Monotype Imaging Holdings Inc.
Form 10-Q
October 30, 2012
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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, 2012

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 October 23, 2012 was 37,012,522.

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MONOTYPE IMAGING HOLDINGS INC.

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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, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 37,988	$ 53,850
Accounts receivable, net of allowance for doubtful accounts of $98 at September 30, 2012 and $91 at December 31, 2011	6,383	6,588
Income tax refunds receivable	429	733
Deferred income taxes	2,529	506
Prepaid expense and other current assets	3,249	3,228
Total current assets	50,578	64,905
Property and equipment, net	2,510	2,404
Goodwill	172,090	140,807
Intangible assets, net	86,463	71,664
Deferred income taxes	328	396
Other assets	3,227	3,646
Total assets	$ 315,196	$ 283,822
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 1,148	$ 1,123
Accrued expenses and other current liabilities	14,296	12,235
Accrued income taxes	2,438	1,280
Deferred revenue	6,854	7,742
Current portion of long-term debt	10,000	10,000
Total current liabilities	34,736	32,380
Long-term debt, less current portion	22,321	27,321
Other long-term liabilities	511	225
Deferred income taxes	26,804	20,596
Reserve for income taxes, net of current portion	901	1,174
Accrued pension benefits	3,924	3,765
Commitments and contingencies *(Note 14)*		
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: 37,061,266 at September 30, 2012 and 36,341,383 at December 31, 2011	37	36
Additional paid-in capital	175,723	167,448
Treasury stock, at cost, 103,975 shares at September 30, 2012 and 98,527 shares at December 31, 2011	(86)	(86)
Retained earnings	50,631	30,986
Accumulated other comprehensive income (loss)	(306)	(23)

Total stockholders equity		225,999		198,361
Total liabilities and stockholders equity	$	315,196	$	283,822

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

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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,	
	2012	**2011**	**2012**	**2011**
Revenue	$ 37,982	$ 30,695	$ 110,827	$ 91,490
Costs and expenses:				
Cost of revenue	5,426	2,503	15,164	7,490
Cost of revenue amortization of acquired technology	1,085	798	2,965	2,373
Total cost of revenue	6,511	3,301	18,129	9,863
Gross profit	31,471	27,394	92,698	81,627
Operating expenses:				
Marketing and selling	8,614	8,169	26,605	24,198
Research and development	4,617	4,116	13,549	12,176
General and administrative	4,386	4,284	14,011	12,621
Amortization of other intangible assets	1,405	1,252	4,057	3,847
Total operating expenses	19,022	17,821	58,222	52,842
Income from operations	12,449	9,573	34,476	28,785
Other (income) expense:				
Interest expense	457	587	1,461	2,388
Interest income	(6)	(29)	(22)	(91)
Loss (gain) on foreign exchange	24	215	301	(266)
Loss (gain) on derivatives	65	(536)	(14)	487
Loss on extinguishment of debt		422		422
Other expense, net	33	2	19	2
Total other expense	573	661	1,745	2,942
Income before provision for income taxes	11,876	8,912	32,731	25,843
Provision for income taxes	3,886	2,920	11,606	8,813
Net income	$ 7,990	$ 5,992	$ 21,125	$ 17,030
Net income available to common shareholders basic & diluted	$ 7,857	$ 5,891	$ 20,779	$ 16,753
Net income per common share:				
Basic	$ 0.22	$ 0.17	$ 0.57	$ 0.48
Diluted	$ 0.21	$ 0.16	$ 0.55	$ 0.46
Weighted average number of shares:				
Basic	36,323,556	35,447,484	36,217,950	35,267,592
Diluted	37,620,269	36,829,518	37,600,448	36,703,298
Dividends declared per share	$ 0.04	$	$ 0.04	$

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

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MONOTYPE IMAGING HOLDINGS INC.

