated expense contribution levels and other assumptions that management considers reasonable. We do not allocate share-based compensation expense, restructuring expense, amortization expense, various corporate charges and certain other income and expense measures to our segments. These income and expense items are not allocated because they are not considered in evaluating the segment s operating performance. Our Chief Executive Officer does not evaluate the financial performance of each segment based on its respective assets or capital expenditures; rather, depreciation amounts are allocated to the segments from their internal cost centers as described above.

The following tables summarize segment information for the quarters and nine months ended June 30, 2013 and 2012:

	Quarter Ended June 30, 2013				
	Applications	Scores	Tools (In thousands)	Unallocated Corporate Expenses	Total
Segment revenues:					
Transactional and maintenance	$ 75,537	$ 45,915	$ 7,970	$	$ 129,422
Professional services	26,230	806	5,270		32,306
License	13,216	431	8,397		22,044
Total segment revenues	114,983	47,152	21,637		183,772
Segment operating expense	(87,688)	(12,977)	(17,569)	(20,004)	(138,238)
Segment operating income	$ 27,295	$ 34,175	$ 4,068	$ (20,004)	45,534
Unallocated share-based compensation expense					(6,652)
Unallocated amortization expense					(3,477)
Unallocated restructuring and acquisition-related					(197)
Operating income					35,208
Unallocated interest income					15
Unallocated interest expense					(7,432)
Unallocated other income, net					830
Income before income taxes					$ 28,621
Depreciation expense	$ 3,789	$ 220	$ 536	$ 705	$ 5,250

Table of Contents

	Quarter Ended June 30, 2012				
	Applications	Scores	Tools	Unallocated Corporate Expenses	Total
			(In thousands)		
Segment revenues:					
Transactional and maintenance	$ 64,729	$ 41,394	$ 7,585	$	$ 113,708
Professional services	27,109	500	4,384		31,993
License	6,484	26	8,267		14,777
Total segment revenues	98,322	41,920	20,236		160,478
Segment operating expense	(69,964)	(12,821)	(13,790)	(19,188)	(115,763)
Segment operating income	$ 28,358	$ 29,099	$ 6,446	$ (19,188)	44,715
Unallocated share-based compensation expense					(6,082)
Unallocated amortization expense					(1,465)
Operating income					37,168
Unallocated interest income					82
Unallocated interest expense					(7,907)
Unallocated other expense, net					911
Income before income taxes					$ 30,254
Depreciation expense	$ 2,420	$ 148	$ 229	$ 244	$ 3,041

	Nine Months Ended June 30, 2013				
	Applications	Scores	Tools	Unallocated Corporate Expenses	Total
			(In thousands)		
Segment revenues:					
Transactional and maintenance	$ 231,174	$ 130,558	$ 24,027	$	$ 385,759
Professional services	79,704	3,333	15,715		98,752
License	46,027	770	21,809		68,606
Total segment revenues	356,905	134,661	61,551		553,117
Segment operating expense	(265,708)	(39,692)	(51,412)	(52,061)	(408,873)
Segment operating income	$ 91,197	$ 94,969	$ 10,139	$ (52,061)	144,244
Unallocated share-based compensation expense					(18,897)
Unallocated amortization expense					(10,453)
Unallocated restructuring and acquisition-related					(3,486)
Operating income					111,408
Unallocated interest income					45
Unallocated interest expense					(23,167)
Unallocated other expense, net					765
Income before income taxes					$ 89,051
Depreciation expense	$ 10,564	$ 659	$ 1,487	$ 1,997	$ 14,707

Table of Contents

	Nine Months Ended June 30, 2012				
	Applications	Scores	Tools	Unallocated Corporate Expenses	Total
			(In thousands)		
Segment revenues:					
Transactional and maintenance	$ 192,524	$ 127,227	$ 22,983	$	$ 342,734
Professional services	77,192	1,309	12,646		91,147
License	34,956	351	21,160		56,467
Total segment revenues	304,672	128,887	56,789		490,348
Segment operating expense	(210,087)	(39,219)	(43,698)	(49,557)	(342,561)
Segment operating income	$ 94,585	$ 89,668	$ 13,091	$ (49,557)	147,787
Unallocated share-based compensation expense					(15,466)
Unallocated amortization expense					(4,885)
Operating income					127,436
Unallocated interest income					276
Unallocated interest expense					(23,878)
Unallocated other expense, net					(271)
Income before income taxes					$ 103,563
Depreciation expense	$ 7,600	$ 540	$ 871	$ 659	$ 9,670

13. Contingencies

We are in disputes with certain customers regarding amounts owed in connection with the sale of certain of our products and services. We also have had claims asserted by former employees relating to compensation and other employment matters. We are also involved in various other claims and legal actions arising in the ordinary course of business. We record litigation accruals for legal matters which are both probable and estimable. For legal proceedings for which there is a reasonable possibility of loss (meaning those losses for which the likelihood is more than remote but less than probable), we have determined we do not have material exposure on an aggregate basis.

