

FAIR ISAAC CORP  
Form 10-Q  
July 26, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

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 1-11689

Fair Isaac Corporation  
(Exact name of registrant as specified in its charter)

Delaware 94-1499887  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

181 Metro Drive, Suite 700 95110-1346  
San Jose, California  
(Address of principal executive offices) (Zip Code)  
Registrant's telephone number, including area code: 408-535-1500

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):  
Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer  Smaller Reporting Company

Emerging Growth Company

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

The number of shares of common stock outstanding on July 13, 2018 was 29,144,337 (excluding 59,712,446 shares held by us as treasury stock).

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

## FAIR ISAAC CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

|   | June 30,<br>2018                      | September 30,<br>2017 |
|---|---------------------------------------|-----------------------|
|   | (In thousands, except par value data) |                       |
| Assets  |                                       |                       |
| Current assets:   |                                       |                       |
| Cash and cash equivalents   | \$ 119,929                            | \$ 105,618            |
| Accounts receivable, net  | 182,419                               | 168,586               |
| Prepaid expenses and other current assets   | 32,944                                | 36,727                |
| Total current assets  | 335,292                               | 310,931               |
| Marketable securities   | 16,930                                | 13,791                |
| Other investments   | 11,711                                | 11,724                |
| Property and equipment, net   | 51,517                                | 40,703                |
| Goodwill  | 802,041                               | 804,414               |
| Intangible assets, net  | 16,079                                | 21,185                |
| Deferred income taxes   | 40,536                                | 47,204                |
| Other assets  | 12,964                                | 5,668                 |
| Total assets  | \$ 1,287,070                          | \$ 1,255,620          |
| Liabilities and Stockholders' Equity  |                                       |                       |
| Current liabilities:  |                                       |                       |
| Accounts payable  | \$ 25,509                             | \$ 19,510             |
| Accrued compensation and employee benefits  | 75,218                                | 77,610                |
| Other accrued liabilities   | 33,899                                | 32,104                |
| Deferred revenue  | 60,587                                | 55,431                |
| Current maturities on debt  | 202,000                               | 142,000               |
| Total current liabilities   | 397,213                               | 326,655               |
| Long-term debt  | 556,713                               | 462,801               |
| Other liabilities   | 38,500                                | 39,627                |
| Total liabilities   | 992,426                               | 829,083               |
| Commitments and contingencies   |                                       |                       |
| Stockholders' equity:   |                                       |                       |
| Preferred stock (\$0.01 par value; 1,000 shares authorized; none issued and outstanding)  | —                                     | —                     |
| Common stock (\$0.01 par value; 200,000 shares authorized, 88,857 shares issued and 29,317 and 30,243 shares outstanding at June 30, 2018 and September 30, 2017, respectively) | 293                                   | 302                   |
| Paid-in-capital   | 1,192,322                             | 1,195,431             |
| Treasury stock, at cost (59,540 and 58,614 shares at June 30, 2018 and September 30, 2017, respectively)  | (2,515,207                            | ) (2,301,097          |
| Retained earnings   | 1,690,330                             | 1,598,395             |
| Accumulated other comprehensive loss  | (73,094                               | ) (66,494             |
| Total stockholders' equity  | 294,644                               | 426,537               |
| Total liabilities and stockholders' equity  | \$ 1,287,070                          | \$ 1,255,620          |

See accompanying notes.



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FAIR ISAAC CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
 (Unaudited)

|  | Quarter Ended June<br>30,             |           | Nine Months Ended<br>June 30, |           |
|--|---------------------------------------|-----------|-------------------------------|-----------|
|  | 2018                                  | 2017      | 2018                          | 2017      |
|  | (In thousands, except per share data) |           |                               |           |
| Revenues:                                    |                                       |           |                               |           |
| Transactional and maintenance                | \$195,491                             | \$166,695 | \$565,348                     | \$481,604 |
| Professional services                        | 43,209                                | 43,871    | 131,913                       | 128,698   |
| License                                      | 20,805                                | 20,420    | 55,423                        | 68,662    |
| Total revenues                               | 259,505                               | 230,986   | 752,684                       | 678,964   |
| Operating expenses:                          |                                       |           |                               |           |
| Cost of revenues *                           | 78,390                                | 69,793    | 231,268                       | 211,921   |
| Research and development                     | 32,483                                | 27,839    | 93,976                        | 80,644    |
| Selling, general and administrative *        | 98,685                                | 84,089    | 286,038                       | 255,534   |
| Amortization of intangible assets *          | 1,571                                 | 3,365     | 5,043                         | 9,997     |
| Restructuring and acquisition-related        | —                                     | 4,471     | —                             | 4,471     |
| Total operating expenses                     | 211,129                               | 189,557   | 616,325                       | 562,567   |
| Operating income                             | 48,376                                | 41,429    | 136,359                       | 116,397   |
| Interest expense, net                        | (8,223 )                              | (6,653 )  | (21,799 )                     | (19,403 ) |
| Other income, net                            | 1,588                                 | 555       | 1,940                         | 128       |
| Income before income taxes                   | 41,741                                | 35,331    | 116,500                       | 97,122    |
| Provision for income taxes                   | 9,380                                 | 10,104    | 24,565                        | 8,910     |
| Net income                                   | 32,361                                | 25,227    | 91,935                        | 88,212    |
| Other comprehensive income (loss):           |                                       |           |                               |           |
| Foreign currency translation adjustments     | (18,796 )                             | 10,395    | (6,600 )                      | 2,137     |
| Comprehensive income                         | \$13,565                              | \$35,622  | \$85,335                      | \$90,349  |
| Earnings per share:                          |                                       |           |                               |           |
| Basic  | \$1.09                                | \$0.82    | \$3.07                        | \$2.85    |
| Diluted                                      | \$1.04                                | \$0.78    | \$2.93                        | \$2.73    |
| Shares used in computing earnings per share: |                                       |           |                               |           |
| Basic  | 29,708                                | 30,914    | 29,924                        | 30,973    |
| Diluted                                      | 31,161                                | 32,224    | 31,341                        | 32,340    |

\* Cost of revenues and selling, general and administrative expenses exclude the amortization of intangible assets. See Note 4.

See accompanying notes.

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FAIR ISAAC CORPORATION  
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
 (Unaudited)  
 (In thousands, except per share data)

|   | Common Stock |           | Paid-in-Capital |                 | Treasury Stock | Retained Earnings | Accumulated Other Comprehensive Loss | Total Stockholders' Equity |
|---|--------------|-----------|-----------------|-----------------|----------------|-------------------|--------------------------------------|----------------------------|
|   | Shares       | Par Value |                 |                 |                |                   |                                      |                            |
| Balance at September 30, 2017                         | 30,243       | \$ 302    | \$ 1,195,431    | \$ (2,301,097 ) | \$ 1,598,395   | \$ (66,494 )      | \$ 426,537                           |                            |
| Share-based compensation                              | —            | —         | 54,631          | —               | —              | —                 | 54,631                               |                            |
| Issuance of treasury stock under employee stock plans | 433          | 4         | (57,740 )       | 17,356          | —              | —                 | (40,380 )                            |                            |
| Repurchases of common stock                           | (1,359 )     | (13 )     | —               | (231,466 )      | —              | —                 | (231,479 )                           |                            |
| Net income  | —            | —         | —               | —               | 91,935         | —                 | 91,935                               |                            |
| Foreign currency translation adjustments              | —            | —         | —               | —               | —              | (6,600 )          | (6,600 )                             |                            |
| Balance at June 30, 2018                              | 29,317       | \$ 293    | \$ 1,192,322    | \$ (2,515,207 ) | \$ 1,690,330   | \$ (73,094 )      | \$ 294,644                           |                            |
| See accompanying notes.                               |              |           |                 |                 |                |                   |                                      |                            |

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FAIR ISAAC CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)

|   | Nine Months Ended June 30,<br>2018<br>(In thousands) | 2017      |
|---|--|-----------|
| Cash flows from operating activities:   |  |           |
| Net income  | \$ 91,935  | \$ 88,212 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |           |
| Depreciation and amortization   | 22,329   | 27,427    |
| Share-based compensation  | 54,631   | 43,546    |
| Deferred income taxes   | 6,749  | (2 )      |
| Net gain on marketable securities   | (635 )   | —         |
| Provision for doubtful accounts, net  | 541  | 1,388     |
| Net loss on sales of property and equipment                                       | 28   | 26        |
| Changes in operating assets and liabilities:                                      |  |           |
| Accounts receivable   | (15,571 )  | 25,605    |
| Prepaid expenses and other assets   | (3,056 )   | (26,171 ) |
| Accounts payable  | 2,623  | (5,432 )  |
| Accrued compensation and employee benefits  | (1,977 )   | (8,317 )  |
| Other liabilities   | 55   | 5,838     |
| Deferred revenue  | 5,437  | 19,303    |
| Net cash provided by operating activities   | 163,089  | 171,423   |
| Cash flows from investing activities:   |  |           |
| Purchases of property and equipment   | (24,220 )  | (14,792 ) |
| Proceeds from sales of marketable securities                                      | 3,005  | —         |
| Purchases of marketable securities  | (5,509 )   | —         |
| Purchase of cost method investees   | —  | (777 )    |
| Net cash used in investing activities   | (26,724 )  | (15,569 ) |



|  |            |   |            |
|--|------------|---|------------|
| Cash flows from financing activities:                                    |            |   |            |
| Proceeds from revolving line of credit                                   | 371,000    |   | 98,000     |
| Payments on revolving line of credit                                     | (480,000)  | ) | (57,000)   |
| Proceeds from issuance of senior notes                                   | 400,000    |   | —          |
| Payments on senior notes   | (131,000)  | ) | —          |
| Payments on debt issuance costs  | (7,869)    | ) | —          |
| Proceeds from issuance of treasury stock under employee stock plans      | 2,492      |   | 13,112     |
| Taxes paid related to net share settlement of equity awards              | (42,872)   | ) | (39,324)   |
| Dividends paid   | —          |   | (1,238)    |
| Repurchases of common stock  | (229,540)  | ) | (116,341)  |
| Net cash used in financing activities                                    | (117,789)  | ) | (102,791)  |
| Effect of exchange rate changes on cash                                  | (4,265)    | ) | 1,678      |
| Increase in cash and cash equivalents                                    | 14,311     |   | 54,741     |
| Cash and cash equivalents, beginning of period                           | 105,618    |   | 75,926     |
| Cash and cash equivalents, end of period                                 | \$ 119,929 |   | \$ 130,667 |
| Supplemental disclosures of cash flow information:                       |            |   |            |
| Cash paid for income taxes, net of refunds                               | \$ 9,975   |   | \$ 22,726  |
| Cash paid for interest   | \$ 20,501  |   | \$ 18,847  |
| Supplemental disclosures of non-cash investing and financing activities: |            |   |            |
| Purchase of property and equipment included in accounts payable          | \$ 5,282   |   | \$ 2,470   |
| Unsettled repurchases of common stock                                    | \$ 7,601   |   | \$ 4,177   |

See accompanying notes.

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FAIR ISAAC CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

1. Nature of Business

Fair Isaac Corporation

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

In these condensed consolidated financial statements, Fair Isaac Corporation is referred to as “FICO,” “we,” “us,” “our,” or “the Company.”

Principles of Consolidation and Basis of Presentation

We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with the instructions to Form 10-Q and the applicable accounting guidance. Consequently, we have not necessarily included all information and footnotes required for audited financial statements. In our opinion, the accompanying unaudited interim condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments, except as otherwise indicated) necessary for a fair presentation of our financial position and results of operations. These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with our audited consolidated financial statements and notes thereto presented in our Annual Report on Form 10-K for the year ended September 30, 2017. The interim financial information contained in this report is not necessarily indicative of the results to be expected for any other interim period or for the entire fiscal year.

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

Use of Estimates

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

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## New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. Generally Accepted Accounting Principles when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. The guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. In August 2015, the FASB issued ASU No. 2015-14, “Deferral of the Effective Date”, which defers the effective date for ASU 2014-09 by one year. For public entities, the guidance in ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods), which means it will be effective for our fiscal year beginning October 1, 2018. Early adoption is permitted to the original effective date of December 15, 2016 (including interim reporting periods within those periods). In March 2016, the FASB issued ASU No. 2016-08, “Principal versus Agent Considerations (Reporting Revenue versus Net)”, which clarifies the implementation guidance on principal versus agent considerations in the new revenue recognition standard. In April 2016, the FASB issued ASU No. 2016-10, “Identifying Performance Obligations and Licensing”, which reduces the complexity when applying the guidance for identifying performance obligations and improves the operability and understandability of the license implementation guidance. In May 2016, the FASB issued ASU No. 2016-12 “Narrow-Scope Improvements and Practical Expedients”, which amends the guidance on transition, collectability, noncash consideration and the presentation of sales and other similar taxes. In December 2016, the FASB further issued ASU No. 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers”, which makes minor corrections or minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. The amendments are intended to address implementation issues that were raised by stakeholders and provide additional practical expedients to reduce the cost and complexity of applying the new revenue standard. These amendments have the same effective date as the new revenue standard. We have established a cross-functional implementation team consisting of representatives across the organization to address the scope of work required to implement the recognition and disclosure requirements under the new standard. This cross-functional implementation team has developed a project plan, which includes evaluating customer contracts across the organization, developing policies, processes and tools to report financial results, and implementing and evaluating our internal controls over financial reporting that will be necessary under the new standard. We currently plan to adopt Topic 606 in the first quarter of our fiscal 2019 using the retrospective transition method. Our ability to adopt Topic 606 using the full retrospective method is dependent on system readiness, and the completion of our analysis of information necessary to restate prior period financial statements. As we continue to assess the new standard along with industry trends and additional interpretive guidance, we may adjust our implementation plan accordingly.

We are continuing to assess the impact of adopting Topic 606 on our consolidated financial statements and believe the new standard will impact the following policies and disclosures:

- Timing of revenue recognition of license revenue on term licenses and transactional revenue on guaranteed minimum fees related to our on-premises software products. Under the new standard, we expect to recognize revenue when control of the license is transferred to the customer, rather than at the date payments become due and payable or ratably over the term of the contract required under the current standard;
- Presentation of contract balances. Under the new standard, when we enter into noncancellable contracts that provide unconditional rights to payment from our customers for services that we have not yet completed providing or services we will provide in the near future, we expect to present the unconditional rights as receivables, regardless of whether cash has been received from customers;
- Required disclosures including information about remaining transaction price and when we expect to recognize revenue; and
- Accounting for commissions under the new standard will result in the deferral of incremental commission costs for obtaining contracts.

We do not currently expect Topic 606 to have a significant effect on the timing of revenue recognition for our maintenance or professional services revenues, or SaaS contracts.

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In October 2016, the FASB issued ASU No. 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory” (“ASU 2016-16”). ASU 2016-16 requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The guidance is effective for fiscal years and interim periods beginning after December 15, 2017, which means it will be effective for our fiscal year beginning October 1, 2018. ASU 2016-16 should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings at the beginning of the period of adoption. Early adoption is permitted as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued. We do not believe that adoption of ASU 2016-16 will have a significant impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which requires lessees to put most leases on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. ASU 2016-02 states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. ASU 2016-02 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2018, which means it will be effective for our fiscal year beginning October 1, 2019. Early adoption is permitted. We are currently evaluating the timing of our adoption and the impact that the updated standard will have on our consolidated financial statements.

2. Fair Value Measurements

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

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

Level 2 - uses inputs other than quoted prices included in Level 1 that are either directly or indirectly observable through correlation with market data. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and inputs to valuation models or other pricing methodologies that do not require significant judgment because the inputs used in the model, such as interest rates and volatility, can be corroborated by readily observable market data. We do not have any assets that are valued using inputs identified under a Level 2 hierarchy as of June 30, 2018 and September 30, 2017.

Level 3 - uses one or more significant inputs that are unobservable and supported by little or no market activity, and that reflect the use of significant management judgment. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, and significant management judgment or estimation. We do not have any assets or liabilities that are valued using inputs identified under a Level 3 hierarchy as of June 30, 2018 and September 30, 2017.

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The following tables represent financial assets that we measured at fair value on a recurring basis at June 30, 2018 and September 30, 2017:

| June 30, 2018             | Active<br>Markets<br>for<br>Identical<br>Instruments<br>(Level 1)<br>(In thousands) | Fair Value as of<br>June 30, 2018 |
|---------------------------|---|-----------------------------------|
| Assets:                   |   |                                   |
| Cash equivalents (1)      | \$ 32,500   | \$ 32,500                         |
| Marketable securities (2) | 16,930  | 16,930                            |
| Total                     | \$ 49,430   | \$ 49,430                         |

| September 30, 2017        | Active<br>Markets<br>for<br>Identical<br>Instruments<br>(Level 1)<br>(In thousands) | Fair Value as of<br>September 30,<br>2017 |
|---------------------------|---|---|
| Assets:                   |   |   |
| Cash equivalents (1)      | \$ 15,295   | \$ 15,295                                 |
| Marketable securities (2) | 13,791  | 13,791                                    |
| Total                     | \$ 29,086   | \$ 29,086                                 |

Included in cash and cash equivalents on our condensed consolidated balance sheet at June 30, 2018 and (1) September 30, 2017. Not included in these tables are cash deposits of \$87.4 million and \$90.3 million at June 30, 2018 and September 30, 2017, respectively.

Represents securities held under a supplemental retirement and savings plan for senior management employees, (2) which are distributed upon termination or retirement of the employees. Included in marketable securities on our condensed consolidated balance sheet at June 30, 2018 and September 30, 2017.

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

For the fair value of our derivative instruments and senior notes, see Note 3 and Note 7, respectively.

### 3. Derivative Financial Instruments

We use derivative instruments to manage risks caused by fluctuations in foreign exchange rates. The primary objective of our derivative instruments is to protect the value of foreign-currency-denominated receivable and cash balances from the effects of volatility in foreign exchange rates that might occur prior to conversion to their respective functional currencies. We principally utilize foreign currency forward contracts, which enable us to buy and sell foreign currencies in the future at fixed exchange rates and economically offset changes in foreign exchange rates. We routinely enter into contracts to offset exposures denominated in the British pound, Euro, and Singapore dollar. Foreign-currency-denominated receivable and cash balances are remeasured at foreign exchange rates in effect on the balance sheet date with the effects of changes in foreign exchange rates reported in other income, net. The forward contracts are not designated as hedges and are marked to market through other income, net. Fair value changes in the forward contracts help mitigate the changes in the value of the remeasured receivable and cash balances attributable to

changes in foreign exchange rates. The forward contracts are short-term in nature and typically have average maturities at inception of less than three months.

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The following tables summarize our outstanding foreign currency forward contracts, by currency, at June 30, 2018 and September 30, 2017:

| June 30, 2018          |                 |            |      |
|------------------------|-----------------|------------|------|
|                        | Contract Amount | Fair Value |      |
| Foreign Currency       | US\$            | US\$       |      |
| (In thousands)         |                 |            |      |
| Sell foreign currency: |                 |            |      |
| Euro (EUR)             | EUR 6,300       | \$7,344    | \$ — |
| Buy foreign currency:  |                 |            |      |
| British pound (GBP)    | GBP 6,963       | \$9,200    | \$ — |
| Singapore dollar (SGD) | SGD 8,326       | \$6,100    | \$ — |

| September 30, 2017     |                 |            |      |
|------------------------|-----------------|------------|------|
|                        | Contract Amount | Fair Value |      |
| Foreign Currency       | US\$            | US\$       |      |
| (In thousands)         |                 |            |      |
| Sell foreign currency: |                 |            |      |
| Euro (EUR)             | EUR 5,050       | \$5,968    | \$ — |
| Buy foreign currency:  |                 |            |      |
| British pound (GBP)    | GBP 9,341       | \$12,500   | \$ — |

The foreign currency forward contracts were entered into on June 30, 2018 and September 30, 2017, respectively; therefore, their fair value was \$0 on each of these dates.

