FAIR ISAAC CORP
Form 10-Q
January 30, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2012

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

[NO FEE REQUIRED]

For the transition period from to

Commission File Number 1-11689

Fair Isaac Corporation

(Exact name of registrant as specified in its charter)

Delaware	**94-1499887**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
181 Metro Drive, Suite 700 San Jose, California	**95110-1346**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code:

408-535-1500

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 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer	x	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 x No

The number of shares of common stock outstanding on January 18, 2013 was 35,493,648 (excluding 53,363,135 shares held by the Company as treasury stock).

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

FAIR ISAAC CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2012 (Unaudited)	September 30, 2012
	(In thousands, except par value data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 90,839	$ 71,609
Marketable securities available for sale, current portion		22,008
Accounts receivable, net	138,159	142,595
Prepaid expenses and other current assets	22,376	23,113
Total current assets	251,374	259,325
Marketable securities available for sale, less current portion	5,496	5,417
Other investments	11,033	11,083
Property and equipment, net	45,788	41,080
Goodwill	769,959	757,504
Intangible assets, net	65,304	52,299
Deferred income taxes	18,158	22,856
Other assets	9,002	9,047
Total assets	$ 1,176,114	$ 1,158,611
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 21,509	$ 18,958
Accrued compensation and employee benefits	30,170	50,043
Other accrued liabilities	40,869	43,645
Deferred revenue	47,455	47,959
Current maturities on long-term debt	49,000	49,000
Total current liabilities	189,003	209,605
Senior notes	455,000	455,000
Other liabilities	23,383	19,600
Total liabilities	667,386	684,205
Commitments and contingencies		
Stockholders equity:		
Preferred stock ($0.01 par value; 1,000 shares authorized; none issued and outstanding)		
Common stock ($0.01 par value; 200,000 shares authorized, 88,857 shares issued and 35,478 and 34,839 shares outstanding at December 31, 2012 and September 30, 2012, respectively)	355	348
Paid-in-capital	1,096,278	1,103,611
Treasury stock, at cost (53,379 and 54,018 shares at December 31, 2012 and September 30, 2012, respectively)	(1,698,250)	(1,718,570)
Retained earnings	1,127,544	1,104,825
Accumulated other comprehensive loss	(17,199)	(15,808)

Total stockholders equity	508,728	474,406
Total liabilities and stockholders equity	$ 1,176,114	$ 1,158,611

See accompanying notes to condensed consolidated financial statements.

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FAIR ISAAC CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Unaudited)

	Quarter Ended December 31, 2012	Quarter Ended December 31, 2011
	(in thousands, except per share data)	
Revenues:		
Transactional and maintenance	$ 129,898	$ 114,183
Professional services	32,337	28,693
License	27,785	27,473
Total revenues	190,020	170,349
Operating expenses:		
Cost of revenues (1)	56,148	45,974
Research and development	14,552	13,049
Selling, general and administrative (1)	69,665	57,324
Amortization of intangible assets (1)	3,372	1,930
Restructuring and acquisition-related	3,289	
Total operating expenses	147,026	118,277
Operating income	42,994	52,072
Interest income	21	88
Interest expense	(7,880)	(7,987)
Other expense, net	(92)	(548)
Income before income taxes	35,043	43,625
Provision for income taxes	11,622	13,628
Net income	23,421	29,997
Other comprehensive income:		
Unrealized losses on investments		(15)
Translation adjustments	(1,391)	(2,684)
Comprehensive income	$ 22,030	$ 27,298
Earnings per share:		
Basic	$ 0.67	$ 0.83
Diluted	$ 0.65	$ 0.81
Shares used in computing earnings per share:		
Basic	35,043	36,034
Diluted	36,151	36,887

(1) Cost of revenues and selling, general and administrative expenses exclude the amortization of intangible assets. See Note 5 to the accompanying condensed consolidated financial statements.

See accompanying notes to condensed consolidated financial statements.

