

Monotype Imaging Holdings Inc.  
Form 10-K  
March 01, 2012  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

December 31, 2011 For the fiscal year ended December 31, 2011

¨ **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)

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

**Delaware**  
(State of incorporation)  
**500 Unicorn Park Drive**

**20-3289482**  
(I.R.S. Employer Identification No.)

**Woburn, Massachusetts**  
(Address of principal executive offices)

**01801**  
(Zip Code)

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

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

**Securities Registered Pursuant to Section 12(b) of the Act:**

**Title of Each Class**  
**Common Stock, \$0.001 par value**

**Name of Exchange on Which Registered**  
**The NASDAQ Stock Market LLC**

**Securities Registered Pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

## Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-K

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant, computed by reference to the last reported sale price of the common stock as reported on the NASDAQ Global Select Market on June 30, 2011 was approximately \$315,116,677 (assumes officers, directors, and all shareholders beneficially owning 5% or more of the outstanding common shares are affiliates).

The number of shares outstanding of the registrant's common stock as of February 21, 2012 was approximately 36,284,883.

### **DOCUMENTS INCORPORATED BY REFERENCE.**

Portions of the registrant's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2012 Annual Meeting of Stockholders are incorporated herein by reference into Part III of this report.

**Table of Contents****MONOTYPE IMAGING HOLDINGS INC.****TABLE OF CONTENTS**

Item No.		Page No.
<b>PART I</b>		
Item 1.	<u>Business</u>	2
Item 1A.	<u>Risk Factors</u>	12
Item 1B.	<u>Unresolved Staff Comments</u>	24
Item 2.	<u>Properties</u>	25
Item 3.	<u>Legal Proceedings</u>	25
Item 4.	<u>Mine Safety Disclosures</u>	25
<b>PART II</b>		
Item 5.	<u>Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	26
Item 6.	<u>Selected Financial Data</u>	28
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
Item 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	49
Item 8.	<u>Financial Statements and Supplementary Data</u>	51
Item 9.	<u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	84
Item 9A.	<u>Controls and Procedures</u>	84
Item 9B.	<u>Other Information</u>	86
<b>PART III</b>		
Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	86
Item 11.	<u>Executive Compensation</u>	86
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	86
Item 13.	<u>Certain Relationships and Related Transactions, and Directors Independence</u>	86
Item 14.	<u>Principal Accounting Fees and Services</u>	86
<b>PART IV</b>		
Item 15.	<u>Exhibits and Financial Statement Schedules</u>	87
	<u>Signatures</u>	91

As used in this report, the terms we, us, our, Monotype Imaging and the Company mean Monotype Imaging Holdings Inc. and its subsidiaries unless the context indicates another meaning.

Unless otherwise noted, all dollar amounts in this report are expressed in United States dollars.

We own, have rights to, or have applied for the trademarks and trade names that we use in conjunction with our business, including our name and logo. All other trademarks and trade names appearing in this report are the property of their respective holders.

---

**Table of Contents**

**PART I**

**Item 1. Business**

*Certain statements in this Annual Report on Form 10-K are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ). These statements involve a number of risks, uncertainties and other factors that could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Factors which could materially affect such forward-looking statements can be found in the section entitled Risk Factors in Part 1, Item 1A in this Annual Report on Form 10-K. Investors are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements made herein are only made as of the date hereof and we will undertake no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances.*

**Overview**

Monotype Imaging Holdings Inc. 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 content. Our technologies 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. In the laser printer market, we have worked together with industry leaders for over 20 years to provide critical components embedded in printing standards. 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). Our technologies solve critical text imaging and user experience issues for CE device manufacturers by rendering high-quality text, graphics and user interfaces on low resolution and memory-constrained CE devices. We combine these proprietary technologies with access to more than 15,000 typefaces from a library of some of the most widely used designs in the world, including popular names such as Helvetica and Times New Roman. We also license our typefaces to creative and business professionals through our e-commerce websites, including *fonts.com*, *linotype.com*, *ascenderfonts.com*, *itcfonts.com* and *webfonts.fonts.com*, which combined attracted more than 40 million visits in 2011 from over 200 countries and territories, and through direct and indirect sales and custom font design services. Our principal office is located in Woburn, Massachusetts; with regional offices in San Mateo, California; Boulder, Colorado; Elk Grove Village, Illinois; New York City, New York; Salfords, United Kingdom; Bad Homburg, Germany (Linotype GmbH); Hong Kong, China (Monotype Imaging Hong Kong Ltd.); Seoul, South Korea; and Tokyo, Japan.

In 2006, we completed two acquisitions. Prior to 2006, we had a minority ownership interest in China Type Design Ltd., or China Type Design, a Hong Kong corporation specializing in font design. On July 28, 2006, the Company acquired the remaining capital stock of China Type Design. With the China Type Design acquisition, we acquired a library of East Asian stroke-based fonts and gained the internal capability to develop and produce these fonts. China Type Design was renamed Monotype Imaging Hong Kong Ltd. On August 1, 2006, the Company acquired Linotype GmbH, or Linotype, a German company and a leader in the development, marketing, licensing and servicing of digital fonts and proprietor of a font library comprised of typefaces. With the purchase of Linotype, we acquired access to a large library of fonts, a strong brand with a significant web presence and a more complete offering for the creative professional market.

On July 30, 2007, we completed an initial public offering and used the proceeds to restructure and pay down a portion of our debt. In June 2008, we completed a secondary offering of our common stock.

## **Table of Contents**

On December 10, 2009, we acquired the principal assets of Planetweb, Inc., a global provider of embedded user interface, or UI, software and developer tools for the consumer electronics industry. On December 8, 2010, we acquired Ascender Corporation and Font Commerce LLC, together Ascender, a privately held font provider. The acquisition enabled us to broaden our font intellectual property offerings, strengthen our relationship with key technology vendors and gain significant typeface design and development talent.

On November 10, 2011, we and Bitstream Inc., or Bitstream, announced that we had entered into a definitive agreement for Monotype Imaging to acquire Bitstream's font business in an all cash merger valued at \$50 million, subject to adjustments based on the net asset value of Bitstream. The transaction has been approved by the boards of directors for both companies. On January 30, 2012 we received a voluntary request for information from the United States Department of Justice (the DOJ) regarding the pending transaction. The DOJ also informed Monotype Imaging that it will likely issue a Civil Investigative Demand (CID) to Monotype Imaging pursuant to the Antitrust Civil Process Act of 1976. The transaction is expected to close following the resolution of the DOJ inquiry, as well as the satisfaction of customary closing conditions, the approval of the transaction by Bitstream's shareholders, and the spinoff by Bitstream of its mobile browsing and variable data publishing businesses. We anticipate financing the deal through a combination of cash balances and our secured revolving credit facility.

## **Industry Overview and Market Opportunity**

Our customers are seeking text imaging solutions and related display technologies that are comprehensive, powerful and easy to use. Our OEM and Creative Professional offerings address the needs of three types of customers: CE device manufacturers, including laser printer manufacturers; independent software vendors; and content creators. These customers use our products to enhance the creation, display, distribution and consumption of digital and print content.

### *CE Device Manufacturers*

CE devices, including laser printers, are marketed globally and increasingly require robust multi-media functionality, as consumers create rich digital content and/or acquire such content from service providers, over the Internet, as packaged media and from other users. CE device manufacturers must display multi-media content, including text, from these different sources, while being expected to provide a consistent look-and-feel across global CE devices, support worldwide languages and in many cases support enhanced navigation systems and brand personalization. As technologies enable media to move seamlessly from one CE device to another, scalable text imaging technologies, including multilingual type, and related display solutions that are optimized for these CE devices, become ever more critical. For example, PC-like rich media functionality has moved to the mobile phone platform and tablet computers, driving the adoption of robust scalable text on those devices. Digital televisions are incorporating scalable text for menu navigation, content delivery and connectivity, and appliance manufacturers worldwide are adding control panels with enhanced graphical user interfaces to improve the user experience and to provide consumers with additional control and functionality. The automotive industry is quickly moving towards digital displays with complex, worldwide language requirements and improved legibility for driver safety to support their evolving market. In addition, electronic publishing and the growth in e-book readers is driving the industry's need for robust, global text-display solutions. Our solutions are compatible with most major operating environments as well as those developed directly by CE device manufacturers.

The market for laser printers and digital copiers is generally more mature than the rest of the CE device market. As a result, the lower end of the market is becoming more commoditized. Laser printer manufacturers are responding by increasing the functionality of their products with advances such as a larger number of embedded fonts and color output, scanning and

## **Table of Contents**

copying capabilities, and enhanced control panel functionality. The increased capabilities are in turn driving the advancement of the printer industry, particularly the laser printer industry. Thus increased reliance by laser printer manufacturers on enhancing technologies to drive value, together with advancing capabilities and functionality of multimedia CE devices, favor comprehensive global text imaging solutions and related display technologies.

### *Independent Software Vendors*

Similar to CE devices, software solutions are marketed globally. For example, independent software vendors require multilingual text solutions for product user interfaces and a range of typefaces to add functionality to their application products. In addition, some software vendors seek to customize their offerings with fonts specific to their solutions. Others, including games manufacturers, require multiple, distinctive fonts to employ a unique look-and-feel within their applications.

Independent software vendors are distributing their solutions through multiple channels (including traditional CD-based distribution models, as well as software-as-a-service distribution through cloud-based computing distribution models) and to multiple devices (including PCs, mobile phones and other CE devices). As a result, software vendors require font technologies that allow their solutions to maintain a consistent, high-quality user experience regardless of distribution channel or device screen resolution.

### *Content Creators*

Content creators include creative professionals (such as graphic designers, advertisers, printers, publishers and bloggers) and non-professional creators of content (such as home users and other amateur writers, designers, bloggers and publishers). Both types of content creators produce electronic and /or printed material for distribution, and they seek creative ways to convey meaning and to differentiate identity. Fonts are an important tool for this differentiation. For example, creative and business professionals at multinational corporations are increasingly tasked with creating solutions that extend branding and marketing communications into new markets around the world. Creative and business professionals historically acquired fonts primarily from local or regional distributors or dealers, however, online font vendors have become the preferred channel due to their larger selection of typefaces, greater ease of use, and the ability to easily access font libraries from anywhere.

In addition, as more content is distributed electronically, content creators are seeking the same creative flexibility for digital documents as for printed documents. Historically, font options for web-based displays (such as websites, blogs and online applications) were limited to a standard set of approximately ten fonts that were common to all operating systems. Web font offerings provide creators of online content with a more extensive pallet of fonts from which to work. Web fonts are independent of a consumer's operating system and travel with the content to a user's device for consistent viewing regardless of the environment.

## **Our Products**

We develop end-user and embedded text imaging solutions and services that enable the display and printing of high-quality text in all of the world's major languages, including the following:

### *Font Products and Services*

Our e-commerce websites including *fonts.com*, *linotype.com*, *ascenderfonts.com* and *itcfonts.com* offer thousands of high-quality font products, in some cases more than 170,000, including our own libraries as well as third party owned fonts.

Our web font service, Fonts.com Web Fonts, accessible from *webfonts.fonts.com*, features more than 20,000 high-quality Web fonts for website design. Fonts.com Web Fonts offers a

## Table of Contents

superior range of fonts, language support and workflow capabilities. Unique to our service, a selection of desktop fonts may also be downloaded each month by professional-tier subscribers for creating website mockups. The evolution to cloud-based solutions also brings new opportunities for our Web font service, as operating environments and software applications require font support to deliver their desired functionality and performance.

Our Monotype, Linotype, ITC and the Ascender Originals typeface libraries contain more than 15,000 typefaces and include some of the world's most widely used designs, such as the Times New Roman, Helvetica, ITC Franklin Gothic and Droid typefaces.

We have strong relationships with a broad network of highly talented font designers and we offer custom font design services for corporate branding and identity purposes. Working directly with clients and through branding agencies, our type design experts developed the branding fonts used by many Fortune 1000 companies.

Our core sets of fonts consist of the PCL 6 and PostScript 3 font collections. These fonts are designed for compatibility with Hewlett Packard, or HP, and Adobe Systems Incorporated, or Adobe, font specifications.

Our FlipFont product enables end users to personalize their user experience through the use of fonts. For example, FlipFont allows mobile phone users to change their phone's user interface, or UI, font with mobile-optimized fonts chosen from a selection available from various online resources.

### *Font Scaling, Compression and Rasterizing Technologies*

Our primary laser printer imaging products are our font scaling engine, Universal Font Scaling Technology, or UFST, and our font compression technology, MicroType. Our font scaling engine and font compression technologies are compatible with virtually all font formats and CE device manufacturers' standards, including PostScript and Printer Command Language, or PCL. We currently license these products to 50 laser printer manufacturers worldwide.

Our iType font scaling engine, or iType, renders high-quality display of text in every major language and in any size on memory-constrained CE devices, including, but not limited to, mobile phones, e-readers, automotive displays, tablets, set-top boxes and digital cameras, and is fully compatible with the industry-standard TrueType and OpenType font formats.

Our iType Connects product suite streamlines the process of integrating iType by providing a pre-integrated solution for common CE platforms.

Our stroke font and various compression technologies, such as Compact Asian for TrueType, or CATT, and Asian Compression for TrueType, or ACT, enable customers to significantly reduce the amount of memory required to store the required font data.

Our SmartHint and Edge rendering technology ensure high legibility even when text is displayed at very small sizes. With conventional technologies, East Asian characters often become illegible when displayed at small sizes due to the visual complexity of the characters.

## Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-K

Our Edge rendering technologies enables the tuning of rendered text. Resolution and display technology LCD or e-paper, for example, can significantly affect the visual display of rendered text. With this tuning capability, the output can be adjusted to enhance quality or to provide consistency across a customer's product line. Our Edge360 technology brings advanced textual effects to 2D and 3D user interfaces, applications and games. For example, text can be zoomed in and out very quickly without having to re-render the text at the end of the zoom process. Text can be rotated in three dimensions all while retaining clarity throughout the process.

## **Table of Contents**

### *Text Layout Engine*

Our WorldType Layout Engine and WorldType Shaper products enable CE devices to accurately display multilingual text, including text composed in complex writing systems such as Indic, Arabic and Hebrew scripts.

### *Printer Driver, Page Description Languages, and Imaging Tools*

Our printer driver kits enable printer manufacturers to create customized laser printer drivers that allow applications to print as intended.

Our ColorSet imaging tools give printer manufacturers control over high-quality color reproduction while reducing development time.

Our page description language, or PDL, software offerings and complete solutions enable printer manufacturers to simplify product development, achieve faster time to market and enhanced ability to manage overall controller development costs.

### *Font Management Technologies*

Our Fontwise product is a comprehensive font license management solution that allows creative and business professionals to audit, manage and purchase font licenses.

Our FontExplorer X Pro and FontExplorer X Server font management solutions provides powerful, flexible and easy-to-use capabilities for managing and accessing fonts.

### *UI Technologies*

Our SpectraWorks graphical user interface development suite is a lightweight, high-performance set of tools for developing embedded graphical user interfaces quickly and inexpensively. SpectraWorks is integrated with iType and our World Type Shaper for worldwide language support and includes access to our proprietary technologies such as Edge rendering, stroke-based fonts, our run-time auto hinter, proprietary compression formats and special effects.

## **Competitive Strengths**

Our text imaging solutions and services provide critical technologies and fonts for users that require the ability to display or print high-quality digital text. Our core strengths include:

*Established Relationships with Market Leaders.* We benefit from established relationships with our OEM customers, many of which date back 20 years or more. We work collaboratively with them and obtain insight into their product roadmaps and future requirements. Our OEM customers include many of the largest and most successful companies in each of the markets that we serve. In the mobile phone and CE device space, we provide technologies to market leaders Nokia, Motorola and Sony Ericsson. In the laser printer market our customers include eight of the top ten laser printer manufacturers based on the volume of units shipped worldwide. Our operating system and application partners include Microsoft, Google, Apple and Amazon. Because our technologies and fonts are embedded in the hardware of our customers' CE devices, it would be costly and time-consuming for customers to replace these solutions.

## Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-K

*Technological and Intellectual Property Leadership.* We are a leading global provider of text and imaging solutions for laser printers. We have achieved this leadership position by combining our proprietary technologies with an extensive font library that includes many of the world's most popular typefaces. We have and are continuing to leverage our intellectual property and experience in this market to secure a leading position in other high volume CE device categories. For example, we currently ship our text imaging solutions on mobile phones manufactured by many of the largest manufacturers of mobile phones. We have established relationships with leading brands in emerging CE device categories such as

## **Table of Contents**

laser printers, digital copiers, mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, digital televisions, set-top boxes and consumer appliances.

*International Presence and Technologies Designed to Serve the Global Market.* In 2011 and in 2010, 53.9% and 62.8% of our revenue, respectively, was derived from sales by our operating subsidiaries located in the United Kingdom, Germany, China and Japan. Our customers are located in Asia, North America, Europe and other parts of the world. Our technologies and font IP are crucial to our OEM customers who manufacture high-volume CE devices that have multimedia functionality and multinational distribution. We support all of the world's major languages and we have specifically designed scalable font rendering technologies for displaying rich content in Asian and other non-Latin languages. We enable OEM customers to engineer a common platform supporting multiple languages, reducing costs and time-to-market and increasing product flexibility. Increasingly, the center of design, manufacturing and consumption of CE devices is in China, Japan and Korea. We have over 20 years of experience partnering with Asian companies such as Ricoh, Toshiba and Kyocera Mita.

*Strong Web Presence and Font Design Services.* We have built an extensive customer base of creative and business professionals to whom we license fonts. Our flagship website with the intuitive domain name, *fonts.com*, along with our other e-commerce websites, including the European site, *linotype.com*, provide us with a substantial online presence offering more than 170,000 font products. We have also provided custom font design and branding services to many multinational corporations. Our Web font solution, introduced in 2010, includes more than 20,000 fonts, with new fonts being added on a continuing basis. Several of the most widely used fonts in branding and advertising, such as the Helvetica, Univers and Trade Gothic typefaces, are available as Web fonts exclusively through our service, Fonts.com Web Fonts.

*Attractive Business Model.* We have a significant, recurring base of licensing revenues that is based, in part, on multi-year financial commitments by our OEM customers. In addition, our revenues are highly visible because of our established relationships with OEM customers and due to quarterly royalty reports we receive from those customers. As a technology licensing business, we generate significant cash flows from incremental OEM revenue. We have a relatively low cash tax rate, due primarily to the tax deductibility of goodwill, which increases our cash flows. We have low capital requirements, which drive high returns on invested capital.

*Experienced Leadership and Employee Base.* Our senior management has an average of 20 years of experience in the text imaging or software solutions businesses. Douglas J. Shaw, our President, Chief Executive Officer and Director, has presided over the successful introduction of our text imaging solutions in each of our markets for 30 years. Our Chief Financial Officer, Scott E. Landers, has 15 years of public company experience which includes experience in the software solutions business. John L. Seguin, our Executive Vice President, is a long-time veteran of companies that supply technologies to the CE device industry. Many of the members of our sales, engineering and support staff have been with us since we began serving OEMs, and creative and business professionals. As a result, there is significant continuity between our team and our key customers.

## **Our Strategy**

Our objective is to extend our position as a leading global provider of text imaging solutions and related display technologies. We intend to:

*Increase Penetration of our Technologies and Fonts into High Growth CE Device Categories.* Our technologies and fonts are increasingly vital to the mass-market success of certain high-growth CE device categories such as mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, and consumer appliances. We have an established base of customers in these CE device categories, and we intend to increase our targeted sales and support activities to add new customers and increase the

## **Table of Contents**

number of platforms, products, models, applications and systems in which our technologies and fonts are embedded. For example, we market our text imaging solutions for inclusion in high growth CE device categories with sophisticated display imaging needs such as e-book readers. Our e-book reader customers use a combination of our rendering technology and our custom-hinted fonts to improve user experience. In addition, we intend to extend our reach into new products, customers and models by continuing to expand our integration into leading industry platforms while increasing our partnerships with leading independent software vendors.

*Extend our Leadership Position with Enhanced Technologies in the Laser Printer Market.* While the laser printer market has been growing at a slower pace than the market for other CE devices, we have historically sustained consistent growth by anticipating and rapidly adapting to changes in this market. For example, we support the increased font offering that is part of Microsoft Windows operating systems and fonts to support global and cloud printing. As laser printers evolved from analog and monochrome to digital and color printers and to multi-function peripherals, we also enhanced our existing compression technologies and imaging tools to maintain the high-quality rendering of printed text in these new CE devices. We also introduced products such as our printer driver kits, color tools and page description language interpreters to address the increasing demand for customized driver applications. Going forward, we intend to expand our offering to provide additional technologies to the laser printer market. We intend to leverage our extensive experience in this market and our long-standing relationships with laser printer manufacturers to maintain our leadership position in the laser printer market.