Losses on derivative financial instruments are recorded in our condensed consolidated statements of income and comprehensive income as a component of other income, net, and consisted of the following:

|  | Quarter Ended June 30, 2018 |      | Nine Months Ended June 30, 2017 |       |
|--|-----------------------------|------|---------------------------------|-------|
| Losses on foreign currency forward contracts | \$870                       | \$ — | -\$251                          | \$505 |

(In thousands)

#### 4. Goodwill and Intangible Assets

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

|  | Quarter Ended June 30, 2018 |         | Nine Months Ended June 30, 2017 |         |
|--|-----------------------------|---------|---------------------------------|---------|
| Cost of revenues                             | \$628                       | \$1,723 | \$1,949                         | \$5,096 |
| Selling, general and administrative expenses | 943                         | 1,642   | 3,094                           | 4,901   |
|  | \$1,571                     | \$3,365 | \$5,043                         | \$9,997 |

(In thousands)

Cost of revenues reflects our amortization of completed technology and selling, general and administrative expenses reflects our amortization of other intangible assets. Intangible assets, gross were \$111.7 million and \$114.5 million as of June 30, 2018 and September 30, 2017, respectively.



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Estimated future intangible asset amortization expense associated with intangible assets existing at June 30, 2018 was as follows (in thousands):

|  |           |
|--|-----------|
| Year Ended September 30,                             |           |
| 2018 (excluding the nine months ended June 30, 2018) | \$ 1,546  |
| 2019   | 5,979     |
| 2020   | 3,648     |
| 2021   | 2,417     |
| 2022   | 2,272     |
| Thereafter   | 217       |
|  | \$ 16,079 |

The following table summarizes changes to goodwill during the nine months ended June 30, 2018, both in total and as allocated to our segments:

|   | Application Scores | Decision Management Software | Total      |
|---|--------------------|------------------------------|------------|
|   | (In thousands)     |                              |            |
| Balance at September 30, 2017           | \$588,288          | \$ 146,648                   | \$ 69,478  |
| Foreign currency translation adjustment | (2,195 )           | —                            | (178 )     |
| Balance at June 30, 2018                | \$586,093          | \$ 146,648                   | \$ 69,300  |
|   |                    |                              | \$ 804,414 |
|   |                    |                              | (2,373 )   |
|   |                    |                              | \$ 802,041 |

#### 5. Composition of Certain Financial Statement Captions

The following table summarizes property and equipment, and the related accumulated depreciation and amortization, at June 30, 2018 and September 30, 2017:

|   | June 30, 2018  | September 30, 2017 |
|---|----------------|--------------------|
|   | (In thousands) |                    |
| Property and equipment                          | \$159,534      | \$ 135,360         |
| Less: accumulated depreciation and amortization | (108,017 )     | (94,657 )          |
|   | \$51,517       | \$ 40,703          |

#### 6. Revolving Line of Credit

On May 8, 2018, we amended our credit agreement with a syndicate of banks, extending the maturity date of the unsecured revolving line of credit from December 30, 2019 to May 8, 2023, while reducing our borrowing capacity to \$400 million with an option to increase it by another \$100 million. Proceeds from the credit facility can be used for working capital and general corporate purposes and may also be used for the refinancing of existing debt, acquisitions and the repurchase of our common stock. Interest on amounts borrowed under the credit facility is based on (i) a base rate, which is the greater of (a) the prime rate, (b) the Federal Funds rate plus 0.500% and (c) the one-month LIBOR rate plus 1.000%, plus, in each case, an applicable margin, or (ii) an adjusted LIBOR rate plus an applicable margin. The applicable margin for base rate borrowings ranges from 0% to 0.875% and for LIBOR borrowings ranges from 1.000% to 1.875%, and is determined based on our consolidated leverage ratio. In addition, we must pay credit facility fees. The credit facility contains certain restrictive covenants including maintaining a maximum consolidated leverage ratio of 3.25, subject to a step up to 3.75 following certain permitted acquisitions; and a minimum fixed charge ratio of 2.50 through the maturity of our 2010 Senior Notes in July 2020, upon which maintaining a minimum interest coverage ratio of 3.00. The credit agreement also contains other covenants typical of unsecured facilities. As of June 30, 2018, we had \$252.0 million in borrowings outstanding at a weighted average interest rate of 3.201%, of which \$50.0 million was classified as a long-term liability and recorded in long-term debt within the accompanying condensed consolidated balance sheets. We were in compliance with all financial covenants under this credit facility as of June 30, 2018.



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## 7. Senior Notes

On May 7, 2008, we issued \$275 million of senior notes in a private placement to a group of institutional investors (the “2008 Senior Notes”).

On July 14, 2010, we issued \$245 million of senior notes in a private placement to a group of institutional investors (the “2010 Senior Notes”). The 2010 Senior Notes were issued in four series with maturities ranging from 6 to 10 years. The outstanding 2010 Senior Notes’ weighted average interest rate is 5.6% and the weighted average maturity is 9.8 years. The 2010 Senior Notes require interest payments semi-annually and contain certain restrictive covenants, including the maintenance of a maximum consolidated net debt to consolidated EBITDA ratio of 3.00 and a minimum fixed charge coverage ratio of 2.50. As of June 30, 2018, we were in compliance with all financial covenants.

On May 8, 2018, we issued \$400 million of senior notes in a private offering to qualified institutional investors (the “2018 Senior Notes”, and with the 2008 Senior Notes and the 2010 Senior Notes, the “Senior Notes”). We have used the net proceeds to repay all the outstanding aggregate principal amount of the 2008 Senior Notes at maturity, as well as a portion of the outstanding balance on our revolving credit facility. The 2018 Senior Notes require interest payments semi-annually at a rate of 5.25% per annum and will mature on May 15, 2026. The purchase agreements for the 2008 and 2010 Senior Notes and the indenture for the 2018 Senior Notes contain certain covenants typical of unsecured obligations.

The following table presents the carrying amounts and fair values for the Senior Notes at June 30, 2018 and September 30, 2017:

|                       | June 30, 2018       |            | September 30, 2017  |            |
|-----------------------|---------------------|------------|---------------------|------------|
|                       | Carrying<br>Amounts | Fair Value | Carrying<br>Amounts | Fair Value |
|                       | (In thousands)      |            |                     |            |
| The 2008 Senior Notes | \$—                 | \$—        | \$131,000           | \$134,250  |
| The 2010 Senior Notes | 113,000             | 114,966    | 113,000             | 119,106    |
| The 2018 Senior Notes | 400,000             | 402,000    | —                   | —          |
| Debt issuance costs   | (6,287 )            | (6,287 )   | (199 )              | (199 )     |
| Total                 | \$506,713           | \$510,679  | \$243,801           | \$253,157  |

We measure the fair value of the Senior Notes based on Level 2 inputs, which include quoted market prices and interest rate spreads of similar securities.

## 8. Restructuring Expenses

There were no restructuring expenses during the quarter and nine months ended June 30, 2018.

During both the quarter and nine months ended June 30, 2017, we incurred net charges totaling \$4.5 million consisting of \$1.7 million in facilities charges associated with vacating excess leased space in San Rafael and \$2.8 million in employee separation costs due to the elimination of 79 positions throughout the Company. Cash payment for all the facilities charges will be paid by the end of our fiscal 2020. Cash payment for all the employee separation costs were paid before the end of the second quarter of fiscal 2018.

The following table summarizes our restructuring accruals related to facility closures and employee separation charges. The current portion and non-current portion is recorded in other accrued liabilities and other liabilities, respectively, within the accompanying condensed consolidated balance sheets. The balance for all the facilities charges will be paid by the end of fiscal 2020.

|                     | Accrual<br>at<br>September<br>30,<br>2017 | Cash<br>Payments | Accrual<br>at<br>June 30,<br>2018 |
|---------------------|---|------------------|-----------------------------------|
|                     | (In thousands)                            |                  |                                   |
| Facilities charges  | \$8,120                                   | \$(2,152 )       | \$5,968                           |
| Employee separation | 185                                       | (185 )           | —                                 |

|                       |          |            |          |
|-----------------------|----------|------------|----------|
|                       | 8,305    | \$(2,337 ) | 5,968    |
| Less: current portion | (3,077 ) |            | (3,720 ) |
| Non-current           | \$5,228  |            | \$2,248  |

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## 9. Income Taxes

## Effective Tax Rate

The effective income tax rate was 22.5% and 28.6% during the quarters ended June 30, 2018 and 2017, respectively, and 21.1% and 9.2% during the nine months ended June 30, 2018 and 2017, respectively. The provision for income taxes during interim quarterly reporting periods is based on our estimates of the effective tax rates for the full fiscal year. The effective tax rate in any quarter can also be affected positively or negatively by adjustments that are required to be reported in the specific quarter of resolution.

The effective tax rate for the nine months ended June 30, 2018 was significantly impacted by recording the impact of the Tax Cuts and Jobs Act (the “Tax Act”), enacted on December 22, 2017 by the U.S. government. The Tax Act makes broad and complex changes to the U.S. tax code that will affect our fiscal year ended September 30, 2018, including, but not limited to, (1) reducing the U.S. federal corporate tax rate and (2) requiring a one-time transition tax on certain un-repatriated earnings of foreign subsidiaries that is payable over eight years.

The Tax Act reduces the federal corporate tax rate to 21.0% effective January 1, 2018. In accordance with Section 15 of the Internal Revenue Code, we will utilize a blended rate of 24.5% for our fiscal 2018 tax year, by applying a prorated percentage of the number of days prior to and subsequent to the January 1, 2018 effective date. We recorded provisional charges for the re-measurement of the deferred tax assets of \$5.6 million to our income tax expense related to long-term deferred tax assets and \$4.4 million related to short-term deferred tax assets during the nine months ended June 30, 2018.

The Deemed Repatriation Transition Tax (the “Transition Tax”) is a tax on previously untaxed accumulated earnings and profits (“E&P”) of certain of our foreign subsidiaries. To determine the amount of the Transition Tax, we must determine, in addition to other factors, the amount of post-1986 E&P of the relevant subsidiaries, as well as the amount of non-U.S. income taxes paid on such earnings. As of June 30, 2018, we were able to make a reasonable estimate and recorded a provisional Transition Tax obligation of \$4.9 million.

On December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provides guidance on accounting for tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under FASB Accounting Standards Codification (“ASC”) 740, “Accounting for Income Taxes” (“ASC 740”). In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Act for which the accounting under ASC 740 is complete. To the extent that a company’s accounting for certain income tax effects of the Tax Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate to be included in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provision of the tax laws that were in effect immediately before the enactment of the Tax Act. While we are able to make reasonable estimates of the impact of the reduction in corporate rate and the deemed repatriation transition tax, the final impact of the Tax Act may differ from these estimates, due to, among other things, changes in our interpretations and assumptions, additional guidance that may be issued by the I.R.S., and actions we may take. We are continuing to gather additional information to determine the final impact.

The total unrecognized tax benefit for uncertain tax positions is estimated to be \$5.2 million and \$6.5 million at June 30, 2018 and September 30, 2017, respectively. We recognize interest expense related to unrecognized tax benefits and penalties as part of the provision for income taxes in our condensed consolidated statements of income and comprehensive income. We have accrued interest of \$0.4 million related to unrecognized tax benefits as of June 30, 2018 and September 30, 2017.

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## 10. Earnings per Share

The following table presents reconciliations for the numerators and denominators of basic and diluted earnings per share (“EPS”) for the quarters and nine-month periods ended June 30, 2018 and 2017:

|   | Quarter Ended                         |          | Nine Months    |                |
|---|---------------------------------------|----------|----------------|----------------|
|   | June 30,                              | June 30, | Ended June 30, | Ended June 30, |
|   | 2018                                  | 2017     | 2018           | 2017           |
|   | (In thousands, except per share data) |          |                |                |
| Numerator for diluted and basic earnings per share: |                                       |          |                |                |
| Net Income  | \$32,361                              | \$25,227 | \$91,935       | \$88,212       |
| Denominator - share:                                |                                       |          |                |                |
| Basic weighted-average shares                       | 29,708                                | 30,914   | 29,924         | 30,973         |
| Effect of dilutive securities                       | 1,453                                 | 1,310    | 1,417          | 1,367          |
| Diluted weighted-average shares                     | 31,161                                | 32,224   | 31,341         | 32,340         |
| Earnings per share:                                 |                                       |          |                |                |
| Basic   | \$1.09                                | \$0.82   | \$3.07         | \$2.85         |
| Diluted   | \$1.04                                | \$0.78   | \$2.93         | \$2.73         |

We exclude the options to purchase shares of common stock in the computation of the diluted EPS where the exercise price of the options exceeds the average market price of our common stock as their inclusion would be antidilutive. There were no options excluded for each of the quarters ended June 30, 2018 and 2017. There were approximately 7,000 and 11,000 options excluded for the nine months ended June 30, 2018 and 2017, respectively.

## 11. Segment Information

We are organized into the following three operating segments, each of which is a reportable segment, to align with internal management of our worldwide business operations based on product offerings.

**Applications.** This segment includes pre-configured decision management applications designed for a specific type of business problem or process — such as marketing, account origination, customer management, fraud, collections and insurance claims management — as well as associated professional services. These applications are available to our customers as on-premises software, and many are available as hosted, software-as-a-service (“SaaS”) applications through the FICO® Analytic Cloud.

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

**Decision Management Software.** This segment is composed of analytic and decision management software tools that clients can use to create their own custom decision management applications, our new FICO® Decision Management Suite, as well as associated professional services. These tools are available to our customers as on-premises software or through the FICO® Analytic Cloud.

Our Chief Executive Officer evaluates segment financial performance based on segment revenues and segment operating income. Segment operating expenses consist of direct and indirect costs principally related to personnel, facilities, consulting, travel and depreciation. Indirect costs are allocated to the segments generally based on relative segment revenues, fixed rates established by management based upon estimated expense contribution levels and other assumptions that management considers reasonable. We do not allocate broad-based incentive expense, share-based compensation expense, restructuring expense, amortization expense, various corporate charges and certain other income and expense measures to our segments. These income and expense items are not allocated because they are not considered in evaluating the segment’s operating performance. Our Chief Executive Officer does not evaluate the financial performance of each segment based on its respective assets, nor capital expenditures where depreciation amounts are allocated to the segments from their internal cost centers as described above.





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The following tables summarize segment information for the quarters and nine-month periods ended June 30, 2018 and 2017:

|   | Quarter Ended June 30, 2018 |           |                              |                                |            |
|---|-----------------------------|-----------|------------------------------|--------------------------------|------------|
|   | Applications                | Scores    | Decision Management Software | Unallocated Corporate Expenses | Total      |
|   | (In thousands)              |           |                              |                                |            |
| Segment revenues:                                 |                             |           |                              |                                |            |
| Transactional and maintenance                     | \$93,598                    | \$90,716  | \$ 11,177                    | \$ —                           | \$195,491  |
| Professional services                             | 34,173                      | 505       | 8,531                        | —                              | 43,209     |
| License   | 13,847                      | 884       | 6,074                        | —                              | 20,805     |
| Total segment revenues                            | 141,618                     | 92,105    | 25,782                       | —                              | 259,505    |
| Segment operating expense                         | (107,228)                   | (16,374 ) | (35,151 )                    | (31,922 )                      | (190,675 ) |
| Segment operating income (loss)                   | \$34,390                    | \$75,731  | \$ (9,369 )                  | \$ (31,922 )                   | \$ 68,830  |
| Unallocated share-based compensation expense      |                             |           |                              |                                | (18,883 )  |
| Unallocated amortization expense                  |                             |           |                              |                                | (1,571 )   |
| Operating income                                  |                             |           |                              |                                | 48,376     |
| Unallocated interest expense, net                 |                             |           |                              |                                | (8,223 )   |
| Unallocated other income, net                     |                             |           |                              |                                | 1,588      |
| Income before income taxes                        |                             |           |                              |                                | \$41,741   |
| Depreciation expense                              | \$3,682                     | \$130     | \$ 1,321                     | \$ 215                         | \$5,348    |
|   | Quarter Ended June 30, 2017 |           |                              |                                |            |
|   | Applications                | Scores    | Decision Management Software | Unallocated Corporate Expenses | Total      |
|   | (In thousands)              |           |                              |                                |            |
| Segment revenues:                                 |                             |           |                              |                                |            |
| Transactional and maintenance                     | \$87,443                    | \$68,376  | \$ 10,876                    | \$ —                           | \$166,695  |
| Professional services                             | 35,990                      | 487       | 7,394                        | —                              | 43,871     |
| License   | 10,349                      | 651       | 9,420                        | —                              | 20,420     |
| Total segment revenues                            | 133,782                     | 69,514    | 27,690                       | —                              | 230,986    |
| Segment operating expense                         | (95,357 )                   | (14,013 ) | (31,312 )                    | (26,724 )                      | (167,406 ) |
| Segment operating income (loss)                   | \$38,425                    | \$55,501  | \$ (3,622 )                  | \$ (26,724 )                   | \$ 63,580  |
| Unallocated share-based compensation expense      |                             |           |                              |                                | (14,315 )  |
| Unallocated amortization expense                  |                             |           |                              |                                | (3,365 )   |
| Unallocated restructuring and acquisition-related |                             |           |                              |                                | (4,471 )   |
| Operating income                                  |                             |           |                              |                                | 41,429     |
| Unallocated interest expense, net                 |                             |           |                              |                                | (6,653 )   |
| Unallocated other income, net                     |                             |           |                              |                                | 555        |
| Income before income taxes                        |                             |           |                              |                                | \$35,331   |
| Depreciation expense                              | \$3,931                     | \$239     | \$ 1,196                     | \$ 331                         | \$5,697    |

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|  | Nine Months Ended June 30, 2018 |           |              |              |            |
|--|---------------------------------|-----------|--------------|--------------|------------|
|  | Application                     | Scores    | Decision     | Unallocated  | Total      |
|  |                                 |           | Management   | Corporate    |            |
|  |                                 |           | Software     | Expenses     |            |
|  | (In thousands)                  |           |              |              |            |
| Segment revenues:                            |                                 |           |              |              |            |
| Transactional and maintenance                | \$284,441                       | \$245,934 | \$ 34,973    | \$ —         | \$565,348  |
| Professional services                        | 107,542                         | 1,465     | 22,906       | —            | 131,913    |
| License                                      | 37,743                          | 2,531     | 15,149       | —            | 55,423     |
| Total segment revenues                       | 429,726                         | 249,930   | 73,028       | —            | 752,684    |
| Segment operating expense                    | (316,886 )                      | (48,673 ) | (98,917 )    | (92,175 )    | (556,651 ) |
| Segment operating income (loss)              | \$112,840                       | \$201,257 | \$ (25,889 ) | \$ (92,175 ) | 196,033    |
| Unallocated share-based compensation expense |                                 |           |              |              | (54,631 )  |
| Unallocated amortization expense             |                                 |           |              |              | (5,043 )   |
| Operating income                             |                                 |           |              |              | 136,359    |
| Unallocated interest expense, net            |                                 |           |              |              | (21,799 )  |
| Unallocated other income, net                |                                 |           |              |              | 1,940      |
| Income before income taxes                   |                                 |           |              |              | \$116,500  |
| Depreciation expense                         | \$11,459                        | \$432     | \$ 4,024     | \$ 737       | \$16,652   |

|   | Nine Months Ended June 30, 2017 |           |             |              |            |
|---|---------------------------------|-----------|-------------|--------------|------------|
|   | Application                     | Scores    | Decision    | Unallocated  | Total      |
|   |                                 |           | Management  | Corporate    |            |
|   |                                 |           | Software    | Expenses     |            |
|   | (In thousands)                  |           |             |              |            |
| Segment revenues:                                 |                                 |           |             |              |            |
| Transactional and maintenance                     | \$258,337                       | \$190,256 | \$ 33,011   | \$ —         | \$481,604  |
| Professional services                             | 102,971                         | 2,002     | 23,725      | —            | 128,698    |
| License   | 41,576                          | 2,071     | 25,015      | —            | 68,662     |
| Total segment revenues                            | 402,884                         | 194,329   | 81,751      | —            | 678,964    |
| Segment operating expense                         | (294,608 )                      | (41,816 ) | (91,549 )   | (76,580 )    | (504,553 ) |
| Segment operating income (loss)                   | \$108,276                       | \$152,513 | \$ (9,798 ) | \$ (76,580 ) | 174,411    |
| Unallocated share-based compensation expense      |                                 |           |             |              | (43,546 )  |
| Unallocated amortization expense                  |                                 |           |             |              | (9,997 )   |
| Unallocated restructuring and acquisition-related |                                 |           |             |              | (4,471 )   |
| Operating income                                  |                                 |           |             |              | 116,397    |
| Unallocated interest expense, net                 |                                 |           |             |              | (19,403 )  |
| Unallocated other income, net                     |                                 |           |             |              | 128        |
| Income before income taxes                        |                                 |           |             |              | \$97,122   |
| Depreciation expense                              | \$11,758                        | \$741     | \$ 3,524    | \$ 1,021     | \$17,044   |

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12. Contingencies

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

13. Subsequent Events

In July 2018, our Board of Directors approved a new stock repurchase program following the completion of a similar program that was approved in October 2017. The new program is open-ended and authorizes repurchases of shares of our common stock up to an aggregate cost of \$250.0 million in the open market or in negotiated transactions.

