

FAIR ISAAC CORP
Form 10-Q
July 28, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

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 94-1499887
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

181 Metro Drive, Suite 700 95110-1346
San Jose, California
(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 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 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 Accelerated Filer

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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 No

The number of shares of common stock outstanding on July 15, 2016 was 30,854,567 (excluding 58,002,216 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)

	June 30, 2016	September 30, 2015
	(In thousands, except par value data)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 118,155	\$ 86,120
Accounts receivable, net	155,196	158,773
Prepaid expenses and other current assets	22,443	41,709
Total current assets	295,794	286,602
Marketable securities available for sale	10,645	9,567
Other investments	10,920	10,958
Property and equipment, net	41,106	38,208
Goodwill	802,202	814,750
Intangible assets, net	37,212	47,321
Deferred income taxes	22,109	15,196
Other assets	6,724	7,561
Total assets	\$ 1,226,712	\$ 1,230,163
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 21,096	\$ 19,852
Accrued compensation and employee benefits	56,720	54,368
Other accrued liabilities	36,543	30,958
Deferred revenue	50,884	46,697
Current maturities on debt	85,000	92,000
Total current liabilities	250,243	243,875
Long-term debt	516,000	516,000
Other liabilities	32,428	33,290
Total liabilities	798,671	793,165
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 30,952 and 31,290 shares outstanding at June 30, 2016 and September 30, 2015, respectively)	310	313
Paid-in-capital	1,165,403	1,152,789
Treasury stock, at cost (57,905 and 57,567 shares at June 30, 2016 and September 30, 2015, respectively)	(2,109,507	) (2,033,644
Retained earnings	1,443,730	1,368,255
Accumulated other comprehensive loss	(71,895	) (50,715
Total stockholders' equity	428,041	436,998
Total liabilities and stockholders' equity	\$ 1,226,712	\$ 1,230,163

See accompanying notes.

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

	Quarter Ended June 30,		Nine Months Ended June 30,	
	2016	2015	2016	2015
	(In thousands, except per share data)			
Revenues:				
Transactional and maintenance	\$153,886	\$144,695	\$451,701	\$414,788
Professional services	44,304	37,998	117,798	111,142
License	40,588	26,673	76,033	80,095
Total revenues	238,778	209,366	645,532	606,025
Operating expenses:				
Cost of revenues *	66,384	66,202	190,875	203,493
Research and development	26,417	25,610	75,896	72,588
Selling, general and administrative *	87,172	74,645	243,511	221,309
Amortization of intangible assets *	3,486	3,599	10,573	10,046
Restructuring and acquisition-related	—	2,256	—	2,256
Total operating expenses	183,459	172,312	520,855	509,692
Operating income	55,319	37,054	124,677	96,333
Interest expense, net	(6,781)	(7,360)	(20,320)	(22,283)
Other income, net	1,752	770	1,853	771
Income before income taxes	50,290	30,464	106,210	74,821
Provision for income taxes	15,303	10,558	28,866	21,638
Net income	34,987	19,906	77,344	53,183
Other comprehensive income (loss):				
Foreign currency translation adjustments	(14,156)	12,779	(21,180)	(17,740)
Comprehensive income	\$20,831	\$32,685	\$56,164	\$35,443
Earnings per share:				
Basic	\$1.12	\$0.64	\$2.48	\$1.69
Diluted	\$1.08	\$0.62	\$2.39	\$1.63
Shares used in computing earnings per share:				
Basic	31,149	31,118	31,201	31,465
Diluted	32,313	32,363	32,337	32,648

* Cost of revenues and selling, general and administrative expenses exclude the amortization of intangible assets. See Note 5.

See accompanying notes.