*Continue to Develop our Online and Offline Offerings and Services for Content Creators.* We have a well-established business licensing fonts and technologies to creators of printed and digital content, including newspapers, magazines, books, advertisements and websites. We have a strong online presence with our websites including *fonts.com*, *linotype.com*, *ascenderfonts.com*, *itcfonts.com*, and *webfonts.fonts.com* as well as a direct sales channel offline through which customers license our offerings. Our websites attracted more than 40 million visits in 2011 from over 200 countries and territories. On our websites, opportunities exist to increase our revenue per visitor by continuing to offer innovative solutions and expanded products and services, as well as to benefit from growth in web traffic.

*Leverage our Installed Base of Leading OEM and Creative Professional Customers by Providing New Technologies and Fonts.* Our customers include many of the largest manufacturers in the CE device markets as well as independent software vendors, publishers and advertising agencies and we continually seek to develop new technologies and fonts to serve these customers. For example, our acquisition of Planetweb provides our OEM customers a powerful user interface development solution that can be integrated with our font rendering technology. Additionally, for our printer OEM customers, we now offer page description languages that, in combination with our fonts and drivers, provide a more complete solution for text rendering in a print environment. By providing additional technologies and fonts, we seek to leverage our core relationships to increase the value we offer to our customers and to expand our presence within our existing customer base. Such technologies include worldwide language support products for laser printers and new products and technologies for multi-function and color printers.

*Expand and Deepen our Global Presence, Particularly in Asia.* We intend to drive our revenue growth by leveraging our knowledge of global markets and through our global operations. We believe that economic growth in Asia will further the demand for Asian text imaging solutions and related display solutions. Through organic expansion and acquisitions, we are increasing our ability to service CE device manufacturers and content creators throughout the world. We intend to focus on the Japanese, Chinese and Korean language markets for laser printers, digital copiers and other CE devices. Significant growth opportunities exist in these markets, as we have limited penetration to date.

*Selectively Pursue Complementary Acquisitions, Strategic Partnerships and Third-Party Intellectual Property.* We intend to continue to pursue selected acquisitions, strategic partnerships and third-party intellectual

**Table of Contents**

property to accelerate our time to market with complementary text imaging solutions, penetrate new geographies and enhance our intellectual property portfolio. We believe that the market for text imaging solutions and related display technologies is still fragmented. We have a demonstrated track record of identifying, acquiring and integrating companies that enhance our intellectual property portfolio. On November 10, 2011, we announced we had entered into a definitive agreement with Bitstream to acquire Bitstream's font business. The transaction is expected to close following the resolution of the DOJ inquiry and the satisfaction of customary closing conditions and the approval of Bitstream's shareholders, among other items. In 2010, we acquired Ascender Corporation, a privately held font provider with long-standing relationships with several leading brands including Google and Microsoft.

**Our Customers**

Our technologies and services are sold to customers in two principal markets: OEM and Creative Professional. The OEM market consists of both CE device manufacturers and independent software vendors. Our Creative Professional customers include purchasers of font end-user licenses, a large proportion of which are large publishing firms, corporations, graphic designers and advertising agencies. In 2011, 2010 and 2009 our revenue in these two markets was as follows (in thousands):

Principal Markets	2011		2010		2009	
	Revenue	Percentage of Total Revenue	Revenue	Percentage of Total Revenue	Revenue	Percentage of Total Revenue
OEM	\$ 91,656	74%	\$ 80,000	75%	\$ 68,967	73%
Creative Professional	31,556	26%	26,659	25%	25,038	27%
<b>Total</b>	<b>\$ 123,212</b>	<b>100%</b>	<b>\$ 106,659</b>	<b>100%</b>	<b>\$ 94,005</b>	<b>100%</b>

Our text imaging solutions are embedded in a broad range of CE devices and are compatible with most major operating environments and those developed by CE device manufacturers. We partner with operating system and software application vendors Microsoft, Google, Apple, Oracle and Access, and have made our patented iType scalable font engine available as a plug-in for open source Linux environments. Additionally, we are an active participant in the development of industry standards, such as the XML Paper Specification with the European Computer Manufacturer's Association, and the use of Web fonts with the World Wide Web Consortium.

Our customers are among the world's leading CE device manufacturers and creative and business professionals, including:

eight of the top ten laser printer manufacturers based on the volume of units shipped worldwide;

twelve of the top fifteen mobile phone manufacturers including Nokia, Motorola, Sony Ericsson, ZTE and RIM;

major software companies including Microsoft and Google;

other multinational corporations such as UBS, Sony Computer Entertainment of America, Nintendo, Activision, Tivo and Ubisoft;

major international media and marketing solutions companies including Gannett;

four of the top five e-book readers, including Amazon and Kobo;

digital camera manufacturers;

digital television and set-top box manufacturers including TTE Technology, Toshiba and Sharp;

many of the top automotive brands; and

major home appliance manufacturers such as Whirlpool Corporation.

## **Table of Contents**

In 2011, 2010 and 2009, our top ten licensees by revenue accounted for approximately 46.0%, 50.8% and 47.1% of our total revenue, respectively. In 2011, 2010 and 2009, no one customer accounted for more than 10% of our total revenue.

## **Sales and Marketing**

Our OEM sales efforts are focused on large CE device manufacturers and independent software vendors with whom we seek to establish long-term relationships. Our creative and business professional sales representatives directly target prospective corporate clients and specialty dealers to whom we may provide our fonts and custom font design services. Our e-commerce websites, *fonts.com*, *linotype.com*, *ascenderfonts.com*, *itcfonts.com* and *webfonts.fonts.com*, offer the ability to preview, license and download thousands of fonts from our Monotype, Linotype, ITC and Ascender collections, as well as typefaces from hundreds of foundries across the globe. Our web font service, Fonts.com Web Fonts, offers web fonts by subscription to provide for the ability to use typefaces in web page design.

Our marketing organization works to deliver a consistent message detailing our capabilities and to develop new avenues for presenting our text imaging solutions. Our marketing efforts are principally focused on promoting our websites *fonts.com*, *linotype.com*, *ascenderfonts.com*, *itcfonts.com* and *webfonts.fonts.com* through affiliate programs, search engine optimization and e-mail marketing which drive traffic to our websites. Once at our websites, creative and business professionals can find recent typographic news, read typeface designer profiles and access a wealth of educational content, in addition to a selection of more than 170,000 font products.

We promote our text imaging solutions through a combination of newsletters, web content, social media, brochures, print advertising and attendance at conferences and trade shows. Our e-mail marketing communications, directed to a registered user base that has opted to receive our e-mails, include font-related articles, company news and product offerings. We also maintain our corporate website at *monotypeimaging.com*, which focuses on promoting our Company and offerings for our OEM customers.

## **Research and Development**

We have a strong commitment to research and development for core technology programs directed at creating new products, product enhancements and new applications for existing products, as well as funding research into future market opportunities. Each of the markets we serve is generally characterized by rapid technological change and product innovation. We believe that continued timely development of new products and product enhancements to serve existing and new markets is necessary to remain competitive. Our research and development operations are located in Woburn, Massachusetts; San Mateo, California; Boulder, Colorado; Salfords, United Kingdom; Bad Homburg, Germany and Hong Kong, China.

In 2011, 2010 and 2009, we incurred research and development expenses of \$16.5 million, or 13.4% of sales, \$15.4 million, or 14.4% of sales and \$14.1 million, or 15.0% of sales, respectively. Further information on research and development expenses may be found in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

## **Intellectual Property**

We rely on a combination of copyright, patent and trademark laws and on contractual restrictions to establish and protect proprietary rights in our technologies and fonts. Whenever possible, we enter into non-disclosure agreements with our suppliers, partners and others to limit access to and disclosure of our proprietary information.

**Table of Contents**

We apply for U.S. and international patents with respect to our technologies, and seek copyright registration of our software and U.S. and international trademark registration in those instances in which we determine that it is competitively advantageous and cost effective to do so. We have been granted a total of ten patents and have fourteen patents pending with the U.S. Patent and Trademark Office. Our most important patents are related to our subpixel rendering technology and ACT technology. We have unregistered trademarks and, where appropriate, registered trademarks on the key fonts in our font libraries. We intend to continue our policy of taking all measures we deem necessary to protect our patent, copyright, trade secret and trademark rights.

Some of our fonts are owned by third parties that we license under exclusive and non-exclusive agreements. We have also collaborated with third parties in the production and development of fonts.

**Competition**

Our text imaging solutions compete with those offered by a variety of companies, including vendors of laser printer and display imaging technologies, printer drivers and providers of fonts. We compete principally on the basis of our technical innovation, engineering and customer support expertise, the breadth of our font offerings and the overall performance of our text imaging solutions, including reliability and timely delivery. Competition with our solutions comes from a variety of sources, including companies that license technologies and fonts, like Adobe and Bitstream, and local providers of text imaging solutions that offer solutions specific to a particular country's language requirements. We also compete with FreeType, an open source collaborative organization that provides its Linux font rendering code for free, with printer driver provider Software Imaging and with Extensis and Insider Software with respect to our FontExplorerX product. The competition for our fonts and custom font design services generally comes from companies offering their own typeface libraries and custom typeface services, including Adobe, Zoran, Bitstream, font foundry websites, font-related websites and independent professionals. We also compete with in-house resources of our OEM customers.

**Employees and Consultants**

At December 31, 2011, we employed 272 persons. In addition, we have an exclusive relationship with a consulting firm that provides font design and production services in China. The table below provides our employees by functional area.

	Number of Employees	Percentage
Sales and marketing	111	41%
Research and development	105	39%
General and administration	56	20%
Total	272	100%

None of our employees or consultants is represented by a union or covered by a collective bargaining agreement. Our Linotype employees are represented by a work council. This work council has the right to participate in certain decisions by Linotype, including operational changes, such as relocation of the business or change of control transactions, and social matters such as wages and salaries and working hours. We believe that our relations with our employees and consultants are good.

**Segment Information**

Information concerning revenue from our two principal markets for the last three years may be found in Note 16 to our consolidated financial statements. We do not allocate expenses and assets to our two principal markets, OEM and Creative Professional, and operating results are assessed on an aggregate

## **Table of Contents**

basis to make decisions about the allocation of resources. Further information about our principal markets and segment information, including geographic revenue, may be found in Note 16 to our consolidated financial statements.

### **Corporate and Investor Information**

We maintain a website at <http://www.monotypeimaging.com>. We make available on our website documents describing our corporate governance and our Code of Business Conduct and Ethics. We are not including the information contained on our website as a part of, or incorporating it by reference into, this Annual Report on Form 10-K. We make available free of charge through our website our proxy statements, registration statements, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission, or the SEC. Our SEC filings are also available over the Internet at the SEC's website at <http://www.sec.gov>. You may also read and copy any document we have filed by visiting the SEC's public reference room at 100 F Street, NE., Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information about the public reference room. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding our filings at [www.sec.gov](http://www.sec.gov). You may also inspect our SEC reports and other information at the offices of the Financial Industry Regulatory Authority, 1735 K Street, N.W., Washington, D.C. 20006.

### **Item 1A. Risk Factors**

*Set forth below are certain risk factors that could harm our business, results of operations and financial condition. You should carefully read the following risk factors, together with the financial statements, related notes and other information contained in this Annual Report on Form 10-K. This Annual Report on Form 10-K contains forward-looking statements that contain risks and uncertainties. Please refer to the discussion of *Forward-Looking Statements* on page two of this Annual Report on Form 10-K in connection with your consideration of the risk factors and other important factors that may affect future results described below.*

### **Risks Related to Our Customers and our Customer Relationships**

*We derive a substantial majority of our revenue from a limited number of licensees, and if we are unable to maintain these customer relationships or attract additional customers, our revenue will be adversely affected.*

We derive a substantial majority of our revenue from the licensing of our text imaging solutions to OEMs. For the years ended December 31, 2011, 2010 and 2009, our top ten licensees by revenue accounted for approximately 46.0%, 50.8% and 47.1% of our total revenue, respectively. Accordingly, if we are unable to maintain these relationships or establish relationships with new customers, our licensing revenue will be adversely affected. In addition, some of our license agreements are for a limited period of time and, upon expiration of their license agreements, these OEMs may not renew their agreements or may elect not to enter into new agreements with us on terms as favorable as our current agreements.

*If Hewlett Packard or Adobe were to discontinue their use of our text imaging solutions in their products, our business could be materially and adversely affected.*

Because of their market position as industry leaders, the incorporation by HP of our text imaging solutions in its laser printers and the incorporation of our text imaging solutions by Adobe in its PostScript product promote widespread adoption of our technologies by manufacturers seeking to maintain compatibility with HP and Adobe. If HP or Adobe were to stop using our text imaging solutions in their

## **Table of Contents**

products, the market acceptance of our technologies by other CE device manufacturers would be materially and adversely affected, and this would in turn adversely affect our revenue.

*We face pressure from our customers to lower our license fees and, to the extent we lower them in the future, our revenue may be adversely affected.*

The CE device markets are highly competitive and CE device manufacturers are continually looking for ways to reduce the costs of components included in their products in order to maintain or broaden consumer acceptance of those products. Because our technologies are a component incorporated into CE devices, when negotiating renewals of customer contracts, we face pressure from our customers to lower our license fees. We have in the past, and may in the future, need to lower our license fees, either immediately or over time, to preserve customer relationships or extend use of our technology to a broader range of products. To the extent contractual license fees for any particular customer are lower in the future, we cannot be certain that we will be able to achieve related increases in the use of our technologies or other benefits to fully offset the effects of these adjustments.

*If we are unable to further penetrate our existing markets or adapt or develop text imaging solutions, our business prospects could be limited.*

We expect that our future success will depend, in part, upon our ability to successfully penetrate existing markets for 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. To date, we have penetrated only some of these markets. Our ability to grow our revenue depends upon our ability to further penetrate these markets and to successfully penetrate those markets in which we currently have no presence. Demand for our text imaging solutions in any of these developing markets may not develop or grow, and a sufficiently broad base of OEMs and Creative Professional customers may not adopt or continue to use products that employ our text imaging solutions. Because of our limited experience in some of these markets, we may not be able to adequately adapt our business and our solutions to the needs of these customers. In addition, we have traditionally licensed our technologies and fonts to OEMs that embed our technology in their platforms, which means our ability to expand in some markets is dependent on the success of our OEM customers to expand in those markets.

*Our success depends on the existence of a market for CE devices that incorporate our text imaging solutions.*

*Our revenue depends in large part on market demand for text imaging solutions that enable CE devices to render high quality text.*

The CE device market is characterized by rapidly changing technology, evolving industry standards and needs, and frequent new platform and product introductions. If the need for laser printers and other CE devices utilizing our technology were to decrease or if current models of these products were replaced by new or existing products for which we do not have a competitive solution or if our solutions are replaced by others that become the industry standard and we are not able to develop technologies to build on such industry standards, our customers may not purchase our solutions and our revenue would be adversely affected. For example, if graphical device interface, or GDI, printers increased their already dominant position and replaced more page description language, or PDL, printers, our revenue would be adversely affected. Similarly, if the Android platform, for example, increases market share in the mobile phone industry and we are not able to develop solutions to build on such platform, our revenue would be adversely affected.

*The market for text imaging solutions for laser printers is a mature market growing at a slower rate than other markets in which we operate. To the extent that sales of laser printers level off or decline, our licensing revenue may be adversely affected.*

## **Table of Contents**

A significant portion of our revenue in 2011, 2010 and 2009 was derived from laser printer manufacturers. The laser printer market is a mature market and as a result, it has grown at a slower rate than other markets in which we operate. In both 2011 and 2009, the laser printer market experienced a decline and our revenue was adversely affected. If sales of printers incorporating our text imaging solutions level off, or decline, then our licensing revenue may be adversely affected.

***Our licensing revenue depends in large part upon OEMs incorporating our text imaging solutions into their products and if our solutions are not incorporated in these products or fewer products are sold that incorporate our solutions, our revenue will be adversely affected.***

Our licensing revenue from OEMs depends upon the extent to which these OEMs embed our technologies in their products. We do not control their decision whether or not to embed our solutions into their products, and we do not control their product development or commercialization efforts. If we fail to develop and offer solutions that adequately or competitively address the needs of the changing marketplace, OEMs may not be willing to embed our solutions into their products. The process utilized by OEMs to design, develop, produce and sell their products is generally 12 to 24 months in duration. As a result, if an OEM is unwilling or unable to embed our solutions into a product that it is manufacturing or developing, we may experience significant delays in generating revenue while we wait for that OEM to begin development of a new product that may embed our solutions. In addition, if OEMs sell fewer products incorporating our solutions, our revenue will be adversely affected.

***Our operating results may fluctuate based upon an increase or decrease of market share by CE device manufacturers to whom we license our text imaging solutions.***

The terms of our license agreements with our CE device manufacturers vary. For example, we have fixed fee licensing agreements with certain customers, some of which may decline over time. If these customers, some of whom are instrumental in setting industry standards and influencing early adoption of platforms or technology incorporating our text imaging solutions, were to increase their share of the CE device market, under the terms of these agreements there would not be a corresponding increase in our revenue. Any change in the market share of CE device manufacturers to whom we license our text imaging solutions is entirely outside of our control.

## **Risks Related to Our Text Imaging Solutions**

***If we fail to develop and deliver innovative text imaging solutions in response to changes in our industry, including changes in consumer tastes or trends, our revenue could decline.***

The markets for our text imaging solutions are characterized by rapid change and technological evolution and are intensely competitive and price sensitive. We will need to expend considerable resources on product development in the future to continue to design and deliver enduring and innovative text imaging solutions. We rely on the introduction of new or expanded solutions with additional or enhanced features and functionality to allow us to maintain our royalty rates in the face of downward pressure on our royalties resulting from efforts by CE device manufacturers to reduce costs. Despite our efforts, we may not be able to develop and effectively market new text imaging solutions that adequately or competitively address the needs of the changing marketplace. In addition, we may not correctly identify new or changing market trends at an early enough stage to capitalize on market opportunities. Our future success depends, to a great extent, on our ability to develop and deliver innovative text imaging solutions that are widely adopted in response to changes in our industry, that are compatible with the solutions introduced by other participants in our industry and for which the CE device manufacturers are willing to pay competitive royalties. Our failure to deliver innovative text imaging solutions that allow us to stay competitive and for which we can maintain our royalty rates would adversely affect our revenue.

## **Table of Contents**

***Open source software may make us more vulnerable to competition because new market entrants and existing competitors could introduce similar products quickly and cheaply.***

Open source refers to the free sharing of software code used to build applications in the software development community. Individual programmers may modify and create derivative works and distribute them at no cost to the end-user. To the extent that open source software that has the same or similar functionality as our technologies is developed or gains market share, demand for our text imaging solutions may decline, we may have to reduce the prices we charge for our text imaging solutions and our results of operations may be negatively affected.

***Current and future industry standards may limit our business opportunities.***

Various industry leaders have adopted or are in the process of adopting standards for CE devices that incorporate, or have the potential to incorporate, our text imaging solutions. Although we have made some efforts to have our text imaging solutions adopted as standards by industry market leaders, these efforts have been limited and we do not control the ultimate decision with respect to whether our solutions will be adopted as industry standards in the future or, to the extent they are adopted, whether and for how long they will continue as such. If industry standards adopted exclude our solutions, we will lose market share and our ability to secure the business of OEMs subject to those standards will be adversely affected. Costs or potential delays in the development of our solutions to comply with such standards could significantly increase our expenses and place us at a competitive disadvantage compared to others who comply faster or in a more cost efficient way or those whose solutions are adopted as the industry standard. We may also need to acquire or license additional intellectual property rights from third parties which may not be available on commercially reasonable terms, and we may be required to license our intellectual property to third parties for purposes of standards compliance.

***The success of our business is influenced by the interoperability of our text imaging solutions with a variety of CE devices and software applications and operating systems.***

To be successful we must design our text imaging solutions to interoperate effectively with a variety of CE devices, software applications, operating systems and content creation platforms. We depend on the cooperation of CE device manufacturers with respect to the components integrated into their devices, such as PDLs, as well as software developers that create the operating systems and applications, to incorporate our solutions into their product offerings. Content creation platforms are evolving rapidly. To the extent our fonts and font technologies are less relevant, or incompatible, our business would be adversely affected.

***Our text imaging solutions compete with solutions offered by some of our customers, which have significant competitive advantages.***

We face competitive risks in situations where our customers are also current or potential competitors. For example, Adobe is a significant licensee of our text imaging solutions, but Adobe is also a competitor with respect to the licensing of technologies and fonts. To the extent that Adobe or our other customers choose to utilize competing text imaging solutions they have developed or in which they have an interest, rather than utilizing our solutions, our business and operating results could be adversely affected. Adobe also offers broader product lines than we do, including software products outside of the text imaging solutions markets that provide Adobe with greater opportunities to bundle and cross-sell products to its large user base. To the extent our customers were to offer text imaging solutions comparable to ours at a similar or lower price, our revenue could decline and our business would be harmed.