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FAIR ISAAC CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(Unaudited)

	Common Stock					Accumulated Other	Total
	Shares	Par Value	Paid-in-Capital	Treasury Stock	Retained Earnings	Comprehensive Loss	Stockholders Equity
			(In thousands, except per share data)				
Balance at September 30, 2012	**34,839**	**$ 348**	**$ 1,103,611**	**$ (1,718,570)**	**$ 1,104,825**	**$ (15,808)**	**$ 474,406**
Share-based compensation			5,832				5,832
Issuance of treasury stock under employee stock plans	639	7	(14,138)	20,320			6,189
Tax effect from share-based payment arrangements			973				973
Dividends paid ($0.02 per share)					(702)		(702)
Net income					23,421		23,421
Translation adjustments						(1,391)	(1,391)
Balance at December 31, 2012	**35,478**	**$ 355**	**$1,096,278**	**$ (1,698,250)**	**$ 1,127,544**	**$ (17,199)**	**$508,728**

See accompanying notes to condensed consolidated financial statements.

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FAIR ISAAC CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Quarter Ended December 31, 2012	2011
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 23,421	$ 29,997
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,973	5,528
Share-based compensation	5,832	4,757
Deferred income taxes	(1,418)	425
Tax effect from share-based payment arrangements	973	1,323
Excess tax benefits from share-based payment arrangements	(2,940)	(1,671)
Net amortization of premium on marketable securities	8	120
Benefit from provision for doubtful accounts, net	92	
Net loss on sales of property and equipment	280	
Changes in operating assets and liabilities:		
Accounts receivable	6,754	(12,589)
Prepaid expenses and other assets	45	2,193
Accounts payable	1,748	6,892
Accrued compensation and employee benefits	(20,242)	(10,058)
Other liabilities	8,967	1,873
Deferred revenue	(2,764)	12,359
Net cash provided by operating activities	28,729	41,149
Cash flows from investing activities:		
Purchases of property and equipment	(9,012)	(7,757)
Purchases of marketable securities		(23,036)
Proceeds from maturities of marketable securities	22,000	72,509
Cash paid for acquisitions, net of cash acquired	(27,605)	
Distribution from cost method investees	50	
Net cash provided by (used in) investing activities	(14,567)	41,716
Cash flows from financing activities:		
Payments on revolving line of credit and other short-term loans	(2,933)	
Proceeds from issuance of treasury stock under employee stock plans	6,189	15,023
Dividends paid	(702)	(717)
Repurchases of common stock		(57,685)
Excess tax benefits from share-based payment arrangements	2,940	1,671
Net cash provided by (used in) financing activities	5,494	(41,708)
Effect of exchange rate changes on cash	(426)	(1,534)
Increase in cash and cash equivalents	19,230	39,623
Cash and cash equivalents, beginning of year	71,609	135,752
Cash and cash equivalents, end of year	$ 90,839	$ 175,375

Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net of refunds	$ 1,978	$ 4,696
Cash paid for interest	$ 9,011	$ 9,246

See accompanying notes to condensed consolidated financial statements.

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FAIR ISAAC CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Business

Fair Isaac Corporation

Incorporated under the laws of the State of Delaware, Fair Isaac Corporation (FICO) is a provider of analytic, software and data management products and services that enable businesses to automate, improve and connect decisions. FICO provides a range of analytical solutions, credit scoring and credit account management products and services to banks, credit reporting agencies, credit card processing agencies, insurers, retailers and healthcare organizations.

In these condensed consolidated financial statements, FICO is referred to as we, us, our, or FICO .

Principles of Consolidation and Basis of Presentation

We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with the instructions to Form 10-Q and the applicable accounting guidance. Consequently, we have not necessarily included in this Form 10-Q all information and footnotes required for audited financial statements. In our opinion, the accompanying unaudited interim condensed consolidated financial statements in this Form 10-Q reflect all adjustments (consisting only of normal recurring adjustments, except as otherwise indicated) necessary for a fair presentation of our financial position and results of operations. These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with our audited consolidated financial statements and notes thereto presented in our Annual Report on Form 10-K for the year ended September 30, 2012. The interim financial information contained in this report is not necessarily indicative of the results to be expected for any other interim period or for the entire fiscal year.

The condensed consolidated financial statements include the accounts of FICO and its subsidiaries. All intercompany accounts and transactions have been eliminated.