Table of Contents

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

FORWARD LOOKING STATEMENTS

Statements contained in this report that are not statements of historical fact should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Act). In addition, certain statements in our future filings with the Securities and Exchange Commission (SEC), in press releases, and in oral and written statements made by us or with our approval that are not statements of historical fact constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenue, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other statements concerning future financial performance; (ii) statements of our plans and objectives by our management or Board of Directors, including those relating to products or services, research and development, and the sufficiency of capital resources; (iii) statements of assumptions underlying such statements, including those related to economic conditions; (iv) statements regarding business relationships with vendors, customers or collaborators, including the proportion of revenues generated from international as opposed to domestic customers; and (v) statements regarding products, their characteristics, performance, sales potential or effect in the hands of customers. Words such as believes, anticipates, expects, intends, targeted, should, potential, goals, strategy, and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to, those described in Part II, Item 1A, Risk Factors. The performance of our business and our securities may be adversely affected by these factors and by other factors common to other businesses and investments, or to the general economy. Forward-looking statements are qualified by some or all of these risk factors. Therefore, you should consider these risk factors with caution and form your own critical and independent conclusions about the likely effect of these risk factors on our future performance. Such forward-looking statements speak only as of the date on which statements are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events or circumstances. Readers should carefully review the disclosures and the risk factors described in this and other documents we file from time to time with the SEC, including our reports on Forms 10-Q and 8-K to be filed by FICO in fiscal 2013.

OVERVIEW

We are a leader in Decision Management solutions that enable businesses to automate, improve and connect decisions to enhance business performance. Our predictive analytics, which include the industry standard FICO® score, and our Decision Management systems power billions of customer decisions each year. We help companies acquire customers more efficiently, increase customer value, reduce fraud and credit losses, lower operating expenses and enter new markets more profitably. Our clients utilize our products and services to facilitate a variety of business processes, including customer marketing and acquisition, account origination, credit and underwriting risk management, fraud loss prevention and control, and client account and policyholder management. Most leading banks and credit card issuers rely on our solutions, as do many insurers, retailers, healthcare organizations, pharmaceutical companies and government agencies. We also serve consumers through online services that enable people to purchase and understand their FICO® scores, the standard measure in the United States of credit risk, empowering them to manage their financial health.

A significant portion of our revenues are derived from the sale of products and services within the consumer banking industry, and approximately 73% and 74% of our revenues during the quarters ended June 30, 2013 and 2012, respectively, and 73% and 75% of our revenues during the nine months ended June 30, 2013 and 2012, respectively, were derived from within this industry. Our remaining revenues are primarily derived from the insurance, healthcare and retail industries. Our revenues derived from clients outside the United States have generally grown, and may in the future grow, more rapidly than our revenues from domestic clients. International revenues totaled $71.9 million and $58.8 million during the quarters ended June 30, 2013 and 2012, respectively, representing 39% and 37% of total consolidated revenues in each of these periods. International revenues totaled $217.7 and $188.1 million during the nine months ended June 30, 2013 and 2012, respectively, representing 39% and 38% of total consolidated revenues in each of these periods.

A significant portion of our revenues is derived from transactional or unit-based software license fees, annual license fees under long-term software license arrangements, transactional fees derived under scoring, network service or internal hosted software arrangements, and annual software maintenance fees. Arrangements with transactional or unit-based pricing accounted for approximately 70% and 71% of our revenues during the quarters ended June 30, 2013 and 2012, respectively. Arrangements with transactional or unit-based pricing accounted for approximately 70% of our revenues during the nine months ended June 30, 2013 and

2012. The recurrence of these revenues is, to a significant degree, dependent upon our clients continued usage of our products and services in their business activities. The more significant activities underlying the use of our products in these areas include: credit and debit card usage or active account levels; lending acquisition, origination and customer management activity; and customer acquisition, cross selling and retention programs. We also derive revenues from other sources which generally do not recur and include, but are not limited to, perpetual or time-based licenses with upfront payment terms and non-recurring consulting service arrangements.

Bookings

Management uses bookings as an indicator of our business performance. Bookings represent contracts signed in the current reporting period that will generate current and future revenue streams. We consider contract terms, knowledge of the marketplace and experience with our customers, among other factors, when determining the estimated value of contract bookings.

Bookings calculations have varying degrees of certainty depending on the revenue type and individual contract terms. Our revenue types are transactional and maintenance, professional services and license. Our estimate of bookings is as of the end of the period in which a contract is signed, and we do not update our initial booking estimates in future periods for changes between estimated and actual results. Actual revenue and the timing thereof could differ materially from our initial estimates. The following paragraphs discuss the key assumptions used to calculate bookings and the susceptibility of these assumptions to variability.

