

Monotype Imaging Holdings Inc.  
Form 10-Q  
May 01, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended March 31, 2013

OR

.. **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 001-33612

**MONOTYPE IMAGING HOLDINGS INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State of incorporation)

**20-3289482**  
(I.R.S. Employer

Identification No.)

**500 Unicorn Park Drive**

**Woburn, Massachusetts**  
(Address of principal executive offices)

**01801**  
(Zip Code)

**Registrant's telephone number, including area code: (781) 970-6000**

(Former Name, Former Address and Former Fiscal year, if changed since last report)

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 (§232.405 of this chapter) 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 the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The number of shares outstanding of the registrant's common stock as of April 23, 2013 was 38,224,895.

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements  
MONOTYPE IMAGING HOLDINGS INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited and in thousands, except share and per share data)**

	March 31, 2013	December 31, 2012
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 42,983	\$ 39,340
Accounts receivable, net of allowance for doubtful accounts of \$156 at March 31, 2013 and \$129 at December 31, 2012	8,507	6,996
Income tax refunds receivable	2,912	2,209
Deferred income taxes	2,218	2,218
Prepaid expenses and other current assets	2,808	2,454
<b>Total current assets</b>	<b>59,428</b>	<b>53,217</b>
Property and equipment, net	2,579	2,587
Goodwill	173,159	174,294
Intangible assets, net	83,675	86,736
Other assets	3,171	3,232
<b>Total assets</b>	<b>\$ 322,012</b>	<b>\$ 320,066</b>
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 813	\$ 1,038
Accrued expenses and other current liabilities	14,985	17,319
Accrued income taxes		2,191
Deferred revenue	8,249	8,725
Current portion of long-term debt	12,321	10,000
<b>Total current liabilities</b>	<b>36,368</b>	<b>39,273</b>
Long-term debt, less current portion		12,321
Other long-term liabilities	584	613
Deferred income taxes	28,269	26,832
Reserve for income taxes, net of current portion	1,010	963
Accrued pension benefits	4,885	4,958
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, Authorized shares: 10,000,000; Issued and outstanding: none		
Common stock, \$0.001 par value, Authorized shares: 250,000,000; Issued: 38,267,656 at March 31, 2013 and 37,331,796 at December 31, 2012.	38	37
Additional paid-in capital	189,196	178,681
Treasury stock, at cost, 116,351 shares at March 31, 2013 and 116,101 shares at December 31, 2012	(86)	(86)
Retained earnings	63,297	56,980
Accumulated other comprehensive income	(1,549)	(506)

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Total stockholders' equity	250,896	235,106
Total liabilities and stockholders' equity	\$ 322,012	\$ 320,066

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****MONOTYPE IMAGING HOLDINGS INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited and in thousands, except share and per share data)

	Three Months Ended March 31,	
	2013	2012
Revenue	\$ 42,039	\$ 34,349
Cost of revenue	6,009	3,658
Cost of revenue amortization of acquired technology	1,138	795
Total cost of revenue	7,147	4,453
Gross profit	34,892	29,896
Operating expenses:		
Marketing and selling	9,919	9,271
Research and development	4,972	4,344
General and administrative	4,705	4,927
Amortization of other intangible assets	1,490	1,221
Total operating expenses	21,086	19,763
Income from operations	13,806	10,133
Other (income) expense:		
Interest expense	418	451
Interest income		(7)
Loss on foreign exchange	577	267
Loss on derivatives		126
Other	(36)	(11)
Total other expense	959	826
Income before provision for income taxes	12,847	9,307
Provision for income taxes	4,231	3,587
Net income	\$ 8,616	\$ 5,720
Net income available to common stockholders basic	\$ 8,478	\$ 5,633
Net income available to common stockholders diluted	\$ 8,481	\$ 5,636
Net income per common share:		
Basic	\$ 0.23	\$ 0.16
Diluted	\$ 0.22	\$ 0.15
Weighted average number of shares:		
Basic	37,102,507	36,282,428
Diluted	38,484,522	37,607,047
Dividends declared per common share	\$ 0.06	\$

The accompanying notes are an integral part of these condensed consolidated financial statements.

**MONOTYPE IMAGING HOLDINGS INC.**

**STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME**

(Unaudited and in thousands)

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Net income	\$ 8,616	\$ 5,720
Other comprehensive (loss) income, net of tax:		
Foreign currency translation adjustments	(1,043)	550
Comprehensive income	\$ 7,573	\$ 6,270

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****MONOTYPE IMAGING HOLDINGS INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited and in thousands)

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 8,616	\$ 5,720
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,997	2,333
Loss on retirement of fixed assets	4	
Amortization of deferred financing costs	75	76
Share based compensation	1,749	1,923
Excess tax benefit on stock options	(1,976)	(352)
Provision for doubtful accounts	39	26
Deferred income taxes	1,940	116
Unrealized currency gain on foreign denominated intercompany transactions	(49)	(258)
Unrealized loss on derivatives		234
Changes in operating assets and liabilities:		
Accounts receivable	(1,762)	360
Prepaid expenses and other assets	(430)	(407)
Accounts payable	(198)	(609)
Accrued income taxes	(1,251)	1,136
Accrued expenses and other liabilities	(2,664)	(2,939)
Deferred revenue	(359)	670
Net cash provided by operating activities	6,731	8,029
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(388)	(296)
Purchase of exclusive license and other intangible assets		(150)
Acquisition of business, net of cash acquired	(72)	(46,536)
Increase in restricted cash for acquisition of business		(2,613)
Net cash used in investing activities	(460)	(49,595)
<b>Cash flows from financing activities</b>		
Payments on long-term debt	(10,000)	(10,000)
Proceeds from issuance of long-term debt		25,000
Excess tax benefit on stock options	1,976	352
Common stock dividend paid	(1,492)	
Proceeds from exercises of common stock options	7,031	403
Net cash (used in) provided by financing activities	(2,485)	15,755
Effect of exchange rates on cash and cash equivalents	(143)	38
Increase (decrease) in cash and cash equivalents	3,643	(25,773)
Cash and cash equivalents at beginning of period	39,340	53,850
Cash and cash equivalents at end of period	\$ 42,983	\$ 28,077



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The accompanying notes are an integral part of these condensed consolidated financial statements.

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**MONOTYPE IMAGING HOLDINGS INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2013**

**1. Nature of the Business**

Monotype Imaging Holdings Inc. (the Company or we ) is a leading provider of type, technology and expertise for creative applications and consumer electronics, or CE, devices. Our end-user and embedded solutions for print, web and mobile environments enable people to create and consume dynamic content on any and every device. The Company's technologies and fonts enable the display and printing of high quality digital text. Our technologies and fonts have been widely deployed across, and embedded in, a range of CE devices, including laser printers, digital copiers, mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, digital televisions, set-top boxes and consumer appliances, as well as in numerous software applications and operating systems. The Company also provides printer drivers, page description language interpreters, printer user interface technology and color imaging solutions to printer manufacturers and OEMs (original equipment manufacturers). We license our fonts and technologies to CE device manufacturers, independent software vendors and creative and business professionals and we are headquartered in Woburn, Massachusetts. We operate in one business segment: the development, marketing and licensing of technologies and fonts. The Company also maintains various offices worldwide for selling and marketing, research and development and administration. We conduct our operations through three domestic operating subsidiaries, Monotype Imaging Inc., Monotype ITC Inc. and MyFonts Inc. ( Bitstream ), and five foreign subsidiaries, Monotype Ltd., Monotype GmbH ( Germany ), formerly Linotype GmbH, Monotype Solutions India Pvt. Ltd., Monotype Hong Kong Ltd. and Monotype KK.

**2. Basis of Presentation**

The accompanying unaudited condensed consolidated interim financial statements as of March 31, 2013 and for the three months ended March 31, 2013 and 2012 include the accounts of the Company and its wholly-owned subsidiaries and have been prepared in conformity with accounting principles generally accepted in the United States ( GAAP ) for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ) for Quarterly Reports on Form 10-Q and Article 10 of Regulation S-X. Accordingly, such financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. The results for interim periods are not necessarily indicative of results to be expected for the year or for any future periods.

