FAIR ISAAC CORP
Form 10-Q
April 27, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015
o 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 1-11689

Fair Isaac Corporation
(Exact name of registrant as specified in its charter)

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

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 ý No o

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	ý	Accelerated Filer	o

Non-Accelerated Filer	o	Smaller Reporting Company	o

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

The number of shares of common stock outstanding on April 17, 2015 was 31,051,574 (excluding 57,805,209 shares held by us as treasury stock).

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements
FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2015	September 30, 2014
	(In thousands, except par value data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 86,841	$ 105,075
Accounts receivable, net	169,932	155,295
Prepaid expenses and other current assets	44,982	28,157
Total current assets	301,755	288,527
Marketable securities available for sale	9,706	8,751
Other investments	10,958	11,033
Property and equipment, net	40,011	36,677
Goodwill	809,117	779,928
Intangible assets, net	53,582	47,914
Deferred income taxes	4,285	13,061
Other assets	7,237	6,407
Total assets	$ 1,236,651	$ 1,192,298
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 38,418	$ 22,000
Accrued compensation and employee benefits	37,301	56,650
Other accrued liabilities	30,755	36,235
Deferred revenue	67,609	56,519
Current maturities on debt	82,000	170,000
Total current liabilities	256,083	341,404
Long-term debt	576,000	376,000
Other liabilities	23,406	20,280
Total liabilities	855,489	737,684
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 31,368 and 32,047 shares outstanding at March 31, 2015 and September 30, 2014, respectively)	314	320
Paid-in-capital	1,130,709	1,129,317
Treasury stock, at cost (57,489 and 56,810 shares at March 31, 2015 and September 30, 2014, respectively)	(2,012,431)	(1,936,095)
Retained earnings	1,316,278	1,284,261
Accumulated other comprehensive loss	(53,708)	(23,189)
Total stockholders' equity	381,162	454,614
Total liabilities and stockholders' equity	$ 1,236,651	$ 1,192,298

See accompanying notes to condensed consolidated financial statements.

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FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Unaudited)

	Quarter Ended March 31,		Six Months Ended March 31,	
	2015	2014	2015	2014
	(In thousands, except per share data)			
Revenues:				
Transactional and maintenance	$138,683	$132,369	$270,093	$262,024
Professional services	37,946	34,619	73,144	68,905
License	30,480	18,474	53,422	38,876
Total revenues	207,109	185,462	396,659	369,805
Operating expenses:				
Cost of revenues *	70,991	58,183	137,291	115,502
Research and development	24,341	19,690	46,978	37,782
Selling, general and administrative *	73,863	65,944	146,664	132,933
Amortization of intangible assets *	3,515	2,908	6,447	5,921
Restructuring and acquisition-related	—	—	—	3,660
Total operating expenses	172,710	146,725	337,380	295,798
Operating income	34,399	38,737	59,279	74,007
Interest expense, net	(7,718)	(7,099)	(14,923)	(14,225)
Other income (expense), net	(648)	(351)	1	(1,312)
Income before income taxes	26,033	31,287	44,357	58,470
Provision for income taxes	7,163	10,536	11,080	20,742
Net income	18,870	20,751	33,277	37,728
Other comprehensive income (loss):				
Foreign currency translation adjustments	(19,068)	2,893	(30,519)	6,898
Comprehensive income (loss)	$(198)	$23,644	$2,758	$44,626
Earnings per share:				
Basic	$0.60	$0.60	$1.05	$1.09
Diluted	$0.58	$0.59	$1.01	$1.06
Shares used in computing earnings per share:				
Basic	31,335	34,500	31,639	34,705
Diluted	32,448	35,311	32,791	35,670

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

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FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)
(In thousands, except per share data)

	Common Stock					Accumulated Other	Total
	Shares	Par Value	Paid-in-Capital	Treasury Stock	Retained Earnings	Comprehensive Loss	Stockholders' Equity
Balance at September 30, 2014	32,047	$320	$ 1,129,317	$ (1,936,095)	$1,284,261	$ (23,189)	$ 454,614
Share-based compensation	—	—	20,596	—	—	—	20,596
Issuance of treasury stock under employee stock plans	705	8	(28,510)	24,363	—	—	(4,139)
Tax effect from share-based payment arrangements	—	—	9,306	—	—	—	9,306
Repurchases of common stock	(1,384)	(14)	—	(100,699)	—	—	(100,713)
Dividends paid	—	—	—	—	(1,260)	—	(1,260)
Net income	—	—	—	—	33,277	—	33,277
Foreign currency translation adjustments	—	—	—	—	—	(30,519)	(30,519)
Balance at March 31, 2015	31,368	$314	$ 1,130,709	$ (2,012,431)	$1,316,278	$ (53,708)	$ 381,162

See accompanying notes to condensed consolidated financial statements.

