FAIR ISAAC CORP
Form 10-Q
May 07, 2010

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2010

o **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.)*
901 Marquette Avenue, Suite 3200 Minneapolis, Minnesota	**55402-3232**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:
612-758-5200

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 þ 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 o 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 o	Accelerated Filer þ	Non-Accelerated Filer o (Do not check if a smaller reporting company)	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). o Yes þ No

The number of shares of common stock outstanding on April 30, 2010 was 45,659,829 (excluding 43,196,954 shares held by the Company as treasury stock).

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1. Financial Statements	1
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	16
Item 3. Quantitative and Qualitative Disclosures About Market Risk	32
Item 4. Controls and Procedures	33

PART II OTHER INFORMATION

Item 1. Legal Proceedings	33
Item 1A. Risk Factors	34
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	43
Item 3. Defaults Upon Senior Securities	43
Item 4. Submission of Matters to a Vote of Security Holders	44
Item 5. Other Information	44
Item 6. Exhibits	44
Signatures	45

EX-31.1
EX-31.2
EX-32.1
EX-32.2

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2010	September 30, 2009
	(In thousands, except par value data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 190,910	$ 178,157
Marketable securities available for sale, current portion	151,609	139,673
Accounts receivable, net	88,412	101,742
Prepaid expenses and other current assets	24,872	22,986
Total current assets	455,803	442,558
Marketable securities available for sale, less current portion	39,484	61,371
Other investments	11,074	11,074
Property and equipment, net	32,800	34,340
Goodwill	661,883	667,640
Intangible assets, net	31,775	38,255
Deferred income taxes	35,645	38,100
Other assets	8,915	10,550
	$ 1,277,379	$ 1,303,888
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 9,054	$ 8,593
Accrued compensation and employee benefits	24,918	28,139
Other accrued liabilities	46,000	38,183
Deferred revenue	40,805	39,673
Total current liabilities	120,777	114,588
Revolving line of credit	295,000	295,000
Senior notes	275,000	275,000
Other liabilities	16,152	19,031
Total liabilities	706,929	703,619
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, 45,861 and 48,156 shares outstanding at March 31, 2010 and September 30, 2009, respectively)		459		482
Paid-in-capital		1,101,178		1,106,292
Treasury stock, at cost (42,996 and 40,701 shares at March 31, 2010 and September 30, 2009, respectively)		(1,419,674)		(1,375,400)
Retained earnings		915,125		886,324
Accumulated other comprehensive loss		(26,638)		(17,429)
Total stockholders equity		570,450		600,269
	$	1,277,379	$	1,303,888

See accompanying notes to condensed consolidated financial statements.

1

Table of Contents

FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Quarter Ended March 31,		Six Months Ended March 31,	
	2010	2009	2010	2009
	(in thousands, except per share data)			
Revenues:				
Transactional and maintenance	$ 113,701	$ 119,454	$ 228,807	$ 243,112
Professional services	23,926	31,312	50,163	59,392
License	6,093	8,569	16,246	20,291
Total revenues	143,720	159,335	295,216	322,795
Operating expenses:				
Cost of revenues (1)	44,641	53,476	87,160	112,495
Research and development	19,251	18,924	38,227	37,045
Selling, general and administrative (1)	53,697	52,460	108,900	107,229
Amortization of intangible assets (1)	3,070	3,156	6,235	6,403
Restructuring		870		8,948
Total operating expenses	120,659	128,886	240,522	272,120
Operating income	23,061	30,449	54,694	50,675
Interest income	507	1,245	1,046	2,900
Interest expense	(5,423)	(6,527)	(10,831)	(13,685)
Other income (expense), net	1,027	(298)	646	1,148
Income from continuing operations before income taxes	19,172	24,869	45,555	41,038
Provision for income taxes	6,180	6,761	14,877	10,820
Income from continuing operations	12,992	18,108	30,678	30,218
Loss from discontinued operations		(363)		(363)
Net income	$ 12,992	$ 17,745	$ 30,678	$ 29,855
Basic earnings (loss) per share:				
Continuing operations	$ 0.28	$ 0.37	$ 0.65	$ 0.62
Discontinued operations		(0.01)		(0.01)
Total	$ 0.28	$ 0.36	$ 0.65	$ 0.61
Diluted earnings (loss) per share:				
Continuing operations	$ 0.28	$ 0.37	$ 0.65	$ 0.62