In management's opinion, these unaudited condensed consolidated interim financial statements contain all adjustments of a normal recurring nature necessary for a fair presentation of the financial statements for the interim periods presented.

These unaudited condensed consolidated interim financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2012 as reported in the Company's Annual Report on Form 10-K.

**3. Acquisition**

*Design by Front Ltd.*

On October 29, 2012, the Company acquired all of the outstanding shares of Design by Front Limited, a privately held web strategy, design and technology studio located in Belfast, Northern Ireland, for approximately \$4.6 million. The Company paid \$2.6 million in cash upon closing, with the remainder of the purchase price to be paid contingent on attainment of certain criteria through 2014. The contingent consideration payable was recorded at \$2.1 million, which represents the net present fair value of the estimated payment. We recognized approximately \$2.5 million of intangible assets and approximately \$2.5 million of goodwill, associated with the transaction. In connection with this acquisition, 13 Design by Front Limited employees joined the Company. Design by Front Limited's Typecase browser-based web authoring tool allows easy use of web fonts when designing web sites.

**4. Derivative Financial Instruments**

On May 24, 2010, we entered into a long term interest rate swap contract to pay a fixed rate of interest of 1.5% in exchange for a floating rate interest payment tied to the one-month London Inter-Bank Offering Rate, or LIBOR, beginning November 28, 2010 to mitigate our exposure to interest rate fluctuations on our debt obligations for the remainder of the term of the note. The contract had a notional amount of \$30.0 million

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and matured on July 30, 2012. We did not designate the contract as a hedge; as such, associated gains and losses were recorded in loss on derivatives in our condensed consolidated statements of income.

On May 7, 2008, we entered into a long-term currency swap contract to purchase 18.3 million Euros in exchange for \$28.0 million to mitigate foreign currency exchange rate risk on a Euro denominated intercompany note. We incurred a net gain of \$0.1 million for the three months ended March 31, 2012, which is included in loss on foreign exchange in the accompanying condensed consolidated statements of income. The currency swap matured on December 14, 2012. The contract payment terms approximated the payment terms of this intercompany note.

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The following table presents the losses on our derivative financial instruments which are included in loss on derivatives in our accompanying condensed consolidated statements of income (in thousands):

	Three Months Ended March 31,	
	2013	2012
Interest rate swaps	\$	\$ 21
Currency swap		105
<b>Total</b>	<b>\$</b>	<b>\$ 126</b>

**5. Fair Value Measurements**

Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, the Codification establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets and liabilities or market corroborated inputs.

Level 3: Unobservable inputs are used when little or no market data is available and requires the Company to develop its own assumptions about how market participants would price the assets or liabilities. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimizes the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value.

The following table presents our financial assets and liabilities that are carried at fair value, classified according to the three categories described above (in thousands):

	Total	Fair Value Measurement at March 31, 2013		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Cash equivalents money market funds	\$ 1,377	\$ 1,377	\$	\$
Cash equivalents commercial paper	4,550		4,550	
Cash equivalents corporate bonds	7,443		7,443	
<b>Total assets</b>	<b>\$ 13,370</b>	<b>\$ 1,377</b>	<b>\$ 11,993</b>	<b>\$</b>
<b>Liabilities:</b>				
Contingent acquisition consideration	\$ 2,147	\$	\$	\$ 2,147
<b>Total liabilities</b>	<b>\$ 2,147</b>	<b>\$</b>	<b>\$</b>	<b>\$ 2,147</b>

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The Company's recurring fair value measures relate to short-term investments, which are classified as cash equivalents and derivative instruments. The fair value of our cash equivalents are either based on quoted prices for similar assets or other observable inputs such as yield curves at commonly quoted intervals and other market corroborated inputs. The fair value of our derivatives is based on quoted market prices of similar instruments from various banking institutions or an independent third party provider for similar instruments. In determining the fair value, we consider our non-performance risk and that of our counterparties. At March 31, 2013 the fair value of our long-term debt approximated its carrying value of \$12.3 million. The Company's non-financial assets and non-financial liabilities subject to non-recurring measures include goodwill and intangible assets. For the recurring fair value measure, contingent acquisition consideration, the Company estimated the fair value of the liability by judgmentally weighting the range of possible achievement of the criteria upon which the contingent consideration to be paid will be determined. The resulting estimated amount was then adjusted to its estimated net present value based upon a present value factor that was derived by applying a rate of return over the applicable contingency period.

**Table of Contents****6. Intangible Assets**

Intangible assets as of March 31, 2013 and December 31, 2012 were as follows (dollar amounts in thousands):

	Life (Years)	March 31, 2013			December 31, 2012		
		Gross Carrying Amount	Accumulated Amortization	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer relationships	7-15	\$ 56,854	\$ (37,858)	\$ 18,996	\$ 57,040	\$ (36,464)	\$ 20,576
Acquired technology	8-15	50,876	(26,220)	24,656	51,067	(25,108)	25,959
Non-compete agreements	3-6	11,980	(11,740)	240	12,016	(11,752)	264
Trademarks		35,383		35,383	35,537		35,537
Domain names		4,400		4,400	4,400		4,400
Total		\$ 159,493	\$ (75,818)	\$ 83,675	\$ 160,060	\$ (73,324)	\$ 86,736

**7. Debt**

On July 13, 2011 the Company entered into a credit agreement with Wells Fargo Capital Finance, LLC, ( Credit Facility ), which provides the Company with a five-year, \$120.0 million secured revolving credit facility. Borrowings under the Credit Facility bear interest at a variable rate based upon, at the Company's option, either LIBOR or the base rate (which is the highest of (i) the prime rate, (ii) 0.5% plus the overnight federal funds rate, and (iii) 1.0% in excess of the three-month LIBOR rate), plus in each case, an applicable margin. The applicable margin for LIBOR loans, based on the applicable leverage ratio, is either 2.25% or 2.50% per annum, and the applicable margin for base rate loans, based on the applicable leverage ratio, is either 1.25% or 1.50% per annum. At March 31, 2013, our rates, inclusive of applicable margins, were 2.5% and 4.5% for LIBOR and prime, respectively. At March 31, 2013, our blended interest rate was 3.0%. The Company is required to pay an unused line fee equal to 0.375% per annum on the undrawn portion available under the revolving credit facility and variable per annum fees in respect of outstanding letters of credit, if any. The Credit Facility contains financial covenants which include (i) a maximum ratio of consolidated total debt to consolidated adjusted EBITDA of 3.00:1.00, and (ii) a minimum consolidated fixed charge coverage ratio of 1.25:1.00. Adjusted EBITDA, under the Credit Facility, is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation expense, plus acquisition expenses not to exceed \$2.0 million, plus restructuring, issuance costs, cash non-operating costs and other expenses or losses minus cash non-operating gains and other non-cash gains; provided however that the aggregate of all cash non-operating expense shall not exceed \$250 thousand and all such fees, costs and expenses shall not exceed \$1.5 million on a trailing twelve months basis. Failure to comply with these covenants, or the occurrence of an event of default, could permit the Lenders under the Credit Facility to declare all amounts borrowed under the Credit Facility, together with accrued interest and fees, to be immediately due and payable. In addition, the Credit Facility is secured by substantially all of our assets and places limits on the Company's and its subsidiaries' ability to incur debt or liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, engage in mergers, acquisitions and asset sales, transact with affiliates and alter its business. We were in compliance with all covenants under our Credit Facility as of March 31, 2013.

In accordance with ASC Subtopic No. 210-10-45, *Balance Sheet, Other Presentation Matters*, the Company has classified \$12.3 million and \$10.0 million in the current portion of long-term debt within the consolidated balance sheet at March 31, 2013 and December 31, 2012, respectively, for payments reasonably expected to be made on the revolving credit facility during the next twelve months. In accordance with the agreement, there are no required scheduled repayments; payments and draws are made at the Company's discretion during the life of the agreement.