Use of Estimates

We make estimates and assumptions that affect the amounts reported in the financial statements and the disclosures made in the accompanying notes. For example, we use estimates in determining the collectibility of accounts receivable; the appropriate levels of various accruals; labor hours in connection with fixed-fee service contracts; the amount of our tax provision and the realizability of deferred tax assets. We also use estimates in determining the remaining economic lives and carrying values of acquired intangible assets, property and equipment, and other long-lived assets. In addition, we use assumptions to estimate the fair value of reporting units and share-based compensation. Actual results may differ from our estimates.

New Accounting Pronouncements Recently Issued or Adopted

On May 12, 2011 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). This update amends Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurement and Disclosure.* ASU 2011-04 clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 is effective for annual and interim reporting periods beginning on or after December 15, 2011, which means that it became effective for our fiscal year that began on October 1, 2012. Our adoption of ASU 2011-04 did not have a significant impact on our consolidated financial statements.

On September 15, 2011, the FASB issued ASU No. 2011-08, *Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment* (ASU 2011-08). This update amends the guidance in ASC 350-20 on testing goodwill for impairment. Under the revised guidance, entities testing goodwill for impairment have the option of performing a qualitative assessment before calculating the fair value of the reporting unit (i.e. step 1 of the goodwill impairment test). If entities determine, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. ASU 2011-08 does not change how goodwill is calculated or assigned to reporting units, nor does it revise the requirement to test goodwill annually for impairment. In addition, ASU 2011-08 does not amend the requirement to test goodwill for impairment between annual tests if events or circumstances warrant; however, it does revise the examples of events and circumstances that an entity should consider. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, which means that it became effective for our fiscal year that began on October 1, 2012. We test our goodwill annually in our fourth fiscal quarter and whenever an event or change in circumstances indicates that the carrying value of the asset may not be recoverable. Our adoption of ASU 2011-08 did not have a significant impact on our consolidated financial statements.

On December 16, 2011 the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities.* (ASU 2011-11). ASU 2011-11 provides for additional disclosures of both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. ASU 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013, which means that it will be effective for our fiscal year beginning October 1, 2013. Retrospective adoption is required. We do not believe that adoption of ASU 2011-11 will have a significant impact on our consolidated financial statements.

2. Acquisitions

On November 21, 2012, we acquired 100% of the ownership interest of CR Software, LLC (CR Software), a provider of enterprise-class collections and recovery solutions for credit issuers, government organizations, collection agencies, retailers, healthcare and other leading enterprises. The primary objective of the acquisition was to help us accelerate the delivery of robust collections and recovery capabilities to clients across multiple industries and organization sizes.

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We have not yet finalized the purchase consideration as the initial purchase price was subject to a working capital adjustment, which is still pending. The following table summarizes the preliminary consideration paid for CR Software and the preliminary allocation of purchase price to assets acquired and liabilities assumed, recognized based on a valuation at the acquisition date:

		(In thousands)
Consideration		
Cash	$	28,816
Acquisition-related costs (included in the company s condensed consolidated statement of income and comprehensive income for the quarter ended December 31, 2012 as a component of restructuring and acquisition-related expense)	$	306
Recognized amounts of identifiable assets acquired and liabilities assumed		
Cash and cash equivalents	$	1,211
Accounts receivable, net		2,598
Prepaid expenses and other current assets		119
Property and equipment, net		238
Intangible assets		
Completed technology		10,800
Customer relationships		5,500
Trade names		200
Other assets		28
Accounts payable		(400)
Accrued compensation and employee benefits		(506)
Other accrued liabilities		(1,057)
Deferred revenue		(178)
Notes payable to affiliate		(2,925)
Total identifiable net assets		15,628
Goodwill		13,188
Total	$	28,816

The acquired identifiable intangible assets have a weighted average useful life of approximately 8.8 years and are being amortized using the straight-line method over their estimated useful lives as follows: completed technology, five to ten years; customer relationships, ten years; and trade names, one year. The goodwill of $13.2 million arising from the acquisition consists largely of revenue synergies created by market expansion and increasingly rapid innovation for our Collections & Recovery solutions. The goodwill was allocated to our Applications segment and is not deductible for tax purposes. CR Software has been included in our operating results since the acquisition date. The pro forma impact of this acquisition was not deemed material to our results of operations for the periods presented.

3. Fair Value Measurements

Fair value is defined as the price that would be received from the sale of an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The accounting guidance establishes a three-level hierarchy for disclosure that is based on the extent and level of judgment used to estimate the fair value of assets and liabilities.