***Our business is dependent in part on technologies and fonts we license from third parties and these license rights may be inadequate for our business.***

Certain of our text imaging solutions are dependent in part on the licensing and incorporation of technologies from third parties, and we license a substantial number of fonts from third parties. For

## **Table of Contents**

example, we have entered into license agreements with AGFA Gevaert N.V. under which we have acquired rights to use certain color technology. We also have license agreements with Microsoft, Adobe and others under which we license certain fonts. Our license agreements with these parties are limited by the ownership or licensing rights of our licensors. If any of the technologies we license from third parties fail to perform as expected, if our licensors do not continue to support any of their technology or intellectual property, including fonts, because they go out of business or otherwise, or if the technologies or fonts we license are subject to infringement claims, then we may incur substantial costs in replacing the licensed technologies or fonts or fall behind in our development schedule and our business plan while we search for a replacement. In addition, replacement technology and fonts may not be available for license on commercially reasonable terms, or at all, which could subject us to claims by our customers for breach of the terms of our agreements with them.

***Certain component technologies in our text imaging solutions may be subject to open source licenses, which may restrict how we use or distribute our technologies or require that we release the source code of certain technologies subject to those licenses.***

Certain open source licenses, such as the GNU Lesser General Public License, require that source code subject to the license be released or made available to the public. Such open source licenses typically mandate that proprietary technologies, when combined in specific ways with open source software, become subject to the open source license. We take steps to ensure that our proprietary technologies are not combined with, or do not incorporate, open source software in ways that would require our proprietary technologies to be subject to an open source license. However, few courts have interpreted the open source licenses, and the manner in which these licenses may be interpreted and enforced is therefore subject to uncertainty. While our end-user license agreement, or EULA, prohibits the use of our technologies in any way that would cause them to become subject to an open source license, our OEM customers could, in violation of our EULA, combine our technologies with technologies covered by an open source license.

In addition, we rely on multiple software engineers to design our proprietary text imaging solutions. Although we take steps to ensure that our engineers do not include open source software in the technologies they design, we may not exercise complete control over the product development efforts of our engineers and we cannot be certain that they have not incorporated open source software into our proprietary technologies. In the event that portions of our proprietary technologies are determined to be subject to an open source license, we might be required to publicly release the affected portions of our source code, which could reduce or eliminate our ability to commercialize our text imaging solutions. Also, our ability to market our text imaging solutions depends in part on the existence of proprietary operating systems. If freely distributed operating systems like Linux become more prevalent, the need for our solutions may diminish and our revenue could be adversely affected. Finally, in the event we develop technologies that operate under or are delivered under an open source license, such technologies may have little or no direct financial benefit to us.

***Our business and prospects depend on the strength of our brands, and if we do not maintain and strengthen our brands, we may be unable to maintain or expand our business.***

Maintaining and strengthening the Monotype, Linotype and Ascender brands, the *fonts.com*, *linotype.com*, *ascenderfonts.com*, *itcfonts.com*, *fontmarketplace.com* and *webfonts.fonts.com* brands, the FontExplorerX brand, as well as the brands of our fonts, such as Helvetica and ITC Avant Garde, is critical to maintaining and expanding our business, as well as to our ability to enter into new markets for our text imaging solutions. If we fail to promote and maintain these brands successfully, our ability to sustain and expand our business and enter into new markets will suffer. Maintaining and strengthening our brands will depend heavily on our ability to continue to develop and provide innovative and high-quality solutions for our customers, as well as to continue to maintain our strong online presence. If we fail to maintain high-quality standards, if we

fail to meet industry standards, or if we introduce text imaging solutions that our customers or potential

## **Table of Contents**

customers reject, the strength of our brands could be adversely affected. Further, unauthorized third parties may use our brands in ways that may dilute or undermine their strength.

***If we fail to adequately protect our intellectual property, we could lose our intellectual property rights, which could negatively affect our revenue or dilute or undermine the strength of our brands.***

Our success is heavily dependent upon our ability to protect our intellectual property, including our fonts. To protect our intellectual property, we rely on a combination of United States and international patents, design registrations, copyrights, trademarks, trade secret restrictions, EULAs, and the implementation and enforcement of nondisclosure and other contractual restrictions. Despite these efforts, we may be unable to effectively protect our proprietary rights and the enforcement of our proprietary rights may be extremely costly. For example, our ability to enforce intellectual property rights in the actual design of our fonts is limited.

We hold patents related to certain of our rasterizer and compression technologies and registered trademarks on many of our fonts. Our patents may be challenged or invalidated, patents may not issue from any of our pending applications or claims allowed from existing or pending patents may not be of sufficient scope or strength (or may not issue in the countries where products incorporating our technology may be sold) to provide meaningful protection or be of any commercial advantage to us. Some of our patents have been and/or may be licensed or cross-licensed to our competitors. We rely on trademark protection for the names of our fonts. Unauthorized parties may attempt to copy or otherwise obtain and distribute our proprietary technologies and fonts. Also, many applications do not need to identify our fonts by name, such as those designs embedded in mobile telephones and set-top boxes, and therefore may not need to license trademarked fonts. We sometimes protect fonts by copyright registration but we do not always own the copyrights in fonts licensed from third parties. In addition, we cannot be certain that we will be able to enforce our copyrights against a third party who independently develops fonts even if it generates font designs identical to ours.

Our EULA generally permits the embedding of our fonts into an electronic document only for the purpose of viewing and printing the document, but technologies, including those related to web-based fonts, may exist or may develop which allow unauthorized persons who receive such an embedded document to use the embedded font for editing the document or even to install the font into an operating system, the same as if the font had been properly licensed. Unauthorized use of our intellectual property or copying of our fonts may dilute or undermine the strength of our brands. Also, we may be unable to generate revenue from products that incorporate our text imaging solutions without our authorization. Monitoring unauthorized use of our text imaging solutions is difficult and expensive. A substantial portion of the CE devices that require text imaging solutions are manufactured in China. We cannot be certain that the steps we take to prevent unauthorized use of our intellectual property will be effective, particularly in countries like China where the laws may not protect proprietary rights as fully as in the United States.

***We may be forced to litigate to defend our intellectual property rights or to defend against claims by third parties against us relating to intellectual property rights.***

Disputes and litigation regarding the ownership of technologies and fonts and rights associated with text imaging solutions, such as ours, are common, and sometimes involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own patents may therefore provide little or no deterrence. Third parties have from time-to-time claimed, and in the future may claim, that our products and services infringe or violate their intellectual property rights. Any such claims could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages and prevent us from selling our products. We may be forced to litigate to enforce or defend our intellectual property rights, to protect our trade secrets or to determine

## **Table of Contents**

the validity and scope of other parties' proprietary rights. Even if we were to prevail, any litigation regarding intellectual property could be costly and time-consuming and divert the attention of our management and key personnel from our business operations. We may also be obligated to indemnify our customers or business partners pursuant to any such litigation, which could further exhaust our resources. Furthermore, as a result of an intellectual property challenge, we may be required to enter into royalty, license or other agreements, and we may not be able to obtain such agreements at all or on terms acceptable to us. We have been in the past involved in litigation with third parties, including Adobe, to defend our intellectual property rights and have not always prevailed.

### **Risks Related to Our Business Operations**

#### ***A prolonged economic downturn could materially harm our business.***

Our ability to generate revenue is affected by the level of business activity of our OEM and Creative Professional customers, which, in most cases, is affected by the level of economic activity occurring in the industries and markets that our customers serve. Negative trends in the general economy, including trends resulting from a recession, the availability of credit, actual or threatened military action by the United States, terrorist attacks on the United States or abroad or increased oil prices, could cause a decrease in consumer and or business spending on computer hardware and software and CE devices in general and could negatively affect the rate of growth of CE device markets or of adoption of CE devices. Any economic downturn, including a reduction in consumer confidence or disposable income in general, could also adversely affect the demand for fonts or impair the ability of our customers to pay for products and services that they have purchased. We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery and this uncertainty makes it difficult to determine if past experience is a good guide to the future. If the general economy or markets in which we operate worsen from present levels, the demand for fonts and font technologies could decline and our revenue and profitability could be materially and adversely impacted.

#### ***Software licensing models are evolving and if we are not able to make our fonts and font technologies available under these models, our business prospects could suffer.***

New licensing and business models are evolving in the software industry. For example, a company may provide software applications, data and related services over the Internet, using primarily advertising or subscription-based revenue models sometimes known as cloud computing. Recent advances in computing and communications technologies, and specifically a growth in the demand for web based fonts that integrate seamlessly with all web browsers and operating systems, have made this model viable. As software licensing models evolve, we may not be successful in adapting to these new business models and our business prospects could suffer.

#### ***We face significant competition in various markets, and if we are unable to compete successfully, our ability to generate revenue from our business could suffer.***

We face significant competition in the text imaging solutions markets. We believe that our most significant competitive threat comes from companies that compete with some of our specific offerings. Those competitors currently include Adobe, Bitstream, Software Imaging, Extensis, Insider Software, FreeType, and local providers of text imaging solutions whose products are specific to a particular country's language. We also compete with the internal development efforts of certain of the CE device manufacturers to whom we license our solutions, most of which have greater financial, technical and other resources than we do. Similarly, we also face competition from font foundries, font related websites and independent professionals.

Some of our current or future competitors may have significantly greater financial, technical, marketing and other resources than we do, may enjoy greater name recognition than we do or may have

**Table of Contents**

more experience or advantages than we have in the markets in which they compete. These advantages may include, among others:

sales and marketing advantages;

advantages in the recruitment and retention of skilled personnel;

advantages in the establishment and negotiation of profitable strategic, distribution and customer relationships;

advantages in the development and acquisition of innovative software technology and the acquisition of software companies;

greater ability to pursue larger scale product development and distribution initiatives on a global basis;

substantially larger patent portfolios; and

operational advantages.

Further, many of the devices that incorporate our text imaging solutions also include technologies and fonts developed by our competitors. As a result, we must continue to invest significant resources in product development in order to enhance our text imaging solutions and introduce new high-quality solutions to meet the wide variety of competitive pressures. Our ability to generate revenue from our business could suffer if we fail to do so successfully.

***We conduct a substantial portion of our business outside North America and, as a result, we face diverse risks related to engaging in international business.***

We have offices in five foreign countries and we are dedicating a significant portion of our sales efforts in countries outside North America. We are dependent on international sales for a substantial amount of our total revenue. In 2011 and 2010, approximately 53.9% and 62.8%, respectively, of our total revenue was derived from operations outside the U.S and we expect that international sales will continue to represent a substantial portion of our revenue for the foreseeable future. This future international revenue will depend on the continued use and expansion of our text imaging solutions, including the licensing of our technologies and fonts worldwide.

We are subject to the risks of conducting business internationally, including:

our ability to enforce our contractual and intellectual property rights, especially in those foreign countries that do not respect and protect intellectual property rights to the same extent that the United States does, which increases the risk of unauthorized and uncompensated use of our text imaging solutions;

United States and foreign government trade restrictions, including those that may impose restrictions on importation of programming, technology or components to or from the United States;

foreign government taxes, regulations and permit requirements, including foreign taxes that we may not be able to offset against taxes imposed upon us in the United States, and foreign tax and other laws limiting our ability to repatriate funds to the United States;

risks related to fluctuations in foreign currency exchange rates, in particular fluctuations in the exchange rate of the Japanese yen, the European Union's euro, and the United Kingdom's pound sterling, including risks related to hedging activities we may undertake;

foreign labor laws, regulations and restrictions;

changes in diplomatic and trade relationships;

## **Table of Contents**

difficulty in staffing and managing foreign operations;

political instability, natural disasters, war and/or events of terrorism; and

the strength of international economies.

***If we have difficulty finding appropriate partnership and/or acquisition candidates, our ability to execute aspects of our strategic plan may be hindered.***

We intend to selectively pursue complementary acquisitions, strategic partnerships and third party intellectual property licenses to accelerate our time to market, penetrate new geographies and expand our offering. Execution of our strategy relies on finding and closing partnerships and/or acquisitions that fit with our business and that meet our financial expectations. To the extent that we are unable to identify appropriate opportunities and close deals on acceptable financial terms, we may face hurdles in executing portions of our strategy. In addition, the pursuit of potential acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated.

***If we do find appropriate acquisition candidates, the acquisition process may divert our management's attention or result in additional dilution to stockholders or use of resources that are necessary to operate other parts of our business.***

As part of our business strategy, we may seek to acquire businesses, products or technologies that we believe could complement or expand our products, enhance our technical capabilities or otherwise offer growth opportunities. Acquisitions could create risks for us, including:

difficulties in assimilating acquired personnel, operations and technologies;

unanticipated costs or liabilities associated with such acquisitions;

incurrence of acquisition-related costs;

diversion of management's attention from other business concerns;

use of resources that are needed in other parts of our business; and

use of substantial portions of our available cash to consummate such acquisitions.

In addition, we could discover deficiencies withheld from us in an acquisition or otherwise not uncovered in our due diligence prior to the acquisition. These deficiencies could include problems in internal controls, product quality, customer relationships or compliance with applicable laws, any of which could result in us becoming subject to unforeseen liabilities. Moreover, a significant portion of the purchase price of companies we acquire may be allocated to acquired goodwill and other intangible assets, which must be assessed for impairment at least annually. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our earnings based on this impairment assessment process, which could harm our results of operations. Acquisitions could also result in potentially dilutive issuances of equity securities or in the incurrence of debt, which could adversely affect our operating results. In addition, if an acquired business fails to meet our expectations, our operating results may suffer.

***We rely on the manufacturers to whom we license our text imaging solutions to accurately prepare royalty reports for our determination of licensing revenue and if these reports are inaccurate, our revenue may be under-, or over-stated and our forecasts and budgets may be incorrect.***

## Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-K

Our license revenue is generated primarily from royalties paid by CE device manufacturers who license our text imaging solutions and incorporate them into their products. Under these arrangements,

## **Table of Contents**

these licensees typically pay us a specified royalty for every consumer hardware device they ship that incorporates our text imaging solutions. We rely on our licensees to accurately report the number of units shipped. We calculate our license fees, prepare our financial reports, projections and budgets and direct our licensing and technology development efforts based in part on these reports. However, it is often difficult for us to independently determine whether or not our licensees are reporting shipments accurately. We understand that CE device manufacturers in specific countries have a history of underreporting or failing to report shipments of their products. We have implemented an audit program of our licensees' records, but the effects of this program may be limited as audits are generally expensive and time consuming and initiating audits could harm our relationships with licensees. In addition, our audit rights are contractually limited. To the extent that our licensees understate or fail to report the number of products incorporating our text imaging solutions that they ship, we will not collect and recognize revenue to which we are entitled. Alternatively, we may encounter circumstances in which an OEM customer may notify us that it previously reported and paid royalties on units in excess of what the customer actually shipped. In such cases, we may be required to give our licensee a credit for the excess royalties paid which would result in a reduction in revenue in the period in which a credit is granted, and such a reduction could be material.

### ***Parties from whom we license text imaging solutions may challenge the basis for our calculations of the royalties due to them.***

Some of our agreements with licensors require us to give them the right to audit our calculations of royalties payable to them. In addition, licensors may at any time challenge the basis of our calculations and we cannot be sure that we will be successful in our defense. Any royalties paid as a result of any successful challenge would increase our expenses and could negatively impact our relationship with such licensor, including by impairing our ability to continue to use and re-license technologies or fonts from that licensor.

### ***We incur significant costs and demands upon management as a result of complying with changing laws and regulations, including those affecting public companies, which could affect our operating results.***

We have incurred and will incur significant costs, and have and could experience internal resources constraints, associated with the evaluation of and compliance with evolving corporate governance, reporting and other requirements, including requirements under the Sarbanes-Oxley Act and the Massachusetts data protection laws, as well as rules implemented by the SEC, and the NASDAQ Global Select Market. The expenses incurred by public companies for reporting and corporate governance purposes have been increasing. We expect that the rules and regulations applicable to us could cause our legal and financial compliance costs to increase and could make some activities more time-consuming and costly. In addition, in the current public company environment officers and directors are subject to increased scrutiny and may be subject to increased potential liability. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as our executive officers. This could negatively impact our future success.

### ***Our quarterly results may fluctuate significantly.***

We expect our operating results to be subject to quarterly fluctuations. The revenue we generate and our operating results will be affected by numerous factors, including:

general economic conditions;

demand for CE devices that include our text imaging solutions;

demand for our fonts and custom font design services;

delays in product shipment by our customers;

industry consolidation;

**Table of Contents**

introduction, enhancement and market acceptance of text imaging solutions by us and our competitors;

price reductions by us or our competitors or changes in how text imaging solutions are priced;

the mix of text imaging solutions offered by us and our competitors;

the mix of international and U.S. revenue generated by our solutions;

financial implications of acquisitions, in particular foreign acquisitions involving different accounting standards, foreign currency issues, international tax planning requirements and the like;

timing of billings to customers on royalty reports received by us under our licensing agreements; and

our ability to hire and retain qualified personnel.

A substantial portion of our quarterly revenue is based on actual shipments by our customers of products incorporating our text imaging solutions in the preceding quarter, and not on contractually agreed upon minimum revenue commitments. Because the shipping of products by our customers is outside our control and difficult to predict, our ability to accurately forecast quarterly revenue is limited. Our revenue also varies from quarter-to-quarter as a result of variances on the timing of transactions through our e-commerce websites. Quarterly fluctuations in our operating results may, in turn, cause the price of our stock to fluctuate substantially. We believe that quarterly comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indication of our future performance.

***The loss of key members of our senior management team may prevent us from executing our business strategy.***

Our future success depends in large part upon the continued services of key members of our senior management team. All of our executive officers and key employees are at-will employees. Douglas J. Shaw, Chief Executive Officer, has been with the Company in various senior management roles for 30 years. Mr. Shaw has been critical to the overall management of the Company, as well as the development of our solutions, our culture and our strategic direction. The loss of his services or of the services of other key members of our senior management could seriously harm our ability to execute our business strategy. We also may have to incur significant costs in identifying, hiring, training and retaining replacements for key employees.

***We rely on highly skilled personnel, and if we are unable to retain or motivate key personnel or hire qualified personnel, we may not be able to maintain our operations or grow effectively.***

Our performance is largely dependent on the talents and efforts of highly skilled individuals, including font designers who are recognized as leaders in the industry and experienced software engineers. These individuals have acquired specialized knowledge and skills with respect to us and our operations. These individuals can be terminated or can leave our employ at any time. Some of these individuals are consultants. If any of these individuals or a group of individuals were to terminate their employment unexpectedly or end their consulting relationship sooner than anticipated, we could face substantial difficulty in hiring qualified successors, could incur significant costs in connection with their termination and could experience a loss in productivity while any such successor obtains the necessary training and experience.

Our future success depends on our continuing ability to identify, hire, develop, motivate and retain highly skilled personnel and consultants for all areas of our organization. In this regard, if we are unable to hire and train a sufficient number of qualified employees and consultants for any reason or retain employees or consultants with the required expertise, we may not be able to implement our current initiatives or grow effectively or execute our business strategy successfully.

## **Table of Contents**

### **Risks Related to the Securities Markets and Investment in our Common Stock**

#### *The structure of our current Credit Facility could affect our financing options and liquidity.*

We have a five-year, \$120.0 million secured revolving credit facility with Wells Fargo Capital Finance LLC (the 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, plus in each case, an applicable margin. The Credit Facility contains certain financial covenants and is secured by substantially all of our assets. In the event that we draw down on the Credit Facility more fully, it could have important consequences to our business or the holders of our common stock, including:

limiting our ability to obtain additional financing in the future for working capital, capital expenditures or acquisitions;

requiring a significant portion of our cash flow from operations to be dedicated to the payment of the principal of and interest on our indebtedness, thereby reducing funds available for other purposes;

making us more vulnerable to economic downturns and limiting our ability to withstand competitive pressures; and

preventing us from paying dividends on our common stock.

#### *Market volatility may affect our stock price and the value of your investment.*

The market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot control, including:

announcements of new products, services or technologies, commercial relationships, acquisitions or other events by us or our competitors;

fluctuations in stock market prices and trading volumes of similar companies;

variations in our quarterly operating results;

changes in our financial guidance or securities analysts' estimates of our financial performance;

changes in accounting principles;

sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;

additions or departures of key personnel;

## Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-K

discussion of us or our stock price by the financial press and in online investor communities;

general market or economic conditions, including factors unrelated to our operating performance or the operating performance of our competitors; and

other risks and uncertainties described in these Risk Factors .

Market prices of technology companies have been extremely volatile. Stock prices of many technology companies have often fluctuated in a manner unrelated or disproportionate to the operating performance of such companies. In the past, following periods of market volatility, stockholders have often instituted securities class action litigation. If we were involved in securities litigation, it could have a substantial cost and divert resources and the attention of management from our business.