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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

(In thousands, except per share data)

	Common Stock				Retained	Accumulated Other	Total
	Shares	Par Value	Paid-in-Capital	Treasury Stock	Earnings	Comprehensive Loss	Stockholders' Equity
Balance at September 30, 2015	31,290	\$ 313	\$ 1,152,789	\$(2,033,644)	\$ 1,368,255	\$ (50,715)	\$ 436,998
Share-based compensation	—	—	41,704	—	—	—	41,704
Issuance of treasury stock under employee stock plans	689	7	(44,794)	24,599	—	—	(20,188)
Tax effect from share-based payment arrangements	—	—	15,704	—	—	—	15,704
Repurchases of common stock	(1,027)	(10)	—	(100,462)	—	—	(100,472)
Dividends paid	—	—	—	—	(1,869)	—	(1,869)
Net income	—	—	—	—	77,344	—	77,344
Foreign currency translation adjustments	—	—	—	—	—	(21,180)	(21,180)
Balance at June 30, 2016	30,952	\$ 310	\$ 1,165,403	\$(2,109,507)	\$ 1,443,730	\$ (71,895)	\$ 428,041
See accompanying notes.							

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

	Nine Months Ended June 30,	
	2016	2015
	(In thousands)	
Cash flows from operating activities:		
Net income	\$77,344	\$53,183
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	23,127	26,093
Share-based compensation	41,704	32,762
Deferred income taxes	(455)	) 75
Tax effect from share-based payment arrangements	15,704	10,903
Excess tax benefits from share-based payment arrangements	(16,100)	) (11,364)
Provision for doubtful accounts, net	1,305	—
Net loss on sales of property and equipment	—	12
Changes in operating assets and liabilities:		
Accounts receivable	(3,184)	) 10,609
Prepaid expenses and other assets	14,306	(11,309)
Accounts payable	(1,635)	) 2,324
Accrued compensation and employee benefits	2,556	(19,700)
Other liabilities	(1,166)	) (6,968)
Deferred revenue	8,119	(220)
Net cash provided by operating activities	161,625	86,400
Cash flows from investing activities:		
Purchases of property and equipment	(12,541)	) (18,266)
Cash paid for acquisitions, net of cash acquired	(5,683)	) (56,992)
Distribution from cost method investees	37	75
Net cash used in investing activities	(18,187)	) (75,183)
Cash flows from financing activities:		
Proceeds from revolving line of credit	49,000	241,000
Payments on revolving line of credit	(56,000)	) (68,000)
Payments on senior notes	—	(71,000)
Proceeds from issuance of treasury stock under employee stock plans	8,356	13,643
Taxes paid related to net share settlement of equity awards	(28,544)	) (18,102)
Dividends paid	(1,869)	) (1,882)
Repurchases of common stock	(96,121)	) (130,719)
Excess tax benefits from share-based payment arrangements	16,100	11,364
Net cash used in financing activities	(109,078)	) (23,696)
Effect of exchange rate changes on cash	(2,325)	) (8,238)
Increase (decrease) in cash and cash equivalents	32,035	(20,717)
Cash and cash equivalents, beginning of period	86,120	105,075
Cash and cash equivalents, end of period	\$118,155	\$84,358
Supplemental disclosures of cash flow information:		
Income taxes refunds (payments), net	\$836	\$ (31,122)
Cash paid for interest	\$19,143	\$22,835
Supplemental disclosures of non-cash investing and financing activities:		
Purchase of property and equipment included in accounts payable	\$3,566	\$733

Unsettled repurchases of common stock	\$4,351	\$—
See accompanying notes.		

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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 “the 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, 2015. 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 March 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2016, which means it will be effective for our fiscal year beginning October 1, 2017. Early adoption is permitted. We are currently evaluating the timing of our adoption and the impact that the updated standard will have on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which requires lessees to put most leases on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. ASU 2016-02 states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. ASU 2016-02 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2018, which means it will be effective for our fiscal year beginning October 1, 2019. Early adoption is permitted. We are currently evaluating the timing of our adoption and the impact that the updated standard will have on our consolidated financial statements.