Level 1 uses unadjusted quoted prices that are available in active markets for identical assets or liabilities. Our Level 1 securities are comprised of money market funds and certain equity securities.

Level 2 uses inputs other than quoted prices included in Level 1 that are either directly or indirectly observable through correlation with market data. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and inputs to valuation models or other pricing methodologies that do not require significant judgment because the inputs used in the model, such as interest rates and volatility, can be corroborated by readily observable market data. Our Level 2 securities are comprised of U.S. government and corporate debt obligations that are generally held to maturity.

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Level 3 uses one or more significant inputs that are unobservable and supported by little or no market activity, and that reflect the use of significant management judgment. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, and significant management judgment or estimation. We do not have any assets or liabilities that are valued using inputs identified under a Level 3 hierarchy.

The following table represents financial assets that we measured at fair value on a recurring basis at December 31, 2012 and September 30, 2012, respectively:

December 31, 2012	Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Fair Value as of December 31, 2012
		(In thousands)	
Assets:			
Cash equivalents (1)	$ 13,681	$	$ 13,681
Marketable securities (3)	5,496		5,496
Total	$ 19,177	$	$ 19,177

September 30, 2012	Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Fair Value as of September 30, 2012
		(In thousands)	
Assets:			
Cash equivalents (1)	$ 644	$	$ 644
U.S. corporate debt (2)		2,008	2,008
U.S. government obligations (2)		20,000	20,000
Marketable securities (3)	5,417		5,417
Total	$ 6,061	$ 22,008	$ 28,069

(1) Included in cash and cash equivalents on our balance sheet at December 31, 2012 and September 30, 2012. Not included in this table are cash deposits of $77.2 million and $71.0 million at December 31, 2012 and September 30, 2012, respectively.

(2) Included in current marketable securities on our balance sheet at September 30, 2012.

(3) Represents securities held under a supplemental retirement and savings plan for certain officers and senior management employees, which are distributed upon termination or retirement of the employees. Included in long-term marketable securities on our balance sheet at December 31, 2012 and September 30, 2012.

Where applicable, we use quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing applies to our Level 1 investments. To the extent quoted prices in active markets for assets or liabilities are not available, the valuation techniques used to measure the fair values of our financial assets incorporate market inputs, which include reported trades, broker/dealer quotes, benchmark yields, issuer spreads, benchmark securities and other inputs derived from or corroborated by observable market data. This methodology applies to our Level 2 investments. We have not changed our valuation techniques in measuring the fair value of any financial assets and liabilities during the period.

For the fair value of our derivative instruments, see Note 4 to the condensed consolidated financial statements.

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Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities measured at fair value on a nonrecurring basis primarily include goodwill and definite-lived intangible assets which are measured at fair value for the purposes of our annual impairment assessment.

4. Derivative Financial Instruments

We use derivative instruments to manage risks caused by fluctuations in foreign exchange rates. The primary objective of our derivative instruments is to protect the value of foreign currency denominated accounts receivable and cash balances from the effects of volatility in foreign exchange rates that might occur prior to conversion to their functional currency. We principally utilize foreign currency forward contracts, which enable us to buy and sell foreign currencies in the future at fixed exchange rates and economically offset changes in foreign currency exchange rates. We routinely enter into contracts to offset exposures denominated in the British pound, Euro and Canadian dollar.

Foreign currency denominated accounts receivable and cash balances are re-measured at foreign currency rates in effect on the balance sheet date with the effects of changes in foreign currency rates reported in other expense, net. The forward contracts are not designated as hedges and are marked to market through other expense, net. Fair value changes in the forward contracts help mitigate the changes in the value of the re-measured accounts receivable and cash balances attributable to changes in foreign currency exchange rates. The forward contracts are short-term in nature and typically have average maturities at inception of less than three months.

