

Monotype Imaging Holdings Inc.

Form 10-Q

November 02, 2015

[Table of Contents](#)

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 September 30, 2015

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)

Delaware
(State of incorporation)

20-3289482
(I.R.S. Employer

Identification No.)

600 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

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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 October 26, 2015 was 39,906,001.

Table of Contents

MONOTYPE IMAGING HOLDINGS INC.

INDEX

	Page
<u>Part I. Financial Information</u>	2
<i>Item 1.</i> <u>Consolidated Financial Statements (Unaudited)</u>	2
<u>Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014</u>	2
<u>Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2015 and 2014</u>	3
<u>Condensed Consolidated Statement of Comprehensive Income for the three and nine months ended September 30, 2015 and 2014</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<i>Item 2.</i> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
<i>Item 3.</i> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
<i>Item 4.</i> <u>Controls and Procedures</u>	31
<u>Part II. Other Information</u>	32
<i>Item 1.</i> <u>Legal Proceedings</u>	32
<i>Item 1A.</i> <u>Risk Factors</u>	32
<i>Item 2.</i> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	32
<i>Item 3.</i> <u>Defaults Upon Senior Securities</u>	32
<i>Item 4.</i> <u>Mine Safety Disclosures</u>	32
<i>Item 5.</i> <u>Other Information</u>	33
<i>Item 6.</i> <u>Exhibits</u>	33
<u>Signatures</u>	34
<u>Exhibit Index</u>	35

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)**

	September 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 86,315	\$ 90,325
Accounts receivable, net of allowance for doubtful accounts of \$300 at September 30, 2015 and \$164 at December 31, 2014	18,460	9,279
Income tax refunds receivable	2,845	2,593
Deferred income taxes	2,409	2,898
Prepaid expense and other current assets	3,590	4,361
Total current assets	113,619	109,456
Property and equipment, net	15,305	10,578
Goodwill	187,136	176,999
Intangible assets, net	71,611	73,862
Other assets	2,490	3,563
Total assets	\$ 390,161	\$ 374,458
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 1,779	\$ 1,156
Accrued expenses and other current liabilities	21,775	24,570
Accrued income taxes payable	1,069	640
Deferred revenue	11,180	7,107
Total current liabilities	35,803	33,473
Other long-term liabilities	3,655	2,326
Contingent acquisition consideration	5,055	270
Deferred income taxes	35,218	32,960
Reserve for income taxes, net of current portion	3,392	4,637
Accrued pension benefits	5,418	5,679
Commitments and contingencies (<i>Note 15</i>)		
Stockholders equity:		

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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:

41,875,191 shares at September 30, 2015 and 40,770,197 shares at December 31, 2014

Additional paid-in capital	41	39
Treasury stock, at cost, 1,991,848 shares at September 30, 2015 and 1,303,737 shares at December 31, 2014	250,764	232,522
Retained earnings	(50,455)	(31,946)
Accumulated other comprehensive loss	108,013	98,672
	(6,743)	(4,174)
Total stockholders' equity	301,620	295,113
Total liabilities and stockholders' equity	\$ 390,161	\$ 374,458

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenue	\$ 49,352	\$ 47,063	\$ 141,803	\$ 138,098
Costs and expenses:				
Cost of revenue	7,351	7,227	22,314	21,057
Cost of revenue amortization of acquired technology	1,048	1,144	3,315	3,435
Total cost of revenue	8,399	8,371	25,629	24,492
Gross profit	40,953	38,692	116,174	113,606
Operating expenses:				
Marketing and selling	15,472	13,361	42,980	36,466
Research and development	5,155	5,227	16,244	15,890
General and administrative	8,171	6,491	22,080	18,075
Amortization of other intangible assets	862	1,587	2,354	4,450
Total operating expenses	29,660	26,666	83,658	74,881
Income from operations	11,293	12,026	32,516	38,725
Other (income) expense:				
Interest expense	253	298	801	832
Interest income	(16)	(33)	(26)	(41)
Loss on foreign exchange	44	817	656	987
Gain on derivatives	(120)	(247)	(48)	(33)
Loss on extinguishment of debt	112		112	
Other expense, net	6	50	4	46
Total other expense	279	885	1,499	1,791
Income before provision for income taxes	11,014	11,141	31,017	36,934
Provision for income taxes	2,975	4,102	9,717	13,759
Net income	\$ 8,039	\$ 7,039	\$ 21,300	\$ 23,175
Net income available to common shareholders basic	\$ 7,837	\$ 6,899	\$ 20,799	\$ 22,745
	\$ 7,838	\$ 6,899	\$ 20,802	\$ 22,745

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Net income available to common
shareholders diluted

Net income per common share:				
Basic	\$ 0.20	\$ 0.18	\$ 0.54	\$ 0.59
Diluted	\$ 0.20	\$ 0.17	\$ 0.53	\$ 0.57
Weighted average number of shares:				
Basic	38,770,626	38,431,031	38,808,446	38,543,401
Diluted	39,230,783	39,487,302	39,382,558	39,663,807
Dividends declared per common share	\$ 0.10	\$ 0.08	\$ 0.30	\$ 0.24