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In May 2014, the 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. In August 2015, the FASB issued ASU No. 2015-14, “Deferral of the Effective Date” (“ASU 2015-14”), which defers the effective date for ASU 2014-09 by one year. For public entities, the guidance in ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods), which means it will be effective for our fiscal year beginning October 1, 2018. Early adoption is permitted to the original effective date of December 15, 2016 (including interim reporting periods within those periods). 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.

2. Business Combinations

On May 19, 2016, we acquired 100% of the equity of QuadMetrics, Inc. (“QuadMetrics”) for \$5.7 million in cash. QuadMetrics is a provider of enterprise security assessment analytics. We expect that this acquisition will help accelerate our efforts to provide a suite of complementary cyber-related analytics solutions to market. QuadMetrics 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.

We recorded \$2.0 million of intangible assets, which are being amortized using the straight-line method over a weighted average useful life of approximately 4.0 years. We allocated \$3.9 million of goodwill to our Applications segment that was not deductible for tax purposes.

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 June 30, 2016 and September 30, 2015.
- 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 June 30, 2016 and September 30, 2015.

The following tables represent financial assets that we measured at fair value on a recurring basis at June 30, 2016 and September 30, 2015:

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June 30, 2016	Active Markets for Identical Instruments (Level 1) (In thousands)	Fair Value as of June 30, 2016
Assets:		
Cash equivalents (1)	\$ 440	\$ 440
Marketable securities (2)	10,645	10,645
Total	\$ 11,085	\$ 11,085

September 30, 2015	Active Markets for Identical Instruments (Level 1) (In thousands)	Fair Value as of September 30, 2015
Assets:		
Cash equivalents (1)	\$ 439	\$ 439
Marketable securities (2)	9,567	9,567
Total	\$ 10,006	\$ 10,006

Included in cash and cash equivalents on our condensed consolidated balance sheet at June 30, 2016 and (1) September 30, 2015. Not included in these tables are cash deposits of \$117.7 million and \$85.7 million at June 30, 2016 and September 30, 2015, respectively.

Represents securities held under a supplemental retirement and savings plan for senior management employees, (2) which are distributed upon termination or retirement of the employees. Included in marketable securities available for sale on our condensed consolidated balance sheet at June 30, 2016 and September 30, 2015.

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.

For the fair value of our derivative instruments and senior notes, see Note 4 and Note 8, 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 June 30, 2016 and September 30, 2015:

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June 30, 2016

Contract Amount Fair Value

Foreign US\$ US\$
Currency

(In thousands)

Sell foreign currency:

Canadian dollar (CAD) CAD 1,000 \$774 \$ —

Euro (EUR) EUR 4,850 \$5,387 \$ —

Buy foreign currency:

British pound (GBP) GBP 4,580 \$6,150 \$ —

September 30, 2015

Contract Amount Fair Value

Foreign US\$ US\$
Currency

(In thousands)

Sell foreign currency:

Canadian dollar (CAD) CAD 2,750 \$2,045 \$ —

Euro (EUR) EUR 5,600 \$6,296 \$ —

Buy foreign currency:

British pound (GBP) GBP 6,943 \$10,550 \$ —

The foreign currency forward contracts were entered into on June 30, 2016 and September 30, 2015, 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, net, and consisted of the following:

	Quarter Ended	Nine Months		
	June 30,	Ended June 30,		
	2016	2015	2016	2015
	(In thousands)			

Gains (losses) on foreign currency forward contracts	\$(1,018)	\$548	\$(2,273)	\$209
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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	Nine Months		
	June 30,	Ended June 30,		
	2016	2015	2016	2015
	(In thousands)			
Cost of revenues	\$1,805	\$1,919	\$5,552	\$5,656
Selling, general and administrative expenses	1,681	1,680	5,021	4,390
	\$3,486	\$3,599	\$10,573	\$10,046

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 \$150.1 million and \$154.2 million as of June 30, 2016 and September 30, 2015, respectively.