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

## FORWARD LOOKING STATEMENTS

Statements contained in this report that are not statements of historical fact should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In addition, certain statements in our future filings with the Securities and Exchange Commission (“SEC”), in press releases, and in oral and written statements made by us or with our approval that are not statements of historical fact constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenue, income or loss, expenses, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other statements concerning future financial performance; (ii) statements of our plans and objectives by our management or Board of Directors, including those relating to products or services, research and development, and the sufficiency of capital resources; (iii) statements of assumptions underlying such statements, including those related to economic conditions; (iv) statements regarding business relationships with vendors, customers or collaborators, including the proportion of revenues generated from international as opposed to domestic customers; and (v) statements regarding products, their characteristics, performance, sales potential or effect in the hands of customers. Words such as “believes,” “anticipates,” “expects,” “intends,” “targeted,” “should,” “potential,” “goals,” “and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to, those described in Part II, Item 1A, Risk Factors. The performance of our business and our securities may be adversely affected by these factors and by other factors common to other businesses and investments, or to the general economy. Forward-looking statements are qualified by some or all of these risk factors. Therefore, you should consider these risk factors with caution and form your own critical and independent conclusions about the likely effect of these risk factors on our future performance. Such forward-looking statements speak only as of the date on which statements are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events or circumstances. Readers should carefully review the disclosures and the risk factors described in this and other documents we file from time to time with the SEC, including our reports on Form 8-K to be filed by us in fiscal 2018.

## OVERVIEW

We use analytics to help businesses automate, improve and connect decisions across their enterprise, an approach we commonly refer to as decision management. Our predictive analytics, which includes the industry-standard FICO® Score, and our decision management systems leverage the use of big data and mathematical algorithms to predict consumer behavior and power hundreds of billions of customer decisions each year. We help thousands of companies in over 100 countries use our decision management technology to target and acquire customers more efficiently, increase customer value, reduce fraud and credit losses, lower operating expenses, and enter new markets more profitably. Most leading banks and credit card issuers rely on our solutions, as do insurers, retailers, telecommunications providers, pharmaceutical companies, healthcare organizations, public agencies and organizations in other industries. We also serve consumers through online services that enable people to purchase and understand their FICO® Scores, the standard measure of consumer credit risk in the U.S., and empower them to manage their financial health. Most of our solutions address customer engagement, including customer acquisition, customer onboarding, customer servicing and management, and customer protection. We also help businesses improve noncustomer decisions such as transaction and claims processing. Our solutions enable users to make decisions that are more precise, consistent and agile, and that systematically advance business goals. This helps our clients to reduce the cost of doing business, increase revenues and profitability, reduce losses from risks and fraud, and increase customer loyalty.

We derive a significant portion of our revenues from clients outside the U.S. International revenues accounted for 33% and 34% of total consolidated revenues for the quarters ended June 30, 2018 and 2017, respectively, and 33% and 35% of total consolidated revenues for the nine months ended June 30, 2018 and 2017, respectively. A significant portion of our revenues are derived from the sale of products and services within the banking (including consumer

credit) industry, and 87% and 74% of our revenues were derived from within this industry during the quarters ended June 30, 2018 and 2017, respectively, and 85% and 74% of our revenues were derived from within this industry during the nine months ended June 30, 2018 and 2017, respectively. In addition, we derive a significant share of revenues from transactional or unit-based software license fees, transactional fees derived under credit scoring, data processing, data management and SaaS subscription services arrangements, and annual software maintenance fees. Arrangements with transactional or unit-based pricing accounted for 75% and 72% of our revenues during the quarters ended June 30, 2018 and 2017, respectively. Arrangements with transactional or unit-based pricing accounted for 75% and 71% of our revenues during the nine months ended June 30, 2018 and 2017, respectively.

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We continue to drive growth in our Scores segment. Scores revenue increased 32% to \$92.1 million during the quarter ended June 30, 2018 from \$69.5 million during the quarter ended June 30, 2017, and 29% to \$249.9 million during the nine months ended June 30, 2018 from \$194.3 million during the nine months ended June 30, 2017. Scores operating income increased 36% to \$75.7 million during the quarter ended June 30, 2018 from \$55.5 million during the quarter ended June 30, 2017, and 32% to \$201.3 million during the nine months ended June 30, 2018 from \$152.5 million during the nine months ended June 30, 2017. For our Applications and Decision Management Software segments, our cloud business continues to grow both in the absolute dollar value and as a percentage of revenues as we pursue our cloud-first strategy. During the quarter ended June 30, 2018, cloud revenues accounted for \$58.1 million, or 35% of non-Scores revenues, compared to \$51.2 million, or 32% during the quarter ended June 30, 2017. During the nine months ended June 30, 2018, cloud revenues accounted for \$177.6 million, or 35% of non-Scores revenues, compared to \$151.1 million, or 31% during the nine months ended June 30, 2017.

Operating income increased 17% to \$48.4 million for the quarter ended June 30, 2018 from \$41.4 million during the quarter ended June 30, 2017 and as a result, net earnings increased 28% to \$32.4 million from \$25.2 million.

Operating income increased 17% to \$136.4 million for the nine months ended June 30, 2018 from \$116.4 million for the nine months ended June 30, 2017, and net earnings increased 4% to \$91.9 million from \$88.2 million primarily due to the increase in operating income, partially offset by the income tax expense related to enactment of the Tax Cuts and Jobs Act.

We continue to enhance stockholder value by returning cash to stockholders through our stock repurchase program. During the quarter and nine months ended June 30, 2018, we repurchased approximately 0.6 million shares at a total repurchase price of \$106.9 million and 1.4 million shares at a total repurchase price of \$231.5 million, respectively. As of June 30, 2018, we had \$55.1 million remaining under our then-current stock repurchase program.

**Bookings**

Management uses bookings as an indicator of our business performance. Bookings represent contracts signed in the current reporting period that generate current and future revenue streams. We consider contract terms, knowledge of the marketplace and experience with our customers, among other factors, when determining the estimated value of contract bookings.

Bookings calculations have varying degrees of certainty depending on the revenue type and individual contract terms. Our revenue types are transactional and maintenance, professional services and license. Our estimate of bookings is as of the end of the period in which a contract is signed, and we do not update initial booking estimates in future periods for changes between estimated and actual results. Actual revenue and the timing thereof could differ materially from our initial estimates. The following paragraphs discuss the key assumptions used to calculate bookings and the susceptibility of these assumptions to variability.

**Transactional and Maintenance Bookings**

We calculate transactional bookings as the total estimated volume of transactions or number of accounts under contract, multiplied by the contractual rate. Transactional contracts generally span multiple years and require us to make estimates about future transaction volumes or number of active accounts. We develop estimates from discussions with our customers and examinations of historical data from similar products and customer arrangements. Differences between estimated bookings and actual results occur due to variability in the volume of transactions or number of active accounts estimated. This variability is primarily caused by the following:

- The health of the economy and economic trends in our customers' industries;
- Individual performance of our customers relative to their competitors; and
- Regulatory and other factors that affect the business environment in which our customers operate.

We calculate maintenance bookings directly from the terms stated in the contract.

**Professional Services Bookings**

We calculate professional services bookings as the estimated number of hours to complete a project multiplied by the rate per hour. We estimate the number of hours based on our understanding of the project scope, conversations with customer personnel and our experience in estimating professional services projects. Estimated bookings may differ from actual results primarily due to differences in the actual number of hours incurred. These differences typically

result from customer decisions to alter the mix of FICO and customer services resources used to complete a project.

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## License Bookings

Licenses are sold on a perpetual or term basis and bookings generally equal the fixed amount stated in the contract.

## Bookings Trend Analysis

|                                 | Bookings      | Bookings Yield (1) | Number of Bookings over \$1 Million | Weighted-Average Term (2) |
|---------------------------------|---------------|--------------------|-------------------------------------|---------------------------|
|                                 | (In millions) |                    |                                     | (Months)                  |
| Quarter Ended June 30, 2018     | \$ 119.9      | 14 %               | 15                                  | 28                        |
| Quarter Ended June 30, 2017     | \$ 95.5       | 19 %               | 14                                  | 29                        |
| Nine Months Ended June 30, 2018 | \$ 303.8      | 27 %               | 37                                  | NM <sup>(a)</sup>         |
| Nine Months Ended June 30, 2017 | \$ 283.0      | 34 %               | 40                                  | NM <sup>(a)</sup>         |

(1) Bookings yield represents the percentage of revenue recognized from bookings for the periods indicated.

(2) Weighted-average term of bookings measures the average term over which bookings are expected to be recognized as revenue.

NM - Measure is not meaningful as our estimate of bookings is as of the end of the period in which a contract is (a) signed, and we do not update our initial booking estimates in future periods for changes between estimated and actual results.

Transactional and maintenance bookings were 43% and 39% of total bookings for the quarters ended June 30, 2018 and 2017, respectively. Professional services bookings were 46% and 43% of total bookings for the quarters ended June 30, 2018 and 2017, respectively. License bookings were 11% and 18% of total bookings for the quarters ended June 30, 2018 and 2017, respectively.

Transactional and maintenance bookings were 41% and 37% of total bookings for the nine months ended June 30, 2018 and 2017, respectively. Professional services bookings were 47% and 45% of total bookings for the nine months ended June 30, 2018 and 2017, respectively. License bookings were 12% and 18% of total bookings for the nine months ended June 30, 2018 and 2017, respectively.

## RESULTS OF OPERATIONS

## Revenues

The following tables set forth certain summary information on a segment basis related to our revenues for the quarters and nine-month periods ended June 30, 2018 and 2017:

| Segment                      | Quarter Ended June 30,     |           | Percentage of Revenues |       |           |      | Period-to-Period Change | Period-to-Period Percentage Change |  |
|------------------------------|----------------------------|-----------|------------------------|-------|-----------|------|-------------------------|------------------------------------|--|
|                              | 2018                       | 2017      | 2018                   | 2017  | 2018      | 2017 |                         |                                    |  |
|                              | (In thousands)             |           |                        |       |           |      | (In thousands)          |                                    |  |
| Applications                 | \$141,618                  | \$133,782 | 55 %                   | 58 %  | \$ 7,836  | 6    | %                       |                                    |  |
| Scores                       | 92,105                     | 69,514    | 35 %                   | 30 %  | 22,591    | 32   | %                       |                                    |  |
| Decision Management Software | 25,782                     | 27,690    | 10 %                   | 12 %  | (1,908)   | (7)  | %                       |                                    |  |
| Total                        | \$259,505                  | \$230,986 | 100 %                  | 100 % | 28,519    | 12   | %                       |                                    |  |
|                              | Nine Months Ended June 30, |           | Percentage of Revenues |       |           |      | Period-to-Period Change | Period-to-Period Percentage Change |  |
| Segment                      | 2018                       | 2017      | 2018                   | 2017  | 2018      | 2017 |                         |                                    |  |
|                              | (In thousands)             |           |                        |       |           |      | (In thousands)          |                                    |  |
| Applications                 | \$429,726                  | \$402,884 | 57 %                   | 59 %  | \$ 26,842 | 7    | %                       |                                    |  |
| Scores                       | 249,930                    | 194,329   | 33 %                   | 29 %  | 55,601    | 29   | %                       |                                    |  |
| Decision Management Software | 73,028                     | 81,751    | 10 %                   | 12 %  | (8,723)   | (11) | %                       |                                    |  |
| Total                        | \$752,684                  | \$678,964 | 100 %                  | 100 % | 73,720    | 11   | %                       |                                    |  |



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## Quarter Ended June 30, 2018 Compared to Quarter Ended June 30, 2017

## Applications

|                               | Quarter Ended June<br>30,<br>2018 |           | 2017           |   | Period-to-Period<br>Change | Period-to-Period<br>Percentage<br>Change |
|-------------------------------|-----------------------------------|-----------|----------------|---|----------------------------|--|
|                               | (In thousands)                    |           | (In thousands) |   |                            |  |
| Transactional and maintenance | \$93,598                          | \$87,443  | \$ 6,155       |   | 7                          | %  |
| Professional services         | 34,173                            | 35,990    | (1,817         | ) | (5                         | )%                                       |
| License                       | 13,847                            | 10,349    | 3,498          |   | 34                         | %  |
| Total                         | \$141,618                         | \$133,782 | 7,836          |   | 6                          | %  |

Applications segment revenues increased \$7.8 million primarily due to a \$2.4 million increase in our Compliance solutions, a \$2.1 million increase in our originations solutions, a \$1.8 million increase in our customer management solutions, and a \$1.4 million increase in our customer communications services. The increases in our compliance, originations and customer management solutions were primarily attributable to an increase in transactional and license revenues. The increase in customer communication services was primarily attributable to an increase in transactional revenue as a result of our continued growth in the mobile communication market.

## Scores

|                               | Quarter Ended<br>June 30,<br>2018 |          | 2017           |  | Period-to-Period<br>Change | Period-to-Period<br>Percentage<br>Change |
|-------------------------------|-----------------------------------|----------|----------------|--|----------------------------|--|
|                               | (In thousands)                    |          | (In thousands) |  |                            |  |
| Transactional and maintenance | \$90,716                          | \$68,376 | \$ 22,340      |  | 33                         | %  |
| Professional services         | 505                               | 487      | 18             |  | 4                          | %  |
| License                       | 884                               | 651      | 233            |  | 36                         | %  |
| Total                         | \$92,105                          | \$69,514 | 22,591         |  | 32                         | %  |

Scores segment revenues increased \$22.6 million due to an increase of \$18.8 million in our business-to-business scores revenue and \$3.8 million in our business-to-consumer services revenue. The increase in business-to-business scores was primarily attributable to an increase in transactional scores in originations, primarily driven by a higher unit price in mortgage activities. The increase in business-to-consumer services was primarily attributable to an increase in royalties derived from scores sold indirectly to consumers through credit reporting agencies.

During the quarters ended June 30, 2018 and 2017, revenues generated from our agreements with Experian accounted for 12% and 9%, respectively, of our total revenues, and revenues generated from our agreements with Equifax and TransUnion together accounted for 15% and 12%, respectively, of our total revenues. Revenues from these customers included amounts recorded in our other segments.

## Decision Management Software

|                               | Quarter Ended<br>June 30,<br>2018 |          | 2017           |   | Period-to-Period<br>Change | Period-to-Period<br>Percentage<br>Change |
|-------------------------------|-----------------------------------|----------|----------------|---|----------------------------|--|
|                               | (In thousands)                    |          | (In thousands) |   |                            |  |
| Transactional and maintenance | \$11,177                          | \$10,876 | \$ 301         |   | 3                          | %  |
| Professional services         | 8,531                             | 7,394    | 1,137          |   | 15                         | %  |
| License                       | 6,074                             | 9,420    | (3,346         | ) | (36                        | )%                                       |
| Total                         | \$25,782                          | \$27,690 | (1,908         | ) | (7                         | )%                                       |

Decision Management Software segment revenues decreased \$1.9 million primarily attributable to a decrease in license revenue related to our FICO® Blaze Advisor® product.



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## Nine Months Ended June 30, 2018 Compared to Nine Months Ended June 30, 2017

## Applications

|                               | Nine Months Ended<br>June 30, |           | Period-to-Period<br>Change | Period-to-Period<br>Percentage<br>Change |   |
|-------------------------------|-------------------------------|-----------|----------------------------|--|---|
|                               | 2018                          | 2017      |                            |  |   |
|                               | (In thousands)                |           | (In thousands)             |  |   |
| Transactional and maintenance | \$284,441                     | \$258,337 | \$ 26,104                  | 10                                       | % |
| Professional services         | 107,542                       | 102,971   | 4,571                      | 4  | % |
| License                       | 37,743                        | 41,576    | (3,833)                    | (9)                                      | % |
| Total                         | \$429,726                     | \$402,884 | 26,842                     | 7  | % |

Applications segment revenues increased \$26.8 million primarily due to a \$13.0 million increase in our originations solutions, a \$9.2 million increase in our customer communications services, a \$4.5 million increase in our compliance solutions, and a \$3.4 million increase in our collections & recovery solutions, partially offset by a \$4.7 million decrease in our fraud solutions. The increase in originations solutions was primarily attributable to an increase in transactional and services revenues from our SaaS products. The increase in customer communication services was primarily attributable to an increase in transactional revenue as a result of our continued growth in the mobile communication market. The increase in compliance solutions was primarily attributable to an increase in license and maintenance revenues. The increase in collections & recovery solutions was primarily attributable to an increase in license revenue. The decrease in fraud solutions was primarily attributable to a decrease in license revenue, partially offset by an increase in transactional revenue.