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

Table of Contents

MONOTYPE IMAGING HOLDINGS INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited and in thousands)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income	\$ 8,039	\$ 7,039	\$ 21,300	\$ 23,175
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(23)	(2,868)	(2,569)	(3,029)
Comprehensive income	\$ 8,016	\$ 4,171	\$ 18,731	\$ 20,146

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)

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities		
Net income	\$ 21,300	\$ 23,175
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,906	9,147
Loss on retirement of fixed assets	20	78
Loss on debt extinguishment	112	
Amortization of deferred financing costs and accreted interest	374	337
Adjustment to contingent consideration		(1,152)
Share based compensation	9,841	7,835
Excess tax benefit on stock options	(1,692)	(3,011)
Provision for doubtful accounts	210	29
Deferred income taxes	2,578	2,202
Unrealized currency loss on foreign denominated intercompany transactions	161	423
Changes in operating assets and liabilities:		
Accounts receivable	(9,385)	(366)
Prepaid expenses and other assets	1,500	934
Accounts payable	653	996
Accrued income taxes payable	1,111	6,493
Accrued expenses and other liabilities	885	(808)
Deferred revenue	4,678	86
Net cash provided by operating activities	40,252	46,398
Cash flows from investing activities		
Purchases of property and equipment	(7,805)	(4,474)
Purchases of exclusive license		(100)
Acquisition of business, net of cash acquired	(14,289)	(10,621)
Net cash used in investing activities	(22,094)	(15,195)
Cash flows from financing activities		
Payment of contingent consideration	(289)	
Purchase of treasury stock	(18,601)	(26,065)
Common stock dividends paid	(11,128)	(8,670)
Excess tax benefit on stock options	1,692	3,011
Proceeds from exercises of common stock options	6,627	5,285

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Net cash used in financing activities	(21,699)	(26,439)
Effect of exchange rates on cash and cash equivalents	(469)	(587)
(Decrease) increase in cash and cash equivalents	(4,010)	4,177
Cash and cash equivalents at beginning of period	90,325	78,411
Cash and cash equivalents at end of period	\$ 86,315	\$ 82,588

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

Table of Contents

MONOTYPE IMAGING HOLDINGS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2015

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 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. Our 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 consumer 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. We also provide 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 consumer 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. We also maintain various offices worldwide for selling and marketing, research and development and administration. We conduct our operations through four domestic operating subsidiaries, Monotype Imaging Inc., Monotype ITC Inc., MyFonts Inc. and Swyft Media Inc., and five foreign operating subsidiaries, Monotype Ltd., Monotype GmbH and its wholly-owned subsidiary, FontShop International Inc., 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 September 30, 2015 and for the three and nine months ended September 30, 2015 and 2014 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, 2014 as reported in the Company s Annual Report on Form 10-K.

The accompanying condensed consolidated financial statements reflect the application of certain significant accounting policies as described below and elsewhere in these notes to the condensed consolidated financial statements. As of September 30, 2015, the Company s significant accounting policies and estimates, which are detailed

in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, have not changed.

3. Recently Issued Accounting Pronouncements

Internal-Use Software

In April 2015, the Financial Accounting Standards Board, or FASB issued ASU 2015-05, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40), Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance will not change GAAP for a customer's accounting for service contracts. The ASU aims to reduce complexity and diversity in practice. The standard is effective for the Company on January 1, 2016, with early adoption permitted. The Company is currently evaluating the impact of the adoption of ASU 2015-03 on its consolidated financial statements.

Table of Contents*Interest*

In April 2015, the FASB, issued ASU 2015-03, *Interest – Imputation of Interest (Subtopic 835-30), Simplifying the Presentation of Debt Issuance Costs*, which provides that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct reduction from the carrying amount of the related debt liability, rather than classifying the costs separately in the balance sheet as a deferred charge. The ASU aims to reduce complexity. The standard is effective for the Company on January 1, 2017. The Company is currently evaluating the impact of the adoption of ASU 2015-03 on its consolidated financial statements, but does not expect the adoption of this standard to have any impact.

Consolidation

In February 2015, the FASB issued updated accounting guidance on consolidation requirements. This update changes the guidance with respect to the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. This guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015, with early adoption permitted. The Company does not expect adoption of this guidance to have a material impact on our financial statements.

Going Concern

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements – Going Concern (Subtopic 205-40); Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*, which requires management of a company to evaluate whether there is substantial doubt about the company’s ability to continue as a going concern. The ASU provides guidance on evaluating an entity’s ability to continue as a going concern and the content of any required footnote disclosure based on that evaluation. The assessment period is one year after the date of the financial statements are issued. The standard is effective for the Company on January 1, 2017. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of ASU 2014-15, but we do not expect the adoption of this standard to have any impact on its consolidated financial statements.