Estimated future intangible asset amortization expense associated with intangible assets existing at June 30, 2016, was as follows (in thousands):

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Year Ended September 30,

2016 (excluding the nine months ended June 30, 2016)	\$3,429
2017	12,968
2018	6,388
2019	5,873
2020	3,626
Thereafter	4,928
	\$37,212

The following table summarizes changes to goodwill during the nine months ended June 30, 2016, both in total and as allocated to our segments:

	Application	Scores	Tools	Total
	(In thousands)			
Balance at September 30, 2015	\$596,765	\$146,648	\$71,337	\$814,750
Addition from acquisitions	3,857	—	—	3,857
Adjustment related to prior acquisitions	283	—	—	283
Foreign currency translation adjustment	(14,885)	—	(1,803)	(16,688)
Balance at June 30, 2016	\$586,020	\$146,648	\$69,534	\$802,202

6. Composition of Certain Financial Statement Captions

The following table summarizes property and equipment, and the related accumulated depreciation and amortization, at June 30, 2016 and September 30, 2015:

	June 30, 2016	September 30, 2015
	(In thousands)	
Property and equipment	\$122,687	\$109,860
Less: accumulated depreciation and amortization	(81,581)	(71,652)
	\$41,106	\$38,208

7. Revolving Line of Credit

We have a \$400 million unsecured revolving line of credit with a syndicate of banks that expires on December 30, 2019. 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, (b) the Federal Funds rate plus 0.500% and (c) the one-month LIBOR rate plus 1.000%, plus, in each case, an applicable margin, or (ii) an adjusted LIBOR rate plus an applicable margin. The applicable margin for base rate borrowings ranges from 0% to 0.875% and for LIBOR borrowings ranges from 1.000% to 1.875%, and is determined based on our consolidated leverage ratio. In addition, we must pay credit facility fees. The credit facility contains certain restrictive covenants including maintaining a minimum fixed charge ratio of 2.5 and a maximum consolidated leverage ratio of 3.0, subject to a step up to 3.5 following certain permitted acquisitions. The credit agreement also contains other covenants typical of unsecured facilities. As of June 30, 2016, we had \$225.0 million in borrowings outstanding at a weighted average interest rate of 1.836%, of which \$200.0 million was classified as a long-term liability and recorded in long-term debt within the accompanying condensed consolidated balance sheets. We were in compliance with all financial covenants under this credit facility as of June 30, 2016.

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8. Senior Notes

On May 7, 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 outstanding 2008 Senior Notes’ weighted average interest rate is 7.2% and the weighted average maturity is 10.0 years. On July 14, 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, 2016, 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 \$376.0 million as of June 30, 2016 and September 30, 2015. The fair value of the Senior Notes was \$397.8 million and \$401.6 million as of June 30, 2016 and September 30, 2015, respectively. We measure the fair value of the Senior Notes based on Level 2 inputs, which include quoted market prices and interest rate spreads of similar securities.

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. The balance for all the facilities charges will be paid by the end of our fiscal 2020.

	Accrual at September 30, 2015 (In thousands)	Cash Payments	Accrual at June 30, 2016
Facilities charges	\$12,995	\$(2,354)	\$10,641
Employee separation	2,405	(2,405)	—
	15,400	\$(4,759)	10,641
Less: current portion	(5,570)		(3,980)
Non-current	\$9,830		\$6,661

10. Income Taxes

Effective Tax Rate

The effective income tax rate was 30.4% and 34.7% during the quarters ended June 30, 2016 and 2015, respectively and 27.2% and 28.9% during the nine months ended June 30, 2016 and 2015, respectively. The provision for income taxes during interim quarterly reporting periods is based on our estimates of the effective tax rates for the 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 effective rates for both periods were significantly impacted by the mix of global earnings toward lower tax jurisdictions, as well as retroactive extensions of the U.S. Federal Research and Development Credit.