STATEMENT OF CONSOLIDATED COMPREHENSIVE INCOME

(Unaudited and in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net income	$ 7,990	$ 5,992	$ 21,125	$ 17,030
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	429	(2,211)	(283)	(20)
Comprehensive income	$ 8,419	$ 3,781	$ 20,842	$ 17,010

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

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MONOTYPE IMAGING HOLDINGS INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and in thousands)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Cash flows from operating activities		
Net income	$ 21,125	$ 17,030
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,985	6,987
Loss on retirement of fixed assets		2
Amortization of deferred financing costs	228	403
Loss on extinguishment of debt		422
Share based compensation	5,300	5,128
Excess tax benefit on stock options	(878)	(1,046)
Provision for doubtful accounts	8	95
Deferred income taxes	1,987	855
Unrealized currency gain on foreign denominated intercompany transactions	(96)	(124)
Unrealized loss on derivatives	432	326
Changes in operating assets and liabilities:		
Accounts receivable	616	(1,932)
Prepaid expenses and other assets	(238)	521
Accounts payable	17	(274)
Accrued income taxes	1,756	(857)
Income tax refunds receivable	(429)	6
Accrued expenses and other liabilities	(441)	(1,474)
Deferred revenue	(928)	2,169
Net cash provided by operating activities	36,444	28,237
Cash flows from investing activities		
Purchases of property and equipment	(1,046)	(1,462)
Purchase of exclusive license and other intangible assets	(150)	
Acquisition of business, net of cash acquired	(49,090)	(219)
Net cash used in investing activities	(50,286)	(1,681)
Cash flows from financing activities		
Payments on long-term debt	(30,000)	(76,845)
Proceeds from issuance of debt	25,000	56,065
Excess tax benefit on stock options	878	1,046
Proceeds from exercises of common stock options	2,098	1,840
Net cash used in financing activities	(2,024)	(17,894)
Effect of exchange rates on cash and cash equivalents	4	30
(Decrease) increase in cash and cash equivalents	(15,862)	8,692
Cash and cash equivalents at beginning of period	53,850	42,786
Cash and cash equivalents at end of period	$ 37,988	$ 51,478

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

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MONOTYPE IMAGING HOLDINGS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

1. Nature of the Business

Monotype Imaging Holdings Inc. (the Company or we) is a leading provider of typefaces, technology and expertise for creative applications and consumer devices. Our end-user and embedded solutions for print, web and mobile environments enable people to create and consume dynamic content on any and every device. The Company s technologies and fonts enable the display and printing of high quality digital content. Our technologies and fonts have been widely deployed across, and embedded in, a range of consumer electronics, or 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 text imaging solutions 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., International Typeface Corporation and Bitstream Inc. (Bitstream), and five foreign subsidiaries, Monotype Imaging Ltd., Linotype GmbH (Linotype), Bitstream India Pvt. Ltd., 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, 2012 and for the three and nine months ended September 30, 2012 and 2011 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, 2011 as reported in the Company s Annual Report on Form 10-K.

3. Recently Issued Accounting Pronouncements

Indefinite-Lived Intangible Assets

In July 2012, the Financial Accounting Standards Board (FASB) issued ASC Topic No. 350, *Intangibles Goodwill and Other,* which amended its guidance on the testing of indefinite-lived intangible assets for impairment to simplify and improve consistency of impairment testing guidance among long-lived asset categories. After an assessment of certain qualitative factors, if it is determined to be more likely than not that an indefinite-lived asset is impaired entities must perform the quantitative impairment test. Otherwise, the quantitative test is optional. The statement is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. We perform our annual testing in the fourth quarter; consequently, the Company is expected to adopt the new standard effective with our current fiscal year end, December 31, 2012. The adoption of this guidance is not expected to have a material impact on the Company s financial results.