## **Table of Contents**

*Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may inhibit attempts by our stockholders to replace or remove our current management.*

Provisions in our certificate of incorporation and by-laws may delay or prevent an acquisition of us or a change in our management. These provisions include a classified board of directors, a prohibition on actions by written consent of our stockholders and the ability of our board of directors to issue preferred stock without stockholder approval. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us. Although we believe these provisions collectively provide for an opportunity to obtain greater value for stockholders by requiring potential acquirers to negotiate with our board of directors, they would apply even if an offer rejected by our board were considered beneficial by some stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

*We do not intend to pay dividends on our common stock.*

We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and the repayment of indebtedness, and do not anticipate declaring or paying any cash dividends for the foreseeable future. Moreover, our Credit Facility imposes restrictions on our ability to declare and pay dividends.

*We may require additional capital, and raising additional funds by issuing securities or additional debt financing may cause dilution to existing stockholders, restrict our operations or require us to relinquish proprietary rights.*

We may need to raise additional capital in the future. We may raise additional funds through public or private equity offerings or debt financings. To the extent that we raise additional capital by issuing equity securities, our existing stockholders' ownership will be diluted. Any new debt financing we enter into may involve covenants that restrict our operations more than our current credit facility. These restrictive covenants would likely include limitations on additional borrowing, specific restrictions on the use of our assets as well as prohibitions on our ability to create liens, pay dividends or make investments.

### **Item 1B. *Unresolved Staff Comments***

None.

**Table of Contents****Item 2. Properties**

The principal leased properties of the Company and its subsidiaries are listed in the table below.

<b>Location</b>	<b>Principal Use</b>	<b>Approximate Square Feet</b>	<b>Lease term</b>
<b>Facilities Used in Current Operations</b>			
Bad Homburg, Germany	Software Development, Marketing, Sales and Administrative	16,000	Leased; expires in December 2017
Boulder, Colorado	Software Development and Marketing	7,000	Leased; expires August 2014
Salfords, United Kingdom	Software Development, Marketing, Sales and Administrative	6,000	Leased; expires in April 2013
Woburn, Massachusetts, USA	Software Development, Marketing, Sales, Administrative and Corporate	38,000	Leased; expires April 2015 with one 5-year renewal option

We also maintain seven additional leased facilities in San Mateo, California; Elk Grove Village, Illinois; New York City, New York; Tokyo, Japan; Hong Kong, China and Seoul, South Korea. These additional offices occupy approximately 13,000 square feet in the aggregate. We do not consider any specific leased facility to be material to our operations. We believe equally suited facilities are available in several other areas throughout the United States and abroad.

**Item 3. Legal Proceedings**

From time to time, we may be a party to various claims, suits and complaints. We are not currently a party to any legal proceedings that, if determined adversely to us, would have a material adverse effect on our business, results of operations or financial condition.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**  
**Market Information and Related Stockholder Matters**

Our common shares, \$0.001 par value, traded on the NASDAQ Global Market under the symbol TYPE from July 25, 2007 until March 17, 2008 and on the NASDAQ Global Select Market since March 18, 2008. Prior to July 25, 2007, there was no public market for our common stock.

The following table sets forth, for the periods indicated, the high and low closing sales prices per share of our common stock as reported by the NASDAQ Global Select Market.

	High	Low
<b>Period 2011:</b>		
First Quarter	\$ 14.50	\$ 10.98
Second Quarter	15.23	12.87
Third Quarter	14.54	10.10
Fourth Quarter	16.79	11.24
<b>Period 2010:</b>		
First Quarter	\$ 10.22	\$ 8.91
Second Quarter	10.88	8.57
Third Quarter	9.59	7.34
Fourth Quarter	11.58	9.03

The closing price of our common stock, as reported by the NASDAQ Global Select Market, was \$14.96 on February 21, 2012.

 **Holders**

As of February 21, 2012, there were approximately 139 holders of record of our common stock.

 **Dividends**

We have never paid or declared any cash dividend on our common stock and we are currently restricted on paying dividends under our debt obligation. We intend to retain future earnings for the development, operation and expansion of our business and the repayment of indebtedness. We do not anticipate declaring or paying any cash dividends for the foreseeable future.

 **Securities Authorized for Issuance Under Equity Compensation Plans**

The following table sets forth information regarding securities authorized for issuance under the Company's equity compensation plans as of December 31, 2011. To date, the Company has not granted any warrants or rights.

Plan Category	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column) (3)
Equity compensation plans approved by security holders (1)	4,271,406	\$ 8.71	2,805,592
Equity compensation plans not approved by security holders (2)	175,697	\$ 11.26	463,020

## Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-K

Total	4,447,103	\$	8.81	3,268,612
-------	-----------	----	------	-----------

- (1) Includes our 2004 Stock Option and Grant Plan, or 2004 Award Plan, and our Amended and Restated 2007 Stock Option and Incentive Plan, or 2007 Award Plan.
- (2) Options issued in connection with our 2010 acquisition of Ascender under Marketplace Rule 5635(c)(4) of the NASDAQ Global Select Market. 53,763 shares of restricted stock were also issued in connection with the Ascender acquisition. For further details, see Note 14.
- (3) Total shares allocated to the plans less the total number of awards granted through December 31, 2011.

## **Table of Contents**

### **Listing Requirements**

The Company is subject to the listing requirements of the NASDAQ Global Select Market.

### **Performance Graph**

*This performance graph shall not be deemed filed with the SEC or subject to Section 18 of the Exchange Act, nor shall it be deemed incorporated by reference in any of our filings under the Securities Act.*

The following graph shows a comparison from July 25, 2007, the date our common stock commenced trading on the NASDAQ Stock Market LLC, through December 31, 2011 of the cumulative total return for our common stock, NASDAQ Composite Index and NASDAQ Computer Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the NASDAQ Composite Index and the NASDAQ Computer Index assumes that dividends, if any, were reinvested.

\* Assumes \$100 was invested on July 25, 2007 in our common stock and in the applicable indexes.

### **Unregistered Sales of Equity Securities**

On December 8, 2010, in connection with the Company's acquisition of Ascender Corporation and Font Commerce LLC, together Ascender, we issued an aggregate of 33,816 shares of our common stock to certain holders of outstanding shares of Ascender in exchange for the shares of Ascender held by them. The shares of the company's common stock issued in connection with the acquisition were issued in an offering exempt from registration under the Securities Act of 1933, as amended, pursuant to Rule 506 of Regulation D promulgated thereunder on the basis that there were fewer than 35 purchasers in the offering and each purchaser represented that he/she was an accredited investor as such term is defined in Rule 501 of Regulation D.

### **Issuer Purchases of Securities**

Pursuant to the terms of our 2004 Award Plan, we have the right to repurchase unvested restricted shares from employees upon their termination, and it is generally our policy to do so. Pursuant to the terms of our 2007 Award Plan and 2010 Inducement Plan, we automatically reacquire any unvested restricted shares at their original price from the grantee upon termination of employment. We did not repurchase any shares of our common stock during the quarter ended December 31, 2011.

**Table of Contents****Item 6. Selected Financial Data**

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this report. The data presented for the years ended December 31, 2011, 2010 and 2009, and as of December 31, 2011 and 2010, are derived from our audited consolidated financial statements included elsewhere in this report. The data presented for the years ended December 31, 2008 and 2007, and as of December 31, 2009, 2008 and 2007, are derived from our consolidated financial statements not included in this report.

	Years Ended December 31,				
	2011	2010	2009	2008	2007
<b>Condensed Consolidated Statement of Income Data:</b>					
Revenue	\$ 123,212	\$ 106,659	\$ 94,005	\$ 110,861	\$ 105,152
Cost of revenue	10,155	7,477	6,861	9,101	8,705
Cost of revenue-amortization of acquired technology	3,169	3,488	3,383	3,392	3,376
Total cost of revenue	13,324	10,965	10,244	12,493	12,081
Gross profit	109,888	95,694	83,761	98,368	93,071
Marketing and selling	32,622	25,935	23,645	22,911	19,206
Research and development	16,540	15,404	14,142	14,867	18,837
General and administrative	17,413	16,488	14,674	19,882	15,605
Amortization of other intangibles	5,071	4,795	4,744	6,924	7,162
Total operating expenses	71,646	62,622	57,205	64,584	60,810
Income from operations	38,242	33,072	26,556	33,784	32,261
Other (income) expense:					
Interest expense, net	2,754	4,405	4,435	8,077	17,554
Loss on extinguishment of debt	422				2,958
Other expense (income), net	446	1,687	1,144	556	(2,147)
Total other expense	3,622	6,092	5,579	8,633	18,365
Income before provision for income taxes	34,620	26,980	20,977	25,151	13,896
Provision for income taxes	11,951	8,620	7,575	9,770	4,832
Net income	\$ 22,669	\$ 18,360	\$ 13,402	\$ 15,381	\$ 9,064
Net income (loss) available to common stockholders	\$ 22,302	\$ 18,237	\$ 13,315	\$ 15,130	\$ (25,022)
Net income (loss) per common share:					
Basic	\$ 0.63	\$ 0.52	\$ 0.39	\$ 0.45	\$ (1.55)
Diluted	\$ 0.61	\$ 0.51	\$ 0.38	\$ 0.43	\$ (1.55)
Weighted average number of common shares outstanding: Basic	35,357,630	34,762,919	34,365,544	33,818,508	16,174,165
Weighted average number of common shares outstanding: Diluted	36,817,379	35,990,295	35,288,126	35,304,794	16,174,165

**Table of Contents**

	2011	2010	2009	2008	2007
<b>Condensed Consolidated Summary Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 53,850	\$ 42,786	\$ 34,616	\$ 31,941	\$ 19,584
Total current assets	64,905	50,676	43,190	41,191	28,096
Total assets	283,822	278,805	272,377	277,421	276,346
Total current liabilities	32,380	31,830	32,672	38,227	40,882
Total debt	37,321	65,859	91,353	113,596	131,400
Additional paid-in capital	167,448	155,791	148,273	142,676	138,219
Total stockholders' equity	198,361	164,982	140,522	120,836	102,007

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and notes to those statements, appearing elsewhere in this report. This report contains forward-looking statements reflecting our current expectations that involve risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. The cautionary statements made in this report should be read as applying to all related forward-looking statements wherever they appear in this report. Our actual results may differ materially from those indicated in the forward-looking statements due to a number of factors, including those discussed in Item 1A, Risk Factors and elsewhere in this report.*

**Overview**

We are 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. Our technologies and fonts enable the display and printing of high quality digital content. Our software technologies have been widely deployed across, and embedded in a range of CE devices, including laser printers, digital copiers, mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, digital televisions, set-top boxes and consumer appliances, as well as in numerous software applications and operating systems. In the laser printer market, we have worked together with industry leaders for over 20 years to provide critical components embedded in printing standards. 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). Our scaling, compression, text layout, printer driver and color technologies solve critical text imaging issues for CE device manufacturers by rendering high quality text on low resolution and memory constrained CE devices. We combine these proprietary technologies with access to more than 15,000 typefaces from a library of some of the most widely used designs in the world, including popular names such as Helvetica and Times New Roman. We also license our typefaces to creative and business professionals through our e-commerce websites including [fonts.com](http://fonts.com), [linotype.com](http://linotype.com), [ascenderfonts.com](http://ascenderfonts.com), [itcfonts.com](http://itcfonts.com) and [webfonts.fonts.com](http://webfonts.fonts.com), which attracted more than 40 million visits in 2011 from over 200 countries and territories, direct and indirect sales and custom font design services.

On November 10, 2011, we entered into a definitive agreement with Bitstream to acquire Bitstream's font business in an all cash merger valued at \$50 million, subject to adjustments based on the net asset value of Bitstream. The transaction has been approved by the boards of directors for both companies. We anticipate financing the deal through a combination of cash balances and our secured revolving credit facility. On January 30, 2012 we received a voluntary request for information from the United States Department of Justice (the "DOJ") regarding the pending transaction. The DOJ also informed Monotype Imaging that it will likely issue a Civil Investigative Demand ("CID") to Monotype Imaging pursuant to the Antitrust Civil Process Act of 1976. We expect the transaction to close following the resolution of the DOJ inquiry, as well as the satisfaction of customary closing conditions, the approval of the transaction by Bitstream's shareholders, and the spinoff by Bitstream of its mobile browsing and variable data publishing businesses.

**Table of Contents**

On December 8, 2010, we acquired Ascender Corporation, a privately held font provider with long-standing relationships with several leading brands including Google and Microsoft, located in Elk Grove Village, Illinois, and Font Commerce LLC for approximately \$11.0 million. Of the purchase price, approximately \$7.4 million was paid in cash and \$3.2 million, or 285,632 shares, in common stock were issued. We accounted for the acquisition using the purchase method of accounting in accordance with Accounting Standards Codification, or ASC, Topic No. 805, *Business Combinations*, or ASC 805. The majority of the common stock issued in connection with the acquisition was issued to shareholders of Ascender, who immediately upon closing became employees of the Company. The stock awards granted are subject to vesting terms that require employment to continue over our standard four-year term. As a result, approximately \$2.8 million of the \$3.2 million in common stock issued is being expensed as share based compensation over the four year vesting term. At the acquisition date, the Company had a pre-existing relationship with Ascender; an exclusive licensing agreement with a fair value equivalent to its book value of \$3.2 million that was effectively settled on acquisition. In accordance with ASC 805-10-25-20, the settlement of the license was included as part of total consideration and has been allocated among the assets acquired.

**Sources of Revenue**

We derive revenue from two principal sources: licensing our text imaging solutions to CE device manufacturers and independent software vendors, which we refer to as our OEM revenue, and licensing our fonts to creative and business professionals, which we refer to as our Creative Professional revenue. We derive our OEM revenue primarily from CE device manufacturers. We derive our Creative Professional revenue primarily from multinational corporations, graphic designers, media organizations, advertisers, printers and publishers. Some of our revenue streams, particularly custom revenue where spending is largely discretionary in nature, have historically been and we expect them to continue to be in the future, susceptible to weakening economic conditions. In 2011, we experienced a decrease in printer imaging royalty revenue from Asia primarily a result of the natural disaster in Japan in March, which we do not expect to occur in 2012.

Our customers are located in the United States, Asia, Europe and throughout the rest of the world, and our operating subsidiaries are located in the United States, Japan, the United Kingdom, Germany and Hong Kong. We are dependent on international sales by our foreign operating subsidiaries for a substantial amount of our total revenue. Revenue from our Asian subsidiaries is generally from Asian customers and revenue from our other subsidiaries is from customers in a number of different countries, including the United States. We attribute revenue to geographic areas based on the location of our subsidiary receiving such revenue. For example, licenses may be sold to a large international company headquartered in Korea, but the sale is 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.

	2011		2010		2009	
	Sales	% of Total	Sales	% of Total	Sales	% of Total
(In thousands of dollars, except %)						
United States	\$ 56,728	46.1%	\$ 39,671	37.2%	\$ 31,634	33.6%
Asia	44,127	35.8	44,935	42.1	36,246	38.6
United Kingdom	5,322	4.3	4,727	4.5	10,418	11.1
Germany	17,035	13.8	17,326	16.2	15,707	16.7
<b>Total</b>	<b>\$ 123,212</b>	<b>100.0%</b>	<b>\$ 106,659</b>	<b>100.0%</b>	<b>\$ 94,005</b>	<b>100.0%</b>

For the years ended December 31, 2011, 2010 and 2009, sales by our subsidiaries located outside North America comprised 53.9%, 62.8% and 66.4%, respectively, of our total revenue. In 2011 revenue from the United States increased both in dollars and as a percent of revenue, as a result of several factors; contractual changes with an existing customer, growth in markets primarily served by our U.S. subsidiary and our acquisition of Ascender. We expect that sales by our international subsidiaries will continue to represent a substantial portion of our revenue for the foreseeable future. Future international revenue will depend on the continued use and expansion of our text imaging solutions worldwide.

## **Table of Contents**

We derive a majority of our revenue from a limited number of customers, in particular manufacturers of laser printers and mobile phones. For the years ended December 31, 2011, 2010 and 2009, our top ten licensees by revenue accounted for approximately 46.0%, 50.8% and 47.1% of our total revenue, respectively. No one customer accounted for more than 10% of our total revenue in 2011, 2010 or 2009.

### **Cost of Revenue**

Our cost of revenue consists of font license fees that we pay on certain fonts that are owned by third parties, allocated internal engineering expense and overhead costs directly related to custom design services. License fees that we pay to third parties are typically based on a percentage of our OEM and Creative Professional revenue and do not involve minimum fees. Our cost of OEM revenue is typically lower than our cost of Creative Professional revenue because we own a higher percentage of the fonts licensed to our OEM customers, provide value-added technology and have negotiated lower royalty rates on the fonts we license from third parties because of volume. The cost of our custom design service revenue is substantially higher than the cost of our other revenue and, as a result, our gross margin varies from period-to-period depending on the level of custom design revenue recorded.

Cost of revenue also includes amortization of acquired technology, which we amortize over 8 to 15 years. For purposes of amortizing acquired technology we estimate the remaining useful life of the technology based upon various considerations, including our knowledge of the technology and the way our customers use it. We use the straight-line method to amortize our acquired technology. There is no reliable evidence to suggest that we should expect any other pattern of amortization than an even pattern, and we believe this best reflects the expected pattern of economic usage.

### **Gross Profit**

Our gross profit percentage is influenced by a number of factors including product mix, pricing and volume at any particular time. However, our cost of OEM revenue is typically lower than our cost of Creative Professional revenue because we own a higher percentage of the fonts licensed to our OEM customers, provide value-added technology and have negotiated lower royalty rates on the fonts we license from third parties because of volume. Within our Creative Professional business, the cost of our custom design service revenue is substantially higher than the cost of our other revenue. As a result, our gross profit varies from period-to-period depending on the mix between, and within, OEM and Creative Professional revenue.

### **Marketing and Selling**

Our marketing and selling expense consists of salaries, bonuses, commissions and benefits related to our marketing and selling personnel, business travel expenses, advertising and trade show expenses, web-related expenses, allocated facilities costs and other overhead expenses. Sales commission expense varies as a function of revenue and goal achievement from period-to-period. During 2011, our marketing and selling expenses increased, as compared to 2010, mainly due to an increase in personnel related expenses and an increase in discretionary spending in areas such as travel and tradeshows, consulting and advertising.

### **Research and Development**

Our research and development expense consists of salaries, bonuses and benefits related to our research and development, engineering, font design and integration support personnel and their business travel expenses, license fees related to certain of our technology licenses, expenses for contracted services and allocated facilities costs and other overhead expenses. Our research and development expense in a given period may be reduced to the extent that internal engineering resources are allocated to cost of revenue for custom design services.

## **Table of Contents**

Our research and development is primarily focused on enhancing the functionality of our text imaging solutions and developing new products. From time-to-time we license third-party font technology in connection with new technology development projects that are part of our research and development efforts. Our research and development costs are expensed as incurred.

### **General and Administrative**

Our general and administrative expense consists of salaries, bonuses and benefits related to our general and administrative personnel, accounting, legal and other professional fees, allocated facilities costs and other overhead expenses and insurance costs.

### **Restructuring**

On November 10, 2008, the Company implemented a restructuring plan. Under the restructuring plan, the Company reduced headcount in certain areas and redeployed certain other employees within the Company in order to focus on key initiatives across the business. The headcount reduction was intended to be offset by the hiring of a few key additional employees whose technical expertise was better aligned with our key initiatives, and accordingly we did not experience an overall change in headcount. The restructuring plan was completed in April 2009, other than making deferred cash payments to certain terminated employees. The Company implemented a restructuring plan on October 21, 2009, which included certain actions that were taken during the three months ended September 30, 2009 in advance of finalizing the plan. Under the restructuring plan, the Company reduced headcount in an effort to improve operational efficiencies, primarily within the Creative Professional area of our business, and consolidated certain functions of our European operations within our United States and United Kingdom offices. The plan provided for the elimination of 15 positions worldwide. The Company recorded charges of approximately \$0.9 million for severance and termination benefits associated with this plan. In the years ended December 31, 2010 and 2009, we recorded \$0.2 million and \$0.7 million, respectively, of restructuring costs for severance and termination benefits for both plans, which is included in our operating expenses. This restructuring plan was completed in the first quarter of 2010, other than the payment of deferred termination benefits to certain terminated employees. Future cash expenditures related to the restructuring are expected to be approximately \$21 thousand, net of tax savings.

### **Amortization of Intangible Assets**

We amortize intangible assets acquired as follows:

Customer relationships 7 to 15 years;

Acquired technology 8 to 15 years; and

Non-compete agreements 3 to 6 years.

For purposes of amortization, we estimate the life of customer relationships based upon various considerations, including our knowledge of the industry and the marketplace in which we operate. We amortize non-compete agreements over the stated life of the agreement. We use the straight-line method to amortize our intangible assets. There is no reliable evidence to suggest that we should expect any other pattern of amortization than an even pattern, and we believe this best reflects the expected pattern of economic usage.