Transactional and Maintenance Bookings

We calculate transactional bookings as the total estimated volume of transactions or number of accounts under contract, multiplied by a contractual rate. Transactional contracts generally span multiple years and require us to make estimates about future transaction volumes or number of active accounts. We develop estimates from discussions with our customers and examinations of historical data from similar products and customer arrangements. Differences between estimated bookings and actual results occur due to variability in the volume of transactions or number of active accounts estimated. This variability is primarily caused by the following:

- The health of the economy and economic trends in our customers industries;
- Individual performance of our customers relative to their competitors; and
- Regulatory and other factors that affect the business environment in which our customers operate.

We calculate maintenance bookings directly from the terms stated in the contract.

Professional Services Bookings

We calculate professional services bookings as the estimated number of hours to complete a project multiplied by the rate per hour. We estimate the number of hours based on our understanding of the project scope, conversations with customer personnel and our experience in estimating professional services projects. Estimated bookings may differ from actual results primarily due to differences in the actual number of hours incurred. These differences typically result from customer decisions to alter the mix of FICO and internal services resources used to complete a project.

License Bookings

Licenses are sold on a perpetual or term basis and bookings generally equal the fixed amount stated in the contract.

Table of Contents

Bookings Trend Analysis

	Bookings (in millions)	Bookings Yield (1)	Number of Bookings over $1 Million	Weighted-Average Term (2) (months)
Quarter Ended June 30, 2013	$ 70.2	28%	17	23
Quarter Ended June 30, 2012	$ 57.5	29%	8	16
Nine Months Ended June 30, 2013	$ 236.9	36%	43	NM
Nine Months Ended June 30, 2012	$ 195.2	39%	35	NM

(1) Bookings yield represents the percentage of revenue recognized from bookings for the periods indicated.
(2) NM Measure is not meaningful as our estimate of bookings is as of the end of the period in which a contract is signed, and we do not update our initial booking estimates in future periods for changes between estimated and actual results.

Transactional and maintenance bookings were 28% of total bookings for the quarters ended June 30, 2013 and 2012. Professional services bookings were 43% and 52% of total bookings for the quarters ended June 30, 2013 and 2012, respectively. License bookings were 29% and 20% of total bookings for the quarters ended June 30, 2013 and 2012, respectively.

Transactional and maintenance bookings were 36% and 33% of total bookings for the nine months ended June 30, 2013 and 2012, respectively. Professional services bookings were 40% and 47% of total bookings for the nine months ended June 30, 2013 and 2012, respectively. License bookings were 24% and 20% of total bookings for the nine months ended June 30, 2013 and 2012, respectively.

The weighted-average term of bookings achieved measures the average term over which the bookings are expected to be recognized as revenue. As the weighted-average term increases, the average amount of revenues expected to be realized in a quarter decreases; however, the revenues are expected to be recognized over a longer period of time. As the weighted-average term decreases, the average amount of revenues expected to be realized in a quarter increases; however, the revenues are expected to be recognized over a shorter period of time.

Management regards the volume of bookings achieved, among other factors, as an important indicator of future revenues, but they are not comparable to, nor should they be substituted for, an analysis of our revenues, and they are subject to a number of risks and uncertainties concerning timing and contingencies affecting product delivery and performance.

Although many of our contracts contain non-cancelable terms, most of our bookings are transactional or service related and are dependent upon estimates such as volume of transactions, number of active accounts, or number of hours incurred. Since these estimates cannot be considered fixed or firm, we do not believe it is appropriate to characterize bookings as backlog.

RESULTS OF OPERATIONS

Revenues

The following tables set forth certain summary information on a segment basis related to our revenues for the fiscal periods indicated:

Table of Contents

Segment	Quarter Ended June 30, 2013	Quarter Ended June 30, 2012	Percentage of Revenues 2013	Percentage of Revenues 2012	Period-to-Period Change	Period-to-Period Percentage Change
	(In thousands)				(In thousands)	
Applications	$ 114,983	$ 98,322	63%	61%	$ 16,661	17%
Scores	47,152	41,920	25%	26%	5,232	12%
Tools	21,637	20,236	12%	13%	1,401	7%
Total revenue	$ 183,772	$ 160,478	100%	100%	23,294	15%

Segment	Nine Months Ended June 30, 2013	Nine Months Ended June 30, 2012	Percentage of Revenues 2013	Percentage of Revenues 2012	Period-to-Period Change	Period-to-Period Percentage Change
	(In thousands)				(In thousands)	
Applications	$ 356,905	$ 304,672	65%	62%	$ 52,233	17%
Scores	134,661	128,887	24%	26%	5,774	4%
Tools	61,551	56,789	11%	12%	4,762	8%
Total revenue	$ 553,117	$ 490,348	100%	100%	62,769	13%

Quarter Ended June 30, 2013 Compared to Quarter Ended June 30, 2012

Applications

	Quarter Ended June 30 2013	Quarter Ended June 30 2012	Period-to-Period Change	Period-to-Period Percentage Change
	(In thousands)		(In thousands)	
Transactional and maintenance	$ 75,537	$ 64,729	$ 10,808	17%
Professional services	26,230	27,109	(879)	(3)%
License	13,216	6,484	6,732	104%
Total	$ 114,983	$ 98,322	16,661	17%