Revenue Recognition

In May 2014, the FASB and the International Accounting Standards Board jointly issued ASU 2014-9, *Revenue from Contracts with Customers (Topic 606)*, which provides a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. This guidance was effective for annual reporting and interim periods beginning after December 15, 2016 and allows for either full retrospective or modified retrospective application, with early adoption not permitted. In August 2015, the FASB deferred the effective date of this guidance; accordingly, the guidance is effective for annual reporting and interim periods beginning after December 15, 2017. Early adoption is permitted for annual and interim periods beginning after December 15, 2016. The Company is currently evaluating the adoption method it will apply and the impact that this guidance will have on its financial statements and related disclosures.

4. Acquisitions*Swyft Media*

On January 30, 2015, the Company purchased all of the outstanding stock of TextPride, Inc. operating under the name of Swyft Media, a privately-held mobile messaging company located in New York, New York. In connection with the

acquisition, TextPride, Inc. was renamed Swyft Media Inc. and became a wholly-owned subsidiary of the registrant. Swyft Media's expertise in the emerging world of branded, in-app mobile messaging content is expected to help Monotype reach new customers, with an opportunity to add value by including some of the world's largest and most popular collections of fonts. The impact of this acquisition was not material to our condensed consolidated financial statements.

The Company acquired Swyft Media for an aggregate purchase price of approximately \$17.0 million, consisting of \$12.1 million in cash, plus contingent consideration of up to \$15.0 million payable through 2018, which had an estimated net present value of \$4.9 million at the date of acquisition. We paid \$11.6 million from cash on hand at the time of the acquisition, net of cash acquired. Of the purchase price, approximately \$4.7 million and \$13.6 million have been allocated to intangible assets and goodwill, respectively. The fair value of the assets acquired and liabilities assumed is less than the purchase price, resulting in the recognition of goodwill. The goodwill reflects the value of the synergies we expect to realize and the assembled workforce. The acquisition of Swyft Media was structured in such a manner that the goodwill is not expected to be deductible for tax purposes. The purchase price has been allocated to the tangible and intangible assets acquired and liabilities assumed based upon the respective estimates of fair value as of the date of the acquisition, which remains preliminary as of September 30, 2015, and using assumptions that the Company's management believes are reasonable given the information currently available. The final allocation of the purchase price to intangible assets, goodwill and deferred tax assets and liabilities may differ materially from the information presented in these condensed

Table of Contents

consolidated financial statements. Twelve employees joined the Company in connection with the acquisition. See Note 6 for additional information on the fair value measurements for all financial assets and liabilities, including contingent consideration, which is measured at fair value on a recurring basis.

5. Derivative Financial Instruments

We incur foreign currency exchange gains and losses related to certain customers that are invoiced in U.S. dollars, but who have the option to make an equivalent payment in their own functional currencies at a specified exchange rate as of a specified date. In the period from that date until payment in the customer's functional currency is received and converted into U.S. dollars, we can incur realized gains and losses. We also incur foreign currency exchange gains and losses on certain intercompany assets and liabilities denominated in foreign currencies. We are currently utilizing 30-day forward contracts to mitigate our exposure on these currency fluctuations. These contracts are generally set to expire and are settled at month end. The instruments are not designated as hedging instruments, and accordingly, the gain or loss is recognized upon cash settlement and is included in loss on derivatives in the accompanying condensed consolidated statements of income. At September 30, 2015 and December 31, 2014 we had one forward foreign exchange contract outstanding which was entered into on those dates. See Note 6 for details regarding the fair value of these instruments.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Currency swaps	\$ (120)	\$ (247)	\$ (48)	\$ (33)
Total	\$ (120)	\$ (247)	\$ (48)	\$ (33)

6. 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 and our own credit risk in its assessment of fair value.

Table of Contents

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):

		Fair Value Measurement at September 30, 2015			
		Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)	
		Significant Unobservable Inputs (Level 3)			
		Total			
Assets:					
Cash equivalents	money market funds	\$ 20,626	\$ 20,626	\$	\$
Cash equivalents	U.S. government and agency securities	1,535		1,535	
Cash equivalents	commercial paper	3,905		3,905	
Cash equivalents	corporate bonds	13,971		13,971	
Total assets		\$ 40,037	\$ 20,626	\$ 19,411	\$
Liabilities:					
Contingent acquisition consideration		\$ 5,055	\$	\$	\$ 5,055
Total liabilities		\$ 5,055	\$	\$	\$ 5,055

		Fair Value Measurement at December 31, 2014			
		Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)	
		Significant Unobservable Inputs (Level 3)			
		Total			
Assets:					
Cash equivalents	money market funds	\$ 34,309	\$ 34,309	\$	\$
Cash equivalents	commercial paper	3,000		3,000	
Cash equivalents	U.S. government and agency securities	2,700		2,700	
Total assets		\$ 40,009	\$ 34,309	\$ 5,700	\$
Liabilities:					
Contingent acquisition consideration		\$ 270	\$	\$ 270	\$
Total liabilities		\$ 270	\$	\$ 270	\$

The Company's recurring fair value measures relate to short-term investments, which are classified as cash equivalents, derivative instruments and contingent consideration. 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 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 September 30, 2015, we had one 30-day forward contract to sell 2.3 million British pound sterling and purchase \$3.4 million that together, had an immaterial fair value. At December 31, 2014, we had one 30-day forward contract outstanding to sell 2.3 million British pound sterling and purchase \$3.5 million that together, had an immaterial fair value.