### **Critical Accounting Policies**

The preparation of financial statements and related disclosures in conformity with generally accepted accounting principles, or GAAP, and our discussion and analysis of our financial condition and results of operations requires us to make judgments, assumptions and estimates that affect the amounts reported in

## **Table of Contents**

our consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates.

We believe the following critical accounting policies affect our more significant judgments used in the preparation of our consolidated financial statements. Additional information about our critical accounting policies may be found in Note 2 to our consolidated financial statements in Item 8.

### ***Revenue Recognition***

We recognize revenue in accordance with ASC Topic No. 805, *Revenue Recognition*, or ASC 805. Revenue is recognized when persuasive evidence of an agreement exists, the product has been delivered or services have been provided, the fee is fixed or determinable, and collection of the fee is probable.

#### ***OEM Revenue***

Our OEM revenue is derived substantially from per-unit royalties received for printer imaging and printer driver, or printer products, and display imaging products. Under our licensing arrangements we typically receive a royalty for each product unit incorporating our text imaging solutions that is shipped by our OEM customers. We also receive OEM revenue from fixed fee licenses with certain of our OEM customers. Fixed fee licensing arrangements are not based on units the customer ships, but instead, customers pay us on a periodic basis for use of our text imaging solutions. Although significantly less than royalties from per-unit shipments and fixed fees from OEM customers, we also receive revenue from software application and operating systems vendors, who include our text imaging solutions in their products, and for font development. Many of our per-unit royalty licenses continue for the duration that our OEM customers ship products that include our technology, unless terminated for breach. Other licenses have terms that typically range from three to five years, and usually provide for automatic or optional renewals. We recognize revenue from per-unit royalties in the period during which we receive a royalty report from a customer, typically one quarter after royalty-bearing units are shipped. Revenue from fixed fee licenses is generally recognized when it is billed to the customer, so long as the product has been delivered, the license fee is fixed and non-refundable and collection is probable.

#### ***Creative Professional Revenue***

Our Creative Professional revenue is derived from font licenses and from custom font design services. We license fonts directly to end-users through our e-commerce websites, via telephone, email and indirectly through third-party resellers. We also license fonts and provide custom font design services to graphic designers, advertising agencies, media organizations and corporations. We refer to direct, indirect and custom revenue, as non-web revenue, and refer to revenue that is derived from our websites, as web revenue.

Revenue from font licenses to our e-commerce customers is recognized upon payment by the customer and electronic shipment of the software embodying the font. Revenue from font licenses to other customers is recognized upon shipment of the software embodying the font and when all other revenue recognition criteria have been met. Revenue from resellers is recognized upon notification from the reseller that our font product has been licensed and when all other revenue recognition criteria have been met. Custom font design services are generally recognized upon delivery. Contract accounting may be used where services are deemed essential to the software.

### ***Goodwill, Indefinite-Lived Intangible Assets and Long-lived Assets***

We record tangible and intangible assets acquired and liabilities assumed in a business combination under the purchase method of accounting. Amounts paid for acquisitions are allocated to the assets

---

## **Table of Contents**

acquired and liabilities assumed based on their fair values at the date of acquisition. We allocate the excess of the cost of an acquired entity over the amounts assigned to assets acquired and liabilities assumed in a business combination to goodwill. The value initially assigned to the acquired assets and assumed liabilities, particularly intangible assets and goodwill, are subject to underlying assumptions that require significant management judgment. If different assumptions were used, it could materially impact the purchase price allocation and our financial position and results of operations.

We assess the impairment of goodwill and indefinite-lived intangible assets annually, or more frequently if events or changes in circumstances indicate that the carrying value of such assets exceeds their fair value. We perform our annual goodwill impairment test as of December 31<sup>st</sup>. In September 2011, the FASB issued an update to ASC Topic No. 350, Intangibles – Goodwill and Other, Testing for Goodwill Impairment ( ASC 350 ). ASC 350 provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. In 2011, we assessed qualitative factors, as described below, to determine whether it was more likely than not that the fair value of our reporting unit was impaired and determined that the fair value was more likely than not higher than its carrying value. With respect to both goodwill and indefinite-lived intangible assets, factors that could trigger an impairment review include significant negative industry or economic trends, exiting an activity in conjunction with a restructuring of operations, a sustained decrease in share price or current, historical or projected losses that demonstrate continuing losses associated with an asset. Impairment evaluations involve management estimates of useful lives and future cash flows, including assumptions about future conditions such as future revenue, operating expenses, the fair values of certain assets based on appraisals and industry trends. Actual useful lives and cash flows could be different from those estimated by our management. If this resulted in an impairment of goodwill and indefinite-lived intangible assets, it could have a material adverse effect on our financial position and results of operations.

### ***Share Based Compensation***

We account for share based compensation in accordance with ASC Topic No. 718, *Compensation – Stock Compensation* or ASC 718, 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.

We valued awards granted based on the grant date closing price of our common stock as traded on the NASDAQ Global Select Market. The Company uses the Black-Scholes option pricing model to determine the weighted-average fair value of options granted and recognizes the compensation cost of share based awards on a straight-line basis over the vesting period of the award. The determination of the fair value of share based payment awards using the Black-Scholes model are affected by our stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. We estimate volatility by using a blend of our stock price history, for the length of time we have market data for our stock and the historical volatility of similar public companies for the remainder of the expected term of each grant. This is estimated in accordance with Staff Accounting Bulletin No. 110, or SAB 110. The expected life of the awards is estimated based on the simplified method, as defined in SAB 110. The risk-free interest rate assumption is based on a US treasury instrument whose term is consistent with the expected life of our awards. The expected dividend yield assumption is based on our history and expectation of paying no dividends.

Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Share based compensation expense recognized in our financial

## **Table of Contents**

statements is based on awards that are ultimately expected to vest. We evaluate the assumptions used to value our awards on a quarterly basis and if factors change and we employ different assumptions, share based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share based compensation expense. Future share based compensation expense and unearned share based compensation will increase to the extent that we grant additional equity awards to employees or we assume unvested equity awards in connection with acquisitions.

During the years ended December 31, 2011, 2010 and 2009, we recorded total share based compensation expense of \$7.0 million, \$5.5 million and \$5.2 million, respectively. As of December 31, 2011, the Company had \$11.7 million of unrecognized compensation expense related to employees and directors unvested stock options and restricted share awards that are expected to be recognized over a weighted average period of 1.8 years.

### ***Pension Plan***

We account for our defined benefit pension plan in accordance with ASC Subtopic No. 715-30, *Defined Benefit Plans Pension*. Our unfunded defined benefit pension plan was acquired in connection with our acquisition of Linotype on August 1, 2006. The plan covers substantially all employees of our Linotype subsidiary who joined Linotype prior to April 1, 2006, at which time the pension plan was closed to new participants. Benefits under this plan are based on the employees' years of service and compensation. We fund the plan sufficiently to meet current benefits only. There are no assets associated with the plan. In 2011 and 2010 we paid \$83 thousand and \$77 thousand, respectively, to the plan participants. At December 31, 2011 and 2010, our unfunded position was \$3.8 million and \$3.6 million, respectively. A significant portion of the pension benefit obligation is determined based on the rate of future compensation increases, inflation and interest rates. Given the fact that the pension plan is unfunded, changes in economic and market conditions may require us to increase cash contributions in future years. In addition, changes to our assumptions may materially impact the accrued pension liability.

### ***Provision for Income Taxes***

We provide for income taxes in accordance with ASC Topic No. 740, *Income Taxes*, or ASC 740. Under this method, a deferred tax asset or liability is determined based on the difference between the financial statement and the tax basis of assets and liabilities, as measured by enacted tax rates in effect when these differences are expected to be reversed. This process includes estimating current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and financial accounting purposes. These differences result in deferred tax assets and liabilities. We also assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe recovery to be unlikely, we have established a valuation allowance. Significant judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance against our deferred tax assets. Our financial position and results of operations may be materially affected if actual results significantly differ from these estimates or the estimates are adjusted in future periods.

We have recorded a valuation allowance against certain deferred tax assets, including foreign tax credits, where we have determined that their future use is uncertain. ASC 740 requires a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. A review of all available positive and negative evidence is considered, including a company's performance, the market environment in which the company operates, length of carry-back and carry-forward periods, existing sales backlog, future taxable income projections and tax planning strategies. We have historically provided valuation allowances on certain tax assets, due to the uncertainty

## **Table of Contents**

of generating taxable income in the appropriate jurisdiction and of the appropriate character to realize such assets. In these instances, the Company has made the determination that it is more likely than not that all or a portion of the deferred tax will not be realized.

We will continue to review our deferred tax position on a periodic basis and will reflect any change in judgment as a discrete item in the related period.

The amount of income taxes we pay is subject to ongoing audits by federal, state and foreign tax authorities, which often result in proposed assessments. Our estimate for the potential outcome for any uncertain tax issue is highly judgmental. We believe we have adequately provided for any reasonably foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period that the assessments are made or resolved, or when the statute of limitations for certain periods expires. As a result, our effective tax rate may fluctuate significantly on a quarterly basis.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax expense together with assessing the future impact of temporary differences resulting from differing treatment of items for tax and accounting purposes. The tax effect of these temporary differences is shown on our December 31, 2011 consolidated balance sheet (see Note 11 to our consolidated financial statements) and denotes these differences as a net deferred tax liability of \$19.7 million. This consists of total deferred tax liabilities of \$27.5 million and net deferred tax assets of \$7.8 million after providing a valuation allowance of \$2.2 million.

### ***Derivative Financial Instruments***

We account for our derivative instruments in accordance with ASC Topic No. 815, *Derivatives and Hedging*, which requires that all derivative instruments be reported on the balance sheet as either assets or liabilities measured at fair value. All changes in the fair value of derivatives are recognized as current period income or expense unless specific hedge criteria are met, which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting at the inception of each instrument. We recorded our derivatives at fair value, which is determined based on the provisions of ASC Topic No. 820, *Fair Value Measurements and Disclosures*, using either quoted market prices or prices for similar instruments. The determination of fair value of our derivatives considers our non-performance risk and that of our counterparties.

**Table of Contents****Results of Operations**

The following table sets forth items in the consolidated statement of income as a percentage of sales for the periods indicated:

	Year Ended December 31,		
	2011	2010	2009
<b>Revenue:</b>			
OEM	74.4%	75.0%	73.4%
Creative Professional	25.6	25.0	26.6
<b>Total revenue</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Cost of revenue	8.2	7.0	7.3
Cost of revenue - amortization of acquired technology	2.6	3.3	3.6
<b>Total cost of revenue</b>	<b>10.8</b>	<b>10.3</b>	<b>10.9</b>
<b>Gross profit</b>	<b>89.2</b>	<b>89.7</b>	<b>89.1</b>
Marketing and selling	26.5	24.3	25.2
Research and development	13.4	14.4	15.1
General and administrative	14.2	15.5	15.6
Amortization of other intangible assets	4.1	4.5	5.0
<b>Total operating expenses</b>	<b>58.2</b>	<b>58.7</b>	<b>60.9</b>
<b>Income from operations</b>	<b>31.0</b>	<b>31.0</b>	<b>28.2</b>
Interest expense, net	2.2	4.1	4.7
Loss (gain) on foreign exchange	0.2	2.0	(0.4)
Loss (gain) on derivatives	0.2	(0.4)	1.6
Loss on extinguishment of debt	0.3		
<b>Total other expenses</b>	<b>2.9</b>	<b>5.7</b>	<b>5.9</b>
<b>Income before provision for income taxes</b>	<b>28.1</b>	<b>25.3</b>	<b>22.3</b>
<b>Provision for income taxes</b>	<b>9.7</b>	<b>8.1</b>	<b>8.0</b>
<b>Net income</b>	<b>18.4%</b>	<b>17.2%</b>	<b>14.3%</b>

**Year Ended December 31, 2011 as Compared to Year Ended December 31, 2010**

*Sales by Market.* 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, our president and chief executive officer, in determining how to allocate resources and assess performance. While our technologies and services are sold to customers in two principal markets CE device manufacturers and independent software vendors, together 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 principal markets (in thousands):

	2011	2010	Increase
OEM	\$ 91,656	\$ 80,000	\$ 11,656
Creative Professional	31,556	26,659	4,897
<b>Total revenue</b>	<b>\$ 123,212</b>	<b>\$ 106,659</b>	<b>\$ 16,553</b>

***Revenue***

Revenue was \$123.2 million and \$106.7 million for the years ended December 31, 2011 and 2010, respectively, an increase of \$16.5 million, or 15.5%, mainly due to increased OEM revenue.

## **Table of Contents**

OEM revenue was \$91.7 million and \$80.0 million for the years ended December 31, 2011 and 2010, respectively, an increase of \$11.7 million, or 14.6%. The increase in OEM revenue is primarily due to increased display imaging revenue from volume of unit shipments of products by our customers that embed our fonts and technology solutions such as e-book readers, mobile phones, digital cameras and automotive displays and service work performed for our independent software vendor customers.

Creative Professional revenue was \$31.6 million and \$26.7 million for the years ended December 31, 2011 and 2010, respectively, an increase of \$4.9 million, or 18.4%. Non-web revenue, which accounted for the majority of the increase, was primarily a result of increased direct sales to our enterprise customers and custom revenue. Web revenue also increased mainly due to our newer product offerings, such as Web font services.

### ***Cost of Revenue***

Cost of revenue, excluding amortization of acquired technology, was \$10.2 million and \$7.5 million for the years ended December 31, 2011 and 2010, respectively, an increase of \$2.7 million, or 35.8%. Cost of revenue as a percentage of total revenue was 8.2% and 7.0% for the years ended December 31, 2011 and 2010, respectively. The increase in cost of revenue in dollars was mainly the result of product mix and partially due to higher sales volume. The increase as a percentage of revenue was mainly due to variations in product mix. For the year ended December 31, 2011, as compared to the same period in 2010, a higher percentage of revenue was derived from products that carry a higher royalty cost. OEM revenue represented 74.4% of our total revenue in 2011, as compared to 75.0% in 2010. Our OEM revenue typically has a lower associated cost than our Creative Professional revenue.

The portion of cost of revenue consisting of amortization of acquired technology was \$3.2 million and \$3.5 million in the years ended December 31, 2011 and 2010, respectively.

### ***Gross Profit***

Gross profit was 89.2% in the year ended December 31, 2011, compared to 89.7% in the same period in 2010, mainly the result of the aforementioned factors in the cost of revenue discussion. Our gross profit percentage is influenced by a number of factors including product mix, pricing and volume at any particular time.

### ***Operating Expenses***

*Marketing and Selling.* Marketing and selling expense was \$32.6 million and \$25.9 million for the years ended December 31, 2011 and 2010, respectively, an increase of \$6.7 million, or 25.8%, primarily the result of increased personnel related expenses and increased discretionary spending. Personnel and personnel related expenses increased \$4.2 million in 2011, as compared to 2010, mainly due to higher salary and share based compensation expenses. In 2011, we experienced the full year impact on expenses of headcount additions made in the latter part of 2010, mainly due to our acquisition of Ascender. Travel related expense, online advertising and consulting expenses increased by a total of \$2.1 million in 2011, as compared to 2010, as discretionary spending increased commensurate with increased sales volume and headcount.

*Research and Development.* Research and development expense was \$16.5 million and \$15.4 million, in 2011 and 2010, respectively, an increase of \$1.1 million, or 7.4%, mainly due to an increase in personnel expenses. Personnel and personnel related expense, including share based compensation expense, increased \$1.5 million, mainly due to annual salary increases and an increase in headcount year-over-year. Headcount increased 16.7% in 2011, as compared to 2010. This increase was partially offset by an increase in reclassifications to cost of sales of \$0.7 million for service work on revenue recognized during 2011.

## **Table of Contents**

*General and Administrative.* General and administrative expense was \$17.4 million and \$16.5 million for the years ended December 31, 2011 and 2010, respectively, an increase of \$0.9 million, or 5.6%. Personnel and personnel related expenses increased \$0.4 million, mainly due to higher salary expense that was partially the result of an increase in headcount. Headcount increased 12.0% in 2011, as compared to 2010. Legal expenses increased \$0.5 million in 2011, as compared to 2010, primarily a result of acquisition related activity.

*Amortization of Other Intangible Assets.* Amortization of other intangible assets was \$5.1 million and \$4.8 million for the years ended December 31, 2011 and 2010, respectively, an increase of \$0.3 million, primarily due to our acquisition of Ascender.

### ***Interest Expense, Net***

Interest expense, net of interest income was \$2.8 million and \$4.4 million in the years ended December 31, 2011 and 2010, respectively. The decrease in the interest expense was mainly the result of lower total debt outstanding coupled with a lower interest rate on the debt. Total debt outstanding, net of unamortized financing, at December 31, 2011 was \$37.3 million, as compared to \$65.9 million at December 31, 2010. At December 31, 2011, the blended rate of interest on our revolving credit facility was 2.6%, as compared to the blended rate of 4.0% on our Amended and Restated Credit Agreement at December 31, 2010.

### ***Loss (Gain) on Foreign Exchange***

Loss (gain) on foreign exchange were losses of \$0.2 million and \$2.1 million in 2011 and 2010, respectively. During 2010, we recorded a loss of \$1.3 million on our Euro denominated intercompany note and in 2011, the loss recorded on the note was immaterial. The note is scheduled to be paid in full during 2012. In 2010, the remainder of the loss, or \$0.8 million, was the result of currency fluctuations, particularly the Japanese Yen and the Euro, as compared to the US dollar. During 2011, currency fluctuations did not result in significant net losses.

### ***Loss (Gain) on Derivatives***

Loss (gain) on derivatives was a loss of \$0.2 million and a gain of \$0.4 million in 2011 and 2010, respectively, the net result of changes to the market value of our swap contracts. In 2011, the loss was primarily related to our interest rate swap contract. In 2010, we recorded a gain of \$1.2 million on our currency swap and a loss of \$0.8 million on our interest rate swap contracts.

### ***Loss on Extinguishment of Debt***

In 2011, we recorded a loss of approximately \$0.4 million on the extinguishment of our Amended and Restated Credit Facility. On July 13, 2011, we entered into a five-year \$120.0 million revolving credit facility and our Amended and Restated Credit Facility was terminated. The \$0.4 million represents the unamortized deferred financing costs associated with the pro-rata share of prior loan syndicate lenders that did not participate in the new revolving credit facility. There were no similar charges during the same period in 2010.

### ***Provision for Income Taxes***

Our effective tax rate was 34.5% and 31.9% for the year ended December 31, 2011 and 2010, respectively. The effective tax rate for the year ended December 31, 2011 included a smaller income tax benefit received from the reversal of reserve for income taxes, as compared to the same period in 2010. This, together with an increase in non-deductible equity compensation in 2011, primarily contributed to the increase in the effective tax rate as compared to 2010.

**Table of Contents**

As of December 31, 2011, the total amount of unrecognized tax benefits was \$0.9 million. At December 31, 2010, we had \$0.8 million of unrecognized tax benefits. We classify potential interest and penalties as a component of tax expense. As of December 31, 2011 and 2010 we had \$0.3 million and \$0.3 million of accrued interest and penalties, respectively.

**Year Ended December 31, 2010 as Compared to Year Ended December 31, 2009**

*Sales by Market.* The following table presents revenue for these two principal markets (in thousands):

	2010	2009	Increase
OEM	\$ 80,000	\$ 68,967	\$ 11,033
Creative Professional	26,659	25,038	1,621
<b>Total revenue</b>	<b>\$ 106,659</b>	<b>\$ 94,005</b>	<b>\$ 12,654</b>

**Revenue**

Revenue was \$106.7 million and \$94.0 million for the years ended December 31, 2010 and 2009, respectively, an increase of \$12.7 million, or 13.5%, mainly due to increased OEM revenue. OEM revenue increased \$11.0 million, or 16.0%, to \$80.0 million for the year ended December 31, 2010 from \$69.0 million for the year ended December 31, 2009, a result of increased revenue from our printer business mainly from an increase in unit shipments by our OEM customers.

Creative Professional revenue was \$26.7 million and \$25.0 million for the years ended December 31, 2010 and 2009, respectively, an increase of \$1.6 million, or 6.5%. Non-web revenue increased \$0.8 million, mainly the result of an increase in direct sales to our enterprise customers. Web revenue increased \$0.8 million partially the result of continued growth in web sales of our Font Explorer X font management software.

**Cost of Revenue**

Cost of revenue, excluding amortization of acquired technology, was \$7.5 million and \$6.9 million for the years ended December 31, 2010 and 2009, respectively, an increase of \$0.6 million, or 9.0%. The dollar increase in cost of revenue was the result of higher sales volume. Cost of revenue as a percentage of total revenue was 7.0% and 7.3% for the years ended December 31, 2010 and 2009, respectively, which reflects the fact that a higher percentage of revenue was derived from products that carry a lower royalty cost or from products we own.