**8. Defined Benefit Pension Plan**

Our German subsidiary maintains an unfunded defined benefit pension plan which covers substantially all employees who joined the company prior to the plan's closure to new participants in 2006. Participants are entitled to benefits in the form of retirement, disability and surviving dependent pensions. Benefits generally depend on years of service and the salary of the employees.

The components of net periodic benefit cost included in the accompanying condensed consolidated statements of income were as follows (in thousands):

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	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2013</b>	<b>2012</b>
Service cost	\$ 29	\$ 21
Interest cost	39	45
Net periodic benefit cost	\$ 68	\$ 66

**Table of Contents****9. Income Taxes**

A reconciliation of income taxes computed at federal statutory rates to income tax expense is as follows (dollar amounts in thousands):

	<b>Three Months Ended March 31,</b>			
	<b>2013</b>		<b>2012</b>	
Provision for income taxes at statutory rate	\$ 4,497	35.0%	\$ 3,257	35.0%
State and local income taxes, net of federal tax benefit	191	1.5%	128	1.4%
Stock compensation	70	0.5%	62	0.6%
Research credits	(325)	(2.5)%		
Disqualifying dispositions on incentive stock options	(148)	(1.2)%	(33)	(0.3)%
Effect of rate changes on deferred taxes			128	1.4%
Other, net	(54)	(0.4)%	45	0.4%
 Reported income tax provision	 \$ 4,231	 32.9%	 \$ 3,587	 38.5%

As of March 31, 2013, the reserve for uncertain tax positions was approximately \$4.7 million. Of this amount, \$3.7 million is recorded as a reduction of deferred tax assets and \$1.0 million is classified as long term liabilities.

**10. Net Income Per Share**

Basic and diluted earnings per share are computed pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating security according to their respective participation rights in undistributed earnings. Unvested restricted stock awards granted to employees are considered participating securities as they receive non-forfeitable rights to cash dividends at the same rate as common stock. In accordance with ASC Topic No. 260, *Earnings Per Share*, diluted net income per share is calculated using the more dilutive of the following two approaches:

1. Assume exercise of stock options and vesting of restricted stock using the treasury stock method.
2. Assume exercise of stock options using the treasury stock method, but assume participating securities (unvested restricted stock) are not vested and allocate earnings to common shares and participating securities using the two-class method.



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For the periods presented the two-class method was used in the computation of diluted net income per share, as the result was more dilutive. The following presents a reconciliation of the numerator and denominator used in the calculation of basic net income per share and a reconciliation of the denominator used in the calculation of diluted net income per share (in thousands, except share and per share data):

	Three Months Ended March 31,	
	2013	2012
<b>Numerator:</b>		
Net income, as reported	\$ 8,616	\$ 5,720
Less: net income attributable to participating securities	(138)	(87)
Net income available to common shareholders basic	\$ 8,478	\$ 5,633
<b>Denominator:</b>		
<b>Basic:</b>		
Weighted-average shares of common stock outstanding	37,717,140	36,839,767
Less: weighted-average shares of unvested restricted common stock outstanding	(614,633)	(557,339)
Weighted-average number of common shares used in computing basic net income per common share	37,102,507	36,282,428
Net income per share applicable to common shareholders basic	\$ 0.23	\$ 0.16

	Three Months Ended March 31,	
	2013	2012
<b>Numerator:</b>		
Net income available to common shareholders basic	\$ 8,478	\$ 5,633
Add-back: undistributed earnings allocated to unvested shareholders	103	87
Less: undistributed earnings reallocated to unvested shareholders	(100)	(84)
Net income available to common shareholders diluted	\$ 8,481	\$ 5,636
<b>Denominator:</b>		
<b>Diluted:</b>		
Weighted-average shares of common stock outstanding	37,717,140	36,839,767
Less: weighted-average shares of unvested restricted common stock outstanding	(614,633)	(557,339)
Weighted-average number of common shares issuable upon exercise of outstanding stock options, based on the treasury stock method	1,382,015	1,324,619
Weighted-average number of common shares used in computing diluted net income per common share	38,484,522	37,607,047
Net income per share applicable to common shareholders diluted	\$ 0.22	\$ 0.15

The following common share equivalents have been excluded from the computation of diluted weighted-average shares outstanding, as their effect would have been anti-dilutive:

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	Three Months Ended	
	March 31,	
	2013	2012
Options	190,861	1,575,517
Unvested restricted stock	67,414	2,063

The Company excludes options with combined exercise prices, and unvested restricted stock with unamortized fair values that are greater than the average market price for the Company's common stock from the calculation of diluted net income per share because their effect is anti-dilutive.

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We account for share based compensation in accordance with ASC Topic No. 718, *Compensation - Stock Compensation*, which requires the measurement of compensation costs at fair value on the date of grant and recognition of compensation expense over the service period for awards expected to vest. The following presents the impact of share based compensation expense on our condensed consolidated statements of income (in thousands):

	Three Months Ended March 31,	
	2013	2012
Marketing and selling	\$ 777	\$ 831
Research and development	416	441
General and administrative	556	651
Total share based compensation	\$ 1,749	\$ 1,923

As of March 31, 2013, the Company had \$19.3 million of unrecognized compensation expense related to employees and directors unvested stock options and restricted stock awards that are expected to be recognized over a weighted average period of 2.5 years.

**12. Segment Reporting**

We view our operations and manage our business as one segment: the development, marketing and licensing of technologies and fonts. Factors used to identify our single segment include the financial information available for evaluation by our chief operating decision maker in making decisions about how to allocate resources and assess performance. While our technologies and services are sold into two principal markets, Creative Professional and OEM, expenses and assets are not formally allocated to these market segments, and operating results are assessed on an aggregate basis to make decisions about the allocation of resources. The following table presents revenue for these two major markets (in thousands):

	Three Months Ended March 31,	
	2013	2012
Creative Professional	\$ 15,332	\$ 9,705
OEM	26,707	24,644
Total	\$ 42,039	\$ 34,349

**Geographic segment information**

The Company attributes revenue to geographic areas based on the location of our subsidiary receiving such revenue. For example, licenses may be sold to large international companies which may be headquartered in Korea, but the sales are received and recorded by our subsidiary located in the United States. In this example, the revenue would be reflected in the United States totals in the table below. We market our products and services through offices in the U.S., United Kingdom, Germany, Hong Kong, Korea and Japan. The following summarizes revenue by location (in thousands of dollars, except percentages):

	Three Months Ended March 31,			
	2013		2012	
	Sales	% of Total	Sales	% of Total
United States	\$ 24,147	57.4%	\$ 16,667	48.5%
Asia	12,889	30.7	10,716	31.2

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United Kingdom	1,383	3.3	1,478	4.3
Germany	3,620	8.6	5,488	16.0
Total	\$ 42,039	100.0%	\$ 34,349	100.0%

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Long-lived assets, which include property, plant and equipment, goodwill and intangibles, but exclude other assets, long-term investments and deferred tax assets, are attributed to geographic areas in which Company assets reside and is shown below (in thousands):

	March 31, 2013	December 31, 2012
Long-lived assets:		
United States	\$ 198,552	\$ 200,804
Asia	3,430	3,438
United Kingdom	4,773	5,130
Germany	52,658	54,245
Total	\$ 259,413	\$ 263,617

**13. Commitments and Contingencies*****Legal Proceedings***

From time to time, we may be a party to various claims, suits and complaints. We are not currently a party to any legal proceedings that, if determined adversely to us, would have a material adverse effect on our business, results of operations or financial condition.