For the contingent acquisition consideration classified as Level 2 at December 31, 2014, fair value approximated book value, and represented the amount to be paid based on actual achievement of the criteria.

At September 30, 2015, the Company had recorded approximately \$5.1 million in contingent consideration related to the January 2015 acquisition of Swyft Media. The contingent consideration is payable in cash based on the achievement of certain revenue and EBITDA margin targets for the years ending December 31, 2015 through 2016, with a catch-up period for the year ending December 31, 2017, and subject to a cap of \$15.0 million. The fair value of this liability was estimated using a Monte Carlo simulation model, relying on significant inputs that are not observable in the market and thus represent a Level 3 fair value measurement. The significant inputs in the Level 3 measurement not supported by market activity included our expected revenues and EBITDA for each of the measurement periods and the estimated level of risk and volatility around the forecast. The Monte Carlo

Table of Contents

simulation was relied on to estimate the projected revenues, EBITDA margins, and contingent acquisition consideration payments for each measurement period. The average contingent acquisition consideration payments for the years 2015 through 2017, following 100,000 simulation trials, were discounted to present value to capture the time value of money and counterparty risk, based upon an assessment of the Company's borrowing risk, and applying its credit rating to adjust the risk free rate.

The changes in the estimated fair value for our liabilities measured on a recurring basis using significant unobservable inputs (Level 3) are as follows (in thousands):

	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2015
Fair value measurement at the beginning of period	\$ 4,997	\$
Contingent consideration recorded upon acquisition		4,900
Accreted interest	58	155
Fair value measurement at end of period	\$ 5,055	\$ 5,055

The Company's non-financial assets and non-financial liabilities subject to non-recurring measurements include goodwill and intangible assets.

7. Property and Equipment

Property and equipment consists of the following (in thousands):

	September 30, 2015	December 31, 2014
Computer equipment and software	\$ 15,885	\$ 12,084
Furniture and fixtures	1,691	1,093
Leasehold improvements	5,479	3,498
Total cost	23,055	16,675
Less accumulated depreciation and amortization	(7,750)	(6,097)
Property and equipment, net	\$ 15,305	\$ 10,578

8. Intangible Assets

Intangible assets consist of the following (dollar amounts in thousands):

	Weighted-Average Amortization Period (Years)	September 30, 2015			December 31, 2014		
		Gross Carrying Amount	Accumulated Amortization	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer relationships	10	\$ 60,167	\$ (48,339)	\$ 11,828	\$ 57,488	\$ (47,018)	\$ 10,470
Acquired technology	11	54,542	(38,118)	16,424	55,064	(34,411)	20,653
Non-compete agreements	4	12,981	(12,050)	931	12,172	(11,862)	310
Indefinite-lived intangible assets:							
Trademarks		38,028		38,028	38,029		38,029
Domain names		4,400		4,400	4,400		4,400
Total		\$ 170,118	\$ (98,507)	\$ 71,611	\$ 167,153	\$ (93,291)	\$ 73,862

9. Debt

On September 15, 2015, the Company entered into a new credit agreement (the New Credit Agreement) by and among the Company, the Company's subsidiary, Monotype Imaging Inc., any financial institution that becomes a Lender (as defined therein) and Silicon Valley Bank (SVB), as agent which provides for a five-year \$150.0 million secured revolving credit facility (the Credit Facility).

Table of Contents

The Credit Facility permits the Company to request that the Lenders, at their election, increase the secured credit facility to a maximum of \$200.0 million. The New Credit Agreement replaced the Company's existing \$120.0 million revolving credit facility (the Original Credit Agreement) by and between the Company and Wells Fargo Capital Finance, LLC. The Original Credit Agreement was terminated effective September 15, 2015 and was scheduled to expire on July 13, 2016.

Borrowings under the Credit Facility bear interest through September 15, 2020 at a variable rate not less than zero based upon, at the Company's option, either LIBOR or the higher of (i) the prime rate as published in the Wall Street Journal, and (ii) 0.5% plus the overnight federal funds rate, plus in each case, an applicable margin. The applicable margin for LIBOR loans, based on the applicable leverage ratio, is 1.25%, 1.50% or 1.75% per annum, and the applicable margin for base rate loans, based on the applicable leverage ratio, is either 0.25%, 0.50% or 0.75% per annum. At September 30, 2015 our rate, inclusive of applicable margins, was 1.4% for LIBOR. At September 30, 2015, the Company had no outstanding borrowings under the Credit Facility. The Company is required to pay a commitment fee, based on the applicable leverage ratio, equal to 0.20%, 0.25% or 0.30% per annum on the undrawn portion available under the revolving credit facility and variable per annum fees in respect of outstanding letters of credit. In connection with the New Credit Agreement, the Company incurred closing and legal fees of approximately \$0.8 million, which have been accounted for as deferred financing costs and will be amortized to interest expense over the term of the New Credit Agreement. In addition, \$0.1 million of unamortized deferred financing costs associated with the pro-rata share of prior loan syndicate lenders that did not participate in the new facility were written off and charged to other expense in the third quarter of 2015.