Comprehensive Income

In June 2011, the FASB issued ASC Topic No. 220, *Comprehensive Income*, which amended its guidance on the presentation of comprehensive income in financial statements to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items that are recorded in other comprehensive income. The new accounting guidance requires entities to report components of comprehensive income in either (1) a single statement of comprehensive income immediately following the income statement, or (2) a separate statement of comprehensive income immediately following the income statement. Companies will no longer be allowed to present comprehensive income on the statement of changes in shareholders equity. In both options, companies must present the components of net income, total net income, the components of other comprehensive income, total other comprehensive income and total comprehensive income. In addition, in December 2011, the FASB issued an amendment to the standard which defers the requirement to present components of reclassifications of other comprehensive income on the face of the income statement. The provisions of both pieces of new guidance are effective for fiscal years, and interim periods within those years,

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beginning after December 15, 2011, and will require retrospective application for all periods presented. We adopted the new standard effective January 1, 2012, which has impacted our presentation of comprehensive income, but did not otherwise impact our financial position or results of operations.

4. Acquisition

On March 19, 2012, we acquired all of the outstanding shares of Bitstream Inc. in an all cash merger for approximately $49.6 million. The Company used approximately $24.6 million in cash and borrowed $25.0 million from its revolving Credit Facility. We have recorded approximately $58 thousand in restricted cash at September 30, 2012, which represents the portion of the purchase price for Bitstream s shareholders who have not yet tendered their shares. The Agreement and Plan of Merger (Merger Agreement) dated November 10, 2011 is by and among the Company, Bitstream and Birch Acquisition Corporation, a Delaware corporation and wholly-owned subsidiary of the Company (the Merger Subsidiary). In accordance with the Merger Agreement, the Merger Subsidiary was merged with and into Bitstream, terminating the separate corporate existence of the Merger Subsidiary, with Bitstream continuing as the surviving corporation of the merger and a wholly-owned subsidiary of the Company. In accordance with the Merger Agreement, on March 14, 2012 Bitstream spun off its mobile browsing and variable data publishing businesses into a separate entity.

Bitstream Inc., a Delaware corporation, and its wholly owned subsidiary, Bitstream India Pvt. Ltd., became wholly-owned subsidiaries of Monotype Imaging Holdings Inc. following the acquisition. Included in the acquisition is the MyFonts.com℠ website, featuring 89,000 fonts from nearly 900 foundries, in addition to the widely used WhatTheFont℠ identification service. The transaction also includes the Bitstream® typeface library, Font Fusion® and Bitstream Panorama font rendering and layout technologies, a range of fonts for embedded and mobile environments, and 10 patents. Twelve employees from Bitstream s U.S. operations and 42 engineers and type designers from Bitstream s India operations have joined the Company in connection with the acquisition.

The results of operations of Bitstream have been included in our consolidated financial statements since the date of acquisition and all intercompany balances have been eliminated. The total purchase price was allocated as follows:

	Estimated Fair Value At Acquisition Date (in thousands)
Cash, accounts receivable and other assets	$ 914
Deferred tax asset, short term	1,829
Goodwill	31,710
Intangible assets	21,770
Accrued expenses and deferred revenue	(2,413)
Deferred tax liability, long term	(4,238)
Total purchase price	$ 49,572

The estimated fair value of intangible assets acquired were preliminarily recorded as follows:

	Estimated Fair Value At Acquisition Date (in thousands)	Estimated Useful Life (In Years)
Customer relationships	$ 7,280	8-10
Technology	9,230	7-8
Trademarks	5,260	Indefinite
Total intangible assets	$ 21,770	

The amounts presented in both of the tables above are preliminary and are subject to change until the acquisition accounting is finalized. The goodwill reflects the value of the assembled workforce and the synergies we expect to realize from the Bitstream acquisition. Since we purchased the Bitstream legal entity, the goodwill and amortization of intangible assets are not deductible for tax purposes. The deferred tax assets acquired are primarily from Bitstream s net operating loss carryforwards, which we expect to utilize going forward. The acquired finite-lived intangible assets will be amortized over their respective useful lives, on a straight-line basis.