***Licensing Warranty***

Under our standard license agreement with our OEM customers, we warrant that the licensed technologies are free of infringement claims of intellectual property rights and will meet the specifications as defined in the licensing agreement for a specified period, typically one year. Under the licensing agreements, liability for such indemnity obligations is limited generally to a maximum of total arrangement fee; however, exceptions have been made on a case-by-case basis, increasing the maximum potential liability to agreed upon amounts at the time the contract is entered into. We have never incurred costs payable to a customer or business partner to defend lawsuits or settle claims related to these warranties, and as a result, management believes the estimated fair value of these warranties is minimal. Accordingly, there are no liabilities recorded for these warranties as of March 31, 2013 and December 31, 2012.

**14. Subsequent Event**

On April 29, 2013 the Company's Board of Directors declared a \$0.06 per share quarterly cash dividend on our outstanding common stock. The record date is set for July 1, 2013 and the dividend is payable to shareholders of record on July 19, 2013. Dividends are declared at the discretion of the Company's Board of Directors and depend on actual cash from operations, the Company's financial condition and capital requirements and any other factors the Company's Board of Directors may consider relevant. Future dividend declarations, as well as the record and payment dates for such dividends, will be determined by the Company's Board of Directors on a quarterly basis.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Forward Looking Statements and Projections**

*This Quarterly Report on Form 10-Q contains forward looking statements. Forward looking statements relate to future events or our future financial performance. We generally identify forward looking statements by terminology such as may, will, should, expects, plans, anticipates, could, intends, target, projects, contemplates, believes, estimates, predicts, potential or continue or the negative of these terms or other similar words. These statements are only predictions. We have based these forward looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, results of operations and financial condition. The outcome of the events described in these forward looking statements is subject to risks, uncertainties and other factors described in Management's Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors and elsewhere in this Quarterly Report on Form 10-Q. Accordingly, you should not rely upon forward looking statements as predictions of future events. We cannot assure you that the events and circumstances reflected in the forward looking statements will be achieved or occur, and actual results could differ materially from those projected in the forward looking statements. The forward looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.*

**Overview**

We are a leading provider of type, technology and expertise for creative applications and consumer electronics, or CE, devices. Our software technologies have been widely deployed across, and embedded in a range of CE devices, including laser printers, digital copiers, mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, digital televisions, set-top boxes and consumer appliances, as well as in numerous software applications and operating systems. In the laser printer market, we have worked together with industry leaders for over 20 years to provide critical components embedded in printing standards. The Company also provides printer drivers, page description language interpreters, printer user interface technology and color imaging solutions to printer manufacturers and OEMs (original equipment manufacturers). Our scaling, compression, text layout, printer driver and color technologies solve critical text imaging issues for CE device manufacturers by rendering high quality text on low resolution and memory constrained CE devices. We offer more than 18,000 typeface designs, and include some of the world's most widely used designs, such as the Times New Roman®, Helvetica®, ITC Franklin Gothic and Droid typefaces, and support more than 200 Latin and non-Latin languages. Our e-commerce websites, including *myfonts.com*, *fonts.com* and *linotype.com*, which attracted more than 68 million visits in 2012 from over 200 countries and territories, offer thousands of high-quality font products, in some cases more than 150,000, including our own fonts from the Monotype Libraries as well as fonts from third parties.

**Sources of Revenue**

We derive revenue from two principal sources: licensing our fonts and font related services to creative and business professionals, which we refer to as our Creative Professional revenue, and licensing our text imaging solutions to CE device manufacturers and independent software vendors, which we refer to as our OEM revenue. We derive our Creative Professional revenue primarily from multinational corporations, graphic designers, media organizations, advertisers, printers and publishers. We derive our OEM revenue primarily from CE device manufacturers. Some of our revenue streams, particularly custom revenue where spending is largely discretionary in nature, have historically been and we expect them to continue to be in the future, susceptible to weakening economic conditions.

Geographic revenue, which is based on the location of our subsidiary receiving such revenue, is in the table below:

	Three Months Ended March 31,			
	2013		2012	
	Sales	% of Total	Sales	% of Total
(In millions of dollars, except percentages)				
United States	\$ 24,147	57.4%	\$ 16,667	48.5%
Asia	12,889	30.7	10,716	31.2
United Kingdom	1,383	3.3	1,478	4.3
Germany	3,620	8.6	5,488	16.0
<b>Total</b>	<b>\$ 42,039</b>	<b>100.0%</b>	<b>\$ 34,349</b>	<b>100.0%</b>

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For the three months ended March 31, 2013 and 2012, sales by our subsidiaries located outside North America comprised 42.6% and 51.5%, respectively, of our total revenue. The decrease in foreign revenue as a percentage of total revenue, is mainly a function of increased U.S. revenue. We expect that sales by our international subsidiaries will continue to represent a substantial portion of our revenue for the foreseeable future. Future international revenue will depend on the continued use and expansion of the use of our text imaging solutions worldwide.

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We derive a majority of our revenue from a limited number of customers, in particular manufacturers of laser printers and mobile phones. For the three months ended March 31, 2013 and 2012, our top ten licensees by revenue accounted for approximately 40.4% and 46.0% of our total revenue, respectively. Although no one customer accounted for more than 10% of our total revenue for the three months ended March 31, 2013 or 2012, if we are unable to maintain relationships with major customers or establish relationships with new customers, our licensing revenue will be adversely affected.

### *Creative Professional Revenue*

Our Creative Professional revenue is derived from font licenses, font related services and from custom font design services. We license fonts directly to end-users through our e-commerce websites, via telephone, email and indirectly through third-party resellers. Font related services refer to our web font services and the web design tools from our latest acquisition, Design by Front. We also license fonts and provide custom font design services to graphic designers, advertising agencies, media organizations and corporations. We refer to direct, indirect and custom revenue, as non-web revenue, and refer to revenue that is derived from our websites, as web revenue.

Revenue from font licenses to our e-commerce customers is recognized upon payment by the customer and electronic shipment of the software embodying the font. Revenue from font licenses to other customers is recognized upon shipment of the software embodying the font and when all other revenue recognition criteria have been met. Revenue from resellers is recognized upon notification from the reseller that our font product has been licensed and when all other revenue recognition criteria have been met. Custom font design services are generally recognized upon delivery. Font related service revenue is mainly subscription based and, from time to time, it may contain software as a service. The subscription revenue is recognized ratably over the subscription period. Web server and commercial rights to online fonts is recurring revenue and is recognized upon payment by the customer and proof of font delivery. Contract accounting is used where services are deemed essential to the software.

### *OEM Revenue*

Our OEM revenue is derived substantially from per-unit royalties received for printer imaging and printer driver, or printer products, and display imaging products. Under our licensing arrangements we typically receive a royalty for each product unit incorporating our text imaging solutions that is shipped by our OEM customers. We also receive OEM revenue from fixed fee licenses with certain of our OEM customers. Fixed fee licensing arrangements are not based on units the customer ships, but instead, customers pay us on a periodic basis for use of our typefaces and technology. Although significantly less than royalties from per-unit shipments and fixed fees from OEM customers, we also receive revenue from software application and operating systems vendors, who include our typefaces and technology in their products, and for font development. Many of our per-unit royalty licenses continue for the duration that our OEM customers ship products that include our technology, unless terminated for breach. Other licenses have terms that typically range from three to five years, and usually provide for automatic or optional renewals. We recognize revenue from per-unit royalties in the period during which we receive a royalty report from a customer, typically one quarter after royalty-bearing units are shipped, as we do not have the ability to estimate the number of units shipped by our customers. Revenue from fixed fee licenses is generally recognized when it is billed to the customer, so long as the product has been delivered, the license fee is fixed and non-refundable and collection is probable.

### *Cost of Revenue*

Our cost of revenue consists of font license fees that we pay on certain fonts that are owned by third parties, allocated internal engineering expense and overhead costs directly related to custom design services. License fees that we pay to third parties are typically based on a percentage of our Creative Professional and OEM revenue and do not involve minimum fees. Our cost of OEM revenue is typically lower than our cost of Creative Professional revenue because we own a higher percentage of the fonts licensed to our OEM customers, provide value-added technology and have negotiated lower royalty rates on the fonts we license from third parties because of volume. The cost of our custom design service revenue is substantially higher than the cost of our other revenue and, as a result, our gross margin varies from period-to-period depending on the level of custom design revenue recorded.