The portion of cost of revenue consisting of amortization of acquired technology was \$3.5 million and \$3.4 million in the years ended December 31, 2010 and 2009, respectively. The increase year-over-year was a result of our acquisition of Planetweb.

**Gross Profit**

Gross profit was 89.7% in the year ended December 31, 2010, compared to 89.1% in the same period in 2009, mainly due to product mix coupled with higher revenue. Our gross profit percentage is influenced by a number of factors including product mix, pricing and volume at any particular time. OEM revenue represented 75.0% of our total revenue in 2010, as compared to 73.4% in 2009. Our OEM revenue typically has a lower associated cost than our Creative Professional revenue.

---

**Table of Contents****Operating Expenses**

*Marketing and Selling.* Marketing and selling expense was \$25.9 million and \$23.6 million for the years ended December 31, 2010 and 2009, respectively, an increase of \$2.3 million, or 9.7%, primarily the result of increased personnel related expenses and increased discretionary spending. Personnel and personnel related expenses, including share based compensation expense, increased \$1.4 million in 2010, as compared to 2009, mainly the result of an increase in variable compensation due to higher sales volume, net of a decrease in severance expense of \$0.4 million. In 2009, the Company limited discretionary spending given the lower sales volume, as compared to 2010. As a result, travel related expenses increased \$0.2 million in 2010, as compared to 2009 and outside third party service expense increased \$0.4 million in 2010, as compared to 2009, as spending on special projects, such as commercial website development, increased.

*Research and Development.* Research and development expense was \$15.4 million and \$14.1 million, in 2010 and 2009, respectively, an increase of \$1.3 million, or 8.9%, mainly due to an increase in personnel expenses partially resulting from increased variable compensation. Personnel and personnel related expense, including share based compensation expense, increased \$2.0 million, mainly the result of increased salary expense, due to annual salary increases and a small increase in headcount year-over-year, and higher variable compensation in 2010. This increase was partially offset by decreased spending on outside consultants of \$0.7 million.

*General and Administrative.* General and administrative expense was \$16.5 million and \$14.7 million for the years ended December 31, 2010 and 2009, respectively, an increase of \$1.8 million, or 12.4%, mainly the result of an increase in personnel related expenses and an increase in legal spending. Personnel and personnel related costs, including share based compensation expense, increased \$1.0 million in 2010, as compared to 2009, mainly the result of variable compensation. Legal expenses increased \$0.6 million primarily due to the timing of intellectual property registration actions, acquisition activity, amendments to our credit facility and other legal matters.

*Amortization of Other Intangible Assets.* Amortization of other intangible assets was \$4.8 million and \$4.7 million for the years ended December 31, 2010 and 2009, respectively, an increase of \$0.1 million, primarily due to our acquisition of Planetweb. We expect amortization of other intangible assets to increase approximately \$0.4 million on an annual basis, as a result of our acquisition of Ascender.

**Interest Expense, Net**

Interest expense, net of interest income was \$4.4 million in both years ended December 31, 2010 and 2009. Although total debt outstanding in 2010 was lower than in 2009, the rate of interest on the outstanding debt was higher during most of 2010, as compared to the prior year, which taken together, resulted in a consistent interest expense year-over-year. Total debt outstanding, net of unamortized financing and debt discounts, at December 31, 2010 was \$65.9 million, as compared to \$91.4 million at December 31, 2009. In March 2010, we paid \$5.2 million on the principal of our Amended and Restated Credit Agreement in accordance with the agreement. On December 30, 2010 we made a \$10.0 million principal prepayment in connection with the third amendment to our Amended and Restated Credit Agreement. The blended rate of interest on our Amended and Restated Credit Agreement was 4.0% at both December 31, 2010 and December 31, 2009. We refinanced the debt on October 30, 2009 resulting in an increase in the rate of interest on our debt of one percentage point, among other term changes. Prior to this amendment, our blended rate of interest was 3.0% on the note. See Note 7 of our consolidated financial statements for further details on the amendments.

## **Table of Contents**

### ***Loss (Gain) on Foreign Exchange***

Loss (gain) on foreign exchange was a loss of \$2.1 million and a gain of \$0.4 million in 2010 and 2009, respectively, related mainly to our Euro denominated intercompany note. During 2010, we recorded a loss of \$1.3 million on the note, and in 2009 we recorded a gain of \$0.6 million on the note. The remainder of the loss, or \$0.8 million, was the result of currency fluctuations during the year, particularly the Japanese Yen and the Euro, as compared to the US dollar.

### ***(Gain) Loss on Derivatives***

(Gain) loss on derivatives was a gain of \$0.4 million and a loss of \$1.5 million in 2010 and 2009, respectively, the net result of changes to the market value of our swap contracts. In 2010, we recorded a gain of \$1.2 million on our currency swap and a loss of \$0.8 million on our interest rate swap contracts. In 2009 we recorded losses on both of our swap instruments. The loss on our interest rate swap contract in 2009 included cash payments of \$1.4 million.

### ***Provision for Income Taxes***

Our effective tax rate was 31.9% and 36.1% for the year ended December 31, 2010 and 2009, respectively. During the year ended December 31, 2010, the effective tax rate was favorably impacted by the reversal of reserves due to the settlement of state income tax audits and the expiration of the statute of limitations on certain tax years. In addition, the tax rate for 2010 was favorably impacted by a reduction in the overall effective state tax rate and a reduction in non-deductible stock compensation.

As of December 31, 2010, the total amount of unrecognized tax benefits was \$0.8 million. At December 31, 2009, we had \$1.5 million of unrecognized tax benefits. We classify potential interest and penalties as a component of tax expense. As of December 31, 2010 and 2009 we had \$0.3 million and \$0.4 million of accrued interest and penalties, respectively.

## **Recently Issued Accounting Pronouncements**

### ***Goodwill Impairment***

In September 2011, the FASB issued an update to ASC Topic No. 350, Intangibles – Goodwill and Other, Testing for Goodwill Impairment ( ASC 350 ). ASC 350 provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The update was intended to simplify how an entity tests for goodwill impairment. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We adopted this standard effective with our fiscal year end December 31, 2011 and the adoption did not have a material impact on our financial statements.

### ***Comprehensive Income***

In June 2011, the Financial Accounting Standards Board ( 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

**Table of Contents**

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, beginning after December 15, 2011, and will require retrospective application for all periods presented. The adoption will impact the presentation of comprehensive income, but will not otherwise impact our financial position or results of operations.

**Liquidity and Capital Resources*****Cash Flows for the Years Ended December 31, 2011, 2010 and 2009***

Since our inception, we have financed our operations primarily through cash from operations, private and public stock sales and long-term debt arrangements, as described below. We believe our existing cash and cash equivalents, our cash flow from operating activities and available bank borrowings will be sufficient to meet our anticipated cash needs for at least the next twelve months. At December 31, 2011, our principal sources of liquidity were cash and cash equivalents totaling \$53.9 million and a \$120.0 million revolving credit facility, of which \$37.3 million was outstanding at December 31, 2011. Our future working capital requirements will depend on many factors, including the operations of our existing business, our potential strategic expansion, and future acquisitions we might undertake. On November 10, 2011, we entered into a definitive agreement with Bitstream to acquire Bitstream's font business in an all cash merger valued at \$50 million, subject to adjustments based on the net asset value of Bitstream. The transaction is expected to close following the resolution of the DOJ inquiry, as well as the satisfaction of other closing conditions. We anticipate financing the deal through a combination of cash balances and our secured revolving credit facility. To the extent that our cash and cash equivalents, our current debt arrangements and our cash flow from operating activities are insufficient to fund our future activities, we may need to raise additional funds through bank credit arrangements or public or private equity or debt financings.

The following table presents our cash flows from operating activities, investing activities and financing activities for the periods presented (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Net cash provided by operating activities	\$ 39,313	\$ 43,658	\$ 28,071
Net cash used in investing activities	(2,144)	(11,020)	(2,555)
Net cash used in financing activities	(26,096)	(24,728)	(22,853)
Effect of exchange rates on cash and cash equivalents	(9)	260	12
<b>Total increase in cash and cash equivalents</b>	<b>\$ 11,064</b>	<b>\$ 8,170</b>	<b>\$ 2,675</b>

***Operating Activities***

Since 2005, our operating activities have generated positive cash flows. Significant variations in operating cash flows frequently occur because, from time to time, our customers make prepayments against future royalties. Prepayments may be required under the terms of our license agreements and are occasionally made on an elective basis and often cause large fluctuations in accounts receivable and deferred revenue. The timing and extent of such prepayments significantly impact our cash balances.

## **Table of Contents**

In 2011 we generated \$39.3 million in cash from our operations. Net income after adjusting for depreciation and amortization, amortization of deferred financing costs, loss on extinguishment of debt, loss on retirement of fixed assets, share based compensation, excess tax benefit on stock options, deferred income taxes, provision for doubtful accounts, unrealized currency loss on foreign denominated intercompany transactions and unrealized loss on derivatives generated \$40.4 million in cash. Accounts payable, prepaid expenses and other assets, accrued income taxes and accrued expenses and other liabilities, net of income tax refunds receivable generated \$1.7 million in cash, due to timing of vendor payments and amounts accrued for variable compensation and taxes to be paid in 2012. Accounts receivable and deferred revenue used \$2.8 million, mainly due to increased sales activity during 2011.

In 2010 we generated \$43.7 million in cash from our operations. Net income after adjusting for depreciation and amortization, amortization of deferred financing costs, loss on retirement of fixed assets, share based compensation, excess tax benefit on stock options, deferred income taxes, provision for doubtful accounts, unrealized currency loss on foreign denominated intercompany transactions and unrealized gains on derivatives generated \$35.7 million in cash. Accounts payable and accrued expenses and other liabilities generated \$4.9 million in cash, due to the timing of vendor payments and amounts accrued for variable compensation to be paid in 2011. Accounts receivable generated \$1.2 million the result of our billing and collections during 2010. Prepaid expenses and other assets provided \$1.2 million in cash. Deferred revenue generated \$0.6 million in cash, mainly due to customer prepayments.

In 2009 we generated \$28.1 million in cash from our operations. Net income after adjusting for depreciation and amortization, amortization of deferred financing costs, loss on retirement of fixed assets, share based compensation, excess tax benefit on stock options, deferred income taxes, provision for doubtful accounts, unrealized currency gain on foreign denominated intercompany transactions and unrealized losses on derivatives generated \$30.6 million in cash. Accounts receivable provided \$1.3 million in cash the result of our cash collection efforts during the year. Accounts payable and accrued expenses and other liabilities used \$2.9 million in cash mainly due to the payment of variable compensation in March and the timing of vendor payments. At December 31, 2008, accrued expenses consisted of a large variable compensation balance resulting from strong revenue in 2008. Deferred revenue provided \$0.9 million in cash, primarily the result of two large prepayments in 2009.

### ***Investing Activities***

During 2011, we used \$1.9 million for the purchase of property and equipment, and paid the final \$0.2 million of costs associated with our acquisition of Ascender Corporation and Font Commerce LLC, which was accrued in 2010. During 2010, we acquired Ascender Corporation and Font Commerce LLC which used cash of \$7.2 million. We accrued \$0.2 million of additional costs at December 31, 2010 pending final adjustments. During 2010, we used \$3.0 million for the purchase of a long-term exclusive license. The remainder of cash used in investing activities was for the purchase property and equipment. During 2009, we acquired Planetweb, Inc. which used cash of \$1.7 million. At December 31, 2009, \$0.2 million was accrued pending final adjustments. The remainder of the cash used in investing activities in 2009, approximately \$0.8 million, was used to purchase property and equipment.

### ***Financing Activities***

During 2011, payments on long-term debt used \$86.8 million in cash, offset by proceeds from the issuance of debt, net of issuance costs of \$56.1 million as a result of the refinancing of our debt in July 2011, see Note 7. Proceeds from the exercise of stock options, combined with the excess tax benefit on stock options provided \$4.7 million in cash during 2011. During 2010 we used \$26.3 million in cash to pay down our long-term debt, which included a \$10.0 million prepayment made in connection with the third amendment to our Amended and Restated Credit Agreement, as discussed in Credit Facility below. Proceeds received for the exercise of stock options, combined with the excess tax benefit on stock options,

## **Table of Contents**

provided \$1.6 million in cash. During 2009, we used \$22.5 million in cash to pay down our long-term debt. This amount included a \$5.0 million principal prepayment on our note in accordance with the second amendment to our Amended and Restated Credit Agreement, discussed in Credit Facility below. We incurred \$0.6 million in refinancing costs associated with the second amendment.

### **Credit Facility**

On July 13, 2011 we entered into a five-year \$120.0 million revolving credit facility (the Credit Facility). The Credit Facility replaced the Amended and Restated Credit Agreement, which was scheduled to expire on July 30, 2012.

Borrowings under the Credit Facility bear interest based on the leverage ratio at either (i) the prime rate plus 1.25%, as defined in the credit agreement, or (ii) LIBOR plus 2.25%. 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. As of December 31, 2011, the blended interest rate on the Credit Facility was 2.6%. There are no required repayments. The Company, in accordance with the Credit Facility, is permitted to request that the Lenders, at their election, increase the secured credit facility to a maximum of \$140.0 million. In addition, the Credit Facility provides that we maintain a maximum leverage ratio. The leverage ratio is defined as the ratio of aggregate outstanding indebtedness to trailing twelve months Adjusted EBITDA. Adjusted EBITDA is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation expense, 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. Additional limits are imposed on acquisition related expenses. We also must maintain a minimum fixed charge ratio. As of December 31, 2011, the maximum leverage ratio permitted was 3.00:1.00 and our leverage ratio was 0.68:1.00 and the minimum fixed charge coverage ratio was 1.25:1.00 and our fixed charge ratio was 2.91:1.00. Failure to comply with these covenants, or the occurrence of an event of default, could permit the Lenders under the Credit Facility to declare all amounts borrowed under the Credit Facility, together with accrued interest and fees, to be immediately due and payable. In addition, the Credit Facility is secured by substantially all of our assets and places limits on the Company's and its subsidiaries' ability to incur debt or liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, engage in mergers, acquisitions and asset sales, transact with affiliates and alter its business.

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 were accounted for as deferred financing costs and will be amortized to interest expense over the term of the Credit Facility. In addition, approximately \$0.4 million of unamortized deferred financing costs associated with the pro-rata share of prior loan syndicate lenders that did not participate in the Credit Facility was written off as a debt extinguishment and charged to other expense in the third quarter of 2011.

**Table of Contents**

The following table presents a reconciliation from net income, which is the most directly comparable GAAP operating performance measure, to EBITDA and from EBITDA to Adjusted EBITDA as defined in our credit facilities (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Net income	\$ 22,669	\$ 18,360	\$ 13,402
Provision for income taxes	11,951	8,620	7,575
Interest expense, net	2,754	4,405	4,435
Depreciation and amortization	9,346	9,323	9,298
<b>EBITDA</b>	<b>\$ 46,720</b>	<b>\$ 40,708</b>	<b>\$ 34,710</b>
Share based compensation	6,974	5,450	5,186
Non-cash add backs	168	803	(163)
Restructuring, issuance and cash non-operating costs (2)	608	390	969
Acquisition expenses	94	248	65
<b>Adjusted EBITDA (1)</b>	<b>\$ 54,564</b>	<b>\$ 47,599</b>	<b>\$ 40,767</b>

(1) Adjusted EBITDA is not a measure of operating performance under GAAP and should not be considered as an alternative or substitute for GAAP profitability measures such as income (loss) from operations and net income (loss). Adjusted EBITDA as an operating performance measure has material limitations since it excludes the statement of income impact of depreciation and amortization expense, interest expense, net, the provision (benefit) for income taxes and share based compensation and therefore does not represent an accurate measure of profitability, particularly in situations where a company is highly leveraged or has a disadvantageous tax structure. We have significant intangible assets and amortization expense is a meaningful element in our financial statements and therefore its exclusion from Adjusted EBITDA is a material limitation. We have a significant amount of debt, and interest expense is a necessary element of our costs and therefore its exclusion from Adjusted EBITDA is a material limitation. We generally incur significant U.S. federal, state and foreign income taxes each year and the provision (benefit) for income taxes is a necessary element of our costs and therefore its exclusion from Adjusted EBITDA is a material limitation. Share based compensation and the associated expense has a meaningful impact on our financial statements. Non-cash expenses, restructuring, issuance and cash non-operating expenses have a meaningful impact on our financial statements. Therefore, their exclusion from Adjusted EBITDA is a material limitation. As a result, Adjusted EBITDA should be evaluated in conjunction with net income (loss) for complete analysis of our profitability, as net income (loss) includes the financial statement impact of these items and is the most directly comparable GAAP operating performance measure to Adjusted EBITDA. As Adjusted EBITDA is not defined by GAAP, our definition of Adjusted EBITDA may differ from and therefore may not be comparable to similarly titled measures used by other companies, thereby limiting its usefulness as a comparative measure. Because of the limitations that Adjusted EBITDA has as an analytical tool, investors should not consider it in isolation, or as a substitute for analysis of our operating results as reported under GAAP.

(2) Permits an add-back of up to \$250 thousand of cash non-operating expense, which is not to exceed \$1.5 million when combined together with restructuring and issuance costs.

The Credit Facility also contains provisions for an increased interest rate during periods of default. We do not believe that these covenants will affect our ability to operate our business, and we were in compliance with the covenants under our Credit Facility as of December 31, 2011.

**Table of Contents****Non-GAAP Measure**

In our quarterly earnings press releases and conference calls, in addition to Adjusted EBITDA as discussed above, we discuss a key measure that is not calculated according to GAAP. This non-GAAP measure is net adjusted EBITDA, which is defined as income (loss) from operations before depreciation, amortization of acquired intangible assets and share based compensation expenses. We use net adjusted EBITDA as a principal indicator of the operating performance of our business. We use net adjusted EBITDA in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our board of directors, determining bonus compensation for our employees based on operating performance and evaluating short-term and long-term operating trends in our operations. We believe that net adjusted EBITDA permits a comparative assessment of our operating performance, relative to our performance based on our GAAP results, while isolating the effects of charges that may vary from period-to-period without direct correlation to underlying operating performance. We believe that these non-GAAP financial adjustments are useful to investors because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making. We believe that trends in our net adjusted EBITDA may be valuable indicators of our operating performance.

The following table presents a reconciliation from income from operations, which is the most directly comparable GAAP operating financial measure, to net adjusted EBITDA as used by management (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Income from operations	\$ 38,242	\$ 33,072	\$ 26,556
Depreciation and amortization	9,346	9,323	9,298
Share based compensation	6,974	5,450	5,186
Net adjusted EBITDA (1)	\$ 54,562	\$ 47,845	\$ 41,040

- (1) Net adjusted EBITDA is not a measure of operating performance under GAAP and should not be considered as an alternative or substitute for GAAP profitability measures such as income (loss) from operations and net income (loss). Net adjusted EBITDA as an operating performance measure has material limitations since it excludes the statement of income impact of depreciation and amortization expense and share based compensation and therefore does not represent an accurate measure of profitability. We have significant intangible assets and amortization expense is a meaningful element in our financial statements and therefore its exclusion from net adjusted EBITDA is a material limitation. Share based compensation and the associated expense has a meaningful impact on our financial statements and therefore its exclusion from net adjusted EBITDA is a material limitation. As a result, net adjusted EBITDA should be evaluated in conjunction with income (loss) from operations for complete analysis of our profitability, as income (loss) from operations includes the financial statement impact of these items and is the most directly comparable GAAP operating performance measure to net adjusted EBITDA. As net adjusted EBITDA is not defined by GAAP, our definition of net adjusted EBITDA may differ from and therefore may not be comparable to similarly titled measures used by other companies, thereby limiting its usefulness as a comparative measure. Because of the limitations that net adjusted EBITDA has as an analytical tool, investors should not consider it in isolation, or as a substitute for analysis of our operating results as reported under GAAP.

**Table of Contents****Other Liquidity Matters***Contractual Obligations*

The following summarizes our contractual obligations at December 31, 2011 and the effect of such obligations on liquidity and cash flow in future years (in thousands):

<b>Contractual Obligations</b>	<b>Total</b>	<b>2012</b>	<b>2013-2014</b>	<b>2015-2016</b>	<b>Thereafter</b>
Debt (1)	\$ 37,321	\$	\$	\$ 37,321	\$
Operating leases (2)	6,744	1,736	3,205	1,353	450
License fees (2)	300	100	200		
Total	\$ 44,365	\$ 1,836	\$ 3,405	\$ 38,674	\$ 450

(1) See Note 7 to the audited consolidated financial statements included in this report under Item 8.

(2) See Note 17 to the audited consolidated financial statements regarding contractual obligations included in this report under Item 8.