In addition to other covenants, the New Credit Agreement places limits on the Company 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 New Credit Agreement also contains events of default, and affirmative covenants, including financial maintenance covenants which include (i) a maximum ratio of consolidated total debt to consolidated adjusted EBITDA of 3.00 to 1.00, and (ii) a minimum consolidated fixed charge coverage ratio of 1.25 to 1.00. Adjusted EBITDA, under the Credit Facility, is defined as consolidated net income (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 on a trailing twelve month basis, plus restructuring, issuance costs, cash non-operating costs and other expenses or losses minus cash non-operating gains and other non-cash gains. Failure to comply with these covenants, or the occurrence of an event of default, could permit the Lenders under the New Credit Agreement to declare all amounts borrowed under the New Credit Agreement, together with accrued interest and fees, to be immediately due and payable. In addition, the Credit Facility is secured by a lien on substantially all of the Company's and its domestic subsidiaries' tangible and intangible property by a pledge of all of the equity interests of the Company's direct and indirect domestic subsidiaries and by a pledge by the Company's domestic subsidiaries of 65% of the equity of their direct foreign subsidiaries, subject to limited exceptions. The Company was in compliance with all covenants under our Credit Facility as of September 30, 2015.

10. 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):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Service cost	\$ 30	\$ 27	\$ 89	\$ 86
Interest cost	29	41	87	129
Amortization	20	1	58	1
Net periodic benefit cost	\$ 79	\$ 69	\$ 234	\$ 216

Table of Contents**11. Income Taxes**

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

	Three Months Ended September 30,			
	2015		2014	
Provision for income taxes at statutory rate	\$ 3,855	35.0%	\$ 3,899	35.0%
State and local income taxes, net of federal tax benefit	132	1.2%	205	1.8%
Stock compensation	39	0.4%	78	0.7%
Foreign rate differential	(76)	(0.7)%	448	4.0%
Reversal of reserve for income taxes	(689)	(6.3)%	(131)	(1.2)%
Disqualifying dispositions on incentive stock options	(6)	(0.1)%	(62)	(0.6)%
Other, net	(280)	(2.5)%	(335)	(2.9)%
Reported income tax provision	\$ 2,975	27.0%	\$ 4,102	36.8%

	Nine Months Ended September 30,			
	2015		2014	
Provision for income taxes at statutory rate	\$ 10,856	35.0%	\$ 12,927	35.0%
State and local income taxes, net of federal tax benefit	419	1.3%	686	1.9%
Stock compensation	101	0.3%	243	0.7%
Foreign rate differential	(262)	(0.8)%	626	1.7%
Reversal of reserve for income taxes	(1,031)	(3.3)%	(131)	(0.4)%
Disqualifying dispositions on incentive stock options	(25)	(0.1)%	(104)	(0.3)%
Other, net	(341)	(1.1)%	(488)	(1.4)%
Reported income tax provision	\$ 9,717	31.3%	\$ 13,759	37.2%

At September 30, 2015, the reserve for uncertain tax positions was approximately \$6.0 million. Of this amount, \$2.7 million is recorded as a reduction of deferred tax assets and \$3.3 million is classified as long term liabilities. During the first quarter of 2015, the Company settled a tax audit related to its Japan subsidiary. As a result of this settlement, the Company recognized a tax benefit of \$0.3 million. During the third quarter of 2015, the Company settled a tax audit related to its 2012 U.S. federal tax return. As a result of this settlement, the Company recognized a tax benefit of \$0.2 million. Additionally, the Company recognized a tax benefit of \$0.5 million in the quarter ended September 30, 2015, as a result of the expiration of the 2011 U.S. federal statute of limitations. The effect of foreign income and dividends resulted in a tax benefit of \$0.1 million in the quarter ended September 2015, as compared to \$0.4 million expense in the same period in 2014, due to changes in the profitability of the Company's UK subsidiary, to an income position in 2015 from a loss position in 2014.

12. Net Income Per Share

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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.

Table of Contents

For the three and nine months ended September 30, 2015, the two-class method was used in the computation of diluted net income per share as this approach was more dilutive. For the three and nine months ended September 30, 2014, the treasury stock method was used in the computation of diluted net income per share, as this approach was more dilutive. The following presents a reconciliation of the numerator and denominator used in the calculation of basic and diluted net income per share (in thousands, except share and per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Numerator:				
Net income, as reported	\$ 8,039	\$ 7,039	\$ 21,300	\$ 23,175
Less: net income attributable to participating securities	(202)	(140)	(501)	(430)
Net income available to common shareholders basic	\$ 7,837	\$ 6,899	\$ 20,799	\$ 22,745
Denominator:				
Basic:				
Weighted-average shares of common stock outstanding	39,797,638	39,222,580	39,771,986	39,290,673
Less: weighted-average shares of unvested restricted common stock outstanding	(1,027,012)	(791,549)	(963,540)	(747,272)
Weighted-average number of common shares used in computing basic net income per common share	38,770,626	38,431,031	38,808,446	38,543,401
Net income per share applicable to common shareholders basic	\$ 0.20	\$ 0.18	\$ 0.54	\$ 0.59
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Numerator:				
Net income available to common shareholders basic	\$ 7,837	\$ 6,899	\$ 20,799	\$ 22,745
Add-back: undistributed earnings allocated to unvested shareholders ⁽¹⁾	105	N/A	227	N/A
Less: undistributed earnings reallocated to unvested shareholders ⁽¹⁾	(104)	N/A	(224)	N/A
Net income available to common shareholders diluted	\$ 7,838	\$ 6,899	\$ 20,802	\$ 22,745

