

Monotype Imaging Holdings Inc.
Form 10-Q
October 31, 2013
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, 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
(State of incorporation)

20-3289482
(I.R.S. Employer

Identification No.)

500 Unicorn Park Drive

Woburn, Massachusetts
(Address of principal executive offices)

01801
(Zip Code)

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares outstanding of the registrant's common stock as of October 24, 2013 was 39,019,001.

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, 2013 and December 31, 2012</u> | 2 |
| <u>Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2013 and 2012</u> | 3 |
| <u>Condensed Consolidated Statement of Comprehensive Income for the three and nine months ended September 30, 2013 and 2012</u> | 4 |
| <u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012</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> | 14 |
| <i>Item 3.</i> <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 26 |
| <i>Item 4.</i> <u>Controls and Procedures</u> | 28 |
| <u>Part II. Other Information</u> | 28 |
| <i>Item 1.</i> <u>Legal Proceedings</u> | 28 |
| <i>Item 1A.</i> <u>Risk Factors</u> | 28 |
| <i>Item 2.</i> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 28 |
| <i>Item 3.</i> <u>Defaults Upon Senior Securities</u> | 29 |
| <i>Item 4.</i> <u>Mine Safety Disclosures</u> | 29 |
| <i>Item 5.</i> <u>Other Information</u> | 29 |
| <i>Item 6.</i> <u>Exhibits</u> | 29 |
| <u>Signatures</u> | 30 |
| <u>Exhibit Index</u> | 31 |

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, 2013 | December 31, 2012 |
|---|-------------------------------|------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 64,335 | \$ 39,340 |
| Accounts receivable, net of allowance for doubtful accounts of \$166 at September 30, 2013 and \$129 at December 31, 2012 | 7,781 | 6,996 |
| Income tax refunds receivable | 3,784 | 2,209 |
| Deferred income taxes | 2,216 | 2,218 |
| Prepaid expense and other current assets | 2,782 | 2,454 |
| Total current assets | 80,898 | 53,217 |
| Property and equipment, net | 2,779 | 2,587 |
| Goodwill | 175,593 | 174,294 |
| Intangible assets, net | 79,094 | 86,736 |
| Other assets | 2,899 | 3,232 |
| Total assets | \$ 341,263 | \$ 320,066 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,075 | \$ 1,038 |
| Accrued expenses and other current liabilities | 17,520 | 17,319 |
| Accrued income taxes | | 2,191 |
| Deferred revenue | 7,649 | 8,725 |
| Current portion of long-term debt | | 10,000 |
| Total current liabilities | 26,244 | 39,273 |
| Long-term debt, less current portion | | 12,321 |
| Other long-term liabilities | 617 | 613 |
| Deferred income taxes | 31,727 | 26,832 |
| Reserve for income taxes, net of current portion | 1,131 | 963 |
| Accrued pension benefits | 5,281 | 4,958 |
| Commitments and contingencies (Note 14) | | |
| Stockholders equity: | | |

Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-Q

| | | |
|---|-------------------|-------------------|
| 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: 39,055,374 at September 30, 2013 and 37,331,796 at December 31, 2012 | 39 | 37 |
| Additional paid-in capital | 203,176 | 178,681 |
| Treasury stock, at cost, 129,830 shares at September 30, 2013 and 116,101 shares at December 31, 2012 | (86) | (86) |
| Retained earnings | 73,004 | 56,980 |
| Accumulated other comprehensive income (loss) | 130 | (506) |
| Total stockholders equity | 276,263 | 235,106 |
| Total liabilities and stockholders equity | \$ 341,263 | \$ 320,066 |

