Monotype Imaging Holdings Inc.
Form 10-Q
November 02, 2010
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, 2010

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 ¨ 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 October 28, 2010 was 34,991,446.

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)

	September 30, 2010	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 54,621	$ 34,616
Accounts receivable, net of allowance for doubtful accounts of $135 at September 30, 2010 and $82 at December 31, 2009	4,036	5,145
Income tax refunds receivable		885
Deferred income taxes	1,013	878
Prepaid expense and other current assets	2,437	1,666
Total current assets	62,107	43,190
Property and equipment, net	1,595	1,790
Goodwill	138,485	140,745
Intangible assets, net	78,214	85,088
Other assets	5,586	1,564
Total assets	$ 285,987	$ 272,377
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 305	$ 395
Accrued expenses and other current liabilities	10,293	8,635
Accrued income taxes	1,704	903
Deferred revenue	12,477	6,446
Current portion of long-term debt	19,250	16,293
Total current liabilities	44,029	32,672
Long-term debt, less current portion	59,279	75,060
Other long-term liabilities	852	784
Deferred income taxes	19,878	18,310
Reserve for income taxes, net of current portion	1,118	1,550
Accrued pension benefits	3,499	3,479
Commitments and contingencies *(Note 15)*		
Stockholders equity:		
Preferred stock, $0.001 par value, Authorized shares: 10,000,000; Issued and outstanding: none		
	35	35

Common stock, $0.001 par value, Authorized shares: 250,000,000; Issued: 35,071,425 at September 30, 2010 and 34,668,554 at December 31, 2009				
Additional paid-in capital		153,719		148,273
Treasury stock, at cost, 95,516 shares at September 30, 2010 and December 31, 2009		(86)		(86)
Retained earnings (accumulated deficit)		2,186		(10,043)
Accumulated other comprehensive income		1,478		2,343
Total stockholders equity		157,332		140,522
Total liabilities and stockholders equity	$	285,987	$	272,377

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, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenue	$ 28,358	$ 23,032	$ 77,254	$ 68,889
Costs and expenses:				
Cost of revenue	1,825	1,788	5,553	4,991
Cost of revenue amortization of acquired technology	869	847	2,608	2,535
Total cost of revenue	2,694	2,635	8,161	7,526
Gross profit	25,664	20,397	69,093	61,363
Operating expenses:				
Marketing and selling	6,731	5,795	18,909	17,287
Research and development	3,934	3,350	11,525	10,184
General and administrative	4,104	3,565	12,200	10,797
Amortization of other intangible assets	1,189	1,190	3,577	3,547
Total operating expenses	15,958	13,900	46,211	41,815
Income from operations	9,706	6,497	22,882	19,548
Other (income) expense:				
Interest expense	1,084	1,009	3,387	3,243
Interest income			(13)	(60)
(Gain) loss on foreign exchange	(1,202)	(688)	1,487	(693)
Loss (gain) on derivatives	1,597	1,073	(168)	1,777
Other expense (income), net		21	(9)	7
Total other expense	1,479	1,415	4,684	4,274
Income before provision for income taxes	8,227	5,082	18,198	15,274
Provision for income taxes	2,304	2,063	5,969	5,894
Net income	$ 5,923	$ 3,019	$ 12,229	$ 9,380
Net income available to common shareholders basic & diluted	$ 5,886	$ 3,001	$ 12,152	$ 9,315
Net income per common share:				
Basic	$ 0.17	$ 0.09	$ 0.35	$ 0.27
Diluted	$ 0.16	$ 0.08	$ 0.34	$ 0.26
Weighted average number of shares:				
Basic	35,208,237	34,403,363	34,710,406	34,330,162
Diluted	36,264,638	35,430,772	35,910,668	35,185,514

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, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities		
Net income	$ 12,229	$ 9,380
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,966	6,949
Loss on retirement of fixed assets	3	20
Amortization of deferred financing costs	614	544
Share based compensation	4,206	3,904
Excess tax benefit on stock options	(533)	(55)
Provision for doubtful accounts	68	(92)
Deferred income taxes	749	873
Unrealized currency loss (gain) on foreign denominated intercompany transactions	1,043	(676)
Unrealized (gain) loss on derivatives	(237)	1,010
Changes in operating assets and liabilities:		
Accounts receivable	1,033	1,614
Prepaid expenses and other assets	876	(54)
Accounts payable	(81)	551
Accrued income taxes	1,113	(839)
Accrued expenses and other liabilities	2,694	(3,226)
Deferred revenue	4,965	2,444
Net cash provided by operating activities	35,708	22,347
Cash flows from investing activities		
Purchases of property and equipment	(633)	(834)
Purchase of exclusive license	(3,000)	
Net cash used in investing activities	(3,633)	(834)
Cash flows from financing activities		
Payments on long-term debt	(13,438)	(14,907)
Excess tax benefit on stock options	533	55
Proceeds from exercises of common stock options	585	77
Net cash used in financing activities	(12,320)	(14,775)
Effect of exchange rates on cash and cash equivalents	250	53
Increase in cash and cash equivalents	20,005	6,791
Cash and cash equivalents at beginning of period	34,616	31,941
Cash and cash equivalents at end of period	$ 54,621	$ 38,732