The following tables summarize our outstanding forward foreign currency contracts, by currency, at December 31, 2012 and September 30, 2012:

	December 31, 2012		
	Contract Amount		Fair Value
	Foreign Currency	US$	US$
	(In thousands)		
Sell foreign currency:			
Canadian dollar (CAD)	CAD 4,700	$ 4,708	$
Euro (EUR)	EUR 5,350	$ 7,033	$
Buy foreign currency:			
British pound (GBP)	GBP 4,983	$ 8,050	$

	September 30, 2012		
	Contract Amount		Fair Value
	Foreign Currency	US$	US$
	(In thousands)		
Sell foreign currency:			
Canadian dollar (CAD)	CAD 2,750	$ 2,794	$
Euro (EUR)	EUR 4,060	$ 5,255	$
Buy foreign currency:			
British pound (GBP)	GBP 6,131	$ 9,950	$

The forward foreign currency contracts were all entered into on December 31, 2012 and September 30, 2012, respectively; therefore, their fair value was $0.

Losses on derivative financial instruments are recorded in our condensed consolidated statements of income and comprehensive income as a component of other expense, net. These amounts are shown for the quarters ended December 31, 2012 and 2011 in the table below:

	Quarter Ended December 31, 2012	Quarter Ended December 31, 2011

		(In thousands)
Foreign currency forward contracts	$ 131	$ 492

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5. Goodwill and Intangible Assets

Amortization expense associated with our intangible assets, which has been reflected as a separate operating expense caption within the accompanying condensed consolidated statements of income and comprehensive income, consisted of the following:

	Quarter Ended December 31, 2012	2011
	(In thousands)	
Cost of revenues	$ 1,471	$ 569
Selling, general and administrative expenses	1,901	1,361
	$ 3,372	$ 1,930

Cost of revenues reflects our amortization of completed technology and selling, general and administrative expenses reflects our amortization of other intangible assets. Intangible assets, gross were $191.8 and $175.3 million as of December 31, 2012 and September 30, 2012, respectively.

Estimated future intangible asset amortization expense associated with intangible assets existing at December 31, 2012, was as follows (in thousands):

Fiscal year	
Remainder of fiscal 2013	$ 9,952
2014	11,116
2015	11,015
2016	10,786
2017	9,649
Thereafter	12,786
	$ 65,304

The following table summarizes changes to goodwill during the quarter ended December 31, 2012, both in total and as allocated to our segments.

	Applications	Scores	Tools	Total
		(In thousands)		
Balance at September 30, 2012	$ 542,943	$ 146,648	$ 67,913	$ 757,504
Addition from acquisition	13,188			13,188
Foreign currency translation adjustment	(614)		(119)	(733)
Balance at December 31, 2012	$ 555,517	$ 146,648	$ 67,794	$ 769,959

6. Composition of Certain Financial Statement Captions

The following table summarizes property and equipment, and the related accumulated depreciation and amortization.

	December 31, 2012	September 30, 2012
	(In thousands)	

Property and equipment	$ 178,567	$ 189,519
Less: accumulated depreciation and amortization	(132,779)	(148,439)
	$ 45,788	$ 41,080

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7. Revolving Line of Credit

We have a $200 million unsecured revolving line of credit with a syndicate of banks that expires on September 28, 2016. Proceeds from the credit facility can be used for working capital and general corporate purposes and may also be used for the refinancing of existing debt, acquisitions, and the repurchase of our common stock. Interest on amounts borrowed under the credit facility is based on (i) a base rate, which is the greater of (a) the prime rate and (b) the Federal Funds rate plus 0.50% or (ii) LIBOR plus an applicable margin. The margin on LIBOR borrowings ranges from 1.000% to 1.625% and is determined based on our consolidated leverage ratio. In addition, we must pay utilization fees if borrowings and commitments under the credit facility exceed 50% of the total credit facility commitment, as well as facility fees. The credit facility contains certain restrictive covenants including maintaining a maximum consolidated leverage ratio of 3.0 and a minimum fixed charge ratio of 2.5, and also contains other covenants typical of unsecured facilities. As of December 31, 2012, we had no borrowings outstanding under the credit facility and were in compliance with all financial covenants.