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FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended March 31,	
	2015	2014
	(In thousands)	
Cash flows from operating activities:		
Net income	$33,277	$37,728
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,047	16,012
Share-based compensation	20,596	16,286
Deferred income taxes	2,453	(5,073)
Tax effect from share-based payment arrangements	9,306	4,697
Excess tax benefits from share-based payment arrangements	(8,616)	(5,078)
Provision for doubtful accounts, net	—	591
Net loss on sales of property and equipment	12	3
Changes in operating assets and liabilities:		
Accounts receivable	(15,072)	3,687
Prepaid expenses and other assets	(15,777)	930
Accounts payable	10,655	(734)
Accrued compensation and employee benefits	(18,912)	(2,740)
Other liabilities	(6,948)	4,651
Deferred revenue	15,261	4,127
Net cash provided by operating activities	43,282	75,087
Cash flows from investing activities:		
Purchases of property and equipment	(10,251)	(4,296)
Cash paid for acquisitions, net of cash acquired	(56,621)	—
Distribution from cost method investees	75	—
Net cash used in investing activities	(66,797)	(4,296)
Cash flows from financing activities:		
Proceeds from revolving line of credit	152,000	23,000
Payments on revolving line of credit	(40,000)	(10,000)
Proceeds from issuance of treasury stock under employee stock plans	11,853	13,256
Taxes paid related to net share settlement of equity awards	(15,992)	(9,571)
Dividends paid	(1,260)	(1,390)
Repurchases of common stock	(100,713)	(67,141)
Excess tax benefits from share-based payment arrangements	8,616	5,078
Net cash provided by (used in) financing activities	14,504	(46,768)
Effect of exchange rate changes on cash	(9,223)	975
Increase (decrease) in cash and cash equivalents	(18,234)	24,998
Cash and cash equivalents, beginning of period	105,075	83,178
Cash and cash equivalents, end of period	$86,841	$108,176
Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net of refunds	$24,496	$9,819
Cash paid for interest	$14,709	$13,983
Supplemental disclosures of non-cash investing and financing activities:		
Purchase of property and equipment included in accounts payable	$4,742	$462

See accompanying notes to condensed consolidated financial statements.

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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, telecommunications providers, pharmaceutical companies, healthcare organizations, public agencies and organizations in other industries.

In these condensed consolidated financial statements, Fair Isaac Corporation is referred to as “FICO,” “we,” “us,” “our,” or “th Company.”

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, 2014. 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

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"). ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. Generally Accepted Accounting Principles when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. The guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. Early adoption is not permitted. ASU 2014-09 is effective for fiscal years and interim periods within those years, beginning on or after December 15, 2016, which means it will be effective for our fiscal year beginning October 1, 2017. We have not yet selected a transition method and we are currently evaluating the impact that the updated standard will have on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, "Simplifying the Presentation of Debt Issuance" ("ASU 2015-03"), which changes the presentation of debt issuance costs in financial statements. Under ASU 2015-03, an entity presents such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs is reported as interest expense. ASU 2015-03 is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2015, which means it will be effective for our fiscal year beginning October 1, 2016. Early adoption is permitted. We do not believe that adoption of ASU 2015-03 will have a significant impact on our consolidated financial statements.

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2. Business Combinations

On January 12, 2015, we acquired 100% of the equity of TONBELLER Aktiengesellschaft ("TONBELLER"). TONBELLER is an innovative provider of financial crime and compliance ("FCC") solutions that support the demanding regulatory compliance requirements of more than a thousand banks and commercial organizations. This acquisition will allow us to capitalize on the escalating demand for new, risk-based, integrated FCC solutions.