5. 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 LIBOR beginning November 28, 2010 to mitigate our exposure to interest rate fluctuations on our debt obligations. The contract had a notional amount of $30.0 million and matured on July 30, 2012. The total fair value of this financial instrument at December 31, 2011 was a liability of $0.2 million. We did not designate this contract as a hedge; as such, associated gains and losses are recorded in our condensed consolidated statements of income. At December 31, 2011, the current portion of the interest rate swap is included in accrued expenses and other current liabilities in the accompanying condensed consolidated balance sheet.

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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 and a net loss of $0.6 million for the three months ended September 30, 2012 and 2011, respectively, on the intercompany note. In the nine months ended September 30, 2012 and 2011, we incurred a net loss of $29 thousand and a net gain of $0.2 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 total fair value of the financial instrument at September 30, 2012 and December 31, 2011 was an asset of approximately $0.2 million and $0.9 million, respectively. The current portion of the currency swap is included in prepaid expenses and other current 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,	
	2012	2011	2012	2011
Interest rate swaps	$	$ 6	$ 26	$ 146
Currency swap	65	(542)	(40)	341
Total	$ 65	$ (536)	$ (14)	$ 487

We also incur foreign currency exchange gains and losses related to certain customers that are invoiced in U.S. dollars, but who have the option to make an equivalent payment in their own functional currencies at a specified exchange rate as of a specified date. In the period from that date until payment in the customer s functional currency is received and converted into U.S. dollars, we can incur unrealized gains and losses. We utilize forward contracts with maturities of 90 days or less to hedge our exposure to these currency fluctuations. Any increase or decrease in the fair value of the forward contracts is offset by the change in the value of the hedged assets of our consolidated foreign affiliate. There were no outstanding currency hedges at September 30, 2012 or December 31, 2011.

6. Fair Value Measurements

Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, the Codification establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets and liabilities or market corroborated inputs.

Level 3: Unobservable inputs are used when little or no market data is available and requires the Company to develop its own assumptions about how market participants would price the assets or liabilities. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimizes the use of unobservable inputs to the extent possible as well as considers counterparty and our own credit risk in its assessment of fair value.

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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, 2012			
	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	$ 1,441	$ 1,441	$	$
Cash equivalents commercial paper	7,749		7,749	
Cash equivalents corporate bonds	4,258		4,258	
Derivatives currency swap, current portion	249		249	
Total assets	$ 13,697	$ 1,441	$ 12,256	$

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 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, 2012 the fair value of our long-term debt approximated its carrying value of $32.3 million. The Company s non-financial assets and non-financial liabilities subject to non-recurring measurements include goodwill and intangible assets.

7. Intangible Assets and Goodwill

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

		September 30, 2012			December 31, 2011		
	Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer relationships	7-15	$ 56,448	$ (35,015)	$ 21,433	$ 49,222	$ (31,080)	$ 18,142
Acquired technology	8-15	50,763	(23,998)	26,765	39,742	(21,038)	18,704
Non-compete agreements	3-6	11,984	(11,696)	288	11,995	(11,605)	390
Trademarks		33,577		33,577	30,028		30,028
Domain names		4,400		4,400	4,400		4,400
Total		$ 157,172	$ (70,709)	$ 86,463	$ 135,387	$ (63,723)	$ 71,664

The goodwill balance at September 30, 2012, of $172.1 million, includes $31.7 million of goodwill associated with our acquisition of Bitstream. Goodwill decreased $0.4 million in the nine months ended September 30, 2012 due to foreign currency exchange rate changes. Our net intangible assets at September 30, 2012 increased $20.8 million as a result of the Bitstream acquisition. Note 4 provides the details of the increase by category.