## Scores

|                               | Nine Months Ended<br>June 30, |           | Period-to-Period<br>Change | Period-to-Period<br>Percentage<br>Change |   |
|-------------------------------|-------------------------------|-----------|----------------------------|--|---|
|                               | 2018                          | 2017      |                            |  |   |
|                               | (In thousands)                |           | (In thousands)             |  |   |
| Transactional and maintenance | \$245,934                     | \$190,256 | \$ 55,678                  | 29                                       | % |
| Professional services         | 1,465                         | 2,002     | (537)                      | (27)                                     | % |
| License                       | 2,531                         | 2,071     | 460                        | 22                                       | % |
| Total                         | \$249,930                     | \$194,329 | 55,601                     | 29                                       | % |

Scores segment revenues increased \$55.6 million due to an increase of \$43.1 million in our business-to-business scores revenue and \$12.5 million in our business-to-consumer services revenue. The increase in business-to-business scores was primarily attributable to a \$35.6 million increase in transactional scores in originations, primarily driven by a higher unit price in mortgage activities; as well as an \$8.9 million increase in transactional scores in account management and prescreen, driven by higher transactional volume. The increase in business-to-consumer services was primarily attributable to an increase in royalties derived from scores sold indirectly to consumers through credit reporting agencies.

During the nine months ended June 30, 2018 and 2017, revenues generated from our agreements with Experian accounted for 11% and 9%, respectively, of our total revenues, and revenues generated from our agreements with Equifax and TransUnion together accounted for 14% and 11%, respectively, of our total revenues. Revenues from these customers included amounts recorded in our other segments.

## Decision Management Software

|                               | Nine Months<br>Ended June 30, |          | Period-to-Period<br>Change | Period-to-Period<br>Percentage<br>Change |   |
|-------------------------------|-------------------------------|----------|----------------------------|--|---|
|                               | 2018                          | 2017     |                            |  |   |
|                               | (In thousands)                |          | (In thousands)             |  |   |
| Transactional and maintenance | \$34,973                      | \$33,011 | \$ 1,962                   | 6  | % |
| Professional services         | 22,906                        | 23,725   | (819)                      | (3)                                      | % |

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|         |          |          |        |   |     |    |
|---------|----------|----------|--------|---|-----|----|
| License | 15,149   | 25,015   | (9,866 | ) | (39 | )% |
| Total   | \$73,028 | \$81,751 | (8,723 | ) | (11 | )% |

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Decision Management Software segment revenues decreased \$8.7 million primarily attributable to a decrease in license revenue related to our FICO® Blaze Advisor®.

## Operating Expenses and Other Income / Expenses

The following tables set forth certain summary information related to our condensed consolidated statements of income and comprehensive income for the quarters and nine-month periods ended June 30, 2018 and 2017:

|                                       | Quarter Ended June 30,           |           | Percentage of Revenues |      |                                  |      | Period-to-Period Change | Period-to-Period Percentage Change |   |
|---------------------------------------|----------------------------------|-----------|------------------------|------|----------------------------------|------|-------------------------|------------------------------------|---|
|                                       | 2018                             | 2017      | 2018                   | 2017 | 2018                             | 2017 |                         |                                    |   |
|                                       | (In thousands, except employees) |           |                        |      | (In thousands, except employees) |      |                         |                                    |   |
| Revenues                              | \$259,505                        | \$230,986 | 100                    | %    | 100                              | %    | \$ 28,519               | 12                                 | % |
| Operating expenses:                   |                                  |           |                        |      |                                  |      |                         |                                    |   |
| Cost of revenues                      | 78,390                           | 69,793    | 30                     | %    | 30                               | %    | 8,597                   | 12                                 | % |
| Research and development              | 32,483                           | 27,839    | 12                     | %    | 12                               | %    | 4,644                   | 17                                 | % |
| Selling, general and administrative   | 98,685                           | 84,089    | 38                     | %    | 37                               | %    | 14,596                  | 17                                 | % |
| Amortization of intangible assets     | 1,571                            | 3,365     | 1                      | %    | 1                                | %    | (1,794)                 | (53)                               | % |
| Restructuring and acquisition-related | —                                | 4,471     | —                      | %    | 2                                | %    | (4,471)                 | (100)                              | % |
| Total operating expenses              | 211,129                          | 189,557   | 81                     | %    | 82                               | %    | 21,572                  | 11                                 | % |
| Operating income                      | 48,376                           | 41,429    | 19                     | %    | 18                               | %    | 6,947                   | 17                                 | % |
| Interest expense, net                 | (8,223)                          | (6,653)   | (4)                    | %    | (3)                              | %    | (1,570)                 | 24                                 | % |
| Other income, net                     | 1,588                            | 555       | 1                      | %    | —                                | %    | 1,033                   | 186                                | % |
| Income before income taxes            | 41,741                           | 35,331    | 16                     | %    | 15                               | %    | 6,410                   | 18                                 | % |
| Provision for income taxes            | 9,380                            | 10,104    | 4                      | %    | 4                                | %    | (724)                   | (7)                                | % |
| Net income                            | \$32,361                         | \$25,227  | 12                     | %    | 11                               | %    | 7,134                   | 28                                 | % |
| Number of employees at quarter end    | 3,546                            | 3,257     |                        |      |                                  |      | 289                     | 9                                  | % |

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|                                       | Nine Months Ended<br>June 30, |           | Percentage of Revenues |   |      |   | Period-to-Period<br>Change | Period-to-<br>Period<br>Percentage<br>Change |   |
|---------------------------------------|-------------------------------|-----------|------------------------|---|------|---|----------------------------|--|---|
|                                       | 2018                          | 2017      | 2018                   |   | 2017 |   |                            | (In thousands)                               |   |
|                                       | (In thousands)                |           |                        |   |      |   | (In thousands)             |  |   |
| Revenues                              | \$752,684                     | \$678,964 | 100                    | % | 100  | % | \$ 73,720                  | 11   | % |
| Operating expenses:                   |                               |           |                        |   |      |   |                            |  |   |
| Cost of revenues                      | 231,268                       | 211,921   | 31                     | % | 31   | % | 19,347                     | 9  | % |
| Research and development              | 93,976                        | 80,644    | 12                     | % | 12   | % | 13,332                     | 17   | % |
| Selling, general and administrative   | 286,038                       | 255,534   | 38                     | % | 38   | % | 30,504                     | 12   | % |
| Amortization of intangible assets     | 5,043                         | 9,997     | 1                      | % | 1    | % | (4,954)                    | (50)   | % |
| Restructuring and acquisition-related | —                             | 4,471     | —                      | % | 1    | % | (4,471)                    | (100)  | % |
| Total operating expenses              | 616,325                       | 562,567   | 82                     | % | 83   | % | 53,758                     | 10   | % |
| Operating income                      | 136,359                       | 116,397   | 18                     | % | 17   | % | 19,962                     | 17   | % |
| Interest expense, net                 | (21,799)                      | (19,403)  | (3)                    | % | (3)  | % | (2,396)                    | 12   | % |
| Other income, net                     | 1,940                         | 128       | —                      | % | —    | % | 1,812                      | 1,416  | % |
| Income before income taxes            | 116,500                       | 97,122    | 15                     | % | 14   | % | 19,378                     | 20   | % |
| Provision for income taxes            | 24,565                        | 8,910     | 3                      | % | 1    | % | 15,655                     | 176  | % |
| Net income                            | \$91,935                      | \$88,212  | 12                     | % | 13   | % | 3,723                      | 4  | % |

**Cost of Revenues**

Cost of revenues consists primarily of employee salaries and benefits for personnel directly involved in developing, installing and supporting revenue products; travel costs; overhead costs; outside services; internal network hosting costs; software royalty fees; and credit bureau data and processing services.

Cost of revenue expenses increased \$8.6 million to \$78.4 million during the quarter ended June 30, 2018 from \$69.8 million during the quarter ended June 30, 2017. The increase was primarily attributable to a \$3.3 million increase in facilities and infrastructure costs, driven by increased resource requirement due to expansion in our cloud infrastructure operations; a \$2.7 million increase in personnel and labor costs; and a \$2.0 million increase in direct materials cost. Cost of revenues as a percentage of revenues was 30% during the quarter ended June 30, 2018, consistent with that incurred during the quarter ended June 30, 2017.

Cost of revenues expenses increased \$19.3 million to \$231.3 million during the nine months ended June 30, 2018 from \$211.9 million during the nine months ended June 30, 2017. The increase was primarily attributable to a \$10.8 million increase in facilities and infrastructure costs and a \$5.5 million increase in personnel and labor costs. The increase in facilities and infrastructure costs was primarily attributable to increased resource requirement due to expansion in our cloud infrastructure operations. The increase in personnel and labor costs was primarily attributable to an increase in incentive cost and share-based compensation costs. Cost of revenues as a percentage of revenues was 31% during the nine months ended June 30, 2018, consistent with that incurred during the nine months ended June 30, 2017.

Over the next several quarters, we expect cost of revenues as a percentage of revenues will be consistent with that incurred during the quarter ended June 30, 2018.

**Research and Development**

Research and development expenses include personnel and related overhead costs incurred in the development of new products and services, including research of mathematical and statistical models and development of new versions of Applications and Decision Management Software products.



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Research and development expenses increased \$4.7 million to \$32.5 million during the quarter ended June 30, 2018 from \$27.8 million during the quarter ended June 30, 2017. The increase was primarily attributable to an increase in labor and personnel costs as a result of our continued investment in cloud computing and SaaS, as well as other new products. Research and development expenses as a percentage of revenues was 12% during the quarter ended June 30, 2018, consistent with that incurred during the quarter ended June 30, 2017.

Research and development expenses increased \$13.4 million to \$94.0 million during the nine months ended June 30, 2018 from \$80.6 million during the nine months ended June 30, 2017, primarily attributable to our continued investment in cloud computing and SaaS, as well as other new products. Research and development expenses as a percentage of revenues was 12% during the nine months ended June 30, 2018, consistent with that incurred during the nine months ended June 30, 2017.

Over the next several quarters, we expect research and development expenditures as a percentage of revenues will be consistent with that incurred during the quarter ended June 30, 2018.

**Selling, General and Administrative**

Selling, general and administrative expenses consist principally of employee salaries, commissions and benefits; travel costs; overhead costs; advertising and other promotional expenses; corporate facilities expenses; legal expenses; business development expenses and the cost of operating computer systems.

Selling, general and administrative expenses as a percentage of revenues increased to 38% during the quarter ended June 30, 2018 from 37% during the quarter ended June 30, 2017. The \$14.6 million increase was primarily attributable to a \$9.6 million increase in personnel and labor costs as a result of increased headcount, higher share-based compensation and incentive costs; as well as a \$6.3 million increase in marketing and travel costs, primarily driven by a company-wide marketing event during the quarter ended June 30, 2018.

Selling, general and administrative expenses increased \$30.5 million to \$286.0 million during the nine months ended June 30, 2018 from \$255.5 million during the nine months ended June 30, 2017, primarily attributable to an increase in personnel and labor costs as a result of increased headcount, higher share-based compensation and incentive costs. Selling, general and administrative expenses as a percentage of revenues was 38% during the nine months ended June 30, 2018, consistent with that incurred during the nine months ended June 30, 2017.

Over the next several quarters, we expect selling, general and administrative expenses as a percentage of revenues will be consistent with that incurred during the quarter ended June 30, 2018.

**Amortization of Intangible Assets**

Amortization of intangible assets consists of amortization expense related to intangible assets recorded in connection with acquisitions accounted for by the acquisition method of accounting. Our finite-lived intangible assets, consisting primarily of completed technology and customer contracts and relationships, are being amortized using the straight-line method over periods ranging from four to fifteen years.

The quarter over quarter decrease in amortization expense of \$1.8 million was primarily attributable to certain intangible assets associated with our HNC and Adepra acquisitions becoming fully amortized in August and September 2017, respectively.

The year-to-date period over period decrease in amortization expense of \$5.0 million was primarily attributable to certain intangible assets associated with our HNC and Adepra acquisitions becoming fully amortized in August and September 2017, respectively.

Over the next several quarters, we expect that amortization expense will be consistent with the amortization expense we recorded during the quarter ended June 30, 2018.

**Restructuring and Acquisition-related**

There were no restructuring or acquisition-related expenses during the quarter and nine months ended June 30, 2018.

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During both the quarter and nine months ended June 30, 2017, we incurred net charges totaling \$4.5 million consisting of \$1.7 million in facilities charges associated with vacating excess leased space in San Rafael and \$2.8 million in employee separation costs due to the elimination of 79 positions throughout the Company. Cash payment for all the facilities charges will be paid by the end of our fiscal 2020. Cash payment for all the employee separation costs were paid before the end of the second quarter of fiscal 2018.

**Interest Expense, Net**

Interest expense includes primarily interest on the senior notes issued in May 2008, July 2010 and May 2018, as well as interest and credit facility fees on the revolving line of credit. Our consolidated statements of income and comprehensive income include interest expense netted with interest income, which is derived primarily from the investment of funds in excess of our immediate operating requirements.

The quarter over quarter increase in interest expense of \$1.6 million was primarily attributable to a higher average outstanding debt balance during the quarter ended June 30, 2018, as well as a higher average interest rate on our 2018 Senior Notes compared to that on our revolving line of credit.

The year-to-date period over period increase in interest expense of \$2.4 million was primarily attributable to a higher average outstanding debt balance during the nine months ended June 30, 2018, as well as a higher average interest rate on our 2018 Senior Notes compared to that on our revolving line of credit.

Over the next several quarters, we expect net interest expense will be higher than the net interest expense incurred during the quarter ended June 30, 2018.

**Other Income (Expense), Net**

Other income (expense), net consists primarily of realized investment gains/losses, exchange rate gains/losses resulting from remeasurement of foreign-currency-denominated receivable and cash balances into their respective functional currencies at period-end market rates, net of the impact of offsetting foreign currency forward contracts and other non-operating items.

**Provision for Income Taxes**

The effective income tax rate was 22.5% and 28.6% during the quarters ended June 30, 2018 and 2017, respectively, and 21.1% and 9.2% during the nine months ended June 30, 2018 and 2017, respectively. The provision for income taxes during interim quarterly reporting periods is based on our estimates of the effective tax rates for the full fiscal year. The effective tax rate in any quarter can also be affected positively or negatively by adjustments that are required to be reported in the specific quarter of resolution. The effective tax rate for the nine months ended June 30, 2018 was significantly impacted by recording the impact of the Tax Cuts and Jobs Act (the "Tax Act"), enacted on December 22, 2017 by the U.S. government. Among other provisions, the Tax Act reduces the federal corporate tax rate to 21% from the existing maximum rate of 35%, effective January 1, 2018, and imposes a deemed repatriation tax on previously untaxed accumulated earnings and profits of foreign subsidiaries. We remeasured our deferred tax assets using a blended rate of 24.5% — by applying a pro-rated percentage of the number of days before and after the January 1, 2018 effective date — and recorded provisional charges for the remeasurement of the deferred tax assets of \$5.6 million to our income tax expense related to long-term deferred tax assets and \$4.4 million related to short-term deferred tax assets during the nine months ended June 30, 2018. We also recorded a provisional charge of \$4.9 million to our income tax expense for the deemed repatriation transition tax. While we are able to make reasonable estimates of the impact of the reduction in corporate rate and the deemed repatriation transition tax, the final impact of the Tax Act may differ from these estimates, due to, among other things, changes in our interpretations and assumptions, additional guidance that may be issued by the I.R.S., and actions we may take. We are continuing to gather additional information to determine the final impact.

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## Operating Income

The following tables set forth certain summary information on a segment basis related to our operating income for the quarters and nine-month periods ended June 30, 2018 and 2017:

| Segment   | Quarter Ended June 30, |           | Period-to-Period Change | Period-to-Period Percentage Change |   |
|---|------------------------|-----------|-------------------------|------------------------------------|---|
|   | 2018                   | 2017      |                         |                                    |   |
|   | (In thousands)         |           | (In thousands)          |                                    |   |
| Applications                                      | \$34,390               | \$38,425  | \$ (4,035 )             | (11 )                              | % |
| Scores  | 75,731                 | 55,501    | 20,230                  | 36                                 | % |
| Decision Management Software                      | (9,369 )               | (3,622 )  | (5,747 )                | 159                                | % |
| Corporate expenses                                | (31,922 )              | (26,724 ) | (5,198 )                | 19                                 | % |
| Total segment operating income                    | 68,830                 | 63,580    | 5,250                   | 8                                  | % |
| Unallocated share-based compensation              | (18,883 )              | (14,315 ) | (4,568 )                | 32                                 | % |
| Unallocated amortization expense                  | (1,571 )               | (3,365 )  | 1,794                   | (53 )                              | % |
| Unallocated restructuring and acquisition-related | —                      | (4,471 )  | 4,471                   | (100 )                             | % |
| Operating income                                  | \$48,376               | \$41,429  | 6,947                   | 17                                 | % |

| Segment   | Nine Months Ended June 30, |           | Period-to-Period Change | Period-to-Period Percentage Change |   |
|---|----------------------------|-----------|-------------------------|------------------------------------|---|
|   | 2018                       | 2017      |                         |                                    |   |
|   | (In thousands)             |           | (In thousands)          |                                    |   |
| Applications                                      | \$112,840                  | \$108,276 | \$ 4,564                | 4                                  | % |
| Scores  | 201,257                    | 152,513   | 48,744                  | 32                                 | % |
| Decision Management Software                      | (25,889 )                  | (9,798 )  | (16,091 )               | 164                                | % |
| Corporate expenses                                | (92,175 )                  | (76,580 ) | (15,595 )               | 20                                 | % |
| Total segment operating income                    | 196,033                    | 174,411   | 21,622                  | 12                                 | % |
| Unallocated share-based compensation              | (54,631 )                  | (43,546 ) | (11,085 )               | 25                                 | % |
| Unallocated amortization expense                  | (5,043 )                   | (9,997 )  | 4,954                   | (50 )                              | % |
| Unallocated restructuring and acquisition-related | —                          | (4,471 )  | 4,471                   | (100 )                             | % |
| Operating income                                  | \$136,359                  | \$116,397 | 19,962                  | 17                                 | % |

| Applications              | Quarter Ended June 30, |           | Percentage of Revenues |        | Nine Months Ended June 30, |            | Percentage of Revenues |        |
|---------------------------|------------------------|-----------|------------------------|--------|----------------------------|------------|------------------------|--------|
|                           | 2018                   | 2017      | 2018                   | 2017   | 2018                       | 2017       | 2018                   | 2017   |
|                           | (In thousands)         |           |                        |        | (In thousands)             |            |                        |        |
| Segment revenues          | \$141,618              | \$133,782 | 100 %                  | 100 %  | \$429,726                  | \$402,884  | 100 %                  | 100 %  |
| Segment operating expense | (107,228 )             | (95,357 ) | (76 )%                 | (71 )% | (316,886 )                 | (294,608 ) | (74 )%                 | (73 )% |
| Segment operating income  | \$34,390               | \$38,425  | 24 %                   | 29 %   | \$112,840                  | \$108,276  | 26 %                   | 27 %   |

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## Scores

|                           | Quarter Ended  |           | Percentage of |        | Nine Months Ended |           | Percentage of |        |
|---------------------------|----------------|-----------|---------------|--------|-------------------|-----------|---------------|--------|
|                           | June 30,       |           | Revenues      |        | June 30,          |           | Revenues      |        |
|                           | 2018           | 2017      | 2018          | 2017   | 2018              | 2017      | 2018          | 2017   |
|                           | (In thousands) |           |               |        | (In thousands)    |           |               |        |
| Segment revenues          | \$92,105       | \$69,514  | 100 %         | 100 %  | \$249,930         | \$194,329 | 100 %         | 100 %  |
| Segment operating expense | (16,374 )      | (14,013 ) | (18 )%        | (20 )% | (48,673 )         | (41,816 ) | (19 )%        | (22 )% |
| Segment operating income  | \$75,731       | \$55,501  | 82 %          | 80 %   | \$201,257         | \$152,513 | 81 %          | 78 %   |

## Decision Management Software

|                           | Quarter Ended  |            | Percentage of |        | Nine Months Ended |            | Percentage of |        |
|---------------------------|----------------|------------|---------------|--------|-------------------|------------|---------------|--------|
|                           | June 30,       |            | Revenues      |        | June 30,          |            | Revenues      |        |
|                           | 2018           | 2017       | 2018          | 2017   | 2018              | 2017       | 2018          | 2017   |
|                           | (In thousands) |            |               |        | (In thousands)    |            |               |        |
| Segment revenues          | \$25,782       | \$27,690   | 100 %         | 100 %  | \$73,028          | \$81,751   | 100 %         | 100 %  |
| Segment operating expense | (35,151 )      | (31,312 )  | (136)%        | (113)% | (98,917 )         | (91,549 )  | (135)%        | (112)% |
| Segment operating loss    | \$(9,369 )     | \$(3,622 ) | (36 )%        | (13 )% | \$(25,889 )       | \$(9,798 ) | (35 )%        | (12 )% |

The quarter over quarter \$6.9 million increase in operating income was attributable to a \$28.6 million increase in segment revenues, a \$4.5 million decrease in restructuring and acquisition-related cost and a \$1.7 million decrease in amortization cost, partially offset by an \$18.1 million increase in segment operating expenses, a \$5.2 million increase in corporate expenses and a \$4.6 million increase in share-based compensation cost.