8. Senior Notes

In May 2008, we issued $275 million of Senior Notes in a private placement to a group of institutional investors. The Senior Notes were issued in four series with maturities ranging from 5 to 10 years. The Senior Notes weighted average interest rate is 6.8% and the weighted average maturity is 7.9 years. In July 2010, we issued $245 million of Senior Notes in a private placement to a group of institutional investors. The Senior Notes were issued in four series with maturities ranging from 5 to 10 years. The Senior Notes weighted average interest rate is 5.2% and the weighted average maturity is 8.0 years. These Senior Notes require interest payments semi-annually and also include certain restrictive covenants. As of December 31, 2012, we were in compliance with all financial covenants which include the maintenance of consolidated net debt to consolidated EBITDA and a fixed charge coverage ratio. The issuance of these Senior Notes also required us to make certain covenants typical of unsecured facilities. The carrying value of our Senior Notes was $504.0 million as of December 31, 2012 and September 30, 2012. The fair value of our Senior Notes was $517.2 million and $519.1 million as of December 31, 2012 and September 30, 2012, respectively. These estimated fair values are based on Level 2 inputs.

9. Restructuring Expenses

During the quarter ended December 31, 2012, we incurred net charges totaling $2.5 million primarily consisting of $1.6 million in facilities charges associated with vacating excess leased space in Minnesota, $1.1 million in severance charges due to the elimination of 52 positions primarily in the U.S., and a reversal of $0.2 million of previously recognized severance costs due to favorable adjustments. Cash payments for all the severance costs will be paid by the end of our second quarter of fiscal 2013. Cash payments for all the facilities charges will be paid by fiscal 2014.

The following table summarizes our restructuring accruals and certain FICO facility closures. The current portion and non-current portion is recorded in other accrued current liabilities and other long-term liabilities, respectively, within the accompanying condensed consolidated balance sheets. These balances are expected to be paid by the end of fiscal 2018.

	Accrual at September 30, 2012	Expense Additions	Cash Payments (In thousands)	Expense Reversals	Accrual at December 31, 2012
Facilities charges	$ 3,333	$ 1,624	$ (390)	$	$ 4,567
Employee separation	2,471	1,095	(2,344)	(253)	969
	5,804	$ 2,719	$ (2,734)	$ (253)	5,536
Less: current portion	(4,944)				(4,384)
Non-current	$ 860				$ 1,152

10. Income Taxes

Effective Tax Rate

The effective income tax rate for the three months ended December 31, 2012 was 33.2% compared to 31.2% for the three months ended December 31, 2011. The provision for income taxes during interim quarterly reporting periods is based on our estimates of the effective tax rates for the respective full fiscal year. The effective tax rate in any quarter can also be affected positively or negatively by adjustments that are required to be reported in the specific quarter of resolution. The quarter over quarter increase in our effective tax rate was due to higher percentage of revenue expected in higher taxing jurisdictions.

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The total unrecognized tax benefit for uncertain tax positions at December 31, 2012 and September 30, 2012 is estimated to be approximately $7.6 million and $7.5 million, respectively. We recognize interest expense related to unrecognized tax benefits and penalties as part of the provision for income taxes in our consolidated statements of income and comprehensive income. As of December 31, 2012 and September 30, 2012, we have accrued interest of $0.7 million related to the unrecognized tax benefits.

11. Share-Based Payments

We maintain the 2012 Long-Term Incentive Plan (the 2012 Plan) under which we could grant all types of equity awards, including stock options, stock appreciation rights, restricted stock awards, stock unit awards and other stock-based awards. All employees, consultants and advisors of FICO or any subsidiary, as well as all non-employee directors are eligible to receive awards under the 2012 Plan. We also have two other stock option plans under which awards are currently outstanding, the 1992 Long-term Incentive Plan, which was adopted in February 1992 and expired in February 2012, and the 2003 Employment Inducement Award Plan, which was adopted in November 2003 and terminated in February 2012. Stock option awards granted typically have a maximum term of seven years and vest ratably over four years. Stock option awards granted prior to October 1, 2005 under the 1992 Plan typically had a maximum term of ten years and vested ratably over four years.