Cost of revenue also includes amortization of acquired technology, which we amortize over 8 to 15 years. For purposes of amortizing acquired technology we estimate the remaining useful life of the technology based upon various considerations, including our knowledge of the technology and the way our customers use it. We use the straight-line method to amortize our acquired technology. There is no reliable evidence to suggest that we should expect any other pattern of amortization than an even pattern, and we believe this best reflects the expected pattern of economic usage.

### *Gross Profit*



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Our gross profit percentage is influenced by a number of factors including product mix, pricing and volume at any particular time. However, our cost of OEM revenue is typically lower than our cost of Creative Professional revenue because we own a higher percentage of the fonts licensed to our OEM customers, provide value-added technology and have negotiated lower royalty rates on

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the fonts we license from third parties because of volume. Within our Creative Professional business, the cost of our custom design service revenue is substantially higher than the cost of our other revenue. As a result, our gross profit varies from period-to-period depending on the mix between, and within, Creative Professional and OEM revenue.

**Critical Accounting Policies**

The preparation of financial statements and related disclosures in conformity with GAAP and our discussion and analysis of our financial condition and results of operations requires us to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates.

There has been no material change in our critical accounting policies since December 31, 2012. Information about our critical accounting policies may be found in Management's Discussion and Analysis of Financial Condition and Results of Operations, under the heading Critical Accounting Policies, included in our Annual Report on Form 10-K for the year ended December 31, 2012.

**Results of Operations for the Three Months Ended March 31, 2013 Compared to Three Months Ended March 31, 2012**

The following table sets forth items in the unaudited consolidated quarterly statement of operations as a percentage of sales for the periods indicated:

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Revenue:</b>		
Creative Professional	36.5%	28.3%
OEM	63.5	71.7
Total revenue	100.0	100.0
Cost of revenue	14.3	10.7
Cost of revenue - amortization of acquired technology	2.7	2.3
Total cost of revenue	17.0	13.0
Gross profit	83.0	87.0
Marketing and selling	23.6	27.0
Research and development	11.8	12.6
General and administrative	11.2	14.3
Amortization of other intangible assets	3.6	3.6
Total operating expenses	50.2	57.5
Income from operations	32.8	29.5
Interest expense, net	1.0	1.3
Loss (gain) on foreign exchange	1.4	0.8
Loss on derivatives		0.4
Other	(0.1)	
Total other expenses	2.3	2.5
Income before provision for income taxes	30.5	27.0
Provision for income taxes	10.0	10.3
Net income	20.5%	16.7%

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The following discussion compares the three months ended March 31, 2013 with the three months ended March 31, 2012.

**Table of Contents***Sales by Market*

We view our operations and manage our business as one segment: the development, marketing and licensing of technologies and fonts. Factors used to identify our single segment include the financial information available for evaluation by our chief operating decision maker in making decisions about how to allocate resources and assess performance. While our technologies and services are sold to customers in two principal markets, Creative Professional and CE device manufacturers and independent software vendors, together OEM, expenses and assets are not formally allocated to these markets, and operating results are assessed on an aggregate basis to make decisions about the allocation of resources. The following table presents revenue for these two principal markets (in thousands):

	Three Months Ended		
	March 31,		
	2013	2012	Increase
Creative Professional	\$ 15,332	\$ 9,705	\$ 5,627
OEM	26,707	24,644	2,063
Total revenue	\$ 42,039	\$ 34,349	\$ 7,690

*Revenue*

Revenue was \$42.0 million and \$34.3 million for the three months ended March 31, 2013 and 2012, respectively, an increase of \$7.7 million, or 22.4%.

Creative Professional revenue increased \$5.6 million, or 58.0%, to \$15.3 million for the three months ended March 31, 2013, as compared to \$9.7 million for the three months ended March 31, 2012, mainly due to an increase in web revenue. Web revenue increased in the first quarter of 2013, as compared to the same period in 2012, mainly due to the acquisition of Bitstream, together with increased sales of our web font services. This was partially offset by a decrease in custom revenue, due to the timing of custom work over the same period.

OEM revenue was \$26.7 million and \$24.6 million for the three months ended March 31, 2013 and 2012, respectively, an increase of \$2.1 million, or 8.4%, mainly due to increased revenue from per unit royalty arrangements with our printer and display based consumer electronic OEM customers. This increase was partially offset by a reduction of revenue from our independent software vendor customers.

*Cost of Revenue and Gross Profit*

Cost of revenue, excluding amortization of acquired technology, was \$6.0 million and \$3.7 million in the three months ended March 31, 2013 and 2012, respectively. Cost of revenue, excluding amortization of acquired technology, was 14.3% and 10.7% of total revenue in the three months ended March 31, 2013 and 2012, respectively. The increase in cost of revenue, excluding amortization of acquired technology, was mainly due to variations in product mix. Bitstream's web business sells a higher proportion of third party fonts, which carries a higher cost of revenue. In the three months ended March 31, 2013, there was a full quarter of Bitstream's web revenue, as compared to the same period in 2012, which included less than one month of Bitstream revenue.

The portion of cost of revenue consisting of amortization of acquired technology was \$1.1 million and \$0.8 million for the three months ended March 31, 2013 and 2012, respectively, an increase of \$0.3 million, or 43.1%, mainly due to our acquisitions of Bitstream and Design by Front.

Gross profit decreased 4.0 percentage points to 83.0% in the three months ended March 31, 2013, as compared to 87.0% in the three months ended March 31, 2012, mainly the result of product mix. Creative Professional revenue, which typically has a lower gross profit than our OEM revenue, represented 36.5% of our total revenue in the three months ended March 31, 2013, as compared to 28.3% in the same period in 2012, mainly due to our acquisition of Bitstream.

*Operating Expenses*

*Marketing and Selling.* Marketing and selling expense was \$9.9 million and \$9.3 million in the three months ended March 31, 2013 and 2012, respectively, an increase of \$0.6 million, or 7.0%, mainly due to a full quarter of Bitstream expenses in 2013. Various expenses mainly related to the increased volume of sales, such as processing fees and other charges on web sales contributed \$0.4 million to the increase. Personnel

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expenses increased \$0.2 million due to a full quarter of Bitstream and due to annual salary increases. Increased spending in other areas, such as in corporate marketing for website design work, was offset by decreases in online advertising expense.

*Research and Development.* Research and development expense increased \$0.7 million, or 14.5%, to \$5.0 million in the three months ended March 31, 2013, as compared to \$4.3 million in the three months ended March 31, 2012. Personnel expenses increased \$0.4 million in the first quarter of 2013, as compared to the same period in 2012, partially due to a full quarter of Bitstream and partially due to annual pay increases.

*General and Administrative.* General and administrative expense was \$4.7 million and \$4.9 million in the three months ended March 31, 2013 and 2012, respectively, a decrease of \$0.2 million or 4.5%. Professional service expense decreased \$0.3 million in the first quarter of 2013, as compared to the same period in 2012, primarily a result of transaction costs incurred in 2012 associated with our Bitstream acquisition. This was partially offset by a \$0.1 million increase in personnel expenses in the three months ended March 31, 2013, as compared to the same period in 2012.

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*Amortization of Other Intangible Assets.* Amortization of other intangible assets was \$1.5 million for the three months ended March 31, 2013, as compared to \$1.2 million for the three months ended March 31, 2012, an increase of \$0.3 million, or 22.0%, mainly due to our acquisitions of Bitstream and Design by Front.