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Denominator:				
Diluted:				
Weighted-average shares of common stock outstanding	39,797,638	39,222,580	39,771,986	39,290,673
Less: weighted-average shares of unvested restricted common stock outstanding	(1,027,012)	(791,549)	(963,540)	(747,272)
Weighted-average number of common shares issuable upon exercise of outstanding stock options, based on the treasury stock method	460,157	893,081	574,112	946,674
Weighted-average number of restricted stock outstanding, based on the treasury stock method ⁽²⁾	N/A	163,190	N/A	173,732
Weighted-average number of common shares used in computing diluted net income per common share	39,230,783	39,487,302	39,382,558	39,663,807
Net income per share applicable to common shareholders diluted	\$ 0.20	\$ 0.17	\$ 0.53	\$ 0.57

(1) Adjustments to net income relate to net income per share calculations under the two class method; therefore, it is not applicable, or N/A, for certain periods presented.

(2) Adjustments pertain to net income per share calculations under the treasury stock method; therefore, it is not applicable, or N/A, for certain periods presented.

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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Options	575,169	307,516	438,524	380,544
Unvested restricted stock	706,865	817	400,800	156,148
Unvested restricted stock units	22,513	2,043	15,065	2,961

Table of Contents**13. Stockholders Equity***Share repurchases*

On October 23, 2013, the Company's Board of Directors approved a share repurchase program permitting repurchases of up to \$50.0 million of the Company's outstanding shares of common shares for a maximum period of two years. Intended to offset shareholder dilution, the Company made repurchases periodically, on the open market as business and market conditions warranted, through June 5, 2015, at which date the maximum amount of repurchases was reached. During the nine months ended September 30, 2015, the Company repurchased a total of 657,028 shares of its common stock for an aggregate purchase price of \$18.5 million, including brokers' fees. Of that amount, the Company purchased 14,278 shares of common stock, for an aggregate purchase price of \$0.4 million, including brokers' fees, in excess of its publicly announced share repurchase program upon the conclusion of the program.

Share Based Compensation

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Marketing and selling	\$ 1,693	\$ 1,257	\$ 4,568	\$ 3,553
Research and development	633	620	1,819	1,747
General and administrative	1,274	942	3,454	2,535
Total expensed	\$ 3,600	\$ 2,819	\$ 9,841	\$ 7,835
Property and equipment		39	82	102
Total share based compensation	\$ 3,600	\$ 2,858	\$ 9,923	\$ 7,937

In the three and nine months ended September 30, 2015, approximately \$0 and \$82 thousand, respectively, and in the three and nine months ended September 30, 2014, approximately \$39 thousand and \$102 thousand, respectively, of share based compensation was capitalized as part of an internal software project, and this amount is included in property and equipment, net in our condensed consolidated balance sheet.

As of September 30, 2015, the Company had \$29.7 million of unrecognized compensation expense, which is net of expected forfeitures, related to employees and directors' unvested stock options, restricted stock units and restricted stock awards that are expected to be recognized over a weighted average period of 2.8 years.

14. 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		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Creative Professional	\$ 22,472	\$ 20,118	\$ 63,654	\$ 56,103
OEM	26,880	26,945	78,149	81,995
Total	\$ 49,352	\$ 47,063	\$ 141,803	\$ 138,098

Table of Contents**Geographic segment information**

The Company attributes revenues 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 South 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, South Korea and Japan. The following summarizes revenue by location:

	Three Months Ended September 30,			
	2015		2014	
	Sales	% of Total	Sales	% of Total
(In thousands, except percentages)				
United States	\$ 27,154	55.0%	\$ 25,041	53.2%
United Kingdom	4,029	8.2	2,248	4.8
Germany	5,877	11.9	7,131	15.2
Japan	12,235	24.8	12,449	26.4
Other Asia	57	0.1	194	0.4
Total	\$ 49,352	100.0%	\$ 47,063	100.0%

	Nine Months Ended September 30,			
	2015		2014	
	Sales	% of Total	Sales	% of Total
(In thousands, except percentages)				
United States	\$ 78,517	55.4%	\$ 73,579	53.3%
United Kingdom	7,407	5.2	7,577	5.5
Germany	17,110	12.1	15,818	11.5
Japan	38,215	26.9	40,530	29.3
Other Asia	554	0.4	594	0.4
Total	\$ 141,803	100.0%	\$ 138,098	100.0%

Long-lived assets, which include property and equipment, goodwill and intangibles assets, 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):

	September 30, 2015	December 31, 2014
Long-lived assets:		
United States	\$ 208,580	\$ 189,927

United Kingdom	4,736	5,138
Germany	57,262	62,917
Asia (including Japan)	3,474	3,457
Total	\$ 274,052	\$ 261,439

15. Commitments and Contingencies

Legal Proceedings

From time to time, we may be a party to various claims, suits and complaints. We do not believe that there are claims or 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

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 the 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 or unlimited liability. We believe the estimated fair value of these warranties is minimal. Accordingly, there are no liabilities recorded for these warranties as of September 30, 2015 and December 31, 2014.