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

Table of Contents

MONOTYPE IMAGING HOLDINGS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

1. Nature of the Business

Monotype Imaging Holdings Inc. (the Company or we) is a leading global provider of text imaging solutions. 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 a range of consumer electronics (CE) devices, including laser printers, digital copiers, mobile phones, digital televisions, set-top boxes, navigation devices, digital cameras, e-book readers and consumer appliances, as well as in numerous software applications and operating systems. We license our text imaging solutions to CE device manufacturers, independent software vendors and creative and business professionals. We operate in one business segment: the development, marketing and licensing of technologies and fonts. We are headquartered in Woburn, Massachusetts and maintain various offices worldwide for selling and marketing, research and development and administration. We conduct our operations through two domestic operating subsidiaries, Monotype Imaging Inc. and International Typeface Corporation, and four foreign operating subsidiaries, Monotype Imaging Ltd., Linotype GmbH (Linotype), Monotype Imaging Hong Kong Ltd. and Monotype Imaging KK.

2. Basis of Presentation

The accompanying unaudited condensed consolidated interim financial statements as of September 30, 2010 and for the three and nine months ended September 30, 2010 and 2009 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, 2009 as reported in the Company s Annual Report on Form 10-K.

3. Recently Issued Accounting Pronouncements

Fair Value Measurements and Disclosures

In January 2010, the FASB issued Accounting Standards Codification (ASC) Topic No. 820, *Fair Value Measurements and Disclosures,* (ASC 820). ASC 820 improves disclosures about fair value measurements, requiring disclosures about valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements (class Level 2 or Level 3). Details regarding each class level, as defined by ASC 820, can be found in Note 4. In addition, more details are required regarding significant transfers between Levels 1 and 2 and the reasons for these transfers. New disclosures and clarifications regarding existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for details regarding purchases, sales, issuances and settlements in the activity roll forward of class Level 3 which is effective for fiscal periods beginning after December 15, 2010 and interim periods within those fiscal periods. We adopted the first provision of ASC 820 and the adoption did not have a material impact on the Company s results of operations, financial position or liquidity.

Multiple-Deliverable Revenue Arrangements

In October 2009, the FASB approved for issuance ASC Subtopic No. 605-25, *Revenue Recognition Multiple-Element Arrangements*, (ASC 605-25). ASC 605-25 provides principles for allocation of consideration among its multiple-elements, allowing more flexibility in identifying and accounting for separate deliverables under an arrangement. It introduces an estimated selling price method for valuing the elements of a bundled arrangement if vendor-specific objective evidence or third-party evidence of selling price is not available, and significantly expands related disclosure requirements. ASC 605-25 is effective on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Alternatively, adoption may be on a retrospective basis, and early application is permitted. We do not expect the adoption of this pronouncement to have a material impact on the Company s results of operations, financial position or liquidity.

Table of Contents

4. Financial Instruments

Derivative Financial Instruments

On November 28, 2008, we entered into a long term interest rate swap contract to pay a fixed rate of interest of 2.2% in exchange for a floating rate interest payment tied to the one-month London Inter-Bank Offering Rate (LIBOR) to mitigate our exposure to interest rate fluctuations on our debt obligations. The contract has a notional amount of $50.0 million and matures on November 28, 2010. The total fair value of this financial instrument at September 30, 2010 and December 31, 2009 was a liability of approximately $0.2 million and $0.8 million, respectively.

On May 24, 2010, we entered into a long term interest rate swap contract to pay a fixed rate of interest of 1.5% in exchange for a floating rate interest payment tied to the one-month LIBOR beginning 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 has a notional amount of $50.0 million with a $20.0 million reduction in the notional amount in 2012 and matures on July 30, 2012. The total fair value of this financial instrument at September 30, 2010 was a liability of $0.7 million. We did not designate either contract as a hedge; as such, associated gains and losses are recorded in our condensed consolidated statements of income. The current portions of the interest rate swaps are included in accrued expenses and other current liabilities and the long-term portion of the swap is included in other long-term liabilities in the accompanying condensed consolidated balance sheets.