In addition to the above, we have contractual obligations under our interest rate swap and currency swap instruments at December 31, 2011. The interest rate swap contract has a notional amount of \$50.0 million, with a \$20.0 million reduction in the notional amount on January 3, 2012 and matures on July 30, 2012. Under the terms of the agreement, we pay a fixed rate of interest on the notional amount of 1.5% and receive interest on the notional amount at the floating one-month LIBOR rate, which at December 31, 2011 was 2.5346%. Net settlements are due monthly. Under the currency swap contract, we pay 1.0 million Euros and we receive payments of \$1.5 million quarterly. The currency swap contract terminates in December 2012.

We may be required to make cash outlays related to our unrecognized tax benefits. However, due to the uncertainty of the timing of future cash flows associated with our unrecognized tax benefits, we are unable to make reasonably reliable estimates of the period of cash settlement, if any, with the respective taxing authorities. Accordingly, unrecognized tax benefits of \$0.9 million as of December 31, 2011 have been excluded from the contractual obligations table above. For further information on unrecognized tax benefits, see Note 11 to our consolidated financial statements included in this report under Item 8.

In addition to the above, we have a pension obligation under the Linotype defined benefit pension plan. The total projected benefit obligation is \$3.8 million and details regarding this plan are located in Note 10 to our consolidated financial statement included in this report under Item 8.

On November 10, 2011, we entered into a definitive agreement with Bitstream to acquire Bitstream's font business in an all cash merger valued at \$50 million, subject to adjustments based on the net asset value of Bitstream. We anticipate financing the deal through a combination of cash balances and our secured revolving credit facility. The transaction is expected to close following the resolution of the DOJ inquiry, as well as the satisfaction of other closing conditions.

*Legal proceedings and disputes*

Details on recent legal matters can be found in Note 17 to our consolidated financial statements included in this report under Item 8.

**Off-Balance Sheet Arrangements**

As of December 31, 2011 and 2010, we did not have any material relationships with unconsolidated entities, often referred to as special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Other than our operating leases for office space and computer equipment, and derivative financial instruments discussed in Quantitative and Qualitative Disclosures about Market Risk, we do not engage in off-balance sheet financing arrangements.

---

**Table of Contents**

**Item 7A. *Quantitative and Qualitative Disclosures about Market Risk***

We are exposed to financial market risk, including interest rate risk and foreign currency exchange risk.

***Concentration of Revenue and Credit Risk***

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables. Cash equivalents consist primarily of bank deposits and certain investments, such as commercial paper and municipal securities, with maturities less than 90 days. Deposits of cash held outside the United States totaled approximately \$3.5 million and \$2.3 million at December 31, 2011 and 2010, respectively. We grant credit to customers in the ordinary course of business. Credit evaluations are performed on an ongoing basis to reduce credit risk, and no collateral is required from our customers. An allowance for uncollectible accounts is provided for those accounts receivable considered to be uncollectible based upon historical experience and credit evaluation. As of December 31, 2011 one customer, Xerox Corporation, individually accounted for 17% of our gross accounts receivable. As of December 31, 2010 two customers, Okidata Corporation and Hewlett Packard, each individually accounted for 12% of our gross accounts receivable. Due to the nature of our quarterly revenue streams derived from royalty revenue, it is not unusual for our accounts receivable balances to include a few customers with large balances. Historically, we have not recorded material losses due to customers' nonpayment.

For the years ended December 31, 2011, 2010 and 2009, no customer accounted for more than 10% of our revenue.

***Interest Rate Risk***

We use interest rate derivative instruments to hedge our exposure to interest rate volatility resulting from our variable rate debt, as more fully described in Note 8 to our consolidated financial statements included in this report under Item 8. ASC Topic No. 815, *Derivatives and Hedging*, or ASC 815, requires that all derivative instruments be reported on the balance sheet at fair value and establishes criteria for designation and effectiveness of hedging relationships, including a requirement that all designations must be made at the inception of each instrument. As we did not make such initial designations, changes in the fair value of the derivative instrument are to be recognized as current period income or expense.

The fair value of derivative instruments is estimated based on the amount that we would receive or pay to terminate the agreements at the reporting date. Our exposure to market risk associated with changes in interest rates relates primarily to our long term debt. The interest rate on our Amended and Restated Credit Agreement fluctuates with either the prime rate or the LIBOR interest rate. At December 31, 2011, the blended rate of interest on our outstanding debt was 2.6%. For each one percent increase in interest rates our interest expense would increase by \$0.4 million; however, this would be mitigated by our interest rate swap. We purchase interest rate swap instruments to hedge our exposure to interest rate fluctuations on our debt obligations. 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 January 2011. The contract has a notional amount of \$50.0 million with a \$20.0 million reduction in the notional amount on January 3, 2012 and matures on July 30, 2012. The total fair value of the financial instrument at December 31, 2011 was a liability of approximately \$0.2 million. In 2011, 2010 and 2009, we recognized losses of \$0.2 million, \$0.8 million and \$0.9 million, respectively, on our interest rate swap contracts which have been included in loss (gain) on derivatives in the accompanying consolidated statement of income.

**Table of Contents**

***Foreign Currency Exchange Rate Risk***

In accordance with ASC Topic No. 830, *Foreign Currency Matters*, or ASC 830, all assets and liabilities of our foreign subsidiaries whose functional currency is a currency other than U.S. dollars are translated into U.S. dollars at an exchange rate as of the balance sheet date. Revenue and expenses of these subsidiaries are translated at the average monthly exchange rates. The resulting translation adjustments as calculated from the translation of the foreign subsidiaries to U.S. dollars are recorded as a separate component of stockholders' equity.

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 realized gains and losses. To mitigate our exposure 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. At December 31, 2011 and 2010 there were no currency contracts outstanding.

In addition, we incur foreign currency exchange rate gains and losses on an intercompany note with one of our foreign subsidiaries that is denominated in Euros. At December 31, 2011 the note balance was approximately \$5.2 million. The effect of an immediate 10% strengthening of the U.S. dollar as compared to the Euro would result in a \$0.5 million unrealized transaction loss on this note receivable which would be reported in loss (gain) on foreign exchange within our results of operations; however, this would be mitigated by our currency swap. 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 our exposure to currency fluctuation risk on this note. The contract payment terms approximate the payment terms of this intercompany note and the notional amount is amortized down over time, as payments are made. The total fair value of the currency swap instrument at December 31, 2011 and 2010 was \$0.9 million and \$1.5 million, respectively. For the years ended December 31, 2011, 2010 and 2009, we incurred a loss of \$0.1 million, gain of \$1.2 million and a loss of \$0.6 million, respectively, on the currency swap contract which is included in loss (gain) on derivatives in the accompanying consolidated statements of income. The loss and gain on the intercompany note are included in loss (gain) on foreign exchange in the accompanying consolidated statements of income.

**Table of Contents**

**Item 8. *Financial Statements and Supplementary Data***

**MONOTYPE IMAGING HOLDINGS INC.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

<u>Report of Independent Registered Public Accounting Firm</u>	52
<u>Consolidated Balance Sheets as of December 31, 2011 and 2010</u>	53
<u>Consolidated Statements of Income for the years ended December 31, 2011, 2010 and 2009</u>	54
<u>Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the years ended December 31, 2011, 2010 and 2009</u>	55
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009</u>	57
<u>Notes to Consolidated Financial Statements</u>	58

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of Monotype Imaging Holdings Inc.

We have audited the accompanying consolidated balance sheets of Monotype Imaging Holdings Inc. as of December 31, 2011 and 2010, and the related consolidated statements of income, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Monotype Imaging Holdings Inc. at December 31, 2011 and 2010, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Monotype Imaging Holdings Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 1, 2012, expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Boston, Massachusetts

March 1, 2012

**Table of Contents****MONOTYPE IMAGING HOLDINGS INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share data)

	December 31,	
	2011	2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 53,850	\$ 42,786
Accounts receivable, net of allowance for doubtful accounts of \$91 and \$92 at December 31, 2011 and 2010	6,588	4,720
Income tax refunds receivable	733	340
Deferred income taxes	506	350
Prepaid expenses and other current assets	3,228	2,480
<b>Total current assets</b>	<b>64,905</b>	<b>50,676</b>
Property and equipment, net	2,404	1,589
Goodwill	140,807	142,354
Intangible assets, net	71,664	80,239
Other assets	4,042	3,947
<b>Total assets</b>	<b>\$ 283,822</b>	<b>\$ 278,805</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,123	\$ 753
Accrued expenses and other current liabilities	12,235	13,045
Accrued income taxes	1,280	1,171
Deferred revenue	7,742	8,506
Current portion of long-term debt	10,000	8,355
<b>Total current liabilities</b>	<b>32,380</b>	<b>31,830</b>
Long-term debt, less current portion	27,321	57,504
Other long-term liabilities	225	471
Deferred income taxes	20,596	19,328
Reserve for income taxes	1,174	1,125
Accrued pension benefits	3,765	3,565
Commitments and contingencies (Note 17)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, Authorized shares: 10,000,000 at December 31, 2011 and 2010; Issued and outstanding: none		
Common stock, \$0.001 par value; Authorized shares: 250,000,000 at December 31, 2011 and 2010; Issued: 36,341,383 and 35,490,331 at December 31, 2011 and 2010, respectively	36	35
Additional paid-in capital	167,448	155,791
Treasury stock, at cost, 98,527 at December 31, 2011 and 95,516 shares at December 31, 2010	(86)	(86)
Retained earnings	30,986	8,317
Accumulated other comprehensive (loss) income	(23)	925
<b>Total stockholders' equity</b>	<b>198,361</b>	<b>164,982</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 283,822</b>	<b>\$ 278,805</b>

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

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

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

	Year Ended December 31,		
	2011	2010	2009
Revenue	\$ 123,212	\$ 106,659	\$ 94,005
Cost of revenue	10,155	7,477	6,861
Cost of revenue amortization of acquired technology	3,169	3,488	3,383
Total cost of revenue	13,324	10,965	10,244
Gross profit	109,888	95,694	83,761
Operating expenses:			
Marketing and selling	32,622	25,935	23,645
Research and development	16,540	15,404	14,142
General and administrative	17,413	16,488	14,674
Amortization of other intangible assets	5,071	4,795	4,744
Total operating expenses	71,646	62,622	57,205
Income from operations	38,242	33,072	26,556
Other (income) expense:			
Interest expense	2,854	4,421	4,496
Interest income	(100)	(16)	(61)
Loss (gain) on foreign exchange	211	2,066	(381)
Loss (gain) on derivatives	232	(388)	1,520
Loss on extinguishment of debt	422		
Other expense, net	3	9	5
Total other expense	3,622	6,092	5,579
Income before provision for income taxes	34,620	26,980	20,977
Provision for income taxes	11,951	8,620	7,575
Net income	\$ 22,669	\$ 18,360	\$ 13,402
Net income available to common stockholders	\$ 22,302	\$ 18,237	\$ 13,315
Net income per common share:			
Basic	\$ 0.63	\$ 0.52	\$ 0.39
Diluted	\$ 0.61	\$ 0.51	\$ 0.38
Weighted average number of shares outstanding: Basic	35,357,630	34,762,919	34,365,544
Weighted average number of shares outstanding: Diluted	36,817,379	35,990,295	35,288,126

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

Table of Contents

## MONOTYPE IMAGING HOLDINGS INC.

## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)

(in thousands, except share and per share data)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stock- holders Equity	Compre- hensive Income
	Shares	Amount	Shares	Amount					
<b>Balance, December 31, 2008</b>	34,512,692	\$ 35	86,194	\$ (86)	\$ 142,676	\$ (23,445)	\$ 1,656	\$ 120,836	
Net income						13,402		13,402	\$ 13,402
Issuance of capital shares									
restricted share grants	57,385								
exercised options	107,799				126			126	
Repurchase of unvested shares of restricted common stock	(9,322)		9,322						
Vesting of restricted shares					181			181	
Share based compensation					5,186			5,186	
Tax benefit associated with options					104			104	
Unrecognized actuarial gain, net of tax							(202)	(202)	(202)
Cumulative translation adjustment, net of tax							889	889	889
Comprehensive income									\$ 14,089
<b>Balance, December 31, 2009</b>	34,668,554	\$ 35	95,516	\$ (86)	\$ 148,273	\$ (10,043)	\$ 2,343	\$ 140,522	
Net income						18,360		18,360	\$ 18,360
Issuance of capital shares									
restricted share grants	469,817								
exercised options	318,144				944			944	
Vesting of restricted shares					123			123	
Shares issued as acquisition consideration	33,816				381			381	
Share based compensation					5,450			5,450	
Tax benefit associated with options					620			620	
Unrecognized actuarial gain, net of tax							(130)	(130)	(130)
Cumulative translation adjustment, net of tax							(1,288)	(1,288)	(1,288)
Comprehensive income									\$ 16,942
<b>Balance, December 31, 2010</b>	35,490,331	\$ 35	95,516	\$ (86)	\$ 155,791	\$ 8,317	\$ 925	\$ 164,982	

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



**Table of Contents****MONOTYPE IMAGING HOLDINGS INC.****CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME (LOSS) (Continued)**

(in thousands, except share amounts)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stock- holders Equity	Compre- hensive Income
	Shares	Amount	Shares	Amount					
<b>Balance, December 31, 2010</b>	35,490,331	\$ 35	95,516	\$ (86)	\$ 155,791	\$ 8,317	\$ 925	\$ 164,982	
Net income						22,669		22,669	\$ 22,669
Issuance of capital shares									
restricted share grants	186,379								
exercised options	667,684	1			3,329			3,330	
Repurchase of unvested shares of restricted common stock	(3,011)		3,011						
Share based compensation					6,974			6,974	
Tax benefit associated with options					1,354			1,354	
Unrecognized actuarial loss, net of tax							(98)	(98)	(98)
Cumulative translation adjustment, net of tax							(850)	(850)	(850)
<b>Comprehensive income</b>									<b>\$ 21,721</b>
<b>Balance, December 31, 2011</b>	36,341,383	\$ 36	98,527	\$ (86)	\$ 167,448	\$ 30,986	\$ (23)	\$ 198,361	

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

**Table of Contents****MONOTYPE IMAGING HOLDINGS INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Year Ended December 31,		
	2011	2010	2009
<b>Cash flows from operating activities:</b>			
Net income	\$ 22,669	\$ 18,360	\$ 13,402
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9,346	9,323	9,298
Loss on retirement of fixed assets	2	3	20
Amortization of deferred financing costs	480	798	840
Loss on extinguishment of debt	422		
Share based compensation	6,974	5,450	5,186
Excess tax benefit on stock options	(1,354)	(620)	(104)
Deferred income taxes	1,634	1,480	1,931
Provision for doubtful accounts	46	46	(106)
Unrealized currency (gain) loss on foreign denominated intercompany transactions	94	1,261	(360)
Unrealized loss (gain) on derivatives	136	(450)	437
Changes in operating assets and liabilities, net of effect of acquisitions:			
Accounts receivable	(1,835)	1,197	1,226
Income tax refunds receivable	(421)	(388)	(885)
Prepaid expenses and other assets	117	1,242	(3)
Accounts payable	366	370	(260)
Accrued income taxes	335	429	(833)
Accrued expenses and other liabilities	1,275	4,564	(2,599)
Deferred revenue	(973)	593	881
Net cash provided by operating activities	39,313	43,658	28,071
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment	(1,925)	(870)	(845)
Purchase of exclusive license		(3,000)	
Acquisition of businesses, net of cash acquired	(219)	(7,150)	(1,710)
Net cash used in investing activities	(2,144)	(11,020)	(2,555)
<b>Cash flows from financing activities:</b>			
Debt amendment costs			(599)
Payments on long-term debt	(86,845)	(26,292)	(22,484)
Proceeds from issuance of debt, net of issuance costs	56,065		
Excess tax benefit of stock options	1,354	620	104
Proceeds from exercise of common stock options	3,330	944	126
Net cash used in financing activities	(26,096)	(24,728)	(22,853)
Effect of exchange rates on cash and cash equivalents	(9)	260	12
Increase in cash and cash equivalents	11,064	8,170	2,675
Cash and cash equivalents, beginning of year	42,786	34,616	31,941
Cash and cash equivalents, end of year	\$ 53,850	\$ 42,786	\$ 34,616

Supplemental disclosures:

## Edgar Filing: Monotype Imaging Holdings Inc. - Form 10-K

Interest paid	\$ 2,279	\$ 3,500	\$ 3,210
Income taxes paid	\$ 9,070	\$ 6,196	\$ 7,219
Non cash transactions:			
Issuance of common stock in connection with the acquisition of Ascender Corporation	\$	\$ 381	\$
Exclusive Ascender license included in the purchase price of Ascender Corporation	\$	\$ 3,235	\$

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

**Table of Contents**

**MONOTYPE IMAGING HOLDINGS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2011**

**1. Nature of 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, and embedded in, a range of consumer electronic, 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. At December 31, 2011, 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. Significant Accounting Policies**

The accompanying financial statements reflect the application of certain significant accounting policies as described in this note and elsewhere in the accompanying consolidated financial statements and notes.

***Basis of Presentation and Consolidation***

The consolidated financial statements include the accounts of Monotype Imaging Holdings Inc. and its subsidiaries and have been prepared by the Company in United States (U.S.) dollars and in accordance with accounting principles generally accepted in the United States ( GAAP ) applied on a consistent basis.

On December 10, 2009, we acquired the principal assets of Planetweb, Inc., a global provider of embedded user interface software and developer tools for the consumer electronics industry, located in Redwood Shores, California, for \$1.9 million. Following the acquisition, Planetweb, Inc. was merged into our Monotype Imaging Inc. subsidiary.

On December 8, 2010, we acquired Ascender Corporation and Font Commerce LLC, a privately held font provider with long-standing relationships with several leading brands including Google and Microsoft, located in Elk Grove Village, Illinois, for \$11.0 million in a combination of cash and stock. Following the acquisition, Ascender Corporation and Font Commerce LLC were merged into our Monotype Imaging Inc. subsidiary.

The accompanying consolidated financial statements present the Company as of December 31, 2011 and 2010 and for the years ended December 31, 2011, 2010 and 2009, including the accounts of ITC, Monotype UK, Linotype, Monotype Hong Kong and Monotype Japan. All intercompany accounts and transactions have been eliminated.

**Table of Contents**

***Use of Estimates***

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We believe the most judgmental estimates include those related to allowance for doubtful accounts, income taxes, valuation of goodwill, intangible assets, other long-lived assets, derivatives, the valuation of share based compensation and accrued pension benefits. We base our estimates and judgments on historical experience and various other appropriate factors, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the amount of revenue and expenses that are not readily apparent from other sources. Actual results could differ from those estimates.

***Fair Value of Financial Instruments***

Our financial instruments consist of cash and cash equivalents, accounts receivable, derivative instruments and debt. We value our financial instruments at fair value in accordance with ASC Topic No. 820, *Fair Value Measurement and Disclosures*, ( ASC 820 ). The Company's recurring fair value measures relate to derivative instruments and short-term investments. The Company's non-financial assets and non-financial liabilities subject to non-recurring measures include goodwill and intangibles.

***Cash and Cash Equivalents***

Cash and cash equivalents consist of bank deposits and certain investments, such as commercial paper, corporate bonds and municipal securities, with maturities of less than 90 days. We consider all highly liquid investments with original maturities of three months or less at the time of acquisition to be cash equivalents and are stated at fair value. The Company does not believe it is exposed to any significant credit risk on its cash equivalents.

***Concentration of Credit Risks***

Financial instruments that potentially subject us to concentration of credit risk consist principally of cash and cash equivalents and trade receivables. Cash equivalents consist primarily of bank deposits and certain investments, such as commercial paper and municipal securities, with maturities of less than 90 days. Deposits of cash held outside the U.S. totaled approximately \$3.5 million and \$2.3 million, at December 31, 2011 and 2010, respectively.

We grant credit to customers in the ordinary course of business. Credit evaluations are performed on an ongoing basis to reduce credit risk, and no collateral is required from our customers. An allowance for uncollectible accounts is provided for those accounts receivable considered to be uncollectible based upon historical experience and credit evaluation. As of December 31, 2011, one customer individually accounted for 17% of our gross accounts receivable. As of December 31, 2010, two customers each individually accounted for 12% of our gross accounts receivable. For the years ended December 31, 2011, 2010 and 2009 no one customer accounted for 10% or more of our total revenue. Historically, we have not recorded material losses due to customers' nonpayment.