8. Debt

On July 13, 2011 the Company entered into a new credit agreement with Wells Fargo Capital Finance, LLC, or the Credit Facility, and terminated its Amended and Restated Credit Agreement, which was scheduled to expire on July 30, 2012. The Credit Facility 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 London Interbank Offering Rate, (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 September 30, 2012 our rates, inclusive of applicable margins, were 2.5% and 4.5% for LIBOR and prime, respectively. At September 30, 2012, our blended interest rate was 2.5%. 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

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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 places limits on the Company and its subsidiaries ability to incur debt or liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, engage in mergers, acquisitions and asset sales, transact with affiliates and alter its business. We were in compliance with all covenants under our Credit Facility as of September 30, 2012.

In accordance with ASC Subtopic No. 210-10-45, *Balance Sheet, Other Presentation Matters*, the Company has classified $10.0 million in the current portion of long-term debt within the consolidated balance sheet at September 30, 2012, 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.

In connection with the refinancing, the Company incurred closing fees of $0.8 million plus legal fees of approximately $0.5 million. In accordance with ASC Subtopic No. 470-50, *Modifications and Extinguishments of Debt*, these fees have been accounted for as deferred financing costs and will be amortized to interest expense over the term of the Credit Facility.

9. 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,	
	2012	2011	2012	2011
Service cost	$ 21	$ 21	$ 62	$ 64
Interest cost	44	45	132	138
Net periodic benefit cost	$ 65	$ 66	$ 194	$ 202

10. 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,			
	2012		2011	
Provision for income taxes at statutory rate	$ 4,157	35.0%	$ 3,119	35.0%
State and local income taxes, net of federal tax benefit	181	1.5%	110	1.2%
Stock compensation	79	0.7%	51	0.6%
Research credits			(88)	(1.0)%
Effect of rate changes on deferred taxes	33	0.3%		
Reversal of reserve for income taxes	(383)	(3.2)%	(35)	(0.4)%
Disqualifying dispositions on incentive stock options	(42)	(0.4)%	(40)	(0.5)%
Other, net	(139)	(1.2)%	(197)	(2.1)%

Reported income tax provision	$ 3,886	32.7%	$ 2,920	32.8%

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	Nine Months Ended September 30, 2012		2011	
Provision for income taxes at statutory rate	$ 11,456	35.0%	$ 9,045	35.0%
State and local income taxes, net of federal tax benefit	468	1.4%	318	1.2%
Stock compensation	213	0.7%	179	0.7%
Research credits			(231)	(0.9)%
Effect of rate changes on deferred taxes	161	0.5%	9	
Reversal of reserve for income taxes	(383)	(1.2)%	(35)	(0.1)%
Disqualifying dispositions on incentive stock options	(121)	(0.4)%	(135)	(0.5)%
Other, net	(188)	(0.5)%	(337)	(1.3)%
Reported income tax provision	$ 11,606	35.5%	$ 8,813	34.1%

At September 30, 2012 and December 31, 2011, the reserve for uncertain tax positions (including related interest) was approximately $0.9 million and $1.2 million, respectively.

11. 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.

For all periods presented, the treasury stock 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 and diluted net income per share (in thousands, except share and per share data):

	Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Numerator:				
Net income, as reported	$ 7,990	$ 5,992	$ 21,125	$ 17,030
Less: net income attributable to participating securities	(133)	(101)	(346)	(277)
Net income available to common shareholders basic and diluted	$ 7,857	$ 5,891	$ 20,779	$ 16,753
Denominator:				
Basic:				
Weighted-average shares of common stock outstanding	36,936,791	36,053,462	36,822,423	35,852,081
Less: weighted-average shares of unvested restricted common stock outstanding	(613,235)	(605,978)	(604,473)	(584,489)
Weighted-average number of common shares used in computing basic net income per common share	36,323,556	35,447,484	36,217,950	35,267,592

Net income per share applicable to common shareholders basic	$	0.22	$	0.17	$	0.57	$	0.48