The total unrecognized tax benefit for uncertain tax positions is estimated to be approximately \$6.2 million and \$4.6 million at June 30, 2016 and September 30, 2015, 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. We have accrued interest of \$0.3 million and \$0.2 million, related to unrecognized tax benefits as of June 30, 2016 and September 30, 2015, respectively.

11. Earnings per Share

The following table presents reconciliations for the numerators and denominators of basic and diluted earnings per share (“EPS”) for the quarters and nine months ended June 30, 2016 and 2015:

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	Quarter Ended		Nine Months	
	June 30, 2016	2015	Ended June 30, 2016	2015
	(In thousands, except per share data)			
Numerator for diluted and basic earnings per share:				
Net Income	\$34,987	\$19,906	\$77,344	\$53,183
Denominator - share:				
Basic weighted-average shares	31,149	31,118	31,201	31,465
Effect of dilutive securities	1,164	1,245	1,136	1,183
Diluted weighted-average shares	32,313	32,363	32,337	32,648
Earnings per share:				
Basic	\$1.12	\$0.64	\$2.48	\$1.69
Diluted	\$1.08	\$0.62	\$2.39	\$1.63

We exclude the options to purchase shares of common stock in the computation of the diluted EPS where the exercise price of the options exceeds the average market price of our common stock as their inclusion would be antidilutive. There were no options excluded for the quarters ended June 30, 2016 and 2015. There were approximately 12,003 and 179,850 options excluded for the nine months ended June 30, 2016 and 2015, respectively.

12. Segment Information

We are organized into the following three operating segments, each of which is a reportable segment, 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. This segment is composed of analytic and decision management software tools that clients can use to create their own custom decision management applications, our new FICO® Decision Management Suite, as well as associated professional services.

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 broad-based incentive expense, 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, 2016 and 2015:

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	Quarter Ended June 30, 2016				
	Applications	Software	Tools	Unallocated Corporate Expenses	Total
	(In thousands)				
Segment revenues:					
Transactional and maintenance	\$82,925	\$59,781	\$11,180	\$—	\$153,886
Professional services	36,560	822	6,922	—	44,304
License	22,080	527	17,981	—	40,588
Total segment revenues	141,565	61,130	36,083	—	238,778
Segment operating expense	(92,532)	(14,321)	(30,476)	(29,240)	(166,569)
Segment operating income	\$49,033	\$46,809	\$5,607	\$(29,240)	72,209
Unallocated share-based compensation expense					(13,404)
Unallocated amortization expense					(3,486)
Operating income					55,319
Unallocated interest expense, net					(6,781)
Unallocated other income, net					1,752
Income before income taxes					\$50,290
Depreciation expense	\$2,961	\$211	\$947	\$354	\$4,473

	Quarter Ended June 30, 2015				
	Applications	Software	Tools	Unallocated Corporate Expenses	Total
	(In thousands)				
Segment revenues:					
Transactional and maintenance	\$79,731	\$54,255	\$10,709	\$—	\$144,695
Professional services	31,009	615	6,374	—	37,998
License	16,394	884	9,395	—	26,673
Total segment revenues	127,134	55,754	26,478	—	209,366
Segment operating expense	(90,228)	(14,736)	(28,554)	(20,773)	(154,291)
Segment operating income (loss)	\$36,906	\$41,018	\$(2,076)	\$(20,773)	55,075
Unallocated share-based compensation expense					(12,166)
Unallocated amortization expense					(3,599)
Unallocated restructuring and acquisition-related					(2,256)
Operating income					37,054
Unallocated interest expense, net					(7,360)
Unallocated other income, net					770
Income before income taxes					\$30,464
Depreciation expense	\$3,734	\$258	\$834	\$621	\$5,447

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Nine Months Ended June 30, 2016