At the segment level, the quarter over quarter \$5.3 million increase in segment operating income was the result of a \$20.2 million increase in our Scores segment operating income, partially offset by a \$5.7 million increase in our Decision Management Software segment operating loss, a \$5.2 million increase in corporate expense and a \$4.0 million decrease in our Applications segment operating income.

The quarter over quarter \$4.0 million decrease in Applications segment operating income was due to an \$11.9 million increase in segment operating expenses, partially offset by a \$7.9 million increase in segment revenue. Segment operating income as a percentage of segment revenue for Applications decreased to 24% from 29% mainly due to an increase in personnel cost and an increase in facilities and infrastructure cost, both driven by increased resource requirement due to expansion in our cloud infrastructure operations, which was partially offset by an increase in sales of our higher-margin software products.

The quarter over quarter \$20.2 million increase in Scores segment operating income was due to a \$22.6 million increase in segment revenue, partially offset by a \$2.4 million increase in segment operating expenses. Segment operating income as a percentage of segment revenue for Scores increased to 82% from 80% mainly due to an increase in sales of our higher-margin score products.

The quarter over quarter \$5.7 million increase in Decision Management Software segment operating loss was due to a \$3.8 million increase in segment operating expenses and a \$1.9 million decrease in segment revenue. Segment operating margin for Decision Management Software decreased to a negative 36% from a negative 13% primarily due to a decrease in sales of our higher-margin software products, as well as our continued investment in cloud infrastructure operations and new products.

The year-to-date period over period increase of \$20.0 million in operating income was attributable to a \$73.7 million increase in segment revenues, a \$5.0 million decrease in amortization cost and a \$4.5 million decrease in restructuring and acquisition-related cost, partially offset by a \$36.5 million increase in segment operating expenses, a \$15.6 million increase in corporate expenses and an \$11.1 million increase in share-based compensation cost.

At the segment level, the year-to-date period over period increase of \$21.6 million in segment operating income was the result of a \$48.7 million increase in our Scores segment operating income and a \$4.6 million increase in our Applications segment operating income, partially offset by a \$16.1 million increase in our Decision Management

Software segment operating loss and a \$15.6 million increase in corporate expenses.

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The year-to-date period over period \$4.6 million increase in Applications segment operating income was due to a \$26.8 million increase in segment revenue, partially offset by a \$22.2 million increase in segment operating expenses. Segment operating income as a percentage of segment revenue for Applications was 26%, materially consistent with the nine months ended June 30, 2017.

The year-to-date period over period \$48.7 million increase in Scores segment operating income was attributable to a \$55.6 million increase in segment revenue, partially offset by a \$6.9 million increase in segment operating expenses. Segment operating income as a percentage of segment revenue for Scores increased to 81% from 78%, mainly due to an increase in sales of our higher-margin score products.

The year-to-date period over period \$16.1 million increase in Decision Management Software segment operating loss was attributable to an \$8.7 million decrease in segment revenue and a \$7.4 million increase in segment operating expenses. Segment operating loss as a percentage of segment revenue for Decision Management Software decreased to a negative 35% from a negative 12% primarily due to a decrease in sales of our higher-margin software products, as well as our continued investment in cloud infrastructure operations and new products.

**CAPITAL RESOURCES AND LIQUIDITY****Outlook**

As of June 30, 2018, we had \$119.9 million in cash and cash equivalents, which included \$96.6 million held off-shore by our foreign subsidiaries. We believe these balances, as well as available borrowings from our \$400 million revolving line of credit and anticipated cash flows from operating activities, will be sufficient to fund our working and other capital requirements. Under our current financing arrangements, we have no other significant debt obligations maturing over the next twelve months. Additionally, though we do not anticipate the need to repatriate any undistributed earnings from our foreign subsidiaries for the foreseeable future, we may take advantage of opportunities where we are able to repatriate these earnings to the U.S. without material incremental tax provision. In the normal course of business, we evaluate the merits of acquiring technology or businesses, or establishing strategic relationships with or investing in these businesses. We may elect to use available cash and cash equivalents to fund such activities in the future. In the event additional needs for cash arise, or if we refinance our existing debt, we may raise additional funds from a combination of sources, including the potential issuance of debt or equity securities. Additional financing might not be available on terms favorable to us, or at all. If adequate funds were not available or were not available on acceptable terms, our ability to take advantage of unanticipated opportunities or respond to competitive pressures could be limited.

**Summary of Cash Flows**

|   | Nine Months Ended |            | Period-to-Period |
|---|-------------------|------------|------------------|
|   | June 30,          | June 30,   | Change           |
|   | 2018              | 2017       |                  |
|   | (In thousands)    |            |                  |
| Cash provided by (used in):             |                   |            |                  |
| Operating activities                    | \$163,089         | \$171,423  | \$ (8,334 )      |
| Investing activities                    | (26,724 )         | (15,569 )  | (11,155 )        |
| Financing activities                    | (117,789 )        | (102,791 ) | (14,998 )        |
| Effect of exchange rate changes on cash | (4,265 )          | 1,678      | (5,943 )         |
| Increase in cash and cash equivalents   | \$14,311          | \$54,741   | (40,430 )        |

**Cash Flows from Operating Activities**

Our primary method for funding operations and growth has been through cash flows generated from operating activities. Net cash provided by operating activities decreased to \$163.1 million during the nine months ended June 30, 2018 from \$171.4 million during the nine months ended June 30, 2017. The \$8.3 million decrease was mainly attributable to a \$23.3 million decrease that resulted from timing of receipts and payments in our ordinary course of business, partially offset by an \$11.1 million increase in non-cash share based compensation expense and a \$3.7 million increase in net income.



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Cash Flows from Investing Activities

Net cash used in investing activities increased to \$26.7 million for the nine months ended June 30, 2018 from \$15.6 million for the nine months ended June 30, 2017. The \$11.1 million increase was mainly attributable to a \$9.4 million increase in purchases of property and equipment as well as a \$2.5 million increase in purchases, net of proceeds from sale, of marketable securities.

Cash Flows from Financing Activities

Net cash used in financing activities increased to \$117.8 million for the nine months ended June 30, 2018 from \$102.8 million for the nine months ended June 30, 2017. The \$15.0 million increase was primarily attributable to a \$150.0 million increase in payments, net of proceeds, on our revolving line of credit, a \$113.2 million increase in repurchases of common stock, and a \$10.6 million decrease in proceeds from issuance of treasury stock under employee stock plans, partially offset by a \$269.0 million increase in proceeds, net of payments, from our senior notes.

Repurchases of Common Stock

In July 2016, our Board of Directors approved a stock repurchase program following the completion of our previous program. This program was open-ended and authorized repurchases of shares of our common stock up to an aggregate cost of \$250.0 million in the open market or in negotiated transactions. In October 2017, our Board of Directors approved another stock repurchase program following the completion of the July 2016 program. This program is open-ended and authorizes repurchases of shares of our common stock up to an aggregate cost of \$250.0 million in the open market or in negotiated transactions.

Pursuant to the October 2017 program, we repurchased 563,196 shares of our common stock at a total repurchase price of \$106.9 million during the quarter ended June 30, 2018, and pursuant to the July 2016 and October 2017 programs, we repurchased 1,359,117 shares of our common stock at a total repurchase price of \$231.5 million during the nine months ended June 30, 2018. We had \$55.1 million remaining under the October 2017 authorization as of June 30, 2018.

In July 2018, our Board of Directors approved a new stock repurchase program following the completion of the October 2017 program. The new program is open-ended and authorizes repurchases of shares of our common stock up to an aggregate cost of \$250.0 million in the open market or in negotiated transactions.

Revolving Line of Credit

We have a \$400 million unsecured revolving line of credit with a syndicate of banks that expires on May 8, 2023. Proceeds from the credit facility can be used for working capital and general corporate purposes and may also be used for the refinancing of existing debt, acquisitions, and the repurchase of our common stock. Interest on amounts borrowed under the credit facility is based on (i) a base rate, which is the greater of (a) the prime rate, (b) the Federal Funds rate plus 0.500% and (c) the one-month LIBOR rate plus 1.000%, plus, in each case, an applicable margin, or (ii) an adjusted LIBOR rate plus an applicable margin. The applicable margin for base rate borrowings ranges from 0% to 0.875% and for LIBOR borrowings ranges from 1.000% to 1.875%, and is determined based on our consolidated leverage ratio. In addition, we must pay credit facility fees. The credit facility contains certain restrictive covenants including: maintaining a maximum consolidated leverage ratio of 3.25, subject to a step up to 3.75 following certain permitted acquisitions; and a minimum fixed charge ratio of 2.5 through the maturity of our 2010 Senior Notes in July 2020, upon which maintaining a minimum interest coverage ratio of 3.00. The credit agreement also contains other covenants typical of unsecured facilities. As of June 30, 2018, we had \$252.0 million in borrowings outstanding at a weighted average interest rate of 3.201% and were in compliance with all financial covenants under this credit facility.



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## Senior Notes

On May 7, 2008, we issued \$275 million of senior notes in a private placement to a group of institutional investors (the “2008 Senior Notes”). On July 14, 2010, we issued \$245 million of senior notes in a private placement to a group of institutional investors (the “2010 Senior Notes”). The 2010 Senior Notes were issued in four series with maturities ranging from 6 to 10 years. The outstanding 2010 Senior Notes’ weighted average interest rate is 5.6% and the weighted average maturity is 9.8 years. The 2010 Senior Notes require interest payments semi-annually and contain certain restrictive covenants, including the maintenance of a maximum consolidated net debt to consolidated EBITDA ratio of 3.00 and a minimum fixed charge coverage ratio of 2.50. On May 8, 2018, we issued \$400 million of senior notes in a private offering to qualified institutional investors (the “2018 Senior Notes”, and with the 2008 Senior Notes and the 2010 Senior Notes, the “Senior Notes”). The 2018 Senior Notes require interest payments semi-annually at a rate of 5.25% per annum and will mature on May 15, 2026. The purchase agreements for the 2008 and 2010 Senior Notes and the indenture for the 2018 Senior Notes contain certain covenants typical of unsecured obligations. As of June 30, 2018, the carrying value of the Senior Notes was \$506.7 million and we were in compliance with all financial covenants under these obligations.

## Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We prepare our consolidated financial statements in conformity with U.S. generally accepted accounting principles. These accounting principles require management to make certain judgments and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We periodically evaluate our estimates including those relating to revenue recognition, goodwill and other intangible assets resulting from business acquisitions, share-based compensation, income taxes and contingencies and litigation. We base our estimates on historical experience and various other assumptions that we believe to be reasonable based on the specific circumstances, the results of which form the basis for making judgments about the carrying value of certain assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements:

## Revenue Recognition

## Software Licenses

Software license fee revenue is recognized when persuasive evidence of an arrangement exists, software is made available to our customers, the fee is fixed or determinable and collection is probable. The determination of whether fees are fixed or determinable and collection is probable involves the use of assumptions. If at the outset of an arrangement we determine that the arrangement fee is not fixed or determinable, revenue is deferred until the arrangement fee becomes fixed or determinable, assuming all other revenue recognition criteria have been met. If at the outset of an arrangement we determine that collectability is not probable, revenue is deferred until the earlier of when collectability becomes probable or the receipt of payment. If there is uncertainty as to the customer’s acceptance of our deliverables, revenue is not recognized until the earlier of receipt of customer acceptance, expiration of the acceptance period, or when we can demonstrate we meet the acceptance criteria. We evaluate contract terms and customer information to ensure that these criteria are met prior to our recognition of license fee revenue.

We use the residual method to recognize revenue when a software arrangement includes one or more elements to be delivered at a future date provided the following criteria are met: (i) vendor-specific objective evidence (“VSOE”) of the fair value does not exist for one or more of the delivered items but exists for all undelivered elements, (ii) all other applicable revenue recognition criteria are met and (iii) the fair value of all of the undelivered elements is less than the arrangement fee. VSOE of fair value is based on the normal pricing practices for those products and services when sold separately by us and customer renewal rates for post-contract customer support services. Under the residual

method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. If evidence of the fair value of one or more undelivered elements does not exist, the revenue is deferred and recognized when delivery of those elements occurs or when fair value can be established. Changes to the elements in a software arrangement, the ability to identify VSOE for those elements, the fair value of the respective elements, and change to a product's estimated life cycle could materially impact the amount of earned and unearned revenue.

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Revenues from post-contract customer support services, such as software maintenance, are recognized on a straight-line basis over the term of the support period. The majority of our software maintenance agreements provide technical support as well as unspecified software product upgrades and releases when and if made available by us during the term of the support period.

### Transactional-Based Revenues

Transactional-based revenue is recognized when persuasive evidence of an arrangement exists, fees are fixed or determinable, and collection is probable. Revenues from our credit scoring, data processing, data management and SaaS subscription services are recognized as these services are performed. Revenues from transactional or unit-based license fees under software license arrangements, credit scoring, data processing, data management and SaaS subscription services agreements are recognized based on minimum contractual amounts or on system usage that exceeds minimum contractual amounts. Certain of our transactional-based revenues are based on transaction or active account volumes as reported by our clients. In instances where volumes are reported to us in arrears, we estimate volumes based on preliminary customer transaction information or average actual reported volumes for an immediate trailing period. Differences between our estimates and actual final volumes reported are recorded in the period in which actual volumes are reported. We have not experienced significant variances between our estimates and actual reported volumes in the past and anticipate that we will be able to continue to make reasonable estimates in the future. If for some reason we were unable to reasonably estimate transaction volumes in the future, revenue may be deferred until actual customer data is received, and this could have a material impact on our consolidated results of operations.

### Consulting Services

We provide consulting, training, model development and software integration services under both hourly-based time and materials and fixed-priced contracts. Revenues from these services are generally recognized as the services are performed. For fixed-price service contracts, we use a proportionate performance model with hours as the input method of attribution to determine progress towards completion, with consideration also given to output measures, such as contract milestones, when applicable. In such instances, management is required to estimate the total estimated hours of the project. Adjustments to estimates are made in the period in which the facts requiring such revisions become known and, accordingly, recognized revenues and profits are subject to revisions as the contract progresses to completion. Estimated losses, if any, are recorded in the period in which current estimates of total contract revenue and contract costs indicate a loss. If substantive uncertainty related to customer acceptance of services exists, we defer the associated revenue until the contract is completed. We have not experienced significant variances between our estimates and actual hours in the past and anticipate that we will be able to continue to make reasonable estimates in the future. If for some reason we are unable to accurately estimate the input measures, revenue would be deferred until the contract is complete, and this could have a material impact on our consolidated results of operations.

Services that are sold in connection with software license arrangements generally qualify for separate accounting from the license element because they do not involve significant production, modification or customization of our products and are not otherwise considered to be essential to the functionality of our software. In arrangements where the professional services do not qualify for separate accounting from the license element, the combined software license and professional services revenue are recognized based on contract accounting using either the percentage-of-completion or completed-contract method.

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## Multiple-Deliverable Arrangements including Non-Software

When we enter into a multiple-deliverable arrangement that includes non-software, each deliverable is accounted for as a separate unit of accounting if the following criteria are met: (i) the delivered item or items have value to the customer on a standalone basis and (ii) for an arrangement that includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in our control. We consider a deliverable to have standalone value if we sell this item separately or if the item is sold by another vendor or could be resold by the customer; for example, we conclude professional services offered along with our SaaS subscription services typically have standalone value using this criteria. Further, our revenue arrangements generally do not include a general right of return relative to delivered products. Revenue for multiple element arrangements is allocated to the software and non-software deliverables based on a relative selling price. We use VSOE in our allocation of arrangement consideration when it is available. We define VSOE as a median price of recent standalone transactions that are priced within a narrow range, as defined by us. If a product or service is seldom sold separately, it is unlikely that we can determine VSOE. In circumstances when VSOE does not exist, we then assess whether we can obtain third-party evidence (“TPE”) of the selling price. It may be difficult for us to obtain sufficient information on competitor pricing to substantiate TPE and therefore we may not always be able to use TPE. When we are unable to establish selling price using VSOE or TPE, we use estimated selling price (“ESP”) in our allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact if the product or service were sold by us on a standalone basis. Our determination of ESP involves weighting several factors based on the specific facts and circumstances of each arrangement. The factors include, but are not limited to, geographies, market conditions, gross margin objectives, pricing practices and controls, customer segment pricing strategies and the product lifecycle. Historically, there have been no significant changes in our ESP used in allocation of arrangement consideration. We do not believe there is a reasonable likelihood there will be a material change in the future estimates.

If a deliverable does not have standalone value because the aforementioned criteria are not met, we combine it with the other applicable undelivered item(s) within the arrangement and account for the multiple deliverables as one combined unit of accounting. For example, for hosting arrangements requiring a highly specialized and unique set of initial implementation and setup services prior to the commencement of hosting services, we typically conclude that these implementation or setup services do not have value to the customer on a stand-alone basis; therefore, we combine them with the hosting services as a combined unit of accounting. Revenue is recognized upon commencement of our hosting services over the expected life of the customer relationship.

## Gross vs. Net Revenue Reporting

We apply accounting guidance to determine whether we report revenue for certain transactions based upon the gross amount billed to the customer, or the net amount retained by us. In accordance with the guidance we record revenue on a gross basis for sales in which we have acted as the principal and on a net basis for those sales in which we have in substance acted as an agent or broker in the transaction.

## Business Combinations

Accounting for our acquisitions requires us to recognize, separately from goodwill, the assets acquired and the liabilities assumed at their acquisition-date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition-date fair values of the assets acquired and the liabilities assumed. While we use our best estimates and assumptions to accurately value assets acquired and liabilities assumed at the acquisition date, our estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we record adjustments to the assets acquired and liabilities assumed with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to our consolidated statements of income and comprehensive income.