16. Subsequent Events

Dividend Declaration

On October 26, 2015 the Company's Board of Directors declared a \$0.10 per share quarterly cash dividend on our outstanding common stock. The record date is set for January 4, 2016 and the dividend is payable to shareholders of record on January 22, 2016. 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 devices. Our vision is that our fonts and technology empower every word and experience. We strive to enable the best user experience and ensure brand integrity, regardless of device, platform or language. We help creative professionals, consumer device manufacturers and independent software vendors connect their brands, content, products and services to consumers and businesses everywhere, from content creation to consumption. Monotype is home to some of the world's best known typeface collections. Along with our custom type services, our solutions enable customers to express their creativity, while our tools and technologies improve creative workflows and maximize efficiency as content is published or distributed. Our solutions provide worldwide language coverage and high-quality text, and our embedded solutions support compelling user interfaces and brand fidelity by providing for the display of content on any device or platform, as the author intended. We offer more than 25,000 typeface designs, and include some of the world's most widely used designs, such as the Times New Roman[®], Helvetica[®], Frutiger[®], ITC Franklin Gothic, FF Meta[®] and Droid typefaces, and support more than 250 Latin and non-Latin languages. Our e-commerce websites, including myfonts.com, fonts.com, fontshop.com, linotype.com and fontfont.com, which attracted more than 77 million visits in 2014 from over 200 countries and territories, offer thousands of high-quality font products, in some cases more than 127,000, 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 consumer device manufacturers and independent software vendors, which we refer to as our OEM revenue. We derive our Creative Professional revenue primarily from brands, agencies, publishers, corporations, enterprises, small businesses and individuals. Some of our revenue streams, particularly custom font design service 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.

Table of Contents

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

	Three Months Ended September 30,			
	2015		2014	
	Sales	% of Total	Sales	% of Total
(In thousands, except percentages)				
United States	\$ 27,154	55.0%	\$ 25,041	53.2%
United Kingdom	4,029	8.2	2,248	4.8
Germany	5,877	11.9	7,131	15.2
Japan	12,235	24.8	12,449	26.4
Other Asia	57	0.1	194	0.4
Total	\$ 49,352	100.0%	\$ 47,063	100.0%

	Nine Months Ended September 30,			
	2015		2014	
	Sales	% of Total	Sales	% of Total
(In thousands, except percentages)				
United States	\$ 78,517	55.4%	\$ 73,579	53.3%
United Kingdom	7,407	5.2	7,577	5.5
Germany	17,110	12.1	15,818	11.5
Japan	38,215	26.9	40,530	29.3
Other Asia	554	0.4	594	0.4
Total	\$ 141,803	100.0%	\$ 138,098	100.0%

For the three months ended September 30, 2015 and 2014, sales by our subsidiaries located outside the United States comprised 45.0% and 46.8%, respectively, of our total revenue. For the nine months ended September 30, 2015 and 2014, sales by our subsidiaries located outside the United States comprised 44.6% and 46.7%, respectively, of our total 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 our fonts and font technology worldwide.

We derive a significant portion of our OEM revenue from a limited number of customers, in particular manufacturers of laser printers and consumer electronics. For the three months ended September 30, 2015 and 2014, our top ten licensees by revenue, most of which are OEM customers, accounted for approximately 34.5% and 35.5% of our total revenue, respectively. For the nine months ended September 30, 2015 and 2014, our top ten licensees by revenue, most of which are OEM customers, accounted for approximately 34.4% and 36.3% of our total revenue, respectively. Although no one customer accounted for more than 10% of our total revenue for the three or nine months ended September 30, 2015 or 2014, 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 web design tools. 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 when the software embodying the font is shipped or made available. 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 revenue is generally recognized upon delivery, unless it is part of a bundled services arrangement, in which case, it is recognized over the longest service period. Font related service revenue is mainly subscription based and it may

Table of Contents

contain software as a service. The subscription revenue is recognized ratably over the subscription period. We consider web server and commercial rights to online fonts as recurring revenue and it is recognized upon invoicing and proof of font delivery, when all other revenue recognition criteria have been met. Contract accounting is used where services are deemed essential to the software. We consider both the completed contract and percentage-of-completion method of revenue recognition for contract accounting arrangements. We have the ability to make reasonable estimates, and therefore, typically use the percentage-of-completion method in arrangements subject to contract accounting applying input or output measures, where appropriate. We make certain judgments by estimating the amount of expenses to be recognized, together with the percent of revenue earned in each particular period.

