

Monotype Imaging Holdings Inc.
Form 10-Q
October 31, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from _____ to _____

Commission File Number 001-33612

MONOTYPE IMAGING HOLDINGS INC.
(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation)

20-3289482
(I.R.S. Employer

Identification No.)

500 Unicorn Park Drive

Woburn, Massachusetts
(Address of principal executive offices)

01801
(Zip Code)

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

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

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares outstanding of the registrant's common stock as of October 27, 2014 was 39,307,274.

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MONOTYPE IMAGING HOLDINGS INC.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements
MONOTYPE IMAGING HOLDINGS INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited and in thousands, except share and per share data)**

| | September 30, 2014 | December 31, 2013 |
|---|-------------------------------|------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 82,588 | \$ 78,411 |
| Accounts receivable, net of allowance for doubtful accounts of \$190 at September 30, 2014 and \$171 at December 31, 2013 | 8,622 | 8,317 |
| Income tax refunds receivable | 818 | 3,334 |
| Deferred income taxes | 3,300 | 3,557 |
| Prepaid expense and other current assets | 3,258 | 3,394 |
| Total current assets | 98,586 | 97,013 |
| Property and equipment, net | 7,712 | 3,568 |
| Goodwill | 179,516 | 176,350 |
| Intangible assets, net | 75,811 | 76,684 |
| Other assets | 2,585 | 2,744 |
| Total assets | \$ 364,210 | \$ 356,359 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 2,049 | \$ 1,112 |
| Accrued expenses and other current liabilities | 24,905 | 20,439 |
| Deferred revenue | 6,913 | 6,767 |
| Total current liabilities | 33,867 | 28,318 |
| Deferred revenue | 744 | 972 |
| Deferred income taxes | 34,164 | 32,600 |
| Reserve for income taxes, net of current portion | 2,826 | 2,496 |
| Accrued pension benefits | 4,876 | 5,098 |
| Commitments and contingencies (<i>Note 15</i>) | | |
| Stockholders equity: | | |
| Preferred stock, \$0.001 par value, Authorized shares: 10,000,000; Issued and outstanding: none | | |
| | 39 | 39 |

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| | | |
|---|------------|------------|
| Common stock, \$0.001 par value, Authorized shares: 250,000,000; Issued: 39,825,827 at September 30, 2014 and 39,277,713 at December 31, 2013 | | |
| Additional paid-in capital | 225,609 | 209,376 |
| Treasury stock, at cost, 1,167,615 shares at September 30, 2014 and 204,830 shares at December 31, 2013 | (28,344) | (2,279) |
| Retained earnings | 92,460 | 78,741 |
| Accumulated other comprehensive (loss) income | (2,031) | 998 |
| Total stockholders equity | 287,733 | 286,875 |
| Total liabilities and stockholders equity | \$ 364,210 | \$ 356,359 |

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenue | \$ 47,063 | \$ 40,468 | \$ 138,098 | \$ 123,592 |
| Costs and expenses: | | | | |
| Cost of revenue | 7,227 | 5,935 | 21,057 | 17,960 |
| Cost of revenue amortization of acquired technology | 1,144 | 1,141 | 3,435 | 3,418 |
| Total cost of revenue | 8,371 | 7,076 | 24,492 | 21,378 |
| Gross profit | 38,692 | 33,392 | 113,606 | 102,214 |
| Operating expenses: | | | | |
| Marketing and selling | 13,361 | 10,632 | 36,466 | 30,943 |
| Research and development | 5,227 | 4,655 | 15,890 | 14,518 |
| General and administrative | 6,491 | 4,926 | 18,075 | 14,611 |
| Amortization of other intangible assets | 1,587 | 1,490 | 4,450 | 4,467 |
| Total operating expenses | 26,666 | 21,703 | 74,881 | 64,539 |
| Income from operations | 12,026 | 11,689 | 38,725 | 37,675 |
| Other (income) expense: | | | | |
| Interest expense | 298 | 271 | 832 | 1,002 |
| Interest income | (33) | (5) | (41) | (10) |
| Loss on foreign exchange | 817 | 98 | 987 | 938 |
| (Gain) loss on derivatives | (247) | 216 | (33) | 216 |
| Other expense (income), net | 50 | 8 | 46 | (29) |
| Total other expense | 885 | 588 | 1,791 | 2,117 |
| Income before provision for income taxes | 11,141 | 11,101 | 36,934 | 35,558 |
| Provision for income taxes | 4,102 | 4,037 | 13,759 | 12,567 |
| Net income | \$ 7,039 | \$ 7,064 | \$ 23,175 | \$ 22,991 |
| Net income available to common shareholders basic & diluted | \$ 6,899 | \$ 6,950 | \$ 22,745 | \$ 22,608 |
| Net income per common share: | | | | |
| Basic | \$ 0.18 | \$ 0.18 | \$ 0.59 | \$ 0.60 |
| Diluted | \$ 0.17 | \$ 0.18 | \$ 0.57 | \$ 0.58 |

Weighted average number of shares:

| | | | | |
|-------------------------------------|------------|------------|------------|------------|
| Basic | 38,431,031 | 38,276,890 | 38,543,401 | 37,717,883 |
| Diluted | 39,487,302 | 39,657,474 | 39,663,807 | 39,205,915 |
| Dividends declared per common share | \$ 0.08 | \$ 0.06 | \$ 0.24 | \$ 0.18 |

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

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MONOTYPE IMAGING HOLDINGS INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited and in thousands)

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Net income | \$ 7,039 | \$ 7,064 | \$ 23,175 | \$ 22,991 |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrecognized actuarial gain | | 17 | | 28 |
| Foreign currency translation adjustments | (2,868) | 1,288 | (3,029) | 608 |
| Comprehensive income | \$ 4,171 | \$ 8,369 | \$ 20,146 | \$ 23,627 |

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

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MONOTYPE IMAGING HOLDINGS INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and in thousands)

| | Nine Months Ended September 30, | |
|---|--|-------------|
| | 2014 | 2013 |
| Cash flows from operating activities | | |
| Net income | \$ 23,175 | \$ 22,991 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 9,147 | 9,036 |
| Loss on retirement of fixed assets | 78 | 23 |
| Amortization of deferred financing costs and accretion of interest | 337 | 414 |
| Adjustment to contingent consideration | (1,152) | |
| Share based compensation | 7,835 | 5,994 |
| Excess tax benefit on stock options | (3,011) | (5,242) |
| Provision for doubtful accounts | 29 | 84 |
| Deferred income taxes | 2,202 | 4,382 |
| Unrealized currency gain on foreign denominated intercompany transactions | 423 | (29) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (366) | (905) |
| Prepaid expenses and other assets | 934 | (311) |
| Accounts payable | 996 | 35 |
| Accrued income taxes | 6,493 | 1,099 |
| Accrued expenses and other liabilities | (808) | (520) |
| Deferred revenue | 86 | (1,025) |
| Net cash provided by operating activities | 46,398 | 36,026 |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (4,474) | (1,373) |
| Purchases of exclusive license | (100) | |
| Acquisition of business, net of cash acquired | (10,621) | (72) |
| Net cash used in investing activities | (15,195) | (1,445) |
| Cash flows from financing activities | | |
| Payments on line of credit | | (22,321) |
| Excess tax benefit on stock options | 3,011 | 5,242 |
| Common stock dividends paid | (8,670) | (6,112) |
| Purchase of treasury stock | (26,065) | |
| Proceeds from exercises of common stock options | 5,285 | 13,644 |
| Net cash used in financing activities | (26,439) | (9,547) |

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| | | |
|---|-----------|-----------|
| Effect of exchange rates on cash and cash equivalents | (587) | (39) |
| Increase in cash and cash equivalents | 4,177 | 24,995 |
| Cash and cash equivalents at beginning of period | 78,411 | 39,340 |
| Cash and cash equivalents at end of period | \$ 82,588 | \$ 64,335 |

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

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MONOTYPE IMAGING HOLDINGS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2014

1. Nature of the Business

Monotype Imaging Holdings Inc. (the Company or we) is a leading provider of type, technology and expertise for creative applications and consumer electronics, or CE, devices. Our end-user and embedded solutions for print, web and mobile environments enable people to create and consume dynamic content on any and every device. Our technologies and fonts enable the display and printing of high quality digital text. Our technologies and fonts have been widely deployed across, and embedded in, a range of CE devices including laser printers, digital copiers, mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, digital televisions, set-top boxes and consumer appliances, as well as in numerous software applications and operating systems. We also provide printer drivers, page description language interpreters, printer user interface technology and color imaging solutions to printer manufacturers and OEMs (original equipment manufacturers). We license our fonts and technologies to CE device manufacturers, independent software vendors and creative and business professionals and we are headquartered in Woburn, Massachusetts. We operate in one business segment: the development, marketing and licensing of technologies and fonts. We also maintain various offices worldwide for selling and marketing, research and development and administration. We conduct our operations through three domestic operating subsidiaries, Monotype Imaging Inc., Monotype ITC Inc. and MyFonts Inc., and six foreign operating subsidiaries, Monotype Ltd., Monotype GmbH, Monotype Solutions India Pvt. Ltd., Monotype Hong Kong Ltd. and Monotype KK, and FontShop AG, which was acquired on July 14, 2014, see Note 4.

2. Basis of Presentation

The accompanying unaudited condensed consolidated interim financial statements as of September 30, 2014 and for the three and nine months ended September 30, 2014 and 2013 include the accounts of the Company and its wholly-owned subsidiaries and have been prepared in conformity with accounting principles generally accepted in the United States (GAAP) for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for Quarterly Reports on Form 10-Q and Article 10 of Regulation S-X. Accordingly, such financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. GAAP requires the Company s management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. The results for interim periods are not necessarily indicative of results to be expected for the year or for any future periods.

In management s opinion, these unaudited condensed consolidated interim financial statements contain all adjustments of a normal recurring nature necessary for a fair presentation of the financial statements for the interim periods presented.

These unaudited condensed consolidated interim financial statements should be read in conjunction with the Company s audited consolidated financial statements for the year ended December 31, 2013 as reported in the Company s Annual Report on Form 10-K.

3. Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update 2014-9, *Revenue from Contracts with Customers (Topic 606)*, which provides a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of good or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. This guidance is effective for annual reporting and interim periods beginning after December 15, 2016 and allows for either full retrospective or modified retrospective application, with early adoption not permitted. Accordingly, the standard is effective for the Company on January 1, 2017. The Company is currently evaluating the adoption method it will apply and the impact that this guidance will have on its financial statements and related disclosures.

4. Acquisitions

FontShop

On July 14, 2014 the Company purchased all of the outstanding stock of FontShop International GmbH, a privately-held font distributor located in Berlin, Germany, its wholly-owned subsidiary FontShop International, Inc. based in San Francisco, California, the FontFont typeface library, FontShop AG of Berlin, the largest distributor of the FontFont library, and certain other typeface families, collectively FontShop, for an aggregate purchase price of approximately \$13.0 million plus a working capital adjustment of approximately \$2.2 million. We paid approximately \$11.9 million from cash on hand at the time of the acquisition, and the remainder, or \$3.3 million, is expected to be paid during the fourth quarter of 2014. Of the purchase price, approximately \$8.4 million and \$6.6 million have been preliminarily allocated to intangible assets and goodwill, respectively. The purchase price has been allocated to the tangible and intangible assets acquired and liabilities assumed based upon the respective estimates of fair value as of the date of the

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acquisition, which remains preliminary as of September 30, 2014, and using assumptions that the Company management believes are reasonable given the information currently available. The Company is in the process of completing its valuation of certain intangible assets and the valuation of the acquired deferred tax assets and liabilities. The final allocation of the purchase price to intangible assets, goodwill and deferred tax assets and liabilities may differ materially from the information presented in these unaudited condensed consolidated financial statements. On October 9, 2014, FontShop International GmbH was merged into Monotype GmbH. Following the merger, FontShop International Inc. is a wholly-owned subsidiary of Monotype GmbH. The Company has begun the process of merging FontShop AG into Monotype GmbH. Fifty employees joined the Company in connection with the acquisition.

Mark Boulton Design

On April 7, 2014, the Company purchased all of the outstanding stock of Mark Boulton Design Limited, a privately-held Web design studio located in Cardiff, Wales, United Kingdom, for approximately \$0.8 million in cash. The Company issued approximately \$1.0 million in restricted stock awards in connection with the acquisition, which vest based upon continued employment over four years. In preliminary purchase accounting, the majority of the purchase price, or approximately \$0.7 million, has been allocated to goodwill. Following the acquisition, Mark Boulton Design Limited became a wholly owned subsidiary of the Company. Seven former employees of Mark Boulton Design Limited joined the Company in connection with the acquisition.

5. Derivative Financial Instruments

From time to time, we may incur foreign currency exchange gains and losses related to certain customers that are invoiced in U.S. dollars, but who have the option to make an equivalent payment in their own functional currencies at a specified exchange rate as of a specified date. In the period from that date until payment in the customer's functional currency is received and converted into U.S. dollars, we can incur realized gains and losses. From time to time we may enter into foreign currency contracts to mitigate these exposures. At September 30, 2014 and December 31, 2013 there were no such currency contracts outstanding.

We also incur foreign currency exchange gains and losses on certain intercompany assets and liabilities denominated in foreign currencies. We are currently utilizing 30-day forward contracts to mitigate our exposure on these currency fluctuations. These contracts are generally set to expire and are settled at month end. The instruments are not designated as hedging instruments, and accordingly, the gain or loss is recognized upon cash settlement and is included in loss on derivatives in the accompanying consolidated statements of income. At September 30, 2014 and December 31, 2013 there was one contract outstanding, to purchase and sell two different currencies forward, which was entered into on those dates. See Note 6 for details regarding the fair value of these instruments.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Currency swaps | \$ (247) | \$ 216 | \$ (33) | \$ 216 |
| Total | \$ (247) | \$ 216 | \$ (33) | \$ 216 |

6. Fair Value Measurements

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

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

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

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

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

The following table presents our financial assets and liabilities that are carried at fair value, classified according to the three categories described above (in thousands):

| | Fair Value Measurement at September 30, 2014 | | | |
|--------------------------------------|--|---|---|--|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents money market funds | \$ 38,524 | \$ 38,524 | \$ | \$ |
| Total assets | \$ 38,524 | \$ 38,524 | \$ | \$ |
| Liabilities: | | | | |
| Contingent acquisition consideration | \$ 878 | \$ | \$ | \$ 878 |
| Total liabilities | \$ 878 | \$ | \$ | \$ 878 |

| | Fair Value Measurement at December 31, 2013 | | | |
|--------------------------------------|---|---|---|--|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents money market funds | \$ 832 | \$ 832 | \$ | \$ |
| Cash equivalents commercial paper | 8,998 | | 8,998 | |
| Cash equivalents corporate bonds | 8,585 | | 8,585 | |
| Total assets | \$ 18,415 | \$ 832 | \$ 17,583 | \$ |
| Liabilities: | | | | |
| Contingent acquisition consideration | \$ 2,302 | \$ | \$ | \$ 2,302 |
| Total liabilities | \$ 2,302 | \$ | \$ | \$ 2,302 |

The Company's recurring fair value measures relate to short-term investments, which are classified as cash equivalents and derivative instruments. The fair value of our cash equivalents are either based on quoted prices for similar assets or other observable inputs such as yield curves at commonly quoted intervals and other market corroborated inputs.

The fair value of our derivatives is based on quoted market prices from various banking institutions or an independent third party provider for similar instruments. In determining the fair value, we consider our non-performance risk and that of our counterparties. At September 30, 2014, we had one 30-day forward contract to sell 2.4 million British pound sterling and purchase \$3.9 million that together, had an immaterial fair value. At December 31, 2013, we had one 30-day forward contract outstanding to sell 3.0 million British pound sterling and purchase \$5.0 million that together, had a fair value that was materially equivalent to its book value.

For the recurring fair value measure, contingent acquisition consideration, the Company estimated the fair value of the liability by judgmentally weighting the range of possible achievement of the criteria upon which the contingent consideration to be paid will be determined. The resulting estimated amount was then adjusted to its estimated net present value based upon a present value factor that was derived by applying a risk adjusted discount rate over the applicable contingency period. The contingent acquisition consideration decreased by \$0.6 million in the third quarter of 2014 and by \$1.2 million for the first three quarters of 2014, as the estimated liability was revised based on changes in performance estimates. In addition in 2014, the liability decreased due to the payment of \$0.4 million, in accordance with the terms of the underlying agreement. These decreases were partially offset by the accretion of the net present value of the liability. The gain of \$0.6 million and \$1.2 million in the three and nine months ended September 30, 2014, respectively, is included in general and administrative expense in our condensed consolidated statements of income.

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The Company's non-financial assets and non-financial liabilities subject to non-recurring measurements include goodwill and intangible assets.

7. Property and Equipment

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

| | September 30, 2014 | December 31, 2013 |
|--|-----------------------|----------------------|
| Computer equipment and software | \$ 11,102 | \$ 11,371 |
| Furniture and fixtures | 1,182 | 1,170 |
| Leasehold improvements | 1,301 | 866 |
| Total cost | 13,585 | 13,407 |
| Less accumulated depreciation and amortization | (5,873) | (9,839) |
| Property and equipment, net | \$ 7,712 | \$ 3,568 |

At September 30, 2014, computer equipment and software included \$3.6 million of unamortized software costs related to internal use software projects in process and leasehold improvements included approximately \$0.5 million for building improvements in connection with our new office lease, which amortization will commence once we occupy the space. During the third quarter of 2014, the Company disposed of \$5.0 million of retired computer equipment, that had associated accumulated depreciation of approximately \$4.9 million, as the equipment was no longer in use.

8. Intangible Assets

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

| | September 30, 2014 | | | December 31, 2013 | | | |
|-------------------------------------|--|-----------------------------|-----------------------------|-------------------|-----------------------------|-----------------------------|----------------|
| | Weighted- Average Amortization Period (Years) | Gross Carrying Amount | Accumulated Amortization | Net Balance | Gross Carrying Amount | Accumulated Amortization | Net Balance |
| Customer relationships | 10 | \$ 57,157 | \$ (46,422) | \$ 10,735 | \$ 57,319 | \$ (42,482) | \$ 14,837 |
| Acquired technology | 12 | 55,325 | (33,187) | 22,138 | 51,206 | (29,734) | 21,472 |
| Non-compete agreements | 4 | 12,238 | (11,872) | 366 | 12,077 | (11,903) | 174 |
| Indefinite-lived intangible assets: | | | | | | | |
| Trademarks | | 38,172 | | 38,172 | 35,801 | | 35,801 |
| Domain names | | 4,400 | | 4,400 | 4,400 | | 4,400 |
| Total | | \$ 167,292 | \$ (91,481) | \$ 75,811 | \$ 160,803 | \$ (84,119) | \$ 76,684 |

9. Debt

On July 13, 2011 the Company entered into a credit agreement with Wells Fargo Capital Finance, LLC, or the Credit Facility, which provides the Company with a five-year, \$120.0 million secured revolving credit facility. Borrowings under the Credit Facility bear interest at a variable rate based upon, at the Company's option, either LIBOR or the base rate (which is the highest of (i) the prime rate, (ii) 0.5% plus the overnight federal funds rate, and (iii) 1.0% in excess of the three-month LIBOR rate), plus in each case, an applicable margin. The applicable margin for LIBOR loans, based on the applicable leverage ratio, is either 1.5% or 2.0% per annum, and the applicable margin for base rate loans, based on the applicable leverage ratio, is either 0.5% or 1.0% per annum. At September 30, 2014 our rate, inclusive of applicable margins, was 3.75% for prime. At September 30, 2014, the Company had no outstanding debt under the Credit Facility. The Company is required to pay an unused line fee equal to 0.375% per annum on the undrawn portion available under the revolving credit facility and variable per annum fees in respect of outstanding letters of credit, if any. Such fees are included in interest expense in the accompanying condensed consolidated statements of income.

The Credit Facility contains financial covenants which include (i) a maximum ratio of consolidated total debt to consolidated adjusted EBITDA of 3.00:1.00, and (ii) a minimum consolidated fixed charge coverage ratio of 1.25:1.00. Adjusted EBITDA, under the Credit Facility, is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation expense, plus acquisition expenses not to exceed \$2.0 million, plus restructuring, issuance costs, cash non-operating costs and other expenses or losses minus cash non-operating gains and other non-cash gains; provided

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however that the aggregate of all cash non-operating expense shall not exceed \$250 thousand and all such fees, costs and expenses shall not exceed \$1.5 million on a trailing twelve months basis. Failure to comply with these covenants, or the occurrence of an event of default, could permit the Lenders under the Credit Facility to declare all amounts borrowed under the Credit Facility, together with accrued interest and fees, to be immediately due and payable. In addition, the Credit Facility is secured by substantially all of our assets and places limits on the Company's and its subsidiaries' ability to incur debt or liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, engage in mergers, acquisitions and asset sales, transact with affiliates and alter its business. We were in compliance with all covenants under our Credit Facility as of September 30, 2014.

10. Defined Benefit Pension Plan

Our German subsidiary maintains an unfunded defined benefit pension plan which covers substantially all employees who joined the company prior to the plan's closure to new participants in 2006. Participants are entitled to benefits in the form of retirement, disability and surviving dependent pensions. Benefits generally depend on years of service and the salary of the employees.

The components of net periodic benefit cost included in the accompanying condensed consolidated statements of income were as follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---------------------------|--------------------|-------|-------------------|--------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Service cost | \$ 27 | \$ 30 | \$ 86 | \$ 89 |
| Interest cost | 41 | 40 | 129 | 119 |
| Amortization | 1 | | 1 | |
| Net periodic benefit cost | \$ 69 | \$ 70 | \$ 216 | \$ 208 |

11. Income Taxes

A reconciliation of income taxes computed at federal statutory rates to income tax expense is as follows (dollar amounts in thousands):

| | Three Months Ended | | | |
|--|--------------------|--------|----------|--------|
| | September 30, | | | |
| | 2014 | | 2013 | |
| Provision for income taxes at statutory rate | \$ 3,899 | 35.0% | \$ 3,885 | 35.0% |
| State and local income taxes, net of federal tax benefit | 205 | 1.8% | 209 | 1.9% |
| Stock compensation | 78 | 0.7% | 71 | 0.6% |
| Research credits | | | (47) | (0.4)% |
| Effect of rate changes on deferred taxes | | | 17 | 0.2% |
| Reversal of reserve for income taxes | (131) | (1.2)% | (89) | (0.8)% |
| Disqualifying dispositions on incentive stock options | (62) | (0.6)% | (19) | (0.2)% |
| Other, net | 113 | 1.1% | 10 | 0.1% |

| | | | | |
|-------------------------------|----------|-------|----------|-------|
| Reported income tax provision | \$ 4,102 | 36.8% | \$ 4,037 | 36.4% |
|-------------------------------|----------|-------|----------|-------|

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| | Nine Months Ended September 30, | | | |
|--|--|--------------|------------------|--------------|
| | 2014 | | 2013 | |
| Provision for income taxes at statutory rate | \$ 12,927 | 35.0% | \$ 12,445 | 35.0% |
| State and local income taxes, net of federal tax benefit | 686 | 1.9% | 578 | 1.6% |
| Stock compensation | 243 | 0.7% | 211 | 0.6% |
| Research credits | | | (424) | (1.2%) |
| Effect of rate changes on deferred taxes | | | 17 | |
| Reversal of reserve for income taxes | (131) | (0.4)% | (79) | (0.2)% |
| Disqualifying dispositions on incentive stock options | (104) | (0.3)% | (200) | (0.6)% |
| Other, net | 138 | 0.3% | 19 | 0.1% |
| Reported income tax provision | \$ 13,759 | 37.2% | \$ 12,567 | 35.3% |

At September 30, 2014, the reserve for uncertain tax positions was approximately \$6.6 million. Of this amount, approximately \$3.7 million was recorded as a reduction of deferred tax assets and approximately \$2.8 million was classified as long term liabilities.

12. Net Income Per Share

Basic and diluted earnings per share are computed pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating security according to their respective participation rights in undistributed earnings. Unvested restricted stock awards granted to employees are considered participating securities as they receive non-forfeitable rights to cash dividends at the same rate as common stock. In accordance with ASC Topic No. 260, *Earnings Per Share*, diluted net income per share is calculated using the more dilutive of the following two approaches:

1. Assume exercise of stock options and vesting of restricted stock using the treasury stock method.
2. Assume exercise of stock options using the treasury stock method, but assume participating securities (unvested restricted stock) are not vested and allocate earnings to common shares and participating securities using the two-class method.

For all periods presented, the treasury stock method was used in the computation of diluted net income per share, as the result was more dilutive. The following presents a reconciliation of the numerator and denominator used in the calculation of basic and diluted net income per share (in thousands, except share and per share data):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Numerator: | | | | |
| Net income, as reported | \$ 7,039 | \$ 7,064 | \$ 23,175 | \$ 22,991 |
| Less: net income attributable to participating securities | (140) | (114) | (430) | (383) |

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| | | | | | | | | |
|---|----|-------|----|-------|----|--------|----|--------|
| Net income available to common shareholders basic and diluted | \$ | 6,899 | \$ | 6,950 | \$ | 22,745 | \$ | 22,608 |
|---|----|-------|----|-------|----|--------|----|--------|

Denominator:

Basic:

| | | | | |
|---|------------|------------|------------|------------|
| Weighted-average shares of common stock outstanding | 39,222,580 | 38,919,553 | 39,290,673 | 38,368,929 |
|---|------------|------------|------------|------------|

| | | | | |
|---|-----------|-----------|-----------|-----------|
| Less: weighted-average shares of unvested restricted common stock outstanding | (791,549) | (642,663) | (747,272) | (651,046) |
|---|-----------|-----------|-----------|-----------|

Weighted-average number of common shares used in computing basic net income per common share

| | | | | |
|--|------------|------------|------------|------------|
| | 38,431,031 | 38,276,890 | 38,543,401 | 37,717,883 |
|--|------------|------------|------------|------------|

| | | | | | | | | |
|--|----|------|----|------|----|------|----|------|
| Net income per share applicable to common shareholders basic | \$ | 0.18 | \$ | 0.18 | \$ | 0.59 | \$ | 0.60 |
|--|----|------|----|------|----|------|----|------|

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Diluted: | | | | |
| Weighted-average shares of common stock outstanding | 39,222,580 | 38,919,553 | 39,290,673 | 38,368,929 |
| Less: weighted-average shares of unvested restricted common stock outstanding | (791,549) | (642,663) | (747,272) | (651,046) |
| Weighted-average number of common shares issuable upon exercise of outstanding stock options, based on the treasury stock method | 893,081 | 1,164,688 | 946,674 | 1,283,758 |
| Weighted-average number of restricted stock outstanding, based on the treasury stock method | 163,190 | 215,896 | 173,732 | 204,274 |
| Weighted-average number of common shares used in computing diluted net income per common share | 39,487,302 | 39,657,474 | 39,663,807 | 39,205,915 |
| Net income per share applicable to common shareholders diluted | \$ 0.17 | \$ 0.18 | \$ 0.57 | \$ 0.58 |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Options | 307,516 | 456,627 | 380,544 | 363,137 |
| Unvested restricted stock | 817 | 2,022 | 156,148 | 23,175 |
| Unvested restricted stock units | 2,043 | | 2,961 | |

13. Stockholders Equity*Share purchases*

On October 23, 2013, the Company's Board of Directors approved a share purchase program of up to \$50.0 million of the Company's outstanding shares of common stock over the next two years. Intended to offset shareholder dilution, the Company expects purchases under the program will be made periodically, on the open market as business and market conditions warrant. The share repurchase program does not obligate the Company to acquire any particular amount of common stock, and the program may be suspended or discontinued at management's and/or the Board of Director's discretion. As of September 30, 2014, the Company has purchased a total of 1,016,169 shares of its common stock for an aggregate purchase price of \$28.3 million, including brokers' fees. As of December 31, 2013, the Company purchased 75,000 shares of common stock for an aggregate purchase price of \$2.2 million, including brokers' fees.

Table of Contents*Share Based Compensation*

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Marketing and selling | \$ 1,257 | \$ 1,003 | \$ 3,553 | \$ 2,753 |
| Research and development | 620 | 501 | 1,747 | 1,405 |
| General and administrative | 942 | 655 | 2,535 | 1,836 |
| Total expensed | \$ 2,819 | \$ 2,159 | \$ 7,835 | \$ 5,994 |
| Property and equipment | 39 | | 102 | |
| Total share based compensation | \$ 2,858 | \$ 2,159 | \$ 7,937 | \$ 5,994 |

In the three and nine months ended September 30, 2014, approximately \$39 thousand and \$102 thousand, respectively, of share based compensation was capitalized as part of an internal software project, and this amount is included in property and equipment, net in our condensed consolidated balance sheet.

As of September 30, 2014, the Company had \$21.8 million of unrecognized compensation expense, which is net of expected forfeitures, related to employees and directors' unvested stock options and restricted stock awards that are expected to be recognized over a weighted average period of 1.8 years.

14. Segment Reporting

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Creative Professional | \$ 20,118 | \$ 16,449 | \$ 56,103 | \$ 46,435 |
| OEM | 26,945 | 24,019 | 81,995 | 77,157 |
| Total | \$ 47,063 | \$ 40,468 | \$ 138,098 | \$ 123,592 |

Table of Contents**Geographic segment information**

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

| | Three Months Ended September 30, | | | |
|---|---|-------------------|--------------|-------------------|
| | 2014 | | 2013 | |
| | Sales | % of Total | Sales | % of Total |
| (In thousands, except percentages) | | | | |
| United States | \$ 25,041 | 53.2% | \$ 21,405 | 52.9% |
| United Kingdom | 2,248 | 4.8 | 2,223 | 5.5 |
| Germany | 7,131 | 15.2 | 5,059 | 12.5 |
| Japan | 12,449 | 26.4 | 11,651 | 28.8 |
| Other Asia | 194 | 0.4 | 130 | 0.3 |
| Total | \$ 47,063 | 100.0% | \$ 40,468 | 100.0% |

| | Nine Months Ended September 30, | | | |
|---|--|-------------------|--------------|-------------------|
| | 2014 | | 2013 | |
| | Sales | % of Total | Sales | % of Total |
| (In thousands, except percentages) | | | | |
| United States | \$ 73,579 | 53.3% | \$ 68,911 | 55.7% |
| United Kingdom | 7,577 | 5.5 | 5,168 | 4.2 |
| Germany | 15,818 | 11.5 | 13,179 | 10.7 |
| Japan | 40,530 | 29.3 | 35,958 | 29.1 |
| Other Asia | 594 | 0.4 | 376 | 0.3 |
| Total | \$ 138,098 | 100.0% | \$ 123,592 | 100.0% |

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

| | September 30, 2014 | December 31, 2013 |
|--------------------|-------------------------------|------------------------------|
| Long-lived assets: | | |

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| | | | | |
|------------------------|----|---------|----|---------|
| United States | \$ | 189,912 | \$ | 192,066 |
| United Kingdom | | 5,427 | | 4,926 |
| Germany | | 64,106 | | 56,140 |
| Asia (including Japan) | | 3,594 | | 3,470 |
| Total | \$ | 263,039 | \$ | 256,602 |

Table of Contents**15. Commitments and Contingencies*****Operating Leases***

We conduct operations in facilities under operating leases expiring through 2022. In accordance with the lease terms, we pay real estate taxes and other operating costs. Our leases in California, New York, Massachusetts, Germany, India and Japan contain renewal options. The Company's future minimum payments under non-cancelable operating leases as of September 30, 2014, are approximately as follows (in thousands):

| | |
|----------------------------|-----------|
| Years ending September 30: | |
| 2015 | \$ 3,191 |
| 2016 | 2,823 |
| 2017 | 2,139 |
| 2018 | 1,696 |
| 2019 | 1,539 |
| Thereafter | 4,097 |
| Total | \$ 15,485 |

Legal Proceedings

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

Licensing Warranty

Under our standard license agreement with our OEM customers, we warrant that the licensed technologies are free of infringement claims of intellectual property rights and will meet the specifications as defined in the licensing agreement for a specified period, typically one year. Under the licensing agreements, liability for such indemnity obligations is limited, generally to the total arrangement fee; however, exceptions have been made on a case-by-case basis, increasing the maximum potential liability to agreed upon amounts at the time the contract is entered into. We have never incurred costs payable to a customer or business partner to defend lawsuits or settle claims related to these warranties, and as a result, management believes the estimated fair value of these warranties is minimal. Accordingly, there are no liabilities recorded for these warranties as of September 30, 2014 and December 31, 2013.

16. Subsequent Events***Dividend Declaration***

On October 28, 2014 the Company's Board of Directors declared a \$0.08 per share quarterly cash dividend on our outstanding common stock. The record date is set for January 2, 2015 and the dividend is payable to shareholders of record on January 22, 2015. Dividends are declared at the discretion of the Company's Board of Directors and depend on actual cash from operations, the Company's financial condition and capital requirements and any other factors the Company's Board of Directors may consider relevant. Future dividend declarations, as well as the record and payment dates for such dividends, will be determined by the Company's Board of Directors on a quarterly basis.

Share Purchase Program

Subsequent to September 30, 2014, the Company purchased 41,615 shares of common stock for \$1.1 million, at an average price per share of \$27.77. The Company purchased these shares on the open market at prevailing market prices and in accordance with its previously announced share repurchase program (Plan). At October 20, 2014, \$20.6 million remains for future purchase under the Plan.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**
Forward Looking Statements and Projections

This Quarterly Report on Form 10-Q contains forward looking statements. Forward looking statements relate to future events or our future financial performance. We generally identify forward looking statements by terminology such as may, will, should, expects, plans, anticipates, could, intends, target, projects, contemplates, believes, estimates, predicts, potential or continue or the negative of these terms or other similar words. These statements are only predictions. We have based these forward looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, results of operations and financial condition. The outcome of the events described in these forward looking statements is subject to risks, uncertainties and other factors described in Management's Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors and elsewhere in this Quarterly Report on Form 10-Q. Accordingly, you should not rely upon forward looking statements as predictions of future events. We cannot assure you that the events and circumstances reflected in the forward looking statements will be achieved or occur, and actual results could differ materially from those projected in the forward looking statements. The forward looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

Overview

We are a leading provider of type, technology and expertise for creative applications and consumer electronics, or CE, devices. Our software technologies have been widely deployed across, and embedded in a range of CE devices, including laser printers, digital copiers, mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, digital televisions, set-top boxes and consumer appliances, as well as in numerous software applications and operating systems. In the laser printer market, we have worked together with industry leaders for over 20 years to provide critical components embedded in printing standards. The Company also provides printer drivers, page description language interpreters, printer user interface technology and color imaging solutions to printer manufacturers and OEMs (original equipment manufacturers). Our scaling, compression, text layout, printer driver and color technologies solve critical text imaging issues for CE device manufacturers by rendering high quality text on low resolution and memory constrained CE devices. We offer more than 19,000 typeface designs, and include some of the world's most widely used designs, such as the Times New Roman®, Helvetica®, ITC Franklin Gothic and Droid typefaces, and support more than 250 Latin and non-Latin languages. Our e-commerce websites, including *myfonts.com*, *fonts.com* and *linotype.com*, which attracted more than 68 million visits in 2013 from over 200 countries and territories, offer thousands of high-quality font products, in some cases more than 162,000, including our own fonts from the Monotype Libraries as well as fonts from third parties.

Sources of Revenue

We derive revenue from two principal sources: licensing our fonts to creative and business professionals, which we refer to as our Creative Professional revenue, and licensing our text imaging solutions to CE device manufacturers and independent software vendors, which we refer to as our OEM revenue. We derive our Creative Professional revenue primarily from multinational corporations, graphic designers, media organizations, advertisers, printers and publishers. We derive our OEM revenue primarily from CE device manufacturers. Some of our revenue streams, particularly project-related revenue, have historically been and we expect them to continue to be in the future, more susceptible to weakening economic conditions.

| | Three Months Ended September 30, | | | |
|---|---|-------------------|------------------|-------------------|
| | 2014 | | 2013 | |
| | Sales | % of Total | Sales | % of Total |
| (In thousands, except percentages) | | | | |
| United States | \$ 25,041 | 53.2% | \$ 21,405 | 52.9% |
| United Kingdom | 2,248 | 4.8 | 2,223 | 5.5 |
| Germany | 7,131 | 15.2 | 5,059 | 12.5 |
| Japan | 12,449 | 26.4 | 11,651 | 28.8 |
| Other Asia | 194 | 0.4 | 130 | 0.3 |
| Total | \$ 47,063 | 100.0% | \$ 40,468 | 100.0% |

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| | Nine Months Ended September 30, | | | |
|---|--|-------------------|-------------------|-------------------|
| | 2014 | | 2013 | |
| | Sales | % of Total | Sales | % of Total |
| (In thousands, except percentages) | | | | |
| United States | \$ 73,579 | 53.3% | \$ 68,911 | 55.7% |
| United Kingdom | 7,577 | 5.5 | 5,168 | 4.2 |
| Germany | 15,818 | 11.5 | 13,179 | 10.7 |
| Japan | 40,530 | 29.3 | 35,958 | 29.1 |
| Other Asia | 594 | 0.4 | 376 | 0.3 |
| Total | \$ 138,098 | 100.0% | \$ 123,592 | 100.0% |

For the three months ended September 30, 2014 and 2013, sales by our subsidiaries located outside the United States comprised 46.8% and 47.1%, respectively, of our total revenue. For the nine months ended September 30, 2014 and 2013, sales by our subsidiaries located outside the United States comprised 46.7% and 44.3%, respectively, of our total revenue. In the three months ended September 30, 2014, as compared to the same period in 2013, there was an increase in revenue in dollars and as a percentage of total revenue attributed to Germany as a result of our acquisition of FontShop in July 2014. We expect that sales by our international subsidiaries will continue to represent a substantial portion of our revenue for the foreseeable future. Future international revenue will depend on the continued use and expansion of our text imaging solutions worldwide.

We derive a significant portion of our OEM revenue from a limited number of customers, in particular manufacturers of laser printers and consumer electronics. For the three months ended September 30, 2014 and 2013, our top ten licensees by revenue, all of which are OEM customers, accounted for approximately 35.5% and 36.1% of our total revenue, respectively. For the nine months ended September 30, 2014 and 2013, our top ten licensees by revenue, all of which are OEM customers, accounted for approximately 36.3% and 37.6% of our total revenue, respectively. Although no one customer accounted for more than 10% of our total revenue for the three or nine months ended September 30, 2014 or 2013, if we are unable to maintain relationships with major customers or establish relationships with new customers, our licensing revenue will be adversely affected.

Creative Professional Revenue

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

Revenue from font licenses to our e-commerce customers is recognized upon payment by the customer and electronic shipment of the software embodying the font. Revenue from font licenses to other customers is recognized upon shipment of the software embodying the font and when all other revenue recognition criteria have been met. Revenue from resellers is recognized upon notification from the reseller that our font product has been licensed and when all other revenue recognition criteria have been met. Custom font design services revenue is generally recognized upon delivery. Font related service revenue is mainly subscription based and, from time to time, may contain software as a service. The subscription revenue is recognized ratably over the subscription period. Web server and commercial rights to online fonts is recurring revenue and it is recognized upon invoicing and proof of font delivery, when all

other revenue recognition criteria have been met. Contract accounting is used where services are deemed essential to the software.

OEM Revenue

Our OEM revenue is derived substantially from per-unit royalties received for printer imaging and printer driver, or printer products, and display imaging products. Under our licensing arrangements we typically receive a royalty for each product unit incorporating our text imaging solutions that is shipped by our OEM customers. We also receive OEM revenue from fixed fee licenses with certain of our OEM customers. Fixed fee licensing arrangements are not based on units the customer ships, but instead, customers pay us on a periodic basis for use of our typefaces and technology. Although significantly less than royalties from per-unit shipments and fixed fees from OEM customers, we also receive revenue from software application and operating systems vendors, who include our typefaces and technology in their products, and for font development. Many of our per-unit royalty licenses continue for the duration that our OEM customers ship products that include our technology, unless terminated for breach. Other licenses have terms that typically range from three to five years, and usually provide for automatic or optional renewals. We recognize revenue from

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per-unit royalties in the period during which we receive a royalty report from a customer, typically one quarter after royalty-bearing units are shipped, as we do not have the ability to estimate the number of units shipped by our customers. Revenue from fixed fee licenses is generally recognized when it is billed to the customer, so long as the product has been delivered, the license fee is fixed and non-refundable and collection is probable. OEM revenue also includes project-related agreements for which contract accounting may be used.

Cost of Revenue

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

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

Gross Profit

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

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with GAAP and our discussion and analysis of our financial condition and results of operations requires us to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates.

There has been no material change in our critical accounting policies since December 31, 2013. Information about our critical accounting policies may be found in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, under the heading Critical Accounting Policies, of our Annual Report on Form 10-K for the year ended December 31, 2013.

Table of Contents**Results of Operations for the Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013**

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

| | Three Months Ended September 30, | |
|---|---|-------------|
| | 2014 | 2013 |
| Revenue: | | |
| Creative Professional | 42.7% | 40.6% |
| OEM | 57.3 | 59.4 |
| | | |
| Total revenue | 100.0 | 100.0 |
| Cost of revenue | 15.4 | 14.7 |
| Cost of revenue amortization of acquired technology | 2.4 | 2.8 |
| | | |
| Total cost of revenue | 17.8 | 17.5 |
| | | |
| Gross profit | 82.2 | 82.5 |
| Marketing and selling | 28.4 | 26.3 |
| Research and development | 11.1 | 11.5 |
| General and administrative | 13.8 | 12.1 |
| Amortization of other intangible assets | 3.3 | 3.7 |
| | | |
| Total operating expenses | 56.6 | 53.6 |
| | | |
| Income from operations | 25.6 | 28.9 |
| Interest expense, net | 0.6 | 0.7 |
| Loss on foreign exchange | 1.7 | 0.2 |
| (Gain) loss on derivatives | (0.5) | 0.5 |
| Other expense, net | 0.1 | |
| | | |
| Total other expense | 1.9 | 1.4 |
| Income before provision for income taxes | 23.7 | 27.5 |
| Provision for income taxes | 8.7 | 10.0 |
| | | |
| Net income | 15.0% | 17.5% |

Sales by Market Segment. We view our operations and manage our business as one segment: the development, marketing and licensing of technologies and fonts. Factors used to identify our single segment include the financial information available for evaluation by our chief operating decision maker in making decisions about how to allocate resources and assess performance. While our technologies and services are sold to customers in two principal markets (Creative Professional and CE device manufacturers and independent software vendors, together OEM), expenses and assets are not formally allocated to these markets, and operating results are assessed on an aggregate basis to make decisions about the allocation of resources.

The following table presents revenue for these two principal markets (in thousands):

| | Three Months Ended September 30, | | Increase |
|-----------------------|---|------------------|-----------------|
| | 2014 | 2013 | |
| Creative Professional | \$ 20,118 | \$ 16,449 | \$ 3,669 |
| OEM | 26,945 | 24,019 | 2,926 |
| Total revenue | \$ 47,063 | \$ 40,468 | \$ 6,595 |

Revenue

Revenue was \$47.1 million and \$40.5 million for the three months ended September 30, 2014 and 2013, respectively, an increase of \$6.6 million, or 16.3%.

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Creative Professional revenue increased \$3.7 million, or 22.3%, to \$20.1 million in the three months ended September 30, 2014, as compared to \$16.4 million in the three months ended September 30, 2013, mainly due to increased web and direct revenue. Web revenue increased \$2.7 million, due to the acquisition of FontShop International GmbH, or FontShop, in July 2014 as well as increased volume of sales on our websites, which includes increased sales of our web font services. In addition, direct revenue increased mainly as the result of our acquisition of FontShop and increased sales of our web font services to enterprise customers.

OEM revenue increased \$2.9 million, or 12.2%, to \$26.9 million in the three months ended September 30, 2014, as compared to \$24.0 million in the three months ended September 30, 2013, due to increased printer product revenue and the timing of revenue from our independent software vendor customers.

Cost of Revenue and Gross Profit

Cost of revenue, excluding amortization of acquired technology, increased \$1.3 million, or 21.8%, to \$7.2 million for the three months ended September 30, 2014, as compared to \$5.9 million for the three months ended September 30, 2013. As a percentage of total revenue, cost of revenue, excluding amortization of acquired technology, was 15.4% and 14.7% for the three months ended September 30, 2014 and 2013, respectively. The increases, both in dollars and as a percentage of revenue, are predominantly due to product mix. The increase in dollars is partially a result of increased sales volume and partially the result of a product mix change, period over period. Our Creative Professional revenue typically has a higher associated cost than our OEM revenue. In the three months ended September 30, 2014, creative professional revenue was 42.7% of total revenue, as compared to 40.6% of total revenue in the same period in 2013. We expect our cost of revenue, excluding amortization of acquired technology, to fluctuate as a percentage of revenue from period to period due to variations in product mix.

The portion of cost of revenue consisting of amortization of acquired technology was unchanged at \$1.1 million for the three months ended September 30, 2014 and 2013, respectively.

Gross profit was 82.2% of sales in the three months ended September 30, 2014, as compared to 82.5% in the three months ended September 30, 2013, a decrease of 0.3 percentage points, due to variations in product mix as detailed above.

Operating Expenses

Marketing and Selling. Marketing and selling expense increased \$2.7 million, or 25.7% to \$13.4 million in the three months ended September 30, 2014, as compared to \$10.6 million in the three months ended September 30, 2013. Personnel expenses increased \$2.2 million in the third quarter of 2014, as compared to the same period in 2013, a result of increased headcount mainly from our acquisition of FontShop and increased share based compensation expense. Increased marketing activities, such as trade shows and use of consultants, increased \$0.6 million in the three months ended September 30, 2014, as compared to the same period in 2013.

Research and Development. Research and development expense was \$5.2 million and \$4.7 million in the three months ended September 30, 2014 and 2013, respectively, an increase of \$0.6 million or 12.3%, mainly due to personnel expenses. Personnel and personnel related expenses increased in the third quarter of 2014, as compared to the same period in 2013, a result of increased headcount, including additions from our acquisition of FontShop, and share based compensation.

General and Administrative. General and administrative expense increased \$1.6 million, or 31.8%, to \$6.5 million in the three months ended September 30, 2014, as compared to \$4.9 million in the three months ended September 30,

2013. Legal and professional services expenses increased \$1.2 million in the third quarter of 2014, as compared to the same period in 2013, primarily the result of acquisition related expenses from our FontShop acquisition. Personnel and personnel related expenses increased \$0.5 million in the three months ended September 30, 2014, as compared to the same period in 2013, mainly due to increased share based compensation. These increases were partially offset by a \$0.6 million reduction in expense recognized due to an estimate revision for contingent acquisition consideration.

Amortization of Other Intangible Assets. Amortization of other intangible assets was \$1.6 million and \$1.5 million for the three months ended September 30, 2014 and 2013, respectively, an increase of \$0.1 million or 6.5%.

Interest Expense, Net

Interest expense, net of interest income was consistent at \$0.3 million in the three months ended September 30, 2014 and 2013. There was no debt outstanding during the three months ended September 30, 2014 or during the same period in 2013. Interest expense in both time periods consists mainly of unused line fees in connection with our Credit Facility.

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Loss on Foreign Exchange

Losses on foreign exchange were \$0.8 million and \$0.1 million in the three months ended September 30, 2014 and 2013, respectively, an increase of \$0.7 million primarily due to the revaluation of foreign denominated liabilities.

(Gain) Loss on Derivatives

(Gain) loss on derivatives was a gain of \$0.2 million and a loss of \$0.2 million in the three months ended September 30, 2014 and 2013, respectively, resulting from our short term forward contracts.

Provision for Income Taxes

During the three months ended September 30, 2014 and 2013, our effective tax rate was 36.8% and 36.4%, respectively. The effective tax rate for the third quarter of 2013 included a 0.4% benefit related to federal research tax credits. The federal research tax credit expired as of December 31, 2013, and as of September 30, 2014, the legislation extending the credit had not been passed, and as such, this benefit did not exist at September 30, 2014. The effective tax rate for the third quarter of 2013 also included benefits of 0.2% for disqualifying dispositions on incentive stock options and 0.8% for the reversal of reserves for income taxes, as compared to benefits of 0.6% and 1.2%, respectively, in the same period in 2014. Additionally, the effective rate increased in the third quarter of 2014 by a net 0.8% as compared to the effective rate for the third quarter of 2013 for various items, including the Company's write down of the contingent acquisition consideration, effects of foreign income and domestic manufacturing deduction.

Table of Contents**Results of Operations for the Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013**

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

| | Nine Months Ended September 30, | |
|---|--|-------------|
| | 2014 | 2013 |
| Revenue: | | |
| Creative Professional | 40.6% | 37.6% |
| OEM | 59.4 | 62.4 |
| | | |
| Total revenue | 100.0 | 100.0 |
| Cost of revenue | 15.2 | 14.5 |
| Cost of revenue amortization of acquired technology | 2.5 | 2.8 |
| | | |
| Total cost of revenue | 17.7 | 17.3 |
| | | |
| Gross profit | 82.3 | 82.7 |
| Marketing and selling | 26.5 | 25.0 |
| Research and development | 11.5 | 11.8 |
| General and administrative | 13.1 | 11.8 |
| Amortization of other intangible assets | 3.2 | 3.6 |
| | | |
| Total operating expenses | 54.3 | 52.2 |
| | | |
| Income from operations | 28.0 | 30.5 |
| Interest expense, net | 0.6 | 0.8 |
| Loss on foreign exchange | 0.7 | 0.8 |
| (Gain) loss on derivatives | | 0.2 |
| | | |
| Total other expense | 1.3 | 1.8 |
| Income before provision for income taxes | 26.7 | 28.7 |
| Provision for income taxes | 9.9 | 10.1 |
| | | |
| Net income | 16.8% | 18.6% |

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

| | Nine Months Ended September 30, | | Increase |
|-----------------------|--|-------------|-----------------|
| | 2014 | 2013 | |
| Creative Professional | \$ 56,103 | \$ 46,435 | \$ 9,668 |

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| | | | |
|---------------|------------|------------|-----------|
| OEM | 81,995 | 77,157 | 4,838 |
| Total revenue | \$ 138,098 | \$ 123,592 | \$ 14,506 |

Revenue

Revenue was \$138.1 million and \$123.6 million for the nine months ended September 30, 2014 and 2013, respectively, an increase of \$14.5 million, or 11.7%.

Creative Professional revenue increased \$9.7 million, or 20.8%, to \$56.1 million for the nine months ended September 30, 2014, as compared to \$46.4 million in the same period in 2013, mainly due to increased web and direct revenue. Web revenue increased mainly due to increased desktop license revenue, partially due to our acquisition of FontShop in July 2014, and font license revenue, together with increased sales of our web font services, in the nine months ended September 30, 2014, as compared to the same period in 2013. Direct revenue increased partially the result of recurring royalty and license web server applications and increased sales of our web font services to enterprise customers.

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OEM revenue was \$82.0 million and \$77.2 million for the nine months ended September 30, 2014 and 2013, respectively, an increase of \$4.8 million, or 6.3% due to increased printer product revenue.

Cost of Revenue and Gross Profit

Cost of revenue