Discontinued operations		(0.01)		(0.01)
Total	$ 0.28	$ 0.36	$ 0.65	$ 0.61
Shares used in computing earnings per share:				
Basic	46,447	48,813	47,033	48,643
Diluted	46,870	48,828	47,399	48,673

(1) Cost of revenues and selling, general and administrative expenses exclude the amortization of intangible assets. See Note 2 to the accompanying condensed consolidated financial statements.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME
(Unaudited)

	Common Stock Shares	Par Value	Paid-in-Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity	Comprehensive Income
	(In thousands)							
Balance at September 30, 2009	**48,156**	**$ 482**	**$ 1,106,292**	**$ (1,375,400)**	**$ 886,324**	**$ (17,429)**	**$ 600,269**	
Share-based compensation			9,382				9,382	
Exercise of stock options	262	3	(5,139)	8,690			3,554	
Tax effect from share-based payment arrangements			(3,419)				(3,419)	
Repurchases of common stock	(2,694)	(27)		(57,503)			(57,530)	
Issuance of ESPP shares from treasury	1		(11)	31			20	
Issuance of restricted stock to employees from treasury	136	1	(5,927)	4,508			(1,418)	
Dividends paid					(1,877)		(1,877)	
Net income					30,678		30,678	$ 30,678
Unrealized loss on investments						(287)	(287)	(287)
Cumulative translation adjustments						(8,922)	(8,922)	(8,922)
Balance at March 31, 2010	**45,861**	**$ 459**	**$ 1,101,178**	**$ (1,419,674)**	**$ 915,125**	**$ (26,638)**	**$ 570,450**	**$ 21,469**

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Six Months Ended March 31,	
	2010	2009
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 30,678	$ 29,855
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,128	19,397
Share-based compensation	9,382	10,648
Deferred income taxes		915
Tax effect from share-based payment arrangements	(3,419)	(2,680)
Excess tax benefits from share-based payment arrangements	(1,038)	(121)
Net amortization of premium on marketable securities	1,060	406
Provision for doubtful accounts, net	(810)	499
Net loss on sales of property and equipment	56	117
Changes in operating assets and liabilities, net of disposition effects:		
Accounts receivable	12,324	28,419
Prepaid expenses and other assets	(644)	325
Accounts payable	20	3,018
Accrued compensation and employee benefits	(3,138)	(4,257)
Other liabilities	9,304	(7,913)
Deferred revenue	62	7,688
Net cash provided by operating activities	69,965	86,316
Cash flows from investing activities:		
Purchases of property and equipment	(8,010)	(8,503)
Cash proceeds from sale of property and equipment	50	
Cash proceeds from sale of product line assets	490	
Purchases of marketable securities	(71,749)	(66,512)
Proceeds from maturities of marketable securities	80,666	64,590
Distribution from cost method investees		1,300
Net cash provided by (used in) investing activities	1,447	(9,125)
Cash flows from financing activities:		
Proceeds from issuances of common stock under employee stock option and purchase plans	2,156	2,974
Dividends paid	(1,877)	(1,946)
Repurchases of common stock	(57,530)	
Excess tax benefits from share-based payment arrangements	1,038	121
Net cash provided by (used in) financing activities	(56,213)	1,149

Effect of exchange rate changes on cash	(2,446)	(6,732)
Increase in cash and cash equivalents	12,753	71,608
Cash and cash equivalents, beginning of year	178,157	129,678
Cash and cash equivalents, end of year	$ 190,910	$ 201,286
Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net of refunds	$ 9,607	$ 15,236
Cash paid for interest	$ 10,629	$ 14,063

See accompanying notes to condensed consolidated financial statements.