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

Table of Contents**MONOTYPE IMAGING HOLDINGS INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited and in thousands, except share and per share data)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|-------------|--|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenue | \$ 40,468 | \$ 37,982 | \$ 123,592 | \$ 110,827 |
| Costs and expenses: | | | | |
| Cost of revenue | 5,935 | 5,426 | 17,960 | 15,164 |
| Cost of revenue amortization of acquired technology | 1,141 | 1,085 | 3,418 | 2,965 |
| Total cost of revenue | 7,076 | 6,511 | 21,378 | 18,129 |
| Gross profit | 33,392 | 31,471 | 102,214 | 92,698 |
| Operating expenses: | | | | |
| Marketing and selling | 10,632 | 8,614 | 30,943 | 26,605 |
| Research and development | 4,655 | 4,617 | 14,518 | 13,549 |
| General and administrative | 4,926 | 4,386 | 14,611 | 14,011 |
| Amortization of other intangible assets | 1,490 | 1,405 | 4,467 | 4,057 |
| Total operating expenses | 21,703 | 19,022 | 64,539 | 58,222 |
| Income from operations | 11,689 | 12,449 | 37,675 | 34,476 |
| Other (income) expense: | | | | |
| Interest expense | 271 | 457 | 1,002 | 1,461 |
| Interest income | (5) | (6) | (10) | (22) |
| Loss on foreign exchange | 98 | 24 | 938 | 301 |
| Loss (gain) on derivatives | 216 | 65 | 216 | (14) |
| Other expense (income), net | 8 | 33 | (29) | 19 |
| Total other expense | 588 | 573 | 2,117 | 1,745 |
| Income before provision for income taxes | 11,101 | 11,876 | 35,558 | 32,731 |
| Provision for income taxes | 4,037 | 3,886 | 12,567 | 11,606 |
| Net income | \$ 7,064 | \$ 7,990 | \$ 22,991 | \$ 21,125 |
| Net income available to common shareholders basic & diluted | \$ 6,950 | \$ 7,857 | \$ 22,608 | \$ 20,779 |
| Net income per common share: | | | | |
| Basic | \$ 0.18 | \$ 0.22 | \$ 0.60 | \$ 0.57 |
| Diluted | \$ 0.18 | \$ 0.21 | \$ 0.58 | \$ 0.55 |
| Weighted average number of shares: | | | | |

Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-Q

| | | | | |
|-------------------------------------|------------|------------|------------|------------|
| Basic | 38,276,890 | 36,323,556 | 37,717,883 | 36,217,950 |
| Diluted | 39,657,474 | 37,620,269 | 39,205,915 | 37,600,448 |
| Dividends declared per common share | \$ 0.06 | \$ 0.04 | \$ 0.18 | \$ 0.04 |

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, | |
| | 2013 | 2012 | 2013 | 2012 |
| Net income | \$ 7,064 | \$ 7,990 | \$ 22,991 | \$ 21,125 |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrecognized actuarial gain | 17 | | 28 | |
| Foreign currency translation adjustments | 1,288 | 429 | 608 | (283) |
| Comprehensive income | \$ 8,369 | \$ 8,419 | \$ 23,627 | \$ 20,842 |

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, | |
|---|--|-------------|
| | 2013 | 2012 |
| Cash flows from operating activities | | |
| Net income | \$ 22,991 | \$ 21,125 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 9,036 | 7,985 |
| Loss on retirement of fixed assets | 23 | |
| Amortization of deferred financing costs | 227 | 228 |
| Amortization of imputed interest | 187 | |
| Share based compensation | 5,994 | 5,300 |
| Excess tax benefit on stock options | (5,242) | (878) |
| Provision for doubtful accounts | 84 | 8 |
| Deferred income taxes | 4,382 | 1,987 |
| Unrealized currency gain on foreign denominated intercompany transactions | (29) | (96) |
| Unrealized loss on derivatives | | 432 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (905) | 616 |
| Income tax refunds receivable | | (429) |
| Prepaid expenses and other assets | (311) | (238) |
| Accounts payable | 35 | 17 |
| Accrued income taxes | 1,099 | 1,756 |
| Accrued expenses and other liabilities | (520) | (441) |
| Deferred revenue | (1,025) | (928) |
| Net cash provided by operating activities | 36,026 | 36,444 |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (1,373) | (1,046) |
| Purchase of exclusive license and other intangible assets | | (150) |
| Acquisition of business, net of cash acquired | (72) | (49,090) |
| Net cash used in investing activities | (1,445) | (50,286) |
| Cash flows from financing activities | | |
| Payments on line of credit | (22,321) | (30,000) |
| Borrowings under line of credit | | 25,000 |
| Excess tax benefit on stock options | 5,242 | 878 |
| Common stock dividends paid | (6,112) | |
| Proceeds from exercises of common stock options | 13,644 | 2,098 |

Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-Q

| | | |
|---|-----------|-----------|
| Net cash used in financing activities | (9,547) | (2,024) |
| Effect of exchange rates on cash and cash equivalents | (39) | 4 |
| Increase (decrease) in cash and cash equivalents | 24,995 | (15,862) |
| Cash and cash equivalents at beginning of period | 39,340 | 53,850 |
| Cash and cash equivalents at end of period | \$ 64,335 | \$ 37,988 |

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, 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., formerly Bitstream Inc. (Bitstream), and five foreign subsidiaries, Monotype Ltd., Monotype GmbH, formerly Linotype GmbH (Germany), 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, 2013 and for the three and nine months ended September 30, 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