	Application	Scores	Tools	Unallocated Corporate Expenses	Total
	(In thousands)				
Segment revenues:					
Transactional and maintenance	\$244,659	\$174,263	\$32,779	—	\$451,701
Professional services	95,405	2,682	19,711	—	117,798
License	43,559	1,303	31,171	—	76,033
Total segment revenues	383,623	178,248	83,661	—	645,532
Segment operating expense	(267,924)	(42,580)	(82,890)	(75,184)	(468,578)
Segment operating income	\$115,699	\$135,668	\$771	\$(75,184)	176,954
Unallocated share-based compensation expense					(41,704)
Unallocated amortization expense					(10,573)
Operating income					124,677
Unallocated interest expense, net					(20,320)
Unallocated other income, net					1,853
Income before income taxes					\$106,210
Depreciation expense	\$8,413	\$573	\$2,582	\$986	\$12,554

Nine Months Ended June 30, 2015

	Application	Scores	Tools	Unallocated Corporate Expenses	Total
	(In thousands)				
Segment revenues:					
Transactional and maintenance	\$238,597	\$145,006	\$31,185	—	\$414,788
Professional services	90,500	2,369	18,273	—	111,142
License	47,923	2,257	29,915	—	80,095
Total segment revenues	377,020	149,632	79,373	—	606,025
Segment operating expense	(274,157)	(42,246)	(86,080)	(62,145)	(464,628)
Segment operating income (loss)	\$102,863	\$107,386	\$(6,707)	\$(62,145)	141,397
Unallocated share-based compensation expense					(32,762)
Unallocated amortization expense					(10,046)
Unallocated restructuring and acquisition-related					(2,256)
Operating income					96,333
Unallocated interest expense, net					(22,283)
Unallocated other income, net					771
Income before income taxes					\$74,821
Depreciation expense	\$10,948	\$702	\$2,424	\$1,973	\$16,047

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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.

14. Subsequent Events

In July 2016, our Board of Directors approved a new stock repurchase program following the termination of a similar program that was approved in August 2014. The new program is open-ended and authorizes repurchases of shares of our common stock up to an aggregate cost of \$250.0 million in the open market or in negotiated transactions.

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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. 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,” 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 us in fiscal 2016.

OVERVIEW

We provide products and services that enable businesses to automate, improve and connect decisions across the enterprise, an approach we commonly refer to as decision management. Our predictive analytics, which includes the industry-standard FICO® Score, and our decision management systems power hundreds of billions of customer decisions each year. We help thousands of companies in over 100 countries use our decision management technology to target and acquire customers more efficiently, increase customer value, reduce fraud and credit losses, lower operating expenses, and enter new markets more profitably. Most leading banks and credit card issuers rely on our solutions, as do insurers, retailers, telecommunications providers, pharmaceutical companies, healthcare organizations, public agencies and organizations in other industries. We also serve consumers through online services that enable people to purchase and understand their FICO® Scores, the standard measure in the U.S. of consumer credit risk, empowering them to manage their financial health. Most of our solutions address customer engagement, including customer acquisition, customer servicing and management, and customer protection. We also help businesses improve noncustomer decisions such as transaction and claims processing. Our solutions enable users to make decisions that are more precise, consistent and agile, and that systematically advance business goals. This helps our clients to reduce the cost of doing business, increase revenues and profitability, reduce losses from risks and fraud, and increase customer loyalty.

We derive a significant portion of our revenues from clients outside the U.S. International revenues accounted for 36% and 38% of total consolidated revenues for the quarters ended June 30, 2016 and 2015, respectively, and 35% and 39% of total consolidated revenues for the nine months ended June 30, 2016 and 2015, respectively. A significant portion of our revenues are derived from the sale of products and services within the banking (including consumer credit) industry, and 69% and 66% of our revenues were derived from within this industry during the quarters ended

June 30, 2016 and 2015, respectively, and 72% and 67% of our revenues were derived from within this industry during the nine months ended June 30, 2016 and 2015, respectively. In addition, we derive a significant share of revenue from transactional or unit-based software license fees, transactional fees derived under scoring, network service or internal hosted software arrangements, annual software maintenance fees and annual license fees under long-term software license arrangements. Arrangements with transactional or unit-based pricing accounted for approximately 64% and 69% of our revenues during the quarters ended June 30, 2016 and 2015, respectively. Arrangements with transactional or unit-based pricing accounted for approximately 70% and 68% of our revenues during the nine months ended June 30, 2016 and 2015, respectively.

