Monotype Imaging Holdings Inc.
Form 10-Q
May 01, 2013

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)

Delaware	**20-3289482**
(State of incorporation)	**(I.R.S. Employer Identification No.)**
500 Unicorn Park Drive	
Woburn, Massachusetts	**01801**
(Address of principal executive offices)	**(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 x 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 x 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	x
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 x

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

Table of Contents

MONOTYPE IMAGING HOLDINGS INC.

INDEX

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
Assets		
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
Total current assets	59,428	53,217
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
Total assets	$ 322,012	$ 320,066
Liabilities and Stockholders Equity		
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
Total current liabilities	36,368	39,273
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)

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.

2

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	Three Months Ended March 31, 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)

	Three Months Ended March 31,	
	2013	**2012**
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)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Cash flows from operating activities		
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
Cash flows from investing activities		
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)
Cash flows from financing activities		
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

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

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 Typecast 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 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.

Table of Contents

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
Total	$	$ 126

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):

	Fair Value Measurement at March 31, 2013			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
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	
Total assets	$ 13,370	$ 1,377	$ 11,993	$
Liabilities:				
Contingent acquisition consideration	$ 2,147	$	$	$ 2,147
Total liabilities	$ 2,147	$	$	$ 2,147

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):

		March 31, 2013			December 31, 2012		
	Life (Years)	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):

	Three Months Ended March 31,	
	2013	2012
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):

	Three Months Ended March 31,			
	2013		2012	
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.

Table of Contents

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	Three Months Ended March 31, 2012
Numerator:		
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
Denominator:		
Basic:		
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	Three Months Ended March 31, 2012
Numerator:		
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
Denominator:		
Diluted:		
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:

	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.

Table of Contents

11. 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 March 31,	
	2013	**2012**
Marketing and selling	$ 777	$ 831
Research and development	416	