Accounting for business combinations requires our management to make significant estimates and assumptions, especially at the acquisition date, including our estimates for intangible assets, contractual obligations assumed, pre-acquisition contingencies and contingent consideration, where applicable. If we cannot reasonably determine the fair value of a pre-acquisition contingency (non-income tax related) by the end of the measurement period, we will

recognize an asset or a liability for such pre-acquisition contingency if: (i) it is probable that an asset existed or a liability had been incurred at the acquisition date and (ii) the amount of the asset or liability can be reasonably estimated. Although we believe the assumptions and estimates we have made in the past have been reasonable and appropriate, they are based in part on historical experience and information obtained from the management of the acquired companies and are inherently uncertain. Subsequent to the measurement period, changes in our estimates of such contingencies will affect earnings and could have a material effect on our consolidated results of operations and financial position.

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Examples of critical estimates in valuing certain of the intangible assets we have acquired include but are not limited to: (i) future expected cash flows from software license sales, support agreements, consulting contracts, other customer contracts and acquired developed technologies and patents; (ii) expected costs to develop the in-process research and development into commercially viable products and estimated cash flows from the projects when completed; and (iii) the acquired company's brand and competitive position, as well as assumptions about the period of time the acquired brand will continue to be used in the combined company's product portfolio. Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates or actual results. Historically, there have been no significant changes in our estimates or assumptions. To the extent a significant acquisition is made during a fiscal year, as appropriate we will expand the discussion to include specific assumptions and inputs used to determine the fair value of our acquired intangible assets.

In addition, uncertain tax positions and tax-related valuation allowances assumed in connection with a business combination are initially estimated as of the acquisition date. We reevaluate these items quarterly based upon facts and circumstances that existed as of the acquisition date with any adjustments to our preliminary estimates being recorded to goodwill provided that we are within the measurement period. Subsequent to the measurement period or our final determination of the tax allowance's or contingency's estimated value, whichever comes first, changes to these uncertain tax positions and tax-related valuation allowances will affect our provision for income taxes in our consolidated statements of income and comprehensive income and could have a material impact on our consolidated results of operations and financial position. Historically, there have been no significant changes in our valuation allowances or uncertain tax positions as it relates to business combinations. We do not believe there is a reasonable likelihood there will be a material change in the future estimates.

#### Goodwill, Acquisition Intangibles and Other Long-Lived Assets - Impairment Assessment

Goodwill represents the excess of cost over the fair value of identifiable assets acquired and liabilities assumed in business combinations. We assess goodwill for impairment for each of our reporting units on an annual basis during the fourth quarter using a July 1 measurement date unless circumstances require a more frequent measurement. We have determined that our reporting units are the same as our reportable segments. When evaluating goodwill for impairment, we may first perform an assessment qualitatively whether it is more likely than not that a reporting unit's carrying amount exceeds its fair value, referred to as a "step zero" approach. If, based on the review of the qualitative factors, we determine it is not more likely than not that the fair value of a reporting unit is less than its carrying value, we would bypass the two-step impairment test. Events and circumstances we consider in performing the "step zero" qualitative assessment include macro-economic conditions, market and industry conditions, internal cost factors, share price fluctuations, and the operational stability and the overall financial performance of the reporting units. If we conclude that it is more likely than not that a reporting unit's fair value is less than its carrying amount, we would perform the first step ("step one") of the two-step impairment test and calculate the estimated fair value of the reporting unit by using discounted cash flow valuation models and by comparing our reporting units to guideline publicly-traded companies. These methods require estimates of our future revenues, profits, capital expenditures, working capital, and other relevant factors, as well as selecting appropriate guideline publicly-traded companies for each reporting unit. We estimate these amounts by evaluating historical trends, current budgets, operating plans, industry data, and other relevant factors. Using assumptions that are different from those used in our estimates, but in each case reasonable, could produce significantly different results and materially affect the determination of fair value and/or goodwill impairment for each reporting unit. For example, if the economic environment impacts our forecasts beyond what we have anticipated, it could cause the fair value of a reporting unit to fall below its respective carrying value.

For fiscal 2017, we elected to proceed directly to the step one quantitative analysis for all of our reporting units, as three years had elapsed since the date of our previous quantitative valuation. There was a substantial excess of fair value over carrying value for each of our reporting units and we determined goodwill was not impaired for any of our reporting units for fiscal 2017.

Our intangible assets that have finite useful lives and other long-lived assets are assessed for potential impairment when there is evidence that events and circumstances related to our financial performance and economic environment indicate the carrying amount of the assets may not be recoverable. When impairment indicators are identified, we test

for impairment using undiscounted cash flows. If such tests indicate impairment, then we measure and record the impairment as the difference between the carrying value of the asset and the fair value of the asset. Significant management judgment is required in forecasting future operating results used in the preparation of the projected cash flows. Should different conditions prevail, material write downs of our intangible assets or other long-lived assets could occur. We review the estimated remaining useful lives of our acquired intangible assets at each reporting period. A reduction in our estimate of remaining useful lives, if any, could result in increased annual amortization expense in future periods.

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As discussed above, while we believe that the assumptions and estimates utilized were appropriate based on the information available to management, different assumptions, judgments and estimates could materially affect our impairment assessments for our goodwill, acquired intangibles with finite lives and other long-lived assets. Historically, there have been no significant changes in our estimates or assumptions that would have had a material impact for our goodwill or intangible assets impairment assessment. We believe our projected operating results and cash flows would need to be significantly less favorable to have a material impact on our impairment assessment. However, based upon our historical experience with operations, we do not believe there is a reasonable likelihood of a significant change in our projections.

### Share-Based Compensation

We measure stock-based compensation cost at the grant date based on the fair value of the award and recognize it as expense, net of estimated forfeitures, over the vesting or service period, as applicable, of the stock award (generally three to four years). We use the Black-Scholes valuation model to determine the fair value of our stock options and the Monte Carlo valuation model to determine the fair value of our market share units. Our valuation models and generally accepted valuation techniques require us to make assumptions and to apply judgment to determine the fair value of our awards. These assumptions and judgments include estimating the volatility of our stock price, expected dividend yield, employee turnover rates and employee stock option exercise behaviors. Historically, there have been no material changes in our estimates or assumptions. We do not believe there is a reasonable likelihood there will be a material change in the future estimates or assumptions.

### Income Taxes

We estimate our income taxes based on the various jurisdictions where we conduct business, which involves significant judgment in determining our income tax provision. We estimate our current tax liability using currently enacted tax rates and laws and assess temporary differences that result from differing treatments of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities recorded on our consolidated balance sheets using the currently enacted tax rates and laws that will apply to taxable income for the years in which those tax assets are expected to be realized or settled. We then assess the likelihood our deferred tax assets will be realized and to the extent we believe realization is not more likely than not, we establish a valuation allowance. When we establish a valuation allowance or increase this allowance in an accounting period, we record a corresponding income tax expense in our consolidated statements of income and comprehensive income. In assessing the need for the valuation allowance, we consider future taxable income in the jurisdictions we operate, our ability to carry back tax attributes to prior years, an analysis of our deferred tax assets and the periods over which they will be realizable, and ongoing prudent and feasible tax planning strategies. An increase in the valuation allowance would have an adverse impact, which could be material, on our income tax provision and net income in the period in which we record the increase. We have historically had minimal changes in our valuation allowances related to deferred tax assets.

We recognize and measure benefits for uncertain tax positions using a two-step approach. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the technical merits of the tax position indicate it is more likely than not that the tax position will be sustained upon audit, including resolution of any related appeals or litigation processes. For tax positions more likely than not of being sustained upon audit, the second step is to measure the tax benefit as the largest amount more than 50% likely of being realized upon settlement. Significant judgment is required to evaluate uncertain tax positions and they are evaluated on a quarterly basis. Our evaluations are based upon a number of factors, including changes in facts or circumstances, changes in tax law, correspondence with tax authorities during the course of audits and effective settlement of audit issues. Changes in the recognition or measurement of uncertain tax positions could result in material increases or decreases in our income tax expense in the period in which we make the change, which could have a material impact on our effective tax rate and operating results. Historically, settlements related to our unrecognized tax benefits have been minimal.

A description of our accounting policies associated with tax-related contingencies and valuation allowances assumed as part of a business combination is provided under “Business Combinations” above.





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## Contingencies and Litigation

We are subject to various proceedings, lawsuits and claims relating to products and services, technology, labor, stockholder and other matters. We are required to assess the likelihood of any adverse outcomes and the potential range of probable losses in these matters. If the potential loss is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. If the potential loss is considered less than probable or the amount cannot be reasonably estimated, disclosure of the matter is considered. The amount of loss accrual or disclosure, if any, is determined after analysis of each matter, and is subject to adjustment if warranted by new developments or revised strategies. Due to uncertainties related to these matters, accruals or disclosures are based on the best information available at the time. Significant judgment is required in both the assessment of likelihood and in the determination of a range of potential losses. Revisions in the estimates of the potential liabilities could have a material impact on our consolidated financial position or consolidated results of operations. Historically, there have been no material changes in our estimates or assumptions. We do not believe there is a reasonable likelihood there will be a material change in the future estimates.

## New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. Generally Accepted Accounting Principles when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. The guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. In August 2015, the FASB issued ASU No. 2015-14, “Deferral of the Effective Date”, which defers the effective date for ASU 2014-09 by one year. For public entities, the guidance in ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods), which means it will be effective for our fiscal year beginning October 1, 2018. Early adoption is permitted to the original effective date of December 15, 2016 (including interim reporting periods within those periods). In March 2016, the FASB issued ASU No. 2016-08, “Principal versus Agent Considerations (Reporting Revenue versus Net)”, which clarifies the implementation guidance on principal versus agent considerations in the new revenue recognition standard. In April 2016, the FASB issued ASU No. 2016-10, “Identifying Performance Obligations and Licensing”, which reduces the complexity when applying the guidance for identifying performance obligations and improves the operability and understandability of the license implementation guidance. In May 2016, the FASB issued ASU No. 2016-12 “Narrow-Scope Improvements and Practical Expedients”, which amends the guidance on transition, collectability, noncash consideration and the presentation of sales and other similar taxes. In December 2016, the FASB further issued ASU No. 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers”, which makes minor corrections or minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. The amendments are intended to address implementation issues that were raised by stakeholders and provide additional practical expedients to reduce the cost and complexity of applying the new revenue standard. These amendments have the same effective date as the new revenue standard. Preliminarily, we plan to adopt Topic 606 in the first quarter of our fiscal 2019 using the retrospective transition method, and are continuing to evaluate the impact our pending adoption of Topic 606 will have on our consolidated financial statements.

We have established a cross-functional implementation team consisting of representatives across the organization to address the scope of work required to implement the recognition and disclosure requirements under the new standard. This cross-functional implementation team has developed a project plan, which includes evaluating customer contracts across the organization, developing policies, processes and tools to report financial results, and implementing and evaluating our internal controls over financial reporting that will be necessary under the new standard. We currently plan to adopt Topic 606 in the first quarter of our fiscal 2019 using the retrospective transition method. Our ability to adopt Topic 606 using the full retrospective method is dependent on system readiness, and the completion of our analysis of information necessary to restate prior period financial statements. As we continue to

assess the new standard along with industry trends and additional interpretive guidance, we may adjust our implementation plan accordingly.

We are continuing to assess the impact of adopting Topic 606 on our consolidated financial statements and believe the new standard will impact the following policies and disclosures:

- Timing of revenue recognition of license revenue on term licenses and transactional revenue on guaranteed minimum fees related to our on-premises software products. Under the new standard, we expect to recognize revenue when control of the license is transferred to the customer, rather than at the date payments become due and payable or ratably over the term of the contract required under the current standard;

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Presentation of contract balances. Under the new standard, when we enter into noncancellable contracts that provide unconditional rights to payment from our customers for services that we have not yet completed providing or services we will provide in the near future, we expect to present the unconditional rights as receivables, regardless of whether cash has been received from customers;

• Required disclosures including information about remaining transaction price and when we expect to recognize revenue; and

• Accounting for commissions under the new standard will result in the deferral of incremental commission costs for obtaining contracts.

We do not currently expect Topic 606 to have a significant effect on the timing of revenue recognition for our maintenance or professional services revenues, or SaaS contracts.

In October 2016, the FASB issued ASU No. 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory” (“ASU 2016-16”). ASU 2016-16 requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The guidance is effective for fiscal years and interim periods beginning after December 15, 2017, which means it will be effective for our fiscal year beginning October 1, 2018. ASU 2016-16 should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings at the beginning of the period of adoption. Early adoption is permitted as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued. We do not believe that adoption of ASU 2016-16 will have a significant impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which requires lessees to put most leases on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. ASU 2016-02 states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. ASU 2016-02 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2018, which means it will be effective for our fiscal year beginning October 1, 2019. Early adoption is permitted. We are currently evaluating the timing of our adoption and the impact that the updated standard will have on our consolidated financial statements.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

#### Market Risk Disclosures

We are exposed to market risk related to changes in interest rates and foreign exchange rates. We do not use derivative financial instruments for speculative or trading purposes.

#### Interest Rate

We maintain an investment portfolio consisting of bank deposits and money market funds. The funds provide daily liquidity and may be subject to interest rate risk and fall in value if market interest rates increase. We do not expect our operating results or cash flows to be affected to any significant degree by a sudden change in market interest rates. The following table presents the principal amounts and related weighted-average yields for our investments with interest rate risk at June 30, 2018 and September 30, 2017:

|                           | June 30, 2018          |                 |               | September 30, 2017 |                 |               |
|---------------------------|------------------------|-----------------|---------------|--------------------|-----------------|---------------|
|                           | Cost Basis             | Carrying Amount | Average Yield | Cost Basis         | Carrying Amount | Average Yield |
|                           | (Dollars in thousands) |                 |               |                    |                 |               |
| Cash and cash equivalents | \$119,929              | \$119,929       | 0.70 %        | \$105,618          | \$105,618       | 0.56 %        |

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On May 7, 2008, we issued \$275 million of senior notes in a private placement to a group of institutional investors (the “2008 Senior Notes”), the outstanding aggregate principal amount of which was paid in full at maturity on May 7, 2018. On July 14, 2010, we issued \$245 million of senior notes in a private placement to a group of institutional investors (the “2010 Senior Notes”). On May 8, 2018, we issued \$400 million of senior notes in a private placement to a group of institutional investors (the “2018 Senior Notes”, and with the 2008 Senior Notes and the 2010 Senior Notes, the “Senior Notes”). The fair value of the Senior Notes may increase or decrease due to various factors, including fluctuations in market interest rates and fluctuations in general economic conditions. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources and Liquidity” for additional information on the Senior Notes. The following table presents the carrying amounts and fair values for the Senior Notes at June 30, 2018 and September 30, 2017:

|                       | June 30, 2018       |            | September 30, 2017  |            |
|-----------------------|---------------------|------------|---------------------|------------|
|                       | Carrying<br>Amounts | Fair Value | Carrying<br>Amounts | Fair Value |
|                       | (In thousands)      |            |                     |            |
| The 2008 Senior Notes | \$—                 | \$—        | \$131,000           | \$134,250  |
| The 2010 Senior Notes | 113,000             | 114,966    | 113,000             | 119,106    |
| The 2018 Senior Notes | 400,000             | 402,000    | —                   | —          |
| Debt issuance costs   | (6,287 )            | (6,287 )   | (199 )              | (199 )     |
| Total                 | \$506,713           | \$510,679  | \$243,801           | \$253,157  |

We have a \$400 million unsecured revolving line of credit with a syndicate of banks that expires on May 8, 2023. Proceeds from the credit facility can be used for working capital and general corporate purposes and may also be used for the refinancing of existing debt, acquisitions, and the repurchase of our common stock. Interest on amounts borrowed under the credit facility is based on (i) a base rate, which is the greater of (a) the prime rate, (b) the Federal Funds rate plus 0.500% and (c) the one-month LIBOR rate plus 1.000%, plus, in each case, an applicable margin, or (ii) an adjusted LIBOR rate plus an applicable margin. The applicable margin for base rate borrowings ranges from 0% to 0.875% and for LIBOR borrowings ranges from 1.000% to 1.875%, and is determined based on our consolidated leverage ratio. A change in interest rates on this variable rate debt impacts the interest incurred and cash flows, but does not impact the fair value of the instrument. We had \$252.0 million in borrowings outstanding at a weighted average interest rate of 3.201% under the credit facility as of June 30, 2018.

Foreign Currency Forward Contracts

We maintain a program to manage our foreign exchange rate risk on existing foreign-currency-denominated receivable and cash balances by entering into forward contracts to sell or buy foreign currencies. At period end, foreign-currency-denominated receivable and cash balances held by our various reporting entities are remeasured into their respective functional currencies at current market rates. The change in value from this remeasurement is then reported as a foreign exchange gain or loss for that period in our accompanying condensed consolidated statements of income and comprehensive income and the resulting gain or loss on the forward contract mitigates the foreign exchange rate risk of the associated assets. All of our foreign currency forward contracts have maturity periods of less than three months. Such derivative financial instruments are subject to market risk.

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The following tables summarize our outstanding foreign currency forward contracts, by currency, at June 30, 2018 and September 30, 2017:

|                        |           | June 30, 2018   |    |            |  |
|------------------------|-----------|-----------------|----|------------|--|
|                        |           | Contract Amount |    | Fair Value |  |
| Foreign Currency       | US\$      | US\$            |    | US\$       |  |
| (In thousands)         |           |                 |    |            |  |
| Sell foreign currency: |           |                 |    |            |  |
| Euro (EUR)             | EUR 6,300 | \$7,344         | \$ | —          |  |
| Buy foreign currency:  |           |                 |    |            |  |
| British pound (GBP)    | GBP 6,963 | \$9,200         | \$ | —          |  |
| Singapore dollar (SGD) | SGD 8,326 | \$6,100         | \$ | —          |  |

|                        |           | September 30, 2017 |    |            |  |
|------------------------|-----------|--------------------|----|------------|--|
|                        |           | Contract Amount    |    | Fair Value |  |
| Foreign Currency       | US\$      | US\$               |    | US\$       |  |
| (In thousands)         |           |                    |    |            |  |
| Sell foreign currency: |           |                    |    |            |  |
| Euro (EUR)             | EUR 5,050 | \$5,968            | \$ | —          |  |
| Buy foreign currency:  |           |                    |    |            |  |
| British pound (GBP)    | GBP 9,341 | \$12,500           | \$ | —          |  |

The foreign currency forward contracts were entered into on June 30, 2018 and September 30, 2017, respectively; therefore, their fair value was \$0 on each of these dates.

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

An evaluation was carried out under the supervision and with the participation of FICO's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of FICO's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this quarterly report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that FICO's disclosure controls and procedures are effective to ensure that information required to be disclosed by FICO in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) accumulated and communicated to the Chief Executive Officer and Chief Financial Officer to allow timely decisions regarding required disclosure.

##### Changes in Internal Control over Financial Reporting

No change in FICO's internal control over financial reporting was identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act that occurred during the period covered by this quarterly report and that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

Not Applicable.

Item 1A. Risk Factors

Risks Related to Our Business

We continue to expand the pursuit of our Decision Management strategy, and we may not be successful, which could cause our growth prospects and results of operations to suffer.