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 the right to embed 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 one 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. OEM revenue also includes project-related agreements for which contract accounting may be used.

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 font 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 font 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 font design service 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 as 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

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 the fonts we license from third parties because of volume. Within our Creative Professional business, the cost of our custom font 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.

Table of Contents

There has been no material change in our critical accounting policies since December 31, 2014. Information about our critical accounting policies may be found in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, under the heading Critical Accounting Policies, of our Annual Report on Form 10-K for the year ended December 31, 2014.

Results of Operations for the Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014

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

	Three Months Ended September 30,	
	2015	2014
Revenue:		
Creative Professional	45.5%	42.7%
OEM	54.5	57.3
Total revenue	100.0	100.0
Cost of revenue	14.9	15.4
Cost of revenue - amortization of acquired technology	2.1	2.4
Total cost of revenue	17.0	17.8
Gross profit	83.0	82.2
Marketing and selling	31.4	28.4
Research and development	10.4	11.1
General and administrative	16.6	13.8
Amortization of other intangible assets	1.7	3.3
Total operating expenses	60.1	56.6
Income from operations	22.9	25.6
Interest expense, net	0.5	0.6
Loss on foreign exchange	0.1	1.7
Gain on derivatives	(0.2)	(0.5)
Loss on extinguishment of debt	0.2	0.1
Total other expense	0.6	1.9
Income before provision for income taxes	22.3	23.7
Provision for income taxes	6.0	8.7
Net income	16.3%	15.0%

Revenues 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 consumer 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.

Table of Contents

The following table presents revenue for these two principal markets (in thousands):

	Three Months Ended September 30,		Increase (Decrease)
	2015	2014	
Creative Professional	\$ 22,472	\$ 20,118	\$ 2,354
OEM	26,880	26,945	(65)
Total revenue	\$ 49,352	\$ 47,063	\$ 2,289

Revenue

Revenue was \$49.4 million and \$47.1 million for the three months ended September 30, 2015 and 2014, respectively, an increase of \$2.3 million, or 4.9%.

Creative Professional revenue was \$22.5 million and \$20.1 million in the three months ended September 30, 2015 and 2014, respectively, an increase of \$2.4 million, or 11.7%, mainly due to increased direct revenue. Direct revenue increased partially due to increased sales of our web font services and partially due to increased recurring royalties and licenses of web server applications to enterprise customers.

OEM revenue was consistent at \$26.9 million in the three months ended September 30, 2015 and 2014. Decreased printer product royalty revenue was offset by increased license revenue from our display imaging consumer electronic OEM and independent software vendor customers in the third quarter of 2015, as compared to the same period in 2014.

Cost of Revenue and Gross Profit

Cost of revenue, excluding amortization of acquired technology, was \$7.4 million and \$7.2 million for the three months ended September 30, 2015 and 2014, respectively, an increase of \$0.2 million, or 1.7%. As a percentage of total revenue, cost of revenue, excluding amortization of acquired technology, was 14.9% and 15.4% for the three months ended September 30, 2015 and 2014, respectively, mainly due to product mix. In the three months ended September 30, 2015, Creative Professional revenue was 45.5% of total revenue, as compared to 42.7% of total revenue in the same period in 2014. Our Creative Professional revenue has a higher associated cost than our OEM revenue because Creative Professional revenue typically contains a higher proportion of third party fonts.

Accordingly, when Creative Professional revenue increases as a percentage of total revenue, we would normally expect our overall gross profit percentage to decrease. However, in the three months ended September 30, 2015, as compared to the same period in 2014, our Creative Professional revenue included several large contracts with enterprise customers that did not include third party fonts.

The portion of cost of revenue consisting of amortization of acquired technology was \$1.0 million and \$1.1 million for the three months ended September 30, 2015 and 2014, respectively, a decrease of \$0.1 million, or 8.4%.

Gross profit was 83.0% of sales in the three months ended September 30, 2015, as compared to 82.2% in the three months ended September 30, 2014, an increase of 0.8 percentage points. We achieved an improved gross profit on our Creative Professional revenue in the three months ended September 30, 2015, as detailed above.

Operating Expenses

Marketing and Selling. Marketing and selling expense was \$15.5 million and \$13.4 million in the three months ended September 30, 2015 and 2014, respectively, an increase of \$2.1 million, or 15.8%. Personnel expenses increased \$1.1 million in the third quarter of 2015, as compared to the same period in 2014, due to additional headcount primarily from our acquisition of Swyft Media, key hiring and higher share based compensation expense. Targeted marketing spending, including branding campaigns and website redesign increased \$0.5 million in the three months ended September 30, 2015, as compared to the same period in 2014.

Research and Development. Research and development expense was consistent at \$5.2 million in the three months ended September 30, 2015 and 2014.

General and Administrative. General and administrative expense increased \$1.7 million, or 25.9%, to \$8.2 million in the three months ended September 30, 2015, as compared to \$6.5 million in the three months ended September 30, 2014. Personnel and personnel related expenses increased \$1.0 million in the three months ended September 30, 2015, as compared to the same period in