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 net gains of $1.3 million and $0.8 million for the three months ended September 30, 2010 and 2009, respectively, on the intercompany note. In the nine months ended September 30, 2010 and 2009, we incurred a net loss of $1.0 million and a gain of $0.9 million, respectively, on the intercompany note. The currency swap matures on December 14, 2012. The contract payment terms approximate the payment terms of this intercompany note. The currency swap contract reduces the availability under our revolving line-of-credit by $4.0 million. The total fair value of the financial instrument at September 30, 2010 and December 31, 2009 was an asset of approximately $1.5 million and $1.1 million, respectively. The current portion of the currency swap is included in prepaid expenses and other current assets and the long-term portion of the swap is included in other long-term assets in the accompanying condensed consolidated balance sheets.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Interest rate swaps	$ 354	$ 204	$ 839	$ 739
Currency swap	1,243	868	(1,010)	1,040
Other		1	3	(2)
Total	$ 1,597	$ 1,073	$ (168)	$ 1,777

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.

Table of Contents

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.

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, 2010		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Derivatives currency swap, current portion	$ 616	$	$ 616	$
Derivatives currency swap, long-term portion	873		873	
Total assets	$ 1,489	$	$ 1,489	$
Liabilities:				
Derivatives interest rate swaps, current portion	$ 594	$	$ 594	$
Derivatives interest rate swaps, long-term portion	290		290	
Total liabilities	$ 884	$	$ 884	$

The Company s recurring fair value measurements relate to derivative instruments. 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, 2010 the fair value of our long-term debt approximated its carrying value of $78.5 million. The Company s non-financial assets and non-financial liabilities subject to non-recurring measurements include goodwill and intangible assets.

5. Intangible Assets and Other Long-term Assets

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

		September 30, 2010			December 31, 2009		
	Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer relationships	9-15	$ 46,707	$ (25,309)	$ 21,398	$ 47,025	$ (22,040)	$ 24,985
Acquired technology	8-15	44,331	(18,556)	25,775	44,449	(15,968)	28,481
Non-compete agreements	3-6	11,614	(11,275)	339	11,685	(11,072)	613
Trademarks		26,302		26,302	26,609		26,609
Domain names		4,400		4,400	4,400		4,400
Total		$ 133,354	$ (55,140)	$ 78,214	$ 134,168	$ (49,080)	$ 85,088

In March 2010, we entered into a $3.0 million font license that expires in December 2020. The license has been classified as other long term assets on the condensed consolidated balance sheet and is being amortized on a straight-line basis over its contractual term.

Table of Contents

6. Debt

Long-term debt consists of the following (in thousands):

	September 30, 2010	December 31, 2009
Credit Facility $79.5 million, interest at London Inter-Bank Offering Rate (LIBOR) plus 2.75% (4.01% at September 30, 2010), and $0.2 million at Prime plus 1.25% (5.50% at September 30, 2010) due in monthly installments of principal and interest through July 2012	$ 79,700	$ 93,138
Less unamortized financing costs	(1,171)	(1,785)
Total debt	78,529	91,353
Less current portion	(19,250)	(16,293)
Long-term debt	$ 59,279	$ 75,060

We are subject to a maximum leverage ratio under the terms of our credit facility arranged by Wells Fargo Foothill, or our Amended and Restated Credit Agreement, and we were in compliance with the covenants under our Amended and Restated Credit Agreement as of September 30, 2010.

7. Defined Benefit Pension Plan

Linotype maintains an unfunded defined benefit pension plan based on the Versorgungsordnung der Heidelberger Druckmaschinen AG (the Linotype Plan) which covers substantially all employees of Linotype who joined before April 1, 2006, at which time the Linotype Plan was closed. Employees 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 statement of income were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Service cost	$ 20	$ 20	$ 60	$ 56
Interest cost	40	43	123	124
Net periodic benefit cost	$ 60	$ 63	$ 183	$ 180

8. 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,

	2010		2009	
Provision for income taxes at statutory rate	$ 2,879	35.0%	$ 1,779	35.0%
State and local income taxes, net of federal tax benefit	54	0.7%	24	0.5%
Stock compensation	78	1.0%	124	2.4%
Effect of rate changes on deferred taxes	(158)	(1.9)%		
Reversal of reserve for income taxes	(351)	(4.3)%		
Other, net	(198)	(2.5)%	136	2.7%
Reported income tax provision	$ 2,304	28.0%	$ 2,063	40.6%

Table of Contents

	Nine Months Ended September 30,			
	2010		2009	
Provision for income taxes at statutory rate	$ 6,369	35.0%	$ 5,346	35.0%
State and local income taxes, net of federal tax benefit	240	1.3%	257	1.7%
Stock compensation	183	1.0%	330	2.2%
Effect of rate changes on deferred taxes	(158)	(0.9)%		
Reversal of reserve for income taxes	(351)	(1.9)%		
Other, net	(314)	(1.7)%	(39)	(0.3)%
Reported income tax provision	$ 5,969	32.8%	$ 5,894	38.6%