4

Table of Contents

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 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, 2009. 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

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. These estimates and assumptions include, but are not limited to, assessing the following: the recoverability of accounts receivable, goodwill and other intangible assets, software development costs and deferred tax assets; the benefits related to uncertain tax positions, the determination of the fair value of stock-based compensation, the ability to estimate hours in connection with fixed-fee service contracts, the ability to estimate transactional-based revenues for which actual transaction volumes have not yet been received and the determination of whether fees are fixed or determinable and collection is probable or reasonably assured.

Adoption of Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). We adopted this guidance on January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for us with the reporting period beginning October 1, 2011. Other than requiring additional disclosures, adoption of this new guidance does not have a material impact on our financial statements.

In October 2009, the Financial Accounting Standards Board (FASB) issued two new accounting standards that removed certain tangible products from the scope of software revenue recognition guidance and altered the accounting for revenue arrangements with multiple deliverables. The new guidance narrows the definition of products subject to software accounting rules to exclude certain tangible products that contain software and non-software elements that function together to deliver the combined product s essential functionality. As such, certain products that were previously accounted for under the scope of software revenue recognition guidance will no longer be accounted for as

software. In addition, the guidance amended the accounting standards for multiple deliverable

revenue arrangements to: (i) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated; (ii) require an entity to allocate revenue in an arrangement using estimated selling prices (ESP) of deliverables if a vendor does not have vendor-specific objective evidence of selling price (VSOE) or third-party evidence of selling price (TPE); and (iii) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

We elected to early adopt this accounting guidance and we have applied these standards to all applicable revenue arrangements entered into or materially modified beginning October 1, 2009. The adoption of these standards had an immaterial effect on our revenues, pre-tax income, net income and earnings per share during the three and six months ended March 31, 2010.

When a sales arrangement contains multiple deliverables we allocate revenue to each deliverable based on a selling price hierarchy. The selling price for a deliverable is based on its VSOE if available, TPE if VSOE is not available, or ESP if neither VSOE nor TPE is available. VSOE is generally limited to the price charged when the same or similar product is sold separately. If a product or service is seldom sold separately, it is unlikely that we can determine VSOE for the product or service. We define VSOE as a median price of recent standalone transactions that are priced within a narrow range, as defined by us. TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately. It may be difficult for us to obtain sufficient information on competitor pricing to substantiate TPE and therefore we may not always be able to use TPE.

When we are unable to establish selling price using VSOE or TPE, we use ESP in its allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact if the product or service were sold by us on a standalone basis. Our determination of ESP involves weighting several factors based on the specific facts and circumstances of each arrangement. The factors include, but are not limited to, geographies, market conditions, gross margin objectives, pricing practices and controls and customer segment pricing strategies and the product lifecycle. We analyze selling prices used in our allocation of arrangement consideration on an annual basis, or more frequently if necessary. Selling prices will be analyzed more frequently if a significant change in our business necessitates a more timely analysis or if we experience significant variances in our selling prices.

Each deliverable within a multiple-deliverable revenue arrangement is accounted for as a separate unit of accounting under the guidance if both of the following criteria are met: (i) the delivered item or items have value to the customer on a standalone basis and (ii) for an arrangement that includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in our control. We consider a deliverable to have standalone value if we sell this item separately or if the item is sold by another vendor or could be resold by the customer. Further, our revenue arrangements generally do not include a general right of return relative to delivered products. Revenue from multiple element arrangements is allocated to the software and non-software deliverables based on the relative selling prices of all of the deliverables in the arrangement using the hierarchy in the new revenue accounting guidance. In circumstances where we cannot determine VSOE or TPE of the selling price for all of the deliverables in the arrangement, including the software deliverable, ESP is used for the purposes of performing this allocation.