We continue to expand the pursuit of our business objective to become a leader in helping businesses automate and improve decisions across their enterprises, an approach that we commonly refer to as Decision Management, or “DM.” Our DM strategy is designed to enable us to increase our business by selling multiple products to clients, as well as to enable the development of custom client solutions that may lead to opportunities to develop new proprietary scores or other new proprietary products. Our DM strategy is also increasingly focused on the delivery of our products through cloud-based deployments. The market may be unreceptive to our general DM business approach, including being unreceptive to purchasing multiple products from us, unreceptive to our customized solutions, or unreceptive to our cloud-based offerings. As we continue to pursue our DM strategy, we may experience volatility in our revenues and operating results caused by various factors, including differences in revenue recognition treatment between our cloud-based offerings and on-premises software licenses, the timing of investments and other expenditures necessary to develop and operate our cloud-based offerings, and the adoption of new sales and delivery methods. If our DM strategy is not successful, we may not be able to grow our business, growth may occur more slowly than we anticipate, or our revenues and profits may decline.

We derive a substantial portion of our revenues from a small number of products and services, and if the market does not continue to accept these products and services, our revenues will decline.

We expect that revenues derived from our scoring solutions, fraud solutions, customer communication services, customer management solutions and decision management software will continue to account for a substantial portion of our total revenues for the foreseeable future. Our revenues will decline if the market does not continue to accept these products and services. Factors that might affect the market acceptance of these products and services include the following:

- changes in the business analytics industry;
- changes in technology;
- our inability to obtain or use key data for our products;
- saturation or contraction of market demand;
- loss of key customers;
- industry consolidation;
- failure to successfully adopt cloud-based technologies;
- failure to execute our selling approach; and
- inability to successfully sell our products in new vertical markets.

If we are unable to access new markets or develop new distribution channels, our business and growth prospects could suffer.

We expect that part of the growth that we seek to achieve through our DM strategy will be derived from the sale of DM products and service solutions in industries and markets we do not currently serve. We also expect to grow our business by delivering our DM solutions through additional distribution channels. If we fail to penetrate these industries and markets to the degree we anticipate utilizing our DM strategy, or if we fail to develop additional

distribution channels, we may not be able to grow our business, growth may occur more slowly than we anticipate, or our revenues and profits may decline.



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If we are unable to develop successful new products or if we experience defects, failures and delays associated with the introduction of new products, our business could suffer serious harm.

Our growth and the success of our DM strategy depend upon our ability to develop and sell new products or suites of products, including the development and sale of our cloud-based product offerings. If we are unable to develop new products, or if we are not successful in introducing new products, we may not be able to grow our business or growth may occur more slowly than we anticipate. In addition, significant undetected errors or delays in new products or new versions of products may affect market acceptance of our products and could harm our business, financial condition or results of operations. In the past, we have experienced delays while developing and introducing new products and product enhancements, primarily due to difficulties developing models, acquiring data, and adapting to particular operating environments or certain client or other systems. We have also experienced errors or “bugs” in our software products, despite testing prior to release of the products. Software errors in our products could affect the ability of our products to work with other hardware or software products, could delay the development or release of new products or new versions of products, and could adversely affect market acceptance of our products. Errors or defects in our products that are significant, or are perceived to be significant, could result in rejection of our products, damage to our reputation, loss of revenues, diversion of development resources, an increase in product liability claims, and increases in service and support costs and warranty claims.

We rely on relatively few customers, as well as our contracts with the three major credit reporting agencies, for a significant portion of our revenues and profits. Many of our customers are significantly larger than we are and may have greater bargaining power. The businesses of our largest customers depend, in large part, on favorable macroeconomic conditions. If these customers are negatively impacted by weak global economic conditions, global economic volatility or the terms of these relationships otherwise change, our revenues and operating results could decline.

Most of our customers are relatively large enterprises, such as banks, credit card processors, insurance companies, healthcare firms, telecommunications providers, retailers and public agencies. As a result, many of our customers and potential customers are significantly larger than we are and may have sufficient bargaining power to demand reduced prices and favorable nonstandard terms.

In addition, the U.S. and other key international economies have experienced in the past a downturn in which economic activity was impacted by falling demand for a variety of goods and services, restricted credit, poor liquidity, reduced corporate profitability, volatility in credit, equity and foreign exchange markets, bankruptcies and overall uncertainty with respect to the economy. The European Union (“E.U.”) continues to face great economic uncertainty which could impact the overall world economy or various other regional economies. The potential for economic disruption presents considerable risks to our business, including potential bankruptcies or credit deterioration of financial institutions with which we have substantial relationships. Such disruption could result in a decline in the volume of transactions that we execute for our customers.

We also derive a substantial portion of our revenues and operating income from our contracts with the three major credit reporting agencies, Experian, TransUnion and Equifax, and other parties that distribute our products to certain markets. The loss of or a significant change in a relationship with one of these credit reporting agencies with respect to their distribution of our products or with respect to our myFICO® offerings, the loss of or a significant change in a relationship with a major customer, the loss of or a significant change in a relationship with a significant third-party distributor (including credit card processors), or the delay of significant revenues from these sources, could have a material adverse effect on our revenues and results of operations.

We rely on relationships with third parties for marketing, distribution and certain services. If we experience difficulties in these relationships, our future revenues may be adversely affected.

Most of our products rely on distributors, and we intend to continue to market and distribute our products through existing and future distributor relationships. Our Scores segment relies on, among others, Experian, TransUnion and Equifax. Failure of our existing and future distributors to generate significant revenues, demands by such distributors to change the terms on which they offer our products, or our failure to establish additional distribution or sales and marketing alliances, could have a material adverse effect on our business, operating results and financial condition. In addition, certain of our distributors presently compete with us and may compete with us in the future, either by developing competitive products themselves or by distributing competitive offerings. For example, Experian, TransUnion and Equifax have developed a credit scoring product to compete directly with our products and are collectively attempting to sell the product. Competition from distributors or other sales and marketing partners could significantly harm sales of our products and services.

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Our acquisition and divestiture activities may disrupt our ongoing business and may involve increased expenses, and we may not realize the financial and strategic goals contemplated at the time of a transaction.

We have acquired and expect to continue to acquire companies, businesses, products, services and technologies. Acquisitions involve significant risks and uncertainties, including:

our ongoing business may be disrupted and our management's attention may be diverted by acquisition, transition or integration activities;

an acquisition may not further our business strategy as we expected, we may not integrate acquired operations or technology as successfully as we expected or we may overpay for our investments, or otherwise not realize the expected return, which could adversely affect our business or operating results;

we may be unable to retain the key employees, customers and other business partners of the acquired operation;

we may have difficulties entering new markets where we have no or limited direct prior experience or where competitors may have stronger market positions;

our operating results or financial condition may be adversely impacted by claims or liabilities we assume from an acquired company, business, product or technology, including claims by government agencies, terminated employees, current or former customers, former stockholders or other third parties; pre-existing contractual relationships of an acquired company we would not have otherwise entered into; unfavorable revenue recognition or other accounting treatment as a result of an acquired company's practices; and intellectual property claims or disputes;

we may fail to identify or assess the magnitude of certain liabilities or other circumstances prior to acquiring a company, business, product or technology, which could result in unexpected litigation or regulatory exposure, unfavorable accounting treatment, unexpected increases in taxes due, a loss of anticipated tax benefits or other adverse effects on our business, operating results or financial condition;

we may not realize the anticipated increase in our revenues from an acquisition for a number of reasons, including if a larger than predicted number of customers decline to renew their contracts, if we are unable to sell the acquired products to our customer base or if contract models of an acquired company do not allow us to recognize revenues on a timely basis;

we may have difficulty incorporating acquired technologies or products with our existing product lines and maintaining uniform standards, architecture, controls, procedures and policies;

our use of cash to pay for acquisitions may limit other potential uses of our cash, including stock repurchases, dividend payments and retirement of outstanding indebtedness;

to the extent we issue a significant amount of equity securities in connection with future acquisitions, existing stockholders may be diluted and earnings per share may decrease; and

we may experience additional or unexpected changes in how we are required to account for our acquisitions pursuant to U.S. generally accepted accounting principles, including arrangements we assume from an acquisition.

We have also divested ourselves of businesses in the past and may do so again in the future. Divestitures involve significant risks and uncertainties, including:

disruption of our ongoing business;

reductions of our revenues or earnings per share;

unanticipated liabilities, legal risks and costs;

the potential loss of key personnel;

distraction of management from our ongoing business; and

impairment of relationships with employees and customers as a result of migrating a business to new owners.

Because acquisitions and divestitures are inherently risky, our transactions may not be successful and may have a material adverse effect on our business, results of operations, financial condition or cash flows. Acquisitions of businesses having a significant presence outside the U.S. will increase our exposure to the risks of conducting

operations in international markets.

Charges to earnings resulting from acquisitions may adversely affect our operating results.

Under business combination accounting standards, we recognize the identifiable assets acquired and the liabilities assumed in acquired companies generally at their acquisition-date fair values and separately from goodwill. Goodwill is measured as the excess amount of consideration transferred, which is also generally measured at fair value, and the net of the amounts of the identifiable assets acquired and the liabilities assumed as of the acquisition date. Our estimates of fair value are based upon assumptions believed to be reasonable but which are inherently uncertain. After we complete an acquisition, the following factors could result in material charges and adversely affect our operating results and may adversely affect our cash flows:

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impairment of goodwill or intangible assets, or a reduction in the useful lives of intangible assets acquired;

- amortization of intangible assets acquired;
- identification of, or changes to, assumed contingent liabilities, both income tax and non-income tax related, after our final determination of the amounts for these contingencies or the conclusion of the measurement period (generally up to one year from the acquisition date), whichever comes first;
- costs incurred to combine the operations of companies we acquire, such as transitional employee expenses and employee retention, redeployment or relocation expenses;
- charges to our operating results to maintain certain duplicative pre-merger activities for an extended period of time or to maintain these activities for a period of time that is longer than we had anticipated, charges to eliminate certain duplicative pre-merger activities, and charges to restructure our operations or to reduce our cost structure; and
- charges to our operating results resulting from expenses incurred to effect the acquisition.

Substantially all of these costs will be accounted for as expenses that will decrease our net income and earnings per share for the periods in which those costs are incurred. Charges to our operating results in any given period could differ substantially from other periods based on the timing and size of our future acquisitions and the extent of integration activities. A more detailed discussion of our accounting for business combinations and other items is presented in the “Critical Accounting Policies and Estimates” section of Management’s Discussion and Analysis of Financial Condition and Results of Operations (Item 2).

Our reengineering initiative may cause our growth prospects and profitability to suffer.

As part of our management approach, we implemented an ongoing reengineering initiative designed to grow revenues through strategic resource allocation and improve profitability through cost reductions. Our reengineering initiative may not be successful over the long term as a result of our failure to reduce expenses at the anticipated level, or a lower, or no, positive impact on revenues from strategic resource allocation. If our reengineering initiative is not successful over the long term, our revenues, results of operations and business may suffer.

The occurrence of certain negative events may cause fluctuations in our stock price.

The market price of our common stock may be volatile and could be subject to wide fluctuations due to a number of factors, including variations in our revenues and operating results. We believe that you should not rely on period-to-period comparisons of financial results as an indication of future performance. Because many of our operating expenses are fixed and will not be affected by short-term fluctuations in revenues, short-term fluctuations in revenues may significantly impact operating results. Additional factors that may cause our stock price to fluctuate include the following:

- variability in demand from our existing customers;
- failure to meet the expectations of market analysts;
- changes in recommendations by market analysts;
- the lengthy and variable sales cycle of many products, combined with the relatively large size of orders for our products, increases the likelihood of short-term fluctuation in revenues;
- consumer or customer dissatisfaction with, or problems caused by, the performance of our products;
- the timing of new product announcements and introductions in comparison with our competitors;
- the level of our operating expenses;
- changes in competitive and other conditions in the consumer credit, banking and insurance industries;
- fluctuations in domestic and international economic conditions;
- .

our ability to complete large installations, and to adopt and configure cloud-based deployments, on schedule and within budget;

• acquisition-related expenses and charges; and

• timing of orders for and deliveries of software systems.

In addition, the financial markets have at various times experienced significant price and volume fluctuations that have particularly affected the stock prices of many technology companies and financial services companies, and these fluctuations sometimes have been unrelated to the operating performance of these companies. Broad market fluctuations, as well as industry-specific and general economic conditions, may negatively affect our business and require us to record an impairment charge related to goodwill, which could adversely affect our results of operations, stock price and business.

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Our products have long and variable sales cycles. If we do not accurately predict these cycles, we may not forecast our financial results accurately, and our stock price could be adversely affected.

We experience difficulty in forecasting our revenues accurately because the length of our sales cycles makes it difficult for us to predict the quarter in which sales will occur. In addition, our selling approach is complex as we look to sell multiple products and services across our customers' organizations. This makes forecasting of revenues in any given period more difficult. As a result of our sales approach and lengthening sales cycles, revenues and operating results may vary significantly from period to period. For example, the sales cycle for licensing our products typically ranges from 60 days to 18 months. Customers are often cautious in making decisions to acquire our products because purchasing our products typically involves a significant commitment of capital and may involve shifts by the customer to a new software and/or hardware platform or changes in the customer's operational procedures. This may cause customers, particularly those experiencing financial stress, to make purchasing decisions more cautiously. Delays in completing sales can arise while customers complete their internal procedures to approve large capital expenditures and test and accept our applications. Consequently, we face difficulty predicting the quarter in which sales to expected customers will occur and experience fluctuations in our revenues and operating results. If we are unable to accurately forecast our revenues, our stock price could be adversely affected.

We typically have revenue-generating transactions concentrated in the final weeks of a quarter, which may prevent accurate forecasting of our financial results and cause our stock price to decline.

Large portions of our customer agreements are consummated in the weeks immediately preceding quarter end. Before these agreements are consummated, we create and rely on forecasted revenues for planning, modeling and earnings guidance. Forecasts, however, are only estimates and actual results may vary for a particular quarter or longer periods of time. Consequently, significant discrepancies between actual and forecasted results could limit our ability to plan, budget or provide accurate guidance, which could adversely affect our stock price. Any publicly-stated revenue or earnings projections are subject to this risk.

The failure to recruit and retain additional qualified personnel could hinder our ability to successfully manage our business.

Our DM strategy and our future success will depend in large part on our ability to attract and retain experienced sales, consulting, research and development, marketing, technical support and management personnel. The complexity of our products requires highly trained customer service and technical support personnel to assist customers with product installation and deployment. The labor market for these individuals is very competitive due to the limited number of people available with the necessary technical skills and understanding and may become more competitive with general market and economic improvement. We cannot be certain that our compensation strategies will be perceived as competitive by current or prospective employees. This could impair our ability to recruit and retain personnel. We have experienced difficulty in recruiting qualified personnel, especially technical, sales and consulting personnel, and we may need additional staff to support new customers and/or increased customer needs. We may also recruit skilled technical professionals from other countries to work in the U.S., and from the U.S. and other countries to work abroad. Limitations imposed by immigration laws in the U.S. and abroad and the availability of visas in the countries where we do business could hinder our ability to attract necessary qualified personnel and harm our business and future operating results. There is a risk that even if we invest significant resources in attempting to attract, train and retain qualified personnel, we will not succeed in our efforts, and our business could be harmed. The failure of the value of our stock to appreciate may adversely affect our ability to use equity and equity-based incentive plans to attract and retain personnel, and may require us to use alternative and more expensive forms of compensation for this purpose.

The failure to obtain certain forms of model construction data from our customers or others could harm our business.

Our business requires that we develop or obtain a reliable source of sufficient amounts of current and statistically relevant data to analyze transactions and update our products. In most cases, these data must be periodically updated and refreshed to enable our products to continue to work effectively in a changing environment. We do not own or control much of the data that we require, most of which is collected privately and maintained in proprietary databases. Customers and key business alliances provide us with the data we require to analyze transactions, report results and build new models. Our DM strategy depends in part upon our ability to access new forms of data to develop custom and proprietary analytic tools. If we fail to maintain sufficient data sourcing relationships with our customers and business alliances, or if they decline to provide such data due to privacy concerns, competition concerns, prohibitions or a lack of permission from their customers or partners, we could lose access to required data and our products, and the development of new products, might become less effective. Third parties have asserted copyright and other intellectual property interests in these data, and these assertions, if successful, could prevent us from using these data. Any interruption of our supply of data could seriously harm our business, financial condition or results of operations.



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We will continue to rely upon proprietary technology rights, and if we are unable to protect them, our business could be harmed.

Our success depends, in part, upon our proprietary technology and other intellectual property rights. To date, we have relied primarily on a combination of copyright, patent, trade secret, and trademark laws, and nondisclosure and other contractual restrictions on copying and distribution, to protect our proprietary technology. This protection of our proprietary technology is limited, and our proprietary technology could be used by others without our consent. In addition, patents may not be issued with respect to our pending or future patent applications, and our patents may not be upheld as valid or may not prevent the development of competitive products. Any disclosure, loss, invalidity of, or failure to protect our intellectual property could negatively impact our competitive position, and ultimately, our business. There can be no assurance that our protection of our intellectual property rights in the U.S. or abroad will be adequate or that others, including our competitors, will not use our proprietary technology without our consent. Furthermore, litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of the proprietary rights of others. Such litigation could result in substantial costs and diversion of resources and could harm our business, financial condition or results of operations.

Some of our technologies were developed under research projects conducted under agreements with various U.S. government agencies or subcontractors. Although we have commercial rights to these technologies, the U.S. government typically retains ownership of intellectual property rights and licenses in the technologies developed by us under these contracts, and in some cases can terminate our rights in these technologies if we fail to commercialize them on a timely basis. Under these contracts with the U.S. government, the results of research may be made public by the government, limiting our competitive advantage with respect to future products based on our research.

If we are subject to infringement claims, it could harm our business.

We expect that products in the industry segments in which we compete, including software products, will increasingly be subject to claims of patent and other intellectual property infringement as the number of products and competitors in our industry segments grow. We may need to defend claims that our products infringe intellectual property rights, and as a result we may:

- incur significant defense costs or substantial damages;
- be required to cease the use or sale of infringing products;
- expend significant resources to develop or license a substitute non-infringing technology;
- discontinue the use of some technology; or
- be required to obtain a license under the intellectual property rights of the third party claiming infringement, which license may not be available or might require substantial royalties or license fees that would reduce our margins.

Moreover, in recent years, individuals and groups that are non-practicing entities, commonly referred to as “patent trolls”, have purchased patents and other intellectual property assets for the purpose of making claims of infringement in order to extract settlements. From time to time, we may receive threatening letters or notices or may be the subject of claims that our solutions and underlying technology infringe or violate the intellectual property rights of others. Responding to such claims, regardless of their merit, can be time consuming, costly to defend in litigation, divert management's attention and resources, damage our reputation and brand, and cause us to incur significant expenses.

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If our security measures are compromised or unauthorized access to customer or consumer data is otherwise obtained, our products and services may be perceived as not being secure, customers may curtail or cease their use of our products and services, our reputation may be damaged and we could incur significant liabilities.

Our business requires the storage, transmission and utilization of sensitive consumer and customer information. Many of our products are provided by us through the Internet. Security breaches could expose us to a risk of loss, the unauthorized disclosure of consumer or customer information, litigation, indemnity obligations and other liability. If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, and as a result, someone obtains unauthorized access to our systems or to consumer or customer information, our reputation may be damaged, our business may suffer and we could incur significant liability. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Malicious third parties may also conduct attacks designed to temporarily deny customers access to our services. Security compromises experienced by our competitors, by our distributors, by our customers or by us may lead to public disclosures, which may lead to widespread negative publicity. Any security compromise in our industry, whether actual or perceived, could harm our reputation, erode customer confidence in the effectiveness of our security measures, negatively impact our ability to attract new customers, cause existing customers to curtail or cease their use of our products and services, cause regulatory or industry changes that impact our products and services, or subject us to third-party lawsuits, regulatory fines or other action or liability, all of which could materially and adversely affect our business and operating results.