The following table summarizes option activity during the quarter ended December 31, 2012:

	Shares (In thousands)	Weighted-average Price	Weighted-average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at October 1, 2012	4,034	$ 33.01		
Granted	546	41.92		
Exercised	(459)	31.05		
Forfeited	(98)	23.07		
Expired	(141)	47.03		
Outstanding at December 31, 2012	3,882	$ 34.24	4.49	$ 31,815
Options exercisable at December 31, 2012	1,848	$ 33.72	2.80	$ 16,205

The following table summarizes restricted stock unit activity during the quarter ended December 31, 2012:

	Shares (In thousands)	Weighted-average Price
Outstanding at October 1, 2012	1,732	$ 33.31
Granted	721	41.86
Released	(398)	29.17
Forfeited	(49)	29.25
Outstanding at December 31, 2012	2,006	$ 37.31

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12. Earnings Per Share

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

	Quarter Ended December 31,	
	2012	2011
	(In thousands, except per share data)	
Numerator for diluted and basic earnings per share:		
Net Income	$ 23,421	$ 29,997
Denominator share:		
Basic weighted-average shares	35,043	36,034
Effect of dilutive securities	1,108	853
Diluted weighted-average shares	36,151	36,887
Earnings per share:		
Basic	$ 0.67	$ 0.83
Diluted	$ 0.65	$ 0.81

The computation of diluted EPS for the quarters ended December 31, 2012 and 2011 excludes options to purchase approximately 257,000 and 2,929,000 shares of common stock, respectively, because the options exercise prices exceeded the average market price of our common stock in these periods and their inclusion would be antidilutive.

13. Segment Information

We are organized into the following three reportable segments to align with internal management of our worldwide business operations based on product offerings.

Applications. Our Applications products are pre-configured Decision Management applications and associated professional services, designed for a specific type of business problem or process, such as marketing, account origination, customer management, fraud and insurance claims management.

Scores. This segment includes our business-to-business scoring solutions, our myFICO® solutions for consumers and associated professional services. Our scoring solutions give our clients access to analytics that can be easily integrated into their transaction streams and decision-making processes. Our scoring solutions are distributed through major credit reporting agencies, as well as services through which we provide our scores to clients directly.

Tools. The Tools segment is composed of software tools and associated professional services that clients can use to create their own custom Decision Management applications.

Our Chief Executive Officer evaluates segment financial performance based on segment revenues and segment operating income. Segment operating expenses consist of direct and indirect costs principally related to personnel, facilities, consulting, travel and depreciation. Indirect costs are allocated to the segments generally based on relative segment revenues, fixed rates established by management based upon estimated expense contribution levels and other assumptions that management considers reasonable. We do not allocate share-based compensation expense, restructuring expense, amortization expense, various corporate charges and certain other income and expense measures to our segments. These income and expense items are not allocated because they are not considered in evaluating the segment s operating performance. Our Chief Executive Officer does not evaluate the financial performance of each segment based on its respective assets or capital expenditures; rather, depreciation amounts are allocated to the segments from their internal cost centers as described above.

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The following tables summarize segment information for the quarters ended December 31, 2012 and 2011:

	Quarter ended December 31, 2012				
	Applications	Scores	Tools (In thousands)	Unallocated Corporate Expenses	Total
Segment revenues:					
Transactional and maintenance	$ 79,625	$ 42,437	$ 7,836	$	$ 129,898
Professional services	26,159	903	5,275		32,337
License	18,923	107	8,755		27,785
Total segment revenues	124,707	43,447	21,866		190,020
Segment operating expense	(91,735)	(13,781)	(18,405)	(10,612)	(134,533)
Segment operating income	$ 32,972	$ 29,666	$ 3,461	$ (10,612)	55,487
Unallocated share-based compensation expense					(5,832)
Unallocated amortization expense					(3,372)
Unallocated restructuring and acquisition-related					(3,289)
Operating income					42,994
Unallocated interest income					21
Unallocated interest expense					(7,880)
Unallocated other expense, net					(92)
Income before income taxes					$ 35,043
Depreciation expense	$ 3,285	$ 216	$ 471	$ 629	$ 4,601

	Quarter ended December 31, 2011				
	Applications	Scores	Tools (In thousands)	Unallocated Corporate Expenses	Total
Segment revenues:					
Transactional and maintenance	$ 64,272	$ 42,197	$ 7,714	$	$ 114,183
Professional services	24,327	288	4,078		28,693
License	21,617	57	5,799		27,473
Total segment revenues	110,216	42,542	17,591		170,349
Segment operating expense	(70,090)	(13,295)	(15,341)	(12,864)	(111,590)
Segment operating income	$ 40,126	$ 29,247	$ 2,250	$ (12,864)	58,759
Unallocated share-based compensation expense					(4,757)
Unallocated amortization expense					(1,930)
Operating income					52,072
Unallocated interest income					88
Unallocated interest expense					(7,987)
Unallocated other expense, net					(548)