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	Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Diluted:				
Weighted-average shares of common stock outstanding	36,936,791	36,053,462	36,822,423	35,852,081
Less: weighted-average shares of unvested restricted common stock outstanding	(613,235)	(605,978)	(604,473)	(584,489)
Weighted-average number of common shares issuable upon exercise of outstanding stock options, based on the treasury stock method	1,169,883	1,262,393	1,252,747	1,317,987
Weighted-average number of restricted stock outstanding, based on the treasury stock method	126,830	119,641	129,751	117,719
Weighted-average number of common shares used in computing diluted net income per common share	37,620,269	36,829,518	37,600,448	36,703,298
Net income per share applicable to common shareholders diluted	$ 0.21	$ 0.16	$ 0.55	$ 0.46

The following common share equivalents have been excluded from the computation of diluted weighted-average shares outstanding, as their effect would have been anti-dilutive:

	Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Options	1,937,631	1,765,782	1,818,198	1,486,671
Unvested restricted stock	0	7,468	1,861	16,171

12. Share Based Compensation

We account for share based compensation in accordance with ASC Topic No. 718, *Compensation Stock Compensation*, which requires the measurement of compensation costs at fair value on the date of grant and recognition of compensation expense over the service period for awards expected to vest. The following presents the impact of share based compensation expense on our condensed consolidated statements of income (in thousands):

	Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Marketing and selling	$ 745	$ 777	$ 2,346	$ 2,172
Research and development	390	414	1,215	1,187
General and administrative	531	615	1,739	1,769
Total share based compensation	$ 1,666	$ 1,806	$ 5,300	$ 5,128

As of September 30, 2012, the Company had $13.5 million of unrecognized compensation expense, which is net of expected forfeitures, related to employees and directors unvested stock option awards and restricted stock awards that are expected to be recognized over a weighted average period of 2.0 years.

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13. Segment Reporting

We view our operations and manage our business as one segment: the development, marketing and licensing of technologies and fonts. Factors used to identify our single segment include the financial information available for evaluation by our chief operating decision maker in making decisions about how to allocate resources and assess performance. While our technologies and services are sold into two principal markets, OEM and Creative Professional, expenses and assets are not formally allocated to these market segments, and operating results are assessed on an aggregate basis to make decisions about the allocation of resources. The following table presents revenue for these two major markets (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
OEM	$ 24,280	$ 23,047	$ 73,873	$ 67,830
Creative Professional	13,702	7,648	36,954	23,660
Total	$ 37,982	$ 30,695	$ 110,827	$ 91,490

Geographic segment information

The Company attributes revenues to geographic areas based on the location of our subsidiary receiving such revenue. For example, licenses may be sold to large international companies which may be headquartered in Korea, but the sales are received and recorded by our subsidiary located in the United States. In this example, the revenue would be reflected in the United States totals in the table below. We market our products and services through offices in the U.S., United Kingdom, Germany, Hong Kong, Korea and Japan. The following summarizes revenue by location:

	Three Months Ended September 30,			
	2012		2011	
	Sales	% of Total	Sales	% of Total
	(In thousands, except percentages)			
United States	$ 20,045	52.8%	$ 14,758	48.1%
Asia	11,511	30.3	10,259	33.4
United Kingdom	1,066	2.8	1,211	3.9
Germany	5,360	14.1	4,467	14.6
Total	$ 37,982	100.0%	$ 30,695	100.0%

	Nine Months Ended September 30,			
	2012		2011	
	Sales	% of Total	Sales	% of Total
	(In thousands, except percentages)			
United States	$ 57,963	52.2%	$ 41,969	45.9%
Asia	33,982	30.7	31,762	34.7
United Kingdom	3,740	3.4	4,014	4.4
Germany	15,142	13.7	13,745	15.0
Total	$ 110,827	100.0%	$ 91,490	100.0%

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Long-lived assets, which include property and equipment, goodwill and intangibles assets, but exclude other assets, long-term investments and deferred tax assets, are attributed to geographic areas in which Company assets reside and is shown below (in thousands):

	September 30, 2012	December 31, 2011
Long-lived assets:		
United States	$ 204,596	$ 157,598
Asia	3,478	3,302
United Kingdom	61	82
Germany	52,928	