FAIR ISAAC CORP
Form 10-Q
May 07, 2007

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, 2007

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 0-16439
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.)*
901 Marquette Avenue, Suite 3200 **Minneapolis, Minnesota** *(Address of principal executive offices)*	**55402-3232** *(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer þ Accelerated Filer o Non-Accelerated Filer 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, 2007 was 57,361,506 (excluding 31,495,277 shares held by the Company as treasury stock).

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value data)
(Unaudited)

	March 31, 2007	September 30, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 122,447	$ 75,154
Marketable securities available for sale, current portion	150,449	152,141
Accounts receivables, net	178,703	165,806
Prepaid expenses and other current assets	22,376	17,998
Deferred income taxes		2,211
Total current assets	473,975	413,310
Marketable securities available for sale, less current portion	28,665	38,318
Other investments	2,374	2,161
Property and equipment, net	53,889	56,611
Goodwill	693,596	695,162
Intangible assets, net	72,745	90,900
Deferred income taxes	18,111	20,010
Other assets	3,937	4,733
	$ 1,347,292	$ 1,321,205
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 15,138	$ 12,162
Senior convertible notes	400,000	400,000
Revolving line of credit	70,000	
Accrued compensation and employee benefits	39,608	34,936
Other accrued liabilities	39,583	41,647
Deferred revenue	44,602	48,284
Total current liabilities	608,931	537,029
Other liabilities	13,356	14,148
Total liabilities	622,287	551,177
Stockholders equity:		
Preferred stock ($0.01 par value; 1,000 shares authorized; none issued and outstanding)		
	571	594

Common stock ($0.01 par value; 200,000 shares authorized, 88,857 shares issued and 57,129 and 59,369 shares outstanding at March 31, 2007 and September 30, 2006, respectively)		
Paid-in-capital	1,083,877	1,073,886
Treasury stock, at cost (31,728 and 29,488 shares at March 31, 2007 and September 30, 2006, respectively)	(1,063,943)	(952,979)
Retained earnings	695,215	644,836
Accumulated other comprehensive income	9,285	3,691
Total stockholders equity	725,005	770,028
	$ 1,347,292	$ 1,321,205

See accompanying notes to condensed consolidated financial statements.

1

FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Quarter Ended March 31,		Six Months Ended March 31,	
	2007	**2006**	**2007**	**2006**
Revenues	$ 201,000	$ 208,157	$ 409,227	$ 410,947
Operating expenses:				
Cost of revenues (1)	74,172	73,144	144,741	140,189
Research and development	17,781	21,694	35,500	44,424
Selling, general and administrative (1)	68,015	64,157	136,663	127,540
Amortization of intangible assets (1)	6,352	6,260	12,742	12,523
Restructuring and acquisition-related		2,184		1,510
Gain on sale of product line assets	(1,541)		(1,541)	
Total operating expenses	164,779	167,439	328,105	326,186
Operating income	36,221	40,718	81,122	84,761
Interest income	3,341	3,950	6,905	7,016
Interest expense	(3,230)	(2,143)	(5,906)	(4,278)
Other income (expense), net	491	(312)	38	(398)
Income before income taxes	36,823	42,213	82,159	87,101
Provision for income taxes	15,385	15,240	29,496	31,671
Net income	$ 21,438	$ 26,973	$ 52,663	$ 55,430
Earnings per share:				
Basic	$ 0.38	$ 0.41	$ 0.92	$ 0.86
Diluted	$ 0.37	$ 0.40	$ 0.89	$ 0.83
Shares used in computing earnings per share:				
Basic	56,940	65,052	57,504	64,626
Diluted	58,659	66,834	59,328	66,521

(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
(In thousands)
(Unaudited)

	Common Stock Shares	Common Stock Par Value	Paid-In-Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders Equity	Comprehensive Income
Balance at September 30, 2006	**59,369**	**$ 594**	**$ 1,073,886**	**$ (952,979)**	**$ 644,836**	**$ 3,691**	**$ 770,028**	
Share-based compensation			20,080				20,080	
Exercise of stock options	2,426	24	(22,844)	80,356			57,536	
Tax benefit from exercised stock options			13,529				13,529	
Forfeitures of restricted stock	(8)		255	(255)				
Repurchases of common stock	(4,818)	(48)		(196,395)			(196,443)	
Issuance of ESPP shares from treasury	140	1	(383)	4,684			4,302	
Issuance of restricted stock to employees from treasury	20		(646)	646				
Dividends paid					(2,284)		(2,284)	
Net income					52,663		52,663	$ 52,663
Unrealized gains on investments						178	178	178
Cumulative translation adjustments						5,416	5,416	5,416
Balance at March 31, 2007	**57,129**	**$ 571**	**$ 1,083,877**	**$ (1,063,943)**	**$ 695,215**	**$ 9,285**	**$ 725,005**	**$ 58,257**