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We continue to invest in our growth initiatives, while continuing to redirect our incremental investment from product development to expanding and refining our distribution capabilities. This emphasis of control over our operating expenses contributed to an increase of our operating income to \$55.3 million and \$124.7 million during the quarter and nine months ended June 30, 2016, respectively, from \$37.1 million and \$96.3 million during the quarter and nine months ended June 30, 2015, respectively, a 49% increase quarter over quarter and a 29% increase year-to-date period over period. Our operating margin increased to 23% from 18%, a 31% increase quarter over quarter and increased to 19% from 16%, a 22% increase year-to-date period over period.

We continue to enhance shareholder value by returning cash to shareholders through our stock repurchase program. During the quarter and nine months ended June 30, 2016, we repurchased approximately 0.3 million shares at a total repurchase price of \$32.1 million and 1.0 million shares at a total repurchase price of \$100.5 million, respectively.

Bookings

Management uses bookings as an indicator of our business performance. Bookings represent contracts signed in the current reporting period that 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 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 the 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 customer 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.

Bookings Trend Analysis

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	Bookings (In millions)	Bookings Yield (1)		Number of Bookings over \$1 Million	Weighted- Average Term (2) (Months)
Quarter Ended June 30, 2016	\$ 78.8	28 %		19	28
Quarter Ended June 30, 2015	\$ 60.2	27 %		11	21
Nine Months Ended June 30, 2016	\$ 297.7	33 %		44	NM ^(a)
Nine Months Ended June 30, 2015	\$ 209.4	45 %		39	NM ^(a)

(1) Bookings yield represents the percentage of revenue recognized from bookings for the periods indicated.

(2) Weighted-average term of bookings measures the average term over which bookings are expected to be recognized as revenue.

NM - Measure is not meaningful as our estimate of bookings is as of the end of the period in which a contract is (a) 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 29% and 25% of total bookings for the quarters ended June 30, 2016 and 2015, respectively. Professional services bookings were 44% and 49% of total bookings for the quarters ended June 30, 2016 and 2015, respectively. License bookings were 27% and 26% of total bookings for the quarters ended June 30, 2016 and 2015, respectively.

Transactional and maintenance bookings were 38% and 25% of total bookings for the nine months ended June 30, 2016 and 2015, respectively. Professional services bookings were 44% and 49% of total bookings for the nine months ended June 30, 2016 and 2015, respectively. License bookings were 18% and 26% of total bookings for the nine months ended June 30, 2016 and 2015, respectively.

RESULTS OF OPERATIONS

Revenues

The following tables set forth certain summary information on a segment basis related to our revenues for the quarters and nine months ended June 30, 2016 and 2015:

Segment	Quarter Ended June 30,		Percentage of Revenues		Period-to-Period Change		Period-to-Period Percentage Change	
	2016	2015	2016	2015	Change			
	(In thousands)				(In thousands)			
Applications	\$ 141,565	\$ 127,134	59 %	61 %	\$ 14,431		11 %	
Scores	61,130	55,754	26 %	26 %	5,376		10 %	
Tools	36,083	26,478	15 %	13 %	9,605		36 %	
Total	\$ 238,778	\$ 209,366	100 %	100 %	29,412		14 %	
								Period-to-Period
Segment	Nine Months Ended June 30,		Percentage of Revenues		Period-to-Period Change		Percentage Change	
	2016	2015	2016	2015	Change			
	(In thousands)				(In thousands)			
Applications	\$ 383,623	\$ 377,020	59 %	62 %	\$ 6,603		2 %	
Scores	178,248	149,632	28 %	25 %	28,616			