*Interest Expense, Net*

Interest expense, net of interest income was unchanged at \$0.4 million for the three months ended March 31, 2013 and 2012. Interest expense increased in the first quarter of 2013, as compared to the same quarter in 2012, due to the accretion of the contingent consideration payable in connection with our acquisition of Design by Front. This liability was recognized at its net present value on the acquisition date and is accreted through interest expense. There was no similar item in the three months ended March 31, 2012. This increase was offset by a decrease in interest expense on our outstanding debt, which resulted from decreased debt outstanding. Our total average debt outstanding in the three months ended March 31, 2013 was \$18.3 million, as compared to \$38.6 million at March 31, 2012.

*Loss on Foreign Exchange*

Loss on foreign exchange was \$0.6 million and \$0.3 million in the three months ended March 31, 2013 and 2012, respectively, an increase of \$0.3 million. In the three months ended March 31, 2013, as compared to the same period in 2012, the increased loss was due primarily to the revaluation of liabilities incurred in the acquisition of Design by Front.

*Loss on Derivatives*

Loss on derivatives was \$0.1 million in the three months ended March 31, 2012, primarily due to our currency swap instrument. The currency swap matured in December 2012. There was no similar item in the three months ended March 31, 2013, as there were no outstanding derivative contracts.

*Provision for Income Taxes*

For the three months ended March 31, 2013 and 2012, our effective tax rate was 32.9% and 38.5%, respectively. The effective tax rate for the three months ended March 31, 2013 includes a benefit of 2.5% related to the 2012 and 2013 federal research credit. This benefit did not exist at March 31, 2012, as the federal research credit was not extended until January 2013. The effective tax rate for the three months ended March 31, 2012, included amounts related to non-deductible expenses and increases in deferred state taxes, as a result of the Bitstream acquisition, which resulted in an increase of 2.9% to the March 31, 2012 rate, as compared the March 31, 2013 tax rate.

The effective tax rate for the three months ended March 31, 2013 rate is lower than the federal statutory rate of 35% primarily as a result of the federal research tax credit and stock compensation benefits, offset by state income taxes.

***Liquidity and Capital Resources***

*Cash Flows for the Three Months Ended March 31, 2013 and 2012*

Since our inception, we have financed our operations primarily through cash from operations, private and public stock sales and long-term debt arrangements, as described below. We believe our existing cash and cash equivalents, our cash flow from operating activities and available bank borrowings will be sufficient to meet our anticipated cash needs for at least the next twelve months. At March 31, 2013, our principal sources of liquidity were cash and cash equivalents totaling \$43.0 million and a \$120.0 million revolving credit facility, of which \$12.3 million was outstanding at March 31, 2013. Our future working capital requirements will depend on many factors, including the operations of our existing business, our potential strategic expansion and future acquisitions we might undertake. To the extent that our cash and cash equivalents, our current debt arrangements and our cash flow from operating activities are insufficient to fund our future activities, we may need to raise additional funds through bank credit arrangements or public or private equity or debt financings.

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The following table presents our cash flows from operating activities, investing activities and financing activities for the periods presented (in thousands):

	Three Months Ended March 31,	
	2013	2012
Net cash provided by operating activities	\$ 6,731	\$ 8,029
Net cash used in investing activities	(460)	(49,595)
Net cash (used in) provided by financing activities	(2,485)	15,755
Effect of exchange rates on cash and cash equivalents	(143)	38
<b>Total increase (decrease) in cash and cash equivalents</b>	<b>\$ 3,643</b>	<b>\$ (25,773)</b>

*Operating Activities*

Significant variations in operating cash flows may occur because, from time-to-time, our customers make prepayments against future royalties. Prepayments may be required under the terms of our license agreements and are occasionally made on an elective basis and often cause large fluctuations in accounts receivable and deferred revenue. The timing and extent of such prepayments significantly impacts our cash balances.

We generated \$6.7 million in cash from operations during the three months ended March 31, 2013. Net income, after adjusting for depreciation and amortization, loss on retirement of fixed assets, amortization of deferred financing costs, share based compensation, excess tax benefit on stock options, provision for doubtful accounts, deferred income taxes and unrealized currency gain on foreign denominated intercompany transactions generated \$13.4 million in cash. Increased accounts receivable and decreased deferred revenue used \$2.1 million in cash, mainly due to timing of customer payments. Accrued income taxes used \$1.3 million during the quarter ended March 31, 2013. Increased prepaid expenses, decreased accounts payable and decreased accrued expenses used \$3.3 million in cash, primarily a result of the payment of 2012 accrued variable compensation amounts.

We generated \$8.0 million in cash from operations during the three months ended March 31, 2012. Net income, after adjusting for depreciation and amortization, amortization of deferred financing costs, share based compensation, excess tax benefit on stock options, provision for doubtful accounts, deferred income taxes, unrealized currency gain on foreign denominated intercompany transactions, and unrealized loss on derivatives generated \$9.8 million in cash. Collections on accounts receivable, decreased income tax receivable, increased accrued income taxes and increased deferred revenue generated \$2.2 million in cash. Increased prepaid expenses, decreased accounts payable and decreased accrued expenses used \$4.0 million in cash, primarily a result of the payment of 2011 accrued variable compensation amounts.

*Investing Activities*

During the three months ended March 31, 2013 we used \$0.5 million mainly for the purchase of property and equipment. During the three months ended March 31, 2012, we used \$49.6 million in cash for investing activities, mainly as a result of our acquisition of Bitstream, which used a total of \$46.5 million, net of cash acquired, and \$2.6 million for restricted cash, which represented the portion of the purchase price for which Bitstream's shareholders have not yet tendered their shares. We used \$0.5 million in cash for the purchase of property and equipment, an exclusive license and other intangible assets during the three months ended March 31, 2012.

*Financing Activities*

Cash used in financing activities for the three months ended March 31, 2013 was \$2.5 million. Payments on long-term debt amounted to \$10.0 million. In addition, we paid out a cash dividend of \$1.5 million. We had a significant amount of employee stock option exercises during the three months ended March 31, 2013, which resulted in \$9.0 million in proceeds from the exercise of common stock options and excess tax benefit on stock options.

Cash provided by financing activities for the three months ended March 31, 2012, was \$15.8 million. Borrowings against our revolving Credit Facility amounted to \$25.0 million to partially fund our acquisition of Bitstream, which was offset by a \$10.0 million repayment earlier in the quarter. We received cash from exercises of stock options of \$0.4 million and excess tax benefit on stock options provided \$0.4 million.

*Dividends*

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On February 12, 2013 our Board of Directors approved a \$0.06 per share or \$2.3 million, quarterly cash dividend on our outstanding common stock. The record date was April 1, 2013 and the dividend was paid to shareholders on April 19, 2013. We anticipate this to be a recurring quarterly dividend with future payments and record dates, subject to board approval. On April 29, 2013, our Board of Directors approved a \$0.06 per share quarterly cash dividend on our outstanding common stock. The record date is set for July 1, 2013 and the dividend is payable to shareholders of record on July 19, 2013.



**Table of Contents****Credit Facility**

On July 13, 2011, we entered into a five-year \$120.0 million revolving credit facility (the Credit Facility). Borrowings under the Credit Facility bear interest based on the leverage ratio at either (i) the prime rate plus 1.25%, as defined in the credit agreement, or (ii) LIBOR plus 2.25%. The Company is required to pay an unused line fee equal to 0.375% per annum on the undrawn portion available under the revolving credit facility and variable per annum fees in respect of outstanding letters of credit. As of March 31, 2013, the blended interest rate on the Credit Facility was 3.0%. There are no required repayments. The Company, in accordance with the Credit Facility, is permitted to request that the Lenders, at their election, increase the secured credit facility to a maximum of \$140.0 million.

In addition, the Credit Facility provides that we not exceed a maximum leverage ratio. The leverage ratio is defined as the ratio of aggregate outstanding indebtedness to trailing twelve months Adjusted EBITDA. Adjusted EBITDA is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation expense, plus restructuring, issuance costs, cash non-operating costs and other expenses or losses minus cash non-operating gains and other non-cash gains; provided however that the aggregate of all cash non-operating expense shall not exceed \$250 thousand and all such fees, costs and expenses shall not exceed \$1.5 million on a trailing twelve months basis.