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Six Months Ended March 31,	
	2007	**2006**
Cash flows from operating activities:		
Net income	$ 52,663	$ 55,430
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	26,867	24,237
Share-based compensation	20,080	19,640
Deferred income taxes	2,001	(3,870)
Tax benefit from exercised stock options	13,529	9,202
Excess tax benefits from share-based payment arrangements	(10,079)	(5,304)
Net amortization (accretion) of premium (discount) on marketable securities	(822)	50
Provision for doubtful accounts	2,803	930
Gain on sale of product line assets	(1,541)	
Changes in operating assets and liabilities, net of disposition effects:		
Receivables	(16,846)	(5,391)
Prepaid expenses and other assets	(1,159)	3,878
Accounts payable	2,986	6,144
Accrued compensation and employee benefits	4,558	450
Other liabilities	(4,952)	2,853
Deferred revenue	(1,684)	1,436
Net cash provided by operating activities	88,404	109,685
Cash flows from investing activities:		
Purchases of property and equipment	(11,651)	(8,125)
Cash proceeds from sale of product line assets	13,904	
Collections of note receivable from sale of product line		500
Purchases of marketable securities	(132,512)	(78,961)
Proceeds from sales of marketable securities	14,250	18,740
Proceeds from maturities of marketable securities	130,999	63,560
Investment in cost-method investee	(213)	
Net cash provided by (used in) investing activities	14,777	(4,286)
Cash flows from financing activities:		
Proceeds from revolving line of credit	70,000	
Debt issuance costs	(408)	
Proceeds from issuances of common stock under employee stock option and purchase plans	61,838	45,577
Dividends paid	(2,284)	(2,596)
Repurchases of common stock	(196,443)	(12,766)

Excess tax benefits from share-based payment arrangements	10,079	5,304
Net cash provided by (used in) financing activities	(57,218)	35,519
Effect of exchange rate changes on cash	1,330	(335)
Increase in cash and cash equivalents	47,293	140,583
Cash and cash equivalents, beginning of period	75,154	82,880
Cash and cash equivalents, end of period	$ 122,447	$ 223,463
Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net	$ 13,796	$ 18,166
Cash paid for interest	$ 3,807	$ 3,000

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Nature of Business

Fair Isaac Corporation

Incorporated under the laws of the State of Delaware, Fair Isaac Corporation is a provider of analytic, software and data management products and services that enable businesses to automate and improve decisions. Fair Isaac Corporation 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, healthcare organizations and government agencies.

In these condensed consolidated financial statements, Fair Isaac Corporation is referred to as we, us, our, and Fair Isaac.

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 standards of accounting measurement set forth in Accounting Principles Board (APB) Opinion No. 28 and any amendments thereto adopted by the Financial Accounting Standards Board (FASB). 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, 2006. 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 Fair Isaac 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; estimated losses associated with contingencies and litigation; 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, the determination of whether fees are fixed or determinable and collection is probable or reasonably assured; and the development of assumptions for use in the Black-Scholes model that estimates the fair value of our share-based awards and assessing forfeiture rates of share-based awards.

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,	
	2007	2006	2007	2006
	(In thousands)			
Cost of revenues	$ 3,771	$ 3,714	$ 7,549	$ 7,428
Selling, general and administrative expenses	2,581	2,546	5,193	5,095

	$ 6,352	$ 6,260	$ 12,742	$ 12,523

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Cost of revenues reflects our amortization of completed technology, and selling, general and administrative expenses reflects our amortization of other intangible assets. Intangible assets were $72.7 million and $90.9 million, net of accumulated amortization of $93.6 million and $84.5 million, as of March 31, 2007 and September 30, 2006, respectively.

3. Restructuring and Acquisition-Related Expenses

The following table summarizes our restructuring and acquisition-related accruals associated with acquisitions and certain Fair Isaac facility closures. The current portion and non-current portion is recorded in other accrued current liabilities and other long-term liabilities within the accompanying condensed consolidated balance sheets. These balances are expected to be paid by fiscal 2012.

	Accrual at September 30, 2006	Cash Payments	Accrual at March 31, 2007
		(In thousands)	
Facilities charges	$ 15,094	$ (4,021)	$ 11,073
Employee separation	90	(90)	
	15,184	$ (4,111)	11,073
Less: current portion	(6,161)		(3,134)
Non-current	$ 9,023		$ 7,939

4. Sale of Product Line Assets

In March 2007, we sold the assets and products associated with our mortgage banking solutions product line for $15.8 million in cash. This amount includes $1.5 million in escrow balance to cover various indemnification and unidentified liabilities and a $0.4 million receivable for a post-closing working capital adjustment. The primary assets sold include accounts receivable, certain identifiable intangible assets and goodwill. We recognized a $1.5 million pre-tax gain, but a $0.4 million after-tax loss on the sale due to goodwill associated with the mortgage banking solutions product line that was not deductible for income tax purposes. We acquired the mortgage banking solutions through our May 2004 acquisition of London Bridge Software Holdings plc. The assets sold include software and e-commerce services used in the origination processing, underwriting, pricing, product definition, closing, secondary marketing, servicing, and default management of mortgage and construction loans, and BridgeLinkTM e-Services for the mortgage industry. Revenues attributable to the mortgage banking solutions product line for the quarter ended March 31, 2007 and 2006 were $3.4 million and $4.9 million, respectively, and revenues for the six months ended March 31, 2007 and 2006 were $7.8 million and $10.5 million, respectively.