We do not expect the adoption of this guidance will result in a change in our units of accounting or in how we allocate arrangement consideration to our units of accounting. In addition, we do not anticipate material changes in the pattern and timing of revenue recognition nor do we expect a material effect on our financial statements in periods subsequent to adoption. However, the new guidance may facilitate our efforts to optimize our offerings due to better alignment between the economics of an arrangement and the accounting. This may lead to engaging in new go-to-market practices in the future. In particular, we expect that the new accounting standards will enable us to better integrate products and services without VSOE into existing offerings and solutions. As these go-to-market strategies evolve, we may modify pricing practices in the future which could result in changes in selling prices, including both VSOE and ESP.

On October 1, 2009 we adopted new guidance on the accounting for business combinations. The guidance states that business combinations will result in all assets and liabilities of an acquired business being recorded at their fair values including contingent assets and liabilities. It also requires the capitalization of in-process research and

development at fair value and requires the expensing of acquisition-related costs as incurred. This guidance has been applied to all acquisitions contemplated subsequent to October 1, 2009.

In December 2007, the FASB issued new accounting guidance on non-controlling interests in consolidated financial statements. The guidance clarifies that a non-controlling or minority interest in a subsidiary is considered an ownership interest and, accordingly, requires all entities to report such interests in subsidiaries as equity in the consolidated financial statements. We adopted this guidance on October 1, 2009. The adoption of this guidance had an immaterial effect on our consolidated financial statements.

On October 1, 2009, we adopted the authoritative guidance on fair value measurement for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Adoption of the new guidance did not impact our consolidated financial statements.

On October 1, 2009, we adopted new accounting guidance for measuring liabilities at fair value. This guidance clarifies that the quoted price for an identical liability is a Level 1 measurement when no adjustments to the quoted price are necessary. If quoted prices for identical liabilities are not available, the guidance provides valuation techniques to be used in determining the fair value of the liability. The adoption of this standard did not impact our consolidated financial statements during the three and six months ended March 31, 2010.

In May 2008, the FASB issued new guidance on the accounting for convertible instruments that may be settled in cash upon conversion. The guidance requires that proceeds from the issuance of convertible debt instruments be allocated between debt (at a discount) and an equity component. The debt discount is amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense. We adopted this guidance on October 1, 2009. The guidance changed the accounting treatment for our Senior Convertible Notes, which were issued in August 2003; however, the only retrospective adjustment to our financial statements is a reclassification between equity accounts. The guidance does not require retrospective adoption if the instruments were not outstanding during any of the periods presented in the annual financial statements for the period of adoption, or if restatement would only lead to a reclassification between its opening equity accounts for periods presented in the annual financial statements. As a result, the adoption of this guidance did not impact our consolidated financial statements.

On October 1, 2009, we adopted new guidance to be used in determining the useful life of intangible assets. The guidance amended the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. This new guidance is intended to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset. The adoption of this guidance did not affect our consolidated financial statements.

2. Amortization of 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, consisted of the following:

	Quarter Ended March 31,		Six Months Ended March 31,	
	2010	2009	2010	2009
	(In thousands)			
Cost of revenues	$ 1,711	$ 1,663	$ 3,450	$ 3,386
Selling, general and administrative expenses	1,359	1,493	2,785	3,017
	$ 3,070	$ 3,156	$ 6,235	$ 6,403

Cost of revenues reflects our amortization of completed technology and selling, general and administrative expenses reflects our amortization of other intangible assets. Intangible assets (excluding goodwill) were $31.8 million and $38.3 million, net of accumulated amortization of $109.6 million and $107.7 million, as of March 31, 2010 and September 30, 2009, respectively.

Estimated future intangible asset amortization expense associated with intangible assets existing at March 31, 2010, was as follows (in thousands):

Fiscal year	
Remainder of fiscal 2010	$ 4,663
2011	7,671
2012	6,094
2013	4,103
2014	2,407

Thereafter	6,837
	$ 31,775

3. Restructuring Expenses

The following table summarizes our restructuring accruals for 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 fiscal 2018.

Accrual at	Accrual at March