The purchase price allocation as of the date of the acquisition was based on a preliminary valuation and is subject to revision as more detailed analyses are completed and additional information about the fair value of assets acquired and liabilities assumed become available. The major classes of assets and liabilities to which we have preliminarily allocated the purchase price are as follows:

	(In thousands)
Consideration	
Cash	$59,640
Acquisition-related costs (included in the company’s condensed consolidated statement of income for the quarter and six months ended March 31, 2015 as a component of selling, general and administrative expenses)	$486
Recognized amounts of identifiable assets acquired and liabilities assumed	
Cash and cash equivalents	$2,640
Accounts receivable, net	5,389
Prepaid expenses and other current assets	209
Intangible assets:	
Completed technology	2,700
Customer relationships	11,600
Trade names	600
Other assets	112
Accounts payable	(1,118)
Accrued compensation and employee benefits	(1,493)
Other accrued liabilities	(2,838)
Deferred income taxes	(4,349)
Total identifiable net assets	13,452
Goodwill	46,188
Total	$59,640

The acquired identifiable intangible assets have a weighted average useful life of approximately 4.9 years and are being amortized using the straight-line method over their estimated useful lives as follows: completed technology, five years; customer relationships, five years; and trade names, three years. The goodwill of $46.2 million arising from the acquisition consists largely of the revenue synergies related to market expansion and more rapid innovation for our solutions. The goodwill was allocated to our Applications segment and is not deductible for tax purposes. TONBELLER has been included in our operating results since the acquisition date. The pro forma impact of this acquisition was not deemed material to our results of operations.

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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 assets 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. We do not have any assets that are valued using inputs identified under a Level 2 hierarchy as of March 31, 2015 and September 30, 2014.
- 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 as of March 31, 2015 and September 30, 2014.

The following tables represent financial assets that we measured at fair value on a recurring basis at March 31, 2015 and September 30, 2014:

March 31, 2015	Active Markets for Identical Instruments (Level 1)	Fair Value as of March 31, 2015
	(In thousands)	
Assets:		
Cash equivalents (1)	$439	$439
Marketable securities (2)	9,706	9,706
Total	$10,145	$10,145

September 30, 2014	Active Markets for Identical Instruments (Level 1)	Fair Value as of September 30, 2014
	(In thousands)	
Assets:		
Cash equivalents (1)	$10,326	$10,326
Marketable securities (2)	8,751	8,751
Total	$19,077	$19,077

(1) Included in cash and cash equivalents on our condensed consolidated balance sheet at March 31, 2015 and September 30, 2014. Not included in these tables are cash deposits of $86.4 million and $94.7 million at March 31, 2015 and September 30, 2014, respectively.

(2) Represents securities held under a supplemental retirement and savings plan for senior management employees, which are distributed upon termination or retirement of the employees. Included in marketable securities available for sale on our condensed consolidated balance sheet at March 31, 2015 and September 30, 2014.

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 would apply 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.

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For the fair value of our derivative instruments and senior notes, see Note 4 and Note 8 to the condensed consolidated financial statements, respectively.

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 receivable and cash balances from the effects of volatility in foreign exchange rates that might occur prior to conversion to their respective functional currencies. 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 exchange rates. We routinely enter into contracts to offset exposures denominated in the British pound, Euro and Canadian dollar. Foreign-currency-denominated receivable and cash balances are remeasured at foreign exchange rates in effect on the balance sheet date with the effects of changes in foreign exchange 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 remeasured receivable and cash balances attributable to changes in foreign 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 foreign currency forward contracts, by currency, at March 31, 2015 and September 30, 2014:

	March 31, 2015		
	Contract Amount		Fair Value
	Foreign Currency	US$	US$
	(In thousands)		
Sell foreign currency:			
Canadian dollar (CAD)	CAD 7,550	$5,923	$—
Euro (EUR)	EUR 6,050	$6,508	$—
Buy foreign currency:			
British pound (GBP)	GBP 6,366	$9,400	$—

	September 30, 2014		
	Contract Amount		Fair Value
	Foreign Currency	US$	US$
	(In thousands)		
Sell foreign currency:			
Canadian dollar (CAD)	CAD 3,300	$2,960	$—
Euro (EUR)	EUR 3,800	$4,790	$—
Buy foreign currency:			
British pound (GBP)	GBP 6,795	$11,000	$—

The foreign currency forward contracts were entered into on March 31, 2015 and September 30, 2014, respectively; therefore, their fair value was $0 on each of these dates.

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 March 31,		Six Months Ended March 31,	
	2015	2014	2015	2014
	(In thousands)			
Gains (losses) on Foreign currency forward contracts	$(10)	$194	$(339)	$532

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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:

	Quarter Ended March 31,		Six Months Ended March 31,
	2015	2014	2015