5. Share-Based Payment

We maintain the 1992 Long-term Incentive Plan (the 1992 Plan) under which we may grant stock options, stock appreciation rights, restricted stock, restricted stock units and common stock to officers, key employees and non-employee directors. Under the 1992 Plan, a number of shares equal to 4% of the number of shares of Fair Isaac common stock outstanding on the last day of the preceding fiscal year is added to the shares available under this plan each fiscal year, provided that the number of shares for grants of incentive stock options for the remaining term of this plan shall not exceed 5,062,500 shares. The 1992 Plan will terminate in February 2012. In November 2003, our Board of Directors approved the adoption of the 2003 Employment Inducement Award Plan (the 2003 Plan). The 2003 Plan reserves 2,250,000 shares of common stock solely for the granting of inducement stock options and other awards, as defined, that meet the employment inducement award exception to the New York Stock Exchange s listing standards requiring shareholder approval of equity-based inducement incentive plans. Except for the employment inducement award criteria, awards under the 2003 Plan will be generally consistent with those made under our 1992 Plan. The 2003 Plan shall remain in effect until terminated by the Board of Directors. We also maintain individual stock option plans for certain of our executive officers and the chairman of the board. Stock option awards granted since October 1, 2005 typically have a maximum term of seven years and vest ratably over four years. Stock option awards granted prior to October 1, 2005, typically had a maximum term of ten years and vest ratably over four years.

Under our 1999 Employee Stock Purchase Plan, we are authorized to issue up to 5,062,500 shares of common stock to eligible employees. Employees may have up to 10% of their base salary withheld through payroll deductions to purchase Fair Isaac common stock during semi-annual offering periods. The purchase price of the stock is the lower of 85% of (i) the fair market value of the common stock on the enrollment date (the first day of the offering period), or (ii) the fair market value on the exercise date (the last

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

day of each offering period). Offering period means approximately six-month periods commencing (a) on the first trading day on or after January 1 and terminating on the last trading day in the following June, and (b) on the first trading day on or after July 1 and terminating on the last trading day in the following December.

We estimate the fair value of options granted using the Black-Scholes option valuation model. We estimate the volatility of our common stock at the date of grant based on a combination of the implied volatility of publicly traded options on our common stock and our historical volatility rate, consistent with Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment* and Securities and Exchange Commission Staff Accounting Bulletin No. 107 (SAB 107). Our decision to use implied volatility was based upon the availability of actively traded options on our common stock and our assessment that implied volatility is more representative of future stock price trends than historical volatility. We estimate expected term consistent with the simplified method identified in SAB 107 for share-based awards. We elected to use the simplified method as we changed the contractual life for share-based awards from ten to seven years starting in fiscal 2006. The simplified method calculates the expected term as the average of the vesting and contractual terms of the award. Previously, we estimated expected term based on historical exercise patterns. The dividend yield assumption is based on historical dividend payouts. The risk-free interest rate assumption is based on observed interest rates appropriate for the term of our employee options. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For options granted, we amortize the fair value on a straight-line basis over the vesting period of the options.

The fair value of restricted stock units is based on the fair market value of our common stock on the date of grant. We use historical data to estimate pre-vesting forfeitures and record share-based compensation expense only for those awards that are expected to vest. Share-based compensation expense for restricted stock units is recognized on a straight-line basis over the vesting period. Upon vesting, restricted stock units will convert into an equivalent number of shares of common stock.

6. Earnings Per Share

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

	Quarter Ended March 31,		Six Months Ended March 31,	
	2007	2006	2007	2006
	(In thousands, except per share data)			
Numerator for basic earnings per share net income	$ 21,438	$ 26,973	$ 52,663	$ 55,430
Interest expense on senior convertible notes, net of tax	1	1	2	2
Numerator for diluted earnings per share	$ 21,439	$ 26,974	$ 52,665	$ 55,432
Denominator shares:				
Basic weighted-average shares	56,940	65,052	57,504	64,626
Effect of dilutive securities	1,719	1,782	1,824	1,895
Diluted weighted-average shares	58,659	66,834	59,328	66,521
Earnings per share:				
Basic	$ 0.38	$ 0.41	$ 0.92	$ 0.86