***Property and Equipment***

Property and equipment are stated at cost. We capitalize expenditures that materially increase asset lives and charge ordinary repairs and maintenance to operations as incurred. Depreciation is computed using the straight-line method over the estimated useful lives of the assets:

	<b>Estimated Useful Life</b>
Computer equipment and software	2 to 5 years
Furniture and fixtures	3 to 13 years
Leasehold improvements	Shorter of lease term or estimated useful life of 3 to 5 years

## **Table of Contents**

### ***Goodwill and Indefinite-lived Intangible Assets***

Goodwill represents the excess of the cost of acquired businesses over the fair value of identifiable net assets assumed in a business combination. We account for goodwill and indefinite-lived intangible assets in accordance with ASC Topic No. 350, *Intangibles Goodwill and Other* ( ASC 350 ) which requires that goodwill not be amortized, but instead be tested at least annually for impairment in accordance with the provisions of ASC 350. The provisions of ASC 350 provide for a two-step impairment test framework to be performed on goodwill with an option for a qualitative approach to fair value. The Company has the option of performing a qualitative assessment of the fair value of the reporting unit. If the Company determines, on the basis of the qualitative factors, that the fair value of the reporting unit is more likely than not less than its carrying value, the quantitative two-step fair value impairment test is required. Otherwise, no further testing is required. In the first step of the two-step test, the Company must compare the fair value of each reporting unit to its carrying value. The Company determines the fair value of its reporting units based on the present value of estimated future cash flows and market approach. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and further testing is not required. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then an impairment loss equal to the difference will need to be recorded.

Impairment testing for goodwill is done at a reporting unit level. Reporting units are one level below the business segment level, but can be combined when reporting units within the same segment have similar economic characteristics. We operate within a single business segment and reporting unit. The Company performs its annual goodwill impairment test as of December 31<sup>st</sup>. As of December 31, 2011, we elected to perform a qualitative analysis of the fair value of our goodwill and determined that the fair value was more likely than not higher than its carrying value. As of December 31, 2010, we conducted our impairment analysis on the Company as a whole by calculating the fair value of our Company as compared to our carrying value, using a discounted cash flow approach as well as the market approach. For both years presented, the fair value was estimated to be greater than the carrying value of the goodwill, and therefore, no write down of goodwill was recorded.

On our indefinite-lived intangible assets, we performed the quantitative two-step fair value impairment test. We apply the relief from royalty method, a variation of the discounted cash flow method, to determine the fair value of these assets. We perform our annual indefinite-lived intangible asset impairment test as of December 31<sup>st</sup>. The fair value was greater than the carrying value of the indefinite-lived intangible assets, and therefore, no write down of such assets was recorded in any of the years presented.

### ***Long-Lived Assets***

We account for long-lived assets including property and equipment and long-lived amortizable intangible assets in accordance with ASC Topic No. 360, *Property, Plant and Equipment*, ( ASC 360 ). ASC 360 requires companies to assess whether indicators of impairment are present on a periodic basis. If such indicators are present, ASC 360 prescribes a two step impairment test (i) if the carrying amount of a long-lived asset is not recoverable based on its undiscounted future cash flows, then (ii) the impairment loss is measured as the difference between the carrying amount and the fair value of the asset based on the forecasted discounted cash flows of the asset. We have had no impairments or indicators of impairment of our long-lived assets during the years presented.

### ***Business Acquisitions***

In accordance with ASC Topic No. 805, *Business Combinations* ( ASC 805 ), we record acquisitions under the purchase method of accounting. Accordingly, the purchase price is allocated to the tangible assets and liabilities and intangible assets acquired, based on their estimated fair values from the

## **Table of Contents**

perspective of a market participant. The excess purchase price over the fair value of indentified assets is recorded as goodwill. Under ASC 350, goodwill and purchased intangible assets with indefinite lives are not amortized but are reviewed for impairment annually, or more frequently, if impairment indicators arise. Purchased intangible assets with definite lives are amortized over their respective useful lives.

### ***Revenue Recognition***

We recognize revenue in accordance with ASC Topic No. 985, *Revenue Recognition* ( ASC 985 ). Revenue is recognized when persuasive evidence of an agreement exists, the product has been delivered or services have been provided, the fee is fixed or determinable and collection of the fee is probable.

#### ***OEM Revenue***

Our OEM revenue is derived substantially from per-unit royalties received for printer imaging and printer driver, or printer products, and display imaging products. Under our licensing arrangements we typically receive a royalty for each product unit incorporating our text imaging solutions that is shipped by our OEM customers. We also receive OEM revenue from fixed fee licenses with certain of our OEM customers. Fixed fee licensing arrangements are not based on units the customer ships, but instead, customers pay us on a periodic basis for the right to embed our text imaging solutions. Though significantly less than royalties from per-unit shipments and fixed fees from OEMs, we also receive revenue from software application and operating systems vendors who include our text imaging solutions in their products, and for font development. Many of our licenses continue so long as our OEM customers ship products that include our technology, unless terminated for breach. Other licenses have terms that range from three to five years, and usually provide for automatic or optional renewals. Revenue from per-unit royalties is recognized in the period during which we receive a royalty report from a customer, typically one quarter after royalty-bearing units are shipped. Revenue from fixed fee licenses is generally recognized when it is billed to the customer, so long as the product has been delivered, the license fee is fixed and non-refundable and collection is probable.

#### ***Creative Professional Revenue***

Our Creative Professional revenue is derived from font licenses and from custom font design services. We license fonts directly to end-users through our e-commerce websites, via telephone, email and indirectly through third-party resellers. We also license fonts and provide custom font design services to graphic designers, advertising agencies, media organizations and corporations. We refer to direct, indirect and custom revenue, as non-web revenue, and refer to revenue that is derived from our websites, as web revenue.

Revenue from font licenses to our e-commerce customers is recognized upon payment by the customer and electronic shipment of the software embodying the font. Revenue from font licenses to other customers is recognized upon shipment of the software embodying the font and when all other revenue recognition criteria have been met. Revenue from resellers is recognized upon notification from the reseller that our font product has been licensed and when all other revenue recognition criteria have been met. We generally recognize custom font design services revenue upon delivery. Contract accounting may be used where services are deemed essential to the software.

#### ***Cost of Revenue***

We pay font license fees on certain fonts that are owned by third parties. We recognize royalty expenses with respect to those font license fees concurrent with the recognition of revenue on licenses to which they relate. Amortization of acquired technology is an additional cost of revenue (see Note 5).

## **Table of Contents**

### ***Deferred Revenue***

Deferred revenue results primarily from prepayments against future royalties received from our customers. These amounts are recognized as revenue as the royalties are earned, based upon subsequent royalty reports received from the customers.

### ***Research and Development Expenses***

Our research and development expense consists principally of salaries, bonuses and benefits of our research and development, engineering and font design personnel who are primarily focused on enhancing the functionality of our text imaging solutions and developing new products. In accordance with ASC Topic No. 730, *Research and Development*, such costs are required to be expensed until the point that technological feasibility of the software is established. Technological feasibility is determined after a working model has been completed. As our research and development costs primarily relate to software development during the period prior to technological feasibility, all research and development costs are charged to operations as incurred.

### ***Advertising Costs***

We expense advertising costs as incurred. Advertising expenses were \$3.8 million, \$2.9 million and \$2.8 million for the years ended December 31, 2011, 2010 and 2009, respectively.

### ***Share Based Compensation***

We account for share based compensation in accordance with ASC Topic No. 718, *Compensation - Stock Compensation*, ( ASC 718 ), which requires all share based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values.

The Company uses the Black-Scholes option pricing model to determine the weighted-average fair value of options granted and recognizes the compensation cost of share based awards on a straight-line basis over the vesting period of the award. The determination of the fair value of share based payment awards using the Black-Scholes model are affected by our stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. We estimate volatility by using a blend of our stock price history, for the length of time we have market data for our stock, and the historical volatility of similar public companies for the remainder of the expected term of each grant. This is estimated in accordance with Staff Accounting Bulletin No. 110, or SAB 110. The expected life of the awards is estimated based on the simplified method, as defined in SAB 110. The risk-free interest rate assumption is based on a US treasury instrument whose term is consistent with the expected life of our awards. The expected dividend yield assumption is based on our history and expectation of paying no dividends.

Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Share based compensation expense recognized in our financial statements is based on awards that are ultimately expected to vest. We evaluate the assumptions used to value our awards on a quarterly basis and if factors change and we employ different assumptions, share based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned share based compensation expense. Future share based compensation expense and unearned share based compensation will increase to the extent that we grant additional equity awards to employees or we assume unvested equity awards in connection with acquisitions.

**Table of Contents**

The fair value of options was estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted average assumptions:

	<b>Year Ended December 31,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
Risk-free interest rate	2.5%	2.6%	1.9%
Expected dividend yield			
Expected volatility	61.9%	64.3%	66.3%
Expected term	6.1 years	6.1 years	6.1 years
Weighted average fair value per share	\$7.76	\$5.93	\$2.45

We value awards granted based on the grant date closing price of our common stock as traded on either the NASDAQ Global Market or NASDAQ Global Select Market. See Note 14 for a summary of the stock option activity under our stock-based employee compensation plans for the year ended December 31, 2011.

***Derivative Financial Instruments***

We use interest rate and foreign currency derivative instruments to hedge our exposure to interest rate volatility resulting from our variable rate debt and fluctuations in foreign currencies on our intercompany note (Note 8) and other foreign currency transactions. ASC Topic No. 815, *Derivatives and Hedging*, ( ASC 815 ), requires that all derivative instruments be reported on the balance sheet at fair value and establishes criteria for designation and effectiveness of hedging relationships, including a requirement that all designations must be made at the inception of each instrument. As we did not make such initial designations, ASC 815 requires changes in the fair value of the derivative instrument to be recognized as current period income or expense.

***Foreign Currency Translation***

In accordance with ASC Topic No. 830, *Foreign Currency Matters*, all assets and liabilities of our foreign subsidiaries whose functional currency is a currency other than US dollars are translated into US dollars at an exchange rate as of the balance sheet date. Revenue and expenses of these subsidiaries are translated at the average monthly exchange rates in effect for the periods in which the transactions occur. Accordingly, gains and losses resulting from translating foreign currency financial statements are reported as a separate component of other comprehensive income in stockholders' equity. Foreign currency transaction gains and losses are included in net income.

***Accumulated Other Comprehensive Income***

ASC Topic No. 220, *Comprehensive Income*, requires disclosure of all components of comprehensive income on an annual and interim basis. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Accumulated other comprehensive income consists of foreign currency translation adjustments and adjustments to record changes in the funded status of our defined benefit pension plan in accordance with ASC Subtopic No. 715-30, *Defined Benefit Plans - Pension*.

***Income Taxes***

We account for income taxes in accordance with ASC Topic No. 740, *Income Taxes* ( ASC 740 ). Under this method, a deferred tax asset or liability is determined based on the difference between the financial statement and the tax basis of assets and liabilities, as measured by enacted tax rates in effect when these differences are expected to be reversed. This process includes estimating current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and

---

**Table of Contents**

financial accounting purposes. These differences result in deferred tax assets and liabilities. We also assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized, we have established a valuation allowance. Significant judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance against our deferred tax assets.

The Company accrues liabilities for uncertain tax positions in accordance with the framework provided in ASC 740. The total amount of uncertain tax positions, at December 31, 2011 and 2010 was \$1.2 million and \$1.1 million, respectively. The Company classifies interest and penalties as a component of tax expense. The total amount of recorded interest and penalties expense at December 31, 2011, 2010 and 2009 was \$0.3 million, \$0.3 million and \$0.4 million, respectively.

***Net income (loss) per share data***

The Company calculates net income (loss) per share in accordance with ASC Topic No. 260, *Earnings Per Share*, ( ASC 260 ). ASC 260 outlines the use of the two-class and treasury stock methods of calculating earnings per share. Under the two-class method, basic net income (loss) per share is computed by dividing the net income (loss) applicable to common stockholders by the weighted-average number of common shares outstanding for the fiscal period. Diluted net income (loss) per share is computed using the more dilutive of (a) the if-converted, or treasury stock, method or (b) the two-class method. The treasury stock method assumes exercise of stock options and vesting of restricted stock. The two-class method assumes exercise of stock options using the treasury stock method, but assumes participating securities (unvested restricted stock) are not vested and allocates earnings to common shares and participating securities. Income is allocated to participating securities and common stockholders. Diluted net income (loss) per share gives effect to all potentially dilutive securities, including stock options and restricted stock, using either the treasury stock method or the two-class method, whichever is more dilutive.

***Recently Issued Accounting Pronouncements******Goodwill Impairment***

In September 2011, the FASB issued an update to ASC Topic No. 350, Intangibles—Goodwill and Other, Testing for Goodwill Impairment ( ASC 350 ). ASC 350 provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The update was intended to simplify how an entity tests for goodwill impairment. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We adopted this standard effective with our fiscal year end December 31, 2011 and the adoption did not have a material impact on our financial statements.

***Comprehensive Income***

In June 2011, the Financial Accounting Standards Board ( 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

**Table of Contents**

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, beginning after December 15, 2011, and will require retrospective application for all periods presented. The adoption will impact the presentation of comprehensive income, but will not otherwise impact our financial position or results of operations.

**3. Acquisitions**

On December 8, 2010, we acquired Ascender Corporation, a privately held Illinois corporation and Font Commerce LLC, a majority owned subsidiary of Ascender (collectively, Ascender) for approximately \$11.0 million. Ascender is a font provider with long-standing relationships with several leading brands including Google and Microsoft, and is located in Elk Grove Village, Illinois. With the acquisition of Ascender, the Company has broadened its font intellectual property offerings and gained significant typeface design and development talent. The Company paid approximately \$7.4 million in cash and issued 285,632 shares of common stock, valued at \$3.2 million. Of the purchase price, \$0.7 million was placed into escrow for standard representations and warranties, expiring in June 2012. The majority of the common stock issued in connection with the acquisition was issued to shareholders of Ascender, who immediately upon closing, became employees of the Company. The stock awards granted are subject to vesting terms that require employment to continue over our standard four-year term. As a result, approximately \$2.8 million of the \$3.2 million in common stock issued is being expensed as share based compensation over the four year vesting term. At the acquisition date, the Company had a pre-existing relationship with Ascender; an exclusive licensing agreement with a fair value equivalent to its book value of \$3.2 million. In accordance with ASC 805-10-25-20, the unamortized license fee was considered settled upon the acquisition and its fair value was included as part of total consideration paid and has been allocated among the assets acquired.

The results of operations of Ascender 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:

	<b>Fair Value at Acquisition Date (in thousands)</b>
Accounts receivable and other assets	\$ 1,011
Customer relationships	2,820
Technology	140
Trademarks	4,020
Non-compete agreements	450
Goodwill	4,745
Accrued royalties and other current liabilities	(834)
Deferred tax liability	(1,359)
<b>Total purchase price</b>	<b>\$ 10,993</b>

The goodwill reflects the value of the assembled workforce and the customer-specific synergies the company expects to realize from the Ascender acquisition. The acquired definitive lived intangible assets will be amortized over their respective useful lives, on a straight-line basis. The acquired intangible assets that are subject to amortization have a weighted average useful life of approximately nine years. Customer relationships have estimated lives of between seven and ten years. Technology has an estimated life of

**Table of Contents**

fifteen years. Non-compete agreements have an estimated five year life. Trademarks have an indefinite life and are subject to annual review to determine if an impairment exists. The fair value of the assets acquired and liabilities assumed was less than the purchase price, resulting in goodwill of \$4.7 million.

The acquisition of Ascender was structured in such a manner that the majority of the goodwill is not deductible for tax purposes. Approximately \$1.1 million of goodwill is deductible for tax purposes and represents the goodwill associated with Font Commerce LLC. Approximately \$3.7 million of the identifiable intangible assets are deductible for tax purposes and represents the previously acquired Ascender license and intangibles associated with Font Commerce LLC.

**4. Property and Equipment**

Property and equipment consists of the following (in thousands):

	December 31,	
	2011	2010
Computer equipment and software	\$ 8,364	\$ 5,173
Furniture and fixtures	1,113	662
Leasehold improvements	635	208
Total cost	10,112	6,043
Less accumulated depreciation and amortization	(7,708)	(4,454)
Property and equipment, net	\$ 2,404	\$ 1,589

Depreciation and amortization expense for the years ended December 31, 2011, 2010 and 2009, was \$1.1 million, \$1.0 million and \$1.2 million, respectively.

**5. Goodwill and Intangible Assets****Goodwill**

The changes in the carrying value of goodwill are as follows (in thousands):

Balance at December 31, 2009	\$ 140,745
Acquisition	4,745
Foreign currency exchange rate changes	(3,068)
Deferred tax adjustment	(68)
Balance at December 31, 2010	\$ 142,354
Acquisition adjustment	(28)
Foreign currency exchange rate changes	(1,422)
Deferred tax adjustment	(97)
Balance at December 31, 2011	\$ 140,807

The majority of the Company's goodwill balance is not denominated in U.S. dollars, and is therefore, subject to currency fluctuations. In 2010, the Company recorded approximately \$4.7 million increase to goodwill related to the Ascender acquisition. See Note 3 for further details on this acquisition.



**Table of Contents****Intangible Assets**

Intangible assets are stated at cost and are amortized over the expected life of the asset. Intangible assets as of December 31, 2011 and 2010 are as follows (dollar amounts in thousands):

	Life (Years)	December 31, 2011			December 31, 2010		
		Gross Carrying Amount	Accumulated Amortization	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer relationships	7-15	\$ 49,222	\$ (31,080)	\$ 18,142	\$ 49,419	\$ (26,413)	\$ 23,006
Acquired technology	8-15	39,742	(21,038)	18,704	39,846	(17,878)	21,968
Non-compete agreements	3-6	11,995	(11,605)	390	12,039	(11,363)	676
Trademarks		30,028		30,028	30,189		30,189
Domain names		4,400		4,400	4,400		4,400
Total		\$ 135,387	\$ (63,723)	\$ 71,664	\$ 135,893	\$ (55,654)	\$ 80,239

Amortization expense is calculated using the straight-line method. The Company's intangible asset balances increased approximately \$4.2 million in 2010 due to the acquisition of Ascender. Approximately \$2.8 million was attributed to customer relationships, approximately \$4.0 million was attributed to trademarks, \$0.5 million was attributed to non-compete agreements and a decrease of approximately \$3.2 million in technology resulted from the re-allocation of previously acquired Ascender license.

Estimated future intangible amortization expense based on balances at December 31, 2011 is as follow (in thousands):

	Acquired Technology	Other Intangible Assets
2012	\$ 3,181	\$ 4,855
2013	3,181	4,818
2014	3,181	4,158
2015	3,181	852
2016	2,780	768
Thereafter	3,200	3,081
Total amortization expense	\$ 18,704	\$ 18,532

**6. Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities consist of the following (in thousands):

	December 31,	
	2011	2010
Payroll and related benefits	\$ 6,677	\$ 6,164
Royalties	1,600	2,047
Interest	62	279
Legal and audit fees	1,342	1,014
Sales taxes	267	689
Derivative liability	237	563
Restructuring	34	35
Other	2,016	2,254

Total	\$ 12,235	\$ 13,045
-------	-----------	-----------

---

**Table of Contents****7. 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 December 31, 2011 our rates, inclusive of applicable margins, were 2.5% and 4.5% for LIBOR and prime, respectively. At December 31, 2011, our blended interest rate was 2.6%. The Company is required to pay an unused line fee equal to 0.375% per annum on the undrawn portion available under the revolving credit facility and variable per annum fees in respect of outstanding letters of credit, if any. The Credit Facility contains financial covenants which include (i) a maximum ratio of consolidated total debt to consolidated adjusted EBITDA of 3.00:1.00, and (ii) a minimum consolidated fixed charge coverage ratio of 1.25:1.00. Adjusted EBITDA, under the Credit Facility, is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation expense, plus acquisition expenses not to exceed \$2.0 million, plus restructuring, issuance costs, cash non-operating costs and other expenses or losses minus cash non-operating gains and other non-cash gains; provided however that the aggregate of all cash non-operating expense shall not exceed \$250 thousand and all such fees, costs and expenses shall not exceed \$1.5 million on a trailing twelve months basis. Failure to comply with these covenants, or the occurrence of an event of default, could permit the Lenders under the Credit Facility to declare all amounts borrowed under the Credit Facility, together with accrued interest and fees, to be immediately due and payable. In addition, the Credit Facility is secured by substantially all of our assets and places limits on the Company 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 December 31, 2011.

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 December 31, 2011, 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. In addition, approximately \$0.4 million of unamortized deferred financing costs associated with the pro-rata share of prior loan syndicate lenders that did not participate in the new Credit Facility were written off and charged to other expense in the third quarter of 2011.

**8. 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 for

**Table of Contents**

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 on January 3, 2012 and matures 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 either contract as a hedge; as such, associated gains and losses are recorded in our 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. In 2011, 2010 and 2009, we incurred net losses of \$32 thousand and \$1.3 million, and a net gain of \$0.6 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. We did not designate the contract as a hedge; as such, associated gains and losses are recorded to loss (gain) on derivatives in our consolidated statements of income. The total fair value of the financial instrument at December 31, 2011 and 2010 was approximately \$0.9 million and \$1.5 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 assets in our accompanying 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):