Income before income taxes									$	43,625
Depreciation expense	$	2,795	$	220	$	373	$	210	$	3,598

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14. Contingencies

We are in disputes with certain customers regarding amounts owed in connection with the sale of certain of our products and services. We also have had claims asserted by former employees relating to compensation and other employment matters. We are also involved in various other claims and legal actions arising in the ordinary course of business. We record litigation accruals for legal matters which are both probable and estimable. For legal proceedings for which there is a reasonable possibility of loss (meaning those losses for which the likelihood is more than remote but less than probable), we have determined we do not have material exposure on an aggregate basis.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

FORWARD LOOKING STATEMENTS

Statements contained in this report that are not statements of historical fact should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Act). In addition, certain statements in our future filings with the Securities and Exchange Commission (SEC), in press releases, and in oral and written statements made by us or with our approval that are not statements of historical fact constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenue, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other statements concerning future financial performance; (ii) statements of our plans and objectives by our management or Board of Directors, including those relating to products or services, research and development, and the sufficiency of capital resources; (iii) statements of assumptions underlying such statements, including those related to economic conditions; (iv) statements regarding business relationships with vendors, customers or collaborators, including the proportion of revenues generated from international as opposed to domestic customers; and (v) statements regarding products, their characteristics, performance, sales potential or effect in the hands of customers. Words such as believes, anticipates, expects, intends, targeted, should, potential, goals, strategy, and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to, those described in Part II, Item 1A, Risk Factors. The performance of our business and our securities may be adversely affected by these factors and by other factors common to other businesses and investments, or to the general economy. Forward-looking statements are qualified by some or all of these risk factors. Therefore, you should consider these risk factors with caution and form your own critical and independent conclusions about the likely effect of these risk factors on our future performance. Such forward-looking statements speak only as of the date on which statements are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events or circumstances. Readers should carefully review the disclosures and the risk factors described in this and other documents we file from time to time with the SEC, including our reports on Forms 10-Q and 8-K to be filed by FICO in fiscal 2013.

OVERVIEW

We are a leader in Decision Management solutions that enable businesses to automate, improve and connect decisions to enhance business performance. Our predictive analytics, which include the industry standard FICO® score, and our Decision Management systems power billions of customer decisions each year. We help companies acquire customers more efficiently, increase customer value, reduce fraud and credit losses, lower operating expenses and enter new markets more profitably. Our clients utilize our products and services to facilitate a variety of business processes, including customer marketing and acquisition, account origination, credit and underwriting risk management, fraud loss prevention and control, and client account and policyholder management. Most leading banks and credit card issuers rely on our solutions, as do many insurers, retailers, healthcare organizations, pharmaceutical companies and government agencies. We also serve consumers through online services that enable people to purchase and understand their FICO® scores, the standard measure in the United States of credit risk, empowering them to manage their financial health.

A significant portion of our revenues are derived from the sale of products and services within the consumer banking industry, and 72% and 75% of our revenues were derived from within this industry during the quarters ended December 31, 2012 and 2011, respectively. Our remaining revenues are primarily derived from the insurance, healthcare and retail industries. Our revenues derived from clients outside the United States have generally grown, and may in the future grow more rapidly than our revenues from domestic clients. International revenues totaled $75.3 million and $72.3 million during the quarters ended December 31, 2012 and 2011, respectively, representing 40% and 42% of total consolidated revenues in each of these periods.

A significant portion of our revenues are derived from transactional or unit-based software license fees, annual license fees under long-term software license arrangements, transactional fees derived under scoring, network service or internal hosted software arrangements, and annual software maintenance fees. Arrangements with transactional or unit-based pricing accounted for approximately 68% and 67% of our revenues during the quarters ended December 31, 2012 and 2011, respectively. The recurrence of these revenues is, to a significant degree, dependent upon our clients continued usage of our products and services in their business activities. The more significant activities underlying the use of our products in these areas include: credit and debit card usage or active account levels; lending acquisition, origination and customer management activity; and customer acquisition, cross selling and retention programs. We also derive revenues from other sources which generally do not recur and include, but are not limited to, perpetual or time-based licenses with upfront payment terms and non-recurring consulting service arrangements.