Protection from system interruptions is important to our business. If we experience system interruptions, it could harm our business.

Systems or network interruptions, including interruptions experienced in connection with our cloud-based and other product offerings, could delay and disrupt our ability to develop, deliver or maintain our products and services, causing harm to our business and reputation and resulting in loss of customers or revenue. These interruptions can include software or hardware malfunctions, communication failures, outages or other failures of third party environments or service providers, fires, floods, earthquakes, power losses, equipment failures and other events beyond our control.

### Risks Related to Our Industry

Our ability to increase our revenues will depend to some extent upon introducing new products and services. If the marketplace does not accept these new products and services, our revenues may decline.

We have a significant share of the available market in portions of our Scores segment and for certain services in our Applications segment, specifically, the markets for account management services at credit card processors and credit card fraud detection software. To increase our revenues, we must enhance and improve existing products and continue to introduce new products and new versions of existing products that keep pace with technological developments, satisfy increasingly sophisticated customer requirements and achieve market acceptance. We believe much of the future growth of our business and the success of our DM strategy will rest on our ability to continue to expand into newer markets for our products and services. Such areas are relatively new to our product development and sales and marketing personnel. Products that we plan to market in the future are in various stages of development. We cannot assure you that the marketplace will accept these products. If our current or potential customers are not willing to switch to or adopt our new products and services, either as a result of the quality of these products and services or due to other factors, such as economic conditions, our revenues will decrease.

If we fail to keep up with rapidly changing technologies, our products could become less competitive or obsolete.

In our markets, technology changes rapidly, and there are continuous improvements in computer hardware, network operating systems, programming tools, programming languages, operating systems, database technologies, cloud-based technologies and the use of the Internet. If we fail to enhance our current products and develop new products in response to changes in technology or industry standards, or if we fail to bring product enhancements or new product developments to market quickly enough, our products could rapidly become less competitive or obsolete. Our future success will depend, in part, upon our ability to:

• innovate by internally developing new and competitive technologies;

- use leading third-party technologies effectively;

• continue to develop our technical expertise;

• anticipate and effectively respond to changing customer needs;

• initiate new product introductions in a way that minimizes the impact of customers delaying purchases of existing products in anticipation of new product releases; and

• influence and respond to emerging industry standards and other technological changes.

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If our competitors introduce new products and pricing strategies, it could decrease our product sales and market share, or could pressure us to reduce our product prices in a manner that reduces our margins.

We may not be able to compete successfully against our competitors, and this inability could impair our capacity to sell our products. The market for business analytics is new, rapidly evolving and highly competitive, and we expect competition in this market to persist and intensify. Our regional and global competitors vary in size and in the scope of the products and services they offer, and include:

- in-house analytic and systems developers;
- scoring model builders;
- enterprise resource planning, customer relationship management, and customer communication and mobility solution providers;
- business intelligence solutions providers;
- credit report and credit score providers;
- business process management and decision rules management providers;
- process modeling tools providers;
- automated application processing services providers;
- data vendors;
- neural network developers and artificial intelligence system builders;
- third-party professional services and consulting organizations;
- account/workflow management software providers;
- software tools companies supplying modeling, rules, or analytic development tools; collections and recovery solutions providers; entity resolution and social network analysis solutions providers; and
- cloud-based customer engagement and risk management solutions providers.

We expect to experience additional competition from other established and emerging companies, as well as from other technologies. For example, certain of our fraud solutions products compete against other methods of preventing credit card fraud, such as credit cards that contain the cardholder's photograph; smart cards; cardholder verification and authentication solutions; biometric measures on devices including fingerprint and face matching; and other card authorization techniques and user verification techniques. Many of our anticipated competitors have greater financial, technical, marketing, professional services and other resources than we do, and industry consolidation is creating even larger competitors in many of our markets. As a result, our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements. They may also be able to devote greater resources than we can to develop, promote and sell their products. Many of these companies have extensive customer relationships, including relationships with many of our current and potential customers. Furthermore, new competitors or alliances among competitors may emerge and rapidly gain significant market share. For example, Experian, TransUnion and Equifax have formed an alliance that has developed a credit scoring product competitive with our products. If we are unable to respond as quickly or effectively to changes in customer requirements as our competition, our ability to expand our business and sell our products will be negatively affected.

Our competitors may be able to sell products competitive to ours at lower prices individually or as part of integrated suites of several related products. This ability may cause our customers to purchase products that directly compete with our products from our competitors. Price reductions by our competitors could negatively impact our margins, and could also harm our ability to obtain new long-term contracts and renewals of existing long-term contracts on favorable terms.

Laws and regulations in the U.S. and abroad that apply to us or to our customers may expose us to liability, cause us to incur significant expense, affect our ability to compete in certain markets, limit the profitability of or demand for

our products, or render our products obsolete. If these laws and regulations require us to change our products and services, it could adversely affect our business and results of operations. New legislation or regulations, or changes to existing laws and regulations, may also negatively impact our business and increase our costs of doing business.

Laws and governmental regulation affect how our business is conducted and, in some cases, subject us to the possibility of government supervision and future lawsuits arising from our products and services. Laws and governmental regulation also influence our current and prospective customers' activities, as well as their expectations and needs in relation to our products and services. Laws and regulations that may affect our business and our current and prospective customers' activities include, but are not limited to, those in the following significant regulatory areas:

Use of data by creditors and consumer reporting agencies (e.g., the U.S. Fair Credit Reporting Act);

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• Laws and regulations that limit the use of credit scoring models (e.g., state “mortgage trigger” or “inquiries” laws, state insurance restrictions on the use of credit-based insurance scores, and the E.U. Consumer Credit Directive);  
 • Fair lending laws (e.g., the U.S. Truth In Lending Act and Regulation Z, the Equal Credit Opportunity Act and Regulation B, and the Fair Housing Act);  
 Privacy and security laws and regulations that limit the use and disclosure of personally identifiable information, require security procedures, or otherwise apply to the collection, processing, storage, use and transmission of protected data (e.g., the U.S. Financial Services Modernization Act of 1999, also known as the Gramm Leach Bliley Act; the E.U. Data Protection Directive and the country-specific regulations that implement that directive; the U.S. Health Insurance Portability and Accountability Act of 1996, as amended by the Health Information Technology for Economic and Clinical Health Act; the Cybersecurity Act of 2015; the U.S. Department of Commerce’s National Institute of Standards and Technology’s Cybersecurity Framework; and identity theft, file freezing, security breach notification and similar state privacy laws);  
 • Extension of credit to consumers through the Electronic Fund Transfers Act and Regulation E, as well as non governmental VISA and MasterCard electronic payment standards;  
 • Regulations and guidelines applicable to secondary market participants (e.g., Fannie Mae and Freddie Mac) that could have an impact on our products;  
 • Laws and regulations applicable to our customer communication clients and their use of our products and services (e.g., the Telemarketing Sales Rule, Telephone Consumer Protection Act and regulations promulgated thereunder);  
 • Laws and regulations applicable to our insurance clients and their use of our insurance products and services;  
 The application or extension of consumer protection laws, including implementing regulations (e.g., the Consumer Financial Protection Act, the Federal Trade Commission Act, the Fair Debt Collection Practices Act, the Servicemembers Civil Relief Act, the Military Lending Act, and the Credit Repair Organizations Act);  
 • Laws and regulations governing the use of the Internet and social media, telemarketing, advertising, endorsements and testimonials;  
 • Anti-bribery and corruption laws and regulations (e.g., the Foreign Corrupt Practices Act);  
 • Financial regulatory standards (e.g., Sarbanes-Oxley Act requirements to maintain and verify internal process controls, including controls for material event awareness and notification);  
 Regulatory requirements for managing third parties (e.g., vendors, contractors, suppliers and distributors);  
 • Anti-money laundering laws and regulations (e.g., the Bank Secrecy Act and the USA Patriot Act);  
 Financial regulatory reform stemming from the Dodd-Frank Wall Street Reform and Consumer Protection Act and the many regulations mandated by that Act, including regulations issued by, and the supervisory and investigative authority of, the Bureau of Consumer Financial Protection; and  
 • Laws and regulations regarding export controls as they apply to FICO products delivered in non-U.S. countries.

In addition, many U.S. and foreign jurisdictions have passed, or are currently contemplating, a variety of consumer protection, privacy, and data security laws and regulations that may relate to our business or affect the demand for our products and services. For example, on April 14, 2016, the European Parliament formally adopted the General Data Protection Regulation (the “GDPR”), which will supersede the existing Data Protection Directive of 95/46/EC in 2018. The GDPR imposes more stringent operational requirements for entities processing personal information and greater penalties for noncompliance. The costs and other burdens of compliance with privacy and data security laws and regulations could negatively impact the use and adoption of our solutions and reduce overall demand for them. Additionally, concerns regarding data privacy may cause our customers, or their customers and potential customers, to resist providing the data necessary to allow us to deliver our solutions effectively. Even the perception that the privacy of personal information is not satisfactorily protected or does not meet regulatory requirements could inhibit sales of our solutions and any failure to comply with such laws and regulations could lead to significant fines, penalties or other liabilities. Any such decrease in demand or incurred fines, penalties or other liabilities could have a material adverse effect on our business, results of operations, and financial condition.

In addition to existing laws and regulations, changes in the U.S. or foreign legislative, judicial, regulatory or consumer environments could harm our business, financial condition or results of operations. The laws and regulations above, and changes to them, could affect the demand for or profitability of our products, including scoring and consumer products. New laws and regulations pertaining to our customers could cause them to pursue new strategies, reducing the demand for our products.

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Our revenues depend, to a great extent, upon conditions in the banking (including consumer credit) and insurance industries. If our clients' industries experience uncertainty, it will likely harm our business, financial condition or results of operations.

During fiscal 2017, 76% of our revenues were derived from sales of products and services to the banking and insurance industries. Global economic uncertainty experienced in the U.S. and other key international economies in the past produced substantial stress, volatility, illiquidity and disruption of global credit and other financial markets, resulting in the bankruptcy or acquisition of, or government assistance to, several major domestic and international financial institutions. The potential for disruptions presents considerable risks to our businesses and operations. These risks include potential bankruptcies or credit deterioration of financial institutions, many of which are our customers. Such disruption would result in a decline in the revenue we receive from financial and other institutions.

While the rate of account growth in the U.S. bankcard industry has been slow and many of our large institutional customers have consolidated in recent years, we have generated most of our revenue growth from our bankcard-related scoring and account management businesses by selling and cross-selling our products and services to large banks and other credit issuers. As the banking industry continues to experience contraction in the number of participating institutions, we may have fewer opportunities for revenue growth due to reduced or changing demand for our products and services that support customer acquisition programs of our customers. In addition, industry contraction could affect the base of recurring revenues derived from contracts in which we are paid on a per-transaction basis as formerly separate customers combine their operations under one contract. There can be no assurance that we will be able to prevent future revenue contraction or effectively promote future revenue growth in our businesses.

While we are attempting to expand our sales of consumer credit, banking and insurance products and services into international markets, the risks are greater as these markets are also experiencing substantial disruption and we are less well-known in them.

### Risks Related to External Conditions

Material adverse developments in global economic conditions, or the occurrence of certain other world events, could affect demand for our products and services and harm our business.

Purchases of technology products and services and decisioning solutions are subject to adverse economic conditions. When an economy is struggling, companies in many industries delay or reduce technology purchases, and we experience softened demand for our decisioning solutions and other products and services. Global economic uncertainty has produced substantial stress, volatility, illiquidity and disruption of global credit and other financial markets in the past. Any economic uncertainty can negatively affect the businesses and purchasing decisions of companies in the industries we serve. The potential for disruptions presents considerable risks to our businesses and operations. If global economic conditions experience stress and negative volatility, or if there is an escalation in regional or global conflicts or terrorism, we will likely experience reductions in the number of available customers and in capital expenditures by our remaining customers, longer sales cycles, deferral or delay of purchase commitments for our products and increased price competition, which may adversely affect our business, results of operations and liquidity.

For example, on June 23, 2016, the United Kingdom ("U.K.") held a referendum in which voters approved an exit from the E.U., commonly referred to as "Brexit." As a result of the referendum, on March 29, 2017, the U.K. triggered Article 50 of the Lisbon Treaty formally starting negotiations regarding its exit from the E.U. The U.K. has two years to complete these negotiations, and the future relationship between the U.K. and the E.U. remains unknown. Brexit has caused, and may continue to create, volatility in global stock markets and regional and global economic uncertainty,



which may cause our customers to closely monitor their costs and reduce their spending budget on our products and services.

Whether or not recent or new legislative or regulatory initiatives or other efforts successfully stabilize and add liquidity to the financial markets, we may need to modify our strategies, businesses or operations, and we may incur additional costs in order to compete in a changed business environment. Given the volatile nature of the global economic environment and the uncertainties underlying efforts to stabilize it, we may not timely anticipate or manage existing, new or additional risks, as well as contingencies or developments, which may include regulatory developments and trends in new products and services. Our failure to do so could materially and adversely affect our business, financial condition, results of operations and prospects.

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In operations outside the U.S., we are subject to unique risks that may harm our business, financial condition or results of operations.

A growing portion of our revenues is derived from international sales. During fiscal 2017, 36% of our revenues were derived from business outside the U.S. As part of our growth strategy, we plan to continue to pursue opportunities outside the U.S., including opportunities in countries with economic systems that are in early stages of development and that may not mature sufficiently to result in growth for our business. Accordingly, our future operating results could be negatively affected by a variety of factors arising out of international commerce, some of which are beyond our control. These factors include:

- general economic and political conditions in countries where we sell our products and services;
- difficulty in staffing and efficiently managing our operations in multiple geographic locations and in various countries;
- effects of a variety of foreign laws and regulations, including restrictions on access to personal information;
- import and export licensing requirements;
- longer payment cycles;
- reduced protection for intellectual property rights;
- currency fluctuations;
- changes in tariffs and other trade barriers; and
- difficulties and delays in translating products and related documentation into foreign languages.

There can be no assurance that we will be able to successfully address each of these challenges in the near term. Additionally, some of our business will be conducted in currencies other than the U.S. dollar. Foreign currency transaction gains and losses are not currently material to our cash flows, financial position or results of operations. However, an increase in our foreign revenues could subject us to increased foreign currency transaction risks in the future.

In addition to the risk of depending on international sales, we have risks incurred in having research and development personnel located in various international locations. We currently have a substantial portion of our product development staff in international locations, some of which have political and developmental risks. If such risks materialize, our business could be damaged.

Our anti-takeover defenses could make it difficult for another company to acquire control of FICO, thereby limiting the demand for our securities by certain types of purchasers or the price investors are willing to pay for our stock.

Certain provisions of our Restated Certificate of Incorporation, as amended, could make a merger, tender offer or proxy contest involving us difficult, even if such events would be beneficial to the interests of our stockholders. These provisions include giving our board the ability to issue preferred stock and determine the rights and designations of the preferred stock at any time without stockholder approval. The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire, or discouraging a third party from acquiring, a majority of our outstanding voting stock. These factors and certain provisions of the Delaware General Corporation Law may have the effect of deterring hostile takeovers or otherwise delaying or preventing changes in control or changes in our management, including transactions in which our stockholders might otherwise receive a premium over the fair market value of our common stock.

If we experience changes in tax laws or adverse outcomes resulting from examination of our income tax returns, it could adversely affect our results of operations.

We are subject to federal and state income taxes in the U.S. and in certain foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. Our future effective tax rates could be adversely affected by changes in tax laws, by our ability to generate taxable income in foreign jurisdictions in order to utilize foreign tax losses, and by the valuation of our deferred tax assets. In addition, we are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from such examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from such examinations will not have an adverse effect on our operating results and financial condition.

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## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Issuer Purchases of Equity Securities

| Period                               | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2) | Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2) |
|--------------------------------------|--------------------------------------|------------------------------|--|--|
| April 1, 2018 through April 30, 2018 | 9,745                                | \$ 172.04                    | —  | \$ 161,990,477   |
| May 1, 2018 through May 31, 2018     | 213,956                              | \$ 180.85                    | 210,000  | \$ 124,002,440   |
| June 1, 2018 through June 30, 2018   | 353,414                              | \$ 195.02                    | 353,196  | \$ 55,121,758  |
|                                      | 577,115                              | \$ 189.38                    | 563,196  | \$ 55,121,758  |

(1) Includes 13,919 shares delivered in satisfaction of the tax withholding obligations resulting from the vesting of restricted stock units held by employees during the quarter ended June 30, 2018.

In October 2017, our Board of Directors approved a stock repurchase program following the completion of our previous program. This program was open-ended and authorized repurchases of shares of our common stock up to an aggregate cost of \$250.0 million in the open market or in negotiated transactions. In July 2018, our Board of Directors approved a new stock repurchase program following the completion of the October 2017 program. The new program is open-ended and authorizes repurchases of shares of our common stock up to an aggregate cost of \$250.0 million in the open market or in negotiated transactions.

## Item 3. Defaults Upon Senior Securities

Not applicable.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

Not applicable.

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Item 6. Exhibits

| Exhibit Number | Description  |
|----------------|--|
| 3.1            | <u>Composite Restated Certificate of Incorporation of Fair Isaac Corporation (incorporated by reference to Exhibit 3.2 to the Company's Form 10-Q for the quarter ended December 31, 2009 (file no. 001-11689)).</u>   |
| 3.2            | <u>By-laws of Fair Isaac Corporation (incorporated by reference to Exhibit 3.1 to the Company's Form 10-Q for the quarter ended December 31, 2009 (file no. 001-11689)).</u>   |
| 4.1            | <u>Indenture dated as of May 8, 2018 by and between the Company and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's Form 8-K filed on May 8, 2018 (file no. 001-11689)).</u>   |
| 4.2            | <u>Form of the Company's 5.25% Senior Notes due 2026 (included in Exhibit 4.1 hereto).</u>   |
| 10.1           | <u>Third Amendment to Amended and Restated Credit Agreement dated as of May 8, 2018 by and among the Company, the several banks and other financial institutions party thereto, and Wells Fargo Bank, National Association, as administrative agent (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on May 8, 2018 (file no. 001-11689)).</u> |
| 31.1 *         | <u>Rule 13a-14(a)/15d-14(a) Certifications of CEO.</u>   |
| 31.2 *         | <u>Rule 13a-14(a)/15d-14(a) Certifications of CFO.</u>   |
| 32.1 *         | <u>Section 1350 Certification of CEO.</u>  |
| 32.2 *         | <u>Section 1350 Certification of CFO.</u>  |
| 101.INS        | XBRL Instance Document.  |
| 101.SCH        | XBRL Taxonomy Extension Schema Document.   |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase Document.   |
| 101.DEF        | XBRL Taxonomy Extension Definition Linkbase Document.  |
| 101.LAB        | XBRL Taxonomy Extension Label Linkbase Document.   |
| 101.PRE        | XBRL Taxonomy Extension Presentation Linkbase Document.  |

\* Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FAIR ISAAC CORPORATION

DATE: July 26, 2018

By/s/ MICHAEL J. PUNG  
Michael J. Pung  
Executive Vice President and Chief Financial Officer  
(for Registrant as duly authorized officer and  
as Principal Financial Officer)

DATE: July 26, 2018

By/s/ MICHAEL S. LEONARD  
Michael S. Leonard  
Vice President and Chief Accounting Officer  
(Principal Accounting Officer)