Additional limits are imposed on acquisition related expenses. We also must maintain a minimum fixed charge ratio. As of March 31, 2013, the maximum leverage ratio permitted was 3.00:1.00 and our leverage ratio was 0.18:1.00 and the minimum fixed charge coverage ratio was 1.25:1.00 and our fixed charge ratio was 4.11:1.00. Failure to comply with these covenants, or the occurrence of an event of default, could permit the Lenders under the Credit Facility to declare all amounts borrowed under the Credit Facility, together with accrued interest and fees, to be immediately due and payable. In addition, the Credit Facility is secured by substantially all of our assets and places limits on the Company's and its subsidiaries' ability to incur debt or liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, engage in mergers, acquisitions and asset sales, transact with affiliates and alter its business.

The following table presents a reconciliation from net income, which is the most directly comparable GAAP operating performance measure, to EBITDA and from EBITDA to Adjusted EBITDA as defined in our credit facilities (in thousands):

	Three Months Ended	
	March 31,	
	2013	2012
Net income	\$ 8,616	\$ 5,720
Provision for income taxes	4,231	3,587
Interest expense, net	418	444
Depreciation and amortization	2,997	2,333
<b>EBITDA</b>	<b>\$ 16,262</b>	<b>\$ 12,084</b>
Share based compensation	1,749	1,923
Non-cash add backs		129
Restructuring, issuance and cash non-operating costs <sup>(2)</sup>	94	(74)
Acquisition expenses		453
<b>Adjusted EBITDA<sup>(1)</sup></b>	<b>\$ 18,105</b>	<b>\$ 14,515</b>

- (1) Adjusted EBITDA is not a measure of operating performance under GAAP and should not be considered as an alternative or substitute for GAAP profitability measures such as income from operations and net income. Adjusted EBITDA as an operating performance measure has material limitations since it excludes the statement of income impact of depreciation and amortization expense, interest expense, net, the provision for income taxes and share based compensation and therefore does not represent an accurate measure of profitability, particularly in situations where a company is highly leveraged or has a disadvantageous tax structure. We have significant intangible assets and amortization expense is a meaningful element in our financial statements and therefore its exclusion from Adjusted EBITDA is a material limitation. We have a significant amount of debt, and interest expense is a necessary element of our costs and therefore its exclusion from Adjusted EBITDA is a material limitation. We generally incur significant U.S. federal, state and foreign income taxes each year and the provision for income taxes is a necessary element of our costs and therefore its exclusion from Adjusted EBITDA is a

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material limitation. We have share based compensation and the associated expense is a meaningful element in our financial statements and therefore its exclusion from Adjusted EBITDA is a material limitation. Non-cash expenses, restructuring, issuance and cash non-operating expenses have a meaningful impact on our financial statements. Therefore, their exclusion from Adjusted EBITDA is a material limitation. As a result, Adjusted EBITDA should be evaluated in conjunction with net income for complete analysis of our profitability, as net income includes the financial statement impact of these items and is the most directly comparable GAAP operating performance

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measure to Adjusted EBITDA. As Adjusted EBITDA is not defined by GAAP, our definition of Adjusted EBITDA may differ from and therefore may not be comparable to similarly titled measures used by other companies, thereby limiting its usefulness as a comparative measure. Because of the limitations that Adjusted EBITDA has as an analytical tool, investors should not consider it in isolation, or as a substitute for analysis of our operating results as reported under GAAP.

- (2) Permits an add-back of up to \$250 thousand of cash non-operating expense, which is not to exceed \$1.5 million when combined together with restructuring and issuance costs.

The Credit Facility also contains provisions for an increased interest rate during periods of default. We do not believe that these covenants will affect our ability to operate our business, and we were in compliance with all covenants under our Credit Facility as of March 31, 2013.

**Non-GAAP Measures**

In our quarterly earnings press releases and conference calls, in addition to Adjusted EBITDA as discussed above, we discuss a key measure that is not calculated according to GAAP. This non-GAAP measure is net adjusted EBITDA, which is defined as income (loss) from operations before depreciation, amortization of acquired intangible assets and share based compensation expenses. We use net adjusted EBITDA as a principal indicator of the operating performance of our business. We use net adjusted EBITDA in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our board of directors, determining bonus compensation for our employees based on operating performance and evaluating short-term and long-term operating trends in our operations. We believe that net adjusted EBITDA permits a comparative assessment of our operating performance, relative to our performance based on our GAAP results, while isolating the effects of charges that may vary from period-to-period without direct correlation to underlying operating performance. We believe that these non-GAAP financial adjustments are useful to investors because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making. We believe that trends in our net adjusted EBITDA may be valuable indicators of our operating performance.

The following table presents a reconciliation from income from operations, which is the most directly comparable GAAP operating financial measure, to net adjusted EBITDA as used by management (in thousands):

	<b>Three Months Ending</b>	
	<b>March 31,</b>	
	<b>2013</b>	<b>2012</b>
Income from operations	\$ 13,806	\$ 10,133
Depreciation and amortization	2,997	2,333
Share based compensation	1,749	1,923
Net adjusted EBITDA <sup>(1)</sup>	\$ 18,552	\$ 14,389

- (1) Net adjusted EBITDA is not a measure of operating performance under GAAP and should not be considered as an alternative or substitute for GAAP profitability measures such as income (loss) from operations and net income (loss). Net adjusted EBITDA as an operating performance measure has material limitations since it excludes the statement of income impact of depreciation and amortization expense and share based compensation and therefore does not represent an accurate measure of profitability. We have significant intangible assets and amortization expense is a meaningful element in our financial statements and therefore its exclusion from net adjusted EBITDA is a material limitation. Share based compensation and the associated expense has a meaningful impact on our financial statements and therefore its exclusion from net adjusted EBITDA is a material limitation. As a result, net adjusted EBITDA should be evaluated in conjunction with income (loss) from operations for complete analysis of our profitability, as income (loss) from operations includes the financial statement impact of these items and is the most directly comparable GAAP operating performance measure to net adjusted EBITDA. As net adjusted EBITDA is not defined by GAAP, our definition of net adjusted EBITDA may differ from and therefore may not be comparable to similarly titled measures used by other companies, thereby limiting its usefulness as a comparative measure. Because of the limitations that net adjusted EBITDA has as an analytical tool, investors should not consider it in isolation, or as a substitute for analysis of our operating results as reported under GAAP.

In our quarterly earnings press releases and conference calls, in addition to Adjusted EBITDA and net adjusted EBITDA as discussed above, we discuss another key measure that is not calculated according to GAAP. This non-GAAP measure is non-GAAP earnings per diluted share, which is defined as earnings per diluted share before amortization of acquired intangible assets and stock-based compensation expenses. We use non-GAAP earnings per diluted share as one of our principal indicators of the operating performance of our business. We use non-GAAP earnings per diluted shares in internal forecasts, supplementing the financial results and forecasts reported to our board of directors and

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evaluating short-term and long-term operating trends in our operations. We believe that non-GAAP earnings per diluted share permits a comparative assessment of our operating performance, relative to our performance based on our GAAP results, while isolating the effects of charges that may vary from period-to-period without direct correlation to underlying operating performance. We believe that these non-GAAP financial adjustments are useful to investors

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because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making. We believe that trends in our non-GAAP earnings per diluted share may be valuable indicators of our operating performance.

The following table presents a reconciliation from earnings per diluted share, which is the most directly comparable GAAP measure, to non-GAAP earnings per diluted share as used by management:

	<b>Three Months Ending</b>	
	<b>March 31,</b>	
	<b>2013</b>	<b>2012</b>
GAAP earnings per diluted share	\$ 0.22	\$ 0.15
Amortization, net of tax	0.05	0.04
Share based compensation, net of tax	0.03	0.03
Non-GAAP earnings per diluted share <sup>(1)</sup>	\$ 0.30	\$ 0.22

- (1) Non-GAAP earnings per diluted share is not a measure of operating performance under GAAP and should not be considered as an alternative or substitute for GAAP profitability measures such as earnings per share and earnings per diluted share. Non-GAAP earnings per diluted share as an operating performance measure has material limitations since it excludes the statement of income impact of amortization expense and share based compensation, and therefore, does not represent an accurate measure of profitability. We have significant intangible assets and amortization expense is a meaningful element in our financial statements and therefore its exclusion from non-GAAP earnings per diluted share is a material limitation. Share based compensation and the associated expense has a meaningful impact on our financial statements and therefore its exclusion from non-GAAP diluted earnings per share is a material limitation. As a result, non-GAAP earnings per diluted share should be evaluated in conjunction with earnings per diluted share for complete analysis of our profitability, as earnings per diluted share includes the financial statement impact of these items and is the most directly comparable GAAP operating performance measure to non-GAAP earnings per diluted share. As non-GAAP earnings per diluted share is not defined by GAAP, our definition of non-GAAP earnings per diluted share may differ from and therefore may not be comparable to similarly titled measures used by other companies, thereby limiting its usefulness as a comparative measure. Because of the limitations that non-GAAP earnings per share has as an analytical tool, investors should not consider it in isolation, or as a substitute for analysis of our operating results as reported under GAAP.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to financial market risk, including interest rate risk and foreign currency exchange risk.

***Concentration of Revenue and Credit Risk***

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables. Cash equivalents consist primarily of bank deposits and certain investments, such as commercial paper, corporate debt and municipal securities, with maturities less than 90 days. Deposits of cash held outside the United States totaled approximately \$3.7 million and \$3.1 million at March 31, 2013 and December 31, 2012, respectively.

We grant credit to customers in the ordinary course of business. Credit evaluations are performed on an ongoing basis to reduce credit risk, and no collateral is required from our customers. An allowance for uncollectible accounts is provided for those accounts receivable considered to be uncollectible based upon historical experience and credit evaluation. As of March 31, 2013, one customer individually accounted for 26% of our gross accounts receivable. As of December 31, 2012, one customer individually accounted for 10% of our gross accounts receivable. Due to the nature of our quarterly revenue streams derived from royalty revenue, it is not unusual for our accounts receivable balances to include a few customers with large balances. Historically, we have not recorded material losses due to customers' nonpayment.

For the three months ended March 31, 2013 and 2012, no customer accounted for more than 10% of our revenue.

***Derivative Financial Instruments and Interest Rate Risk***

We use interest rate derivative instruments to hedge our exposure to interest rate volatility resulting from our variable rate debt. ASC Topic No. 815, *Derivatives and Hedging*, or ASC 815, requires that all derivative instruments be reported on the balance sheet at fair value and establishes criteria for designation and effectiveness of hedging relationships, including a requirement that all designations must be made at the inception of each instrument. As we did not make such initial designations, ASC 815 requires changes in the fair value of the derivative instrument to be recognized as current period income or expense.

The fair value of derivative instruments is estimated based on the amount that we would receive or pay to terminate the agreements at the reporting date. Our exposure to market risk associated with changes in interest rates relates primarily to our long-

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term debt. The interest rate on our Credit Facility fluctuates with the prime rate and LIBOR interest rate. At March 31, 2013, the blended rate of interest on our outstanding debt was 3.0%. For each one percent increase in interest rates our interest expense would increase by \$0.1 million. Historically, we have purchased interest rate swap instruments to hedge our exposure to interest rate fluctuations on our debt obligations. On May 24, 2010, we entered into a long term interest rate swap contract to pay a fixed rate of interest of 1.5% in exchange for a floating rate interest payment tied to the one-month LIBOR beginning January 2011. The contract had a notional amount of \$30.0 million and matured on July 30, 2012; accordingly, in the three months ended March 31, 2013, there was no gain or loss. In the three months ended March 31, 2012, we recognized a loss of \$21 thousand, which was included in loss on derivatives in the accompanying condensed consolidated statement of income.

***Foreign Currency Exchange Rate Risk***

In accordance with ASC Topic No. 830, *Foreign Currency Matters*, or ASC 830, all assets and liabilities of our foreign subsidiaries whose functional currency is a currency other than U.S. dollars are translated into U.S. dollars at an exchange rate as of the balance sheet date. Revenue and expenses of these subsidiaries are translated at the average monthly exchange rates. The resulting translation adjustments as calculated from the translation of our foreign subsidiaries to U.S. dollars are recorded as a separate component of stockholders' equity.

We incurred foreign currency exchange rate gains and losses on an intercompany note with one of our foreign subsidiaries that was denominated in Euros, which matured on December 14, 2012. During the three months ended March 31, 2012, we incurred a gain of \$0.1 million on the intercompany note, which was included in loss on foreign exchange in our accompanying consolidated statement of income. On May 7, 2008, we entered into a long term currency swap contract to purchase 18.3 million Euros in exchange for \$28.0 million to mitigate our exposure to currency fluctuation risk on this note. The contract payment terms approximated the payment terms of this intercompany note and the notional amount was amortized down over time as payments were made. The contract matured on December 14, 2012. For the three months ended March 31, 2012, we recognized a loss of \$0.1 million, which is included in loss on derivatives in the accompanying condensed consolidated statements of income.

**Item 4. Controls and Procedures**

***Evaluation of Disclosure Controls and Procedures***

Our management, with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2013. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our disclosure controls and procedures are designed to provide a reasonable assurance of achieving their objectives.

Based on the evaluation of our disclosure controls and procedures as of March 31, 2013, our principal executive officer and principal financial officer concluded that, as of such date, the Company's disclosure controls and procedures were effective at the reasonable assurance level.

***Changes in Internal Control Over Financial Reporting***

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended March 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Part II OTHER INFORMATION**

**Item 1. Legal Proceedings**

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From time to time, we may be a party to various claims, suits and complaints. We are not currently a party to any legal proceedings that, if determined adversely to us, would have a material adverse effect on our business, results of operations or financial condition.



**Table of Contents****Item 1A. Risk Factors**

There are no material changes in our risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****(a) Unregistered Sales of Equity Securities**

None.

**(b) Use of proceeds**

Not applicable.

**(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following table provides information about purchases by the Company during the quarter ended March 31, 2013 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

**Monotype Imaging Holdings Inc. Purchases of Equity Securities**

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number (or Approximate Dollar Value) of Shares that May Yet be Purchased Under the Plans or Programs</b>
January 1, 2013 to January 31, 2013				
February 1, 2013 to February 28, 2013				
March 1, 2013 to March 31, 2013 <sup>(1)</sup>	250	0.00		
Total	250	\$ 0.00		

- (1) The Company repurchased unvested restricted stock in accordance with the Amended and Restated 2007 Stock Option and Incentive Plan (the 2007 Stock Option Plan). The price paid by the Company was determined pursuant to the terms of the 2007 Stock Option Plan and related restricted stock agreement.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MONOTYPE IMAGING HOLDINGS INC.**

Date: May 1, 2013

By: */s/ DOUGLAS J. SHAW*  
**Douglas J. Shaw**  
**President, Chief Executive Officer and Director**  
**(Principal Executive Officer)**

Date: May 1, 2013

By: */s/ SCOTT E. LANDERS*  
**Scott E. Landers**  
**Senior Vice President, Chief Financial Officer,**  
**Treasurer and Assistant**  
**Secretary (Principal Financial Officer)**

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**EXHIBIT INDEX**

Listed and indexed below are all exhibits filed as part of this report.

<b>Exhibit</b>	
<b>No.</b>	<b>Description</b>
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer.*
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, by Chief Financial Officer.*
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer and Chief Financial Officer.***
101.INS	XBRL Instance Document**
101.SCH	XBRL Taxonomy Extension Schema Document**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document **
101.LAB	XBRL Taxonomy Extension Label Linkbase Document**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document**

\* Filed herewith.

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

\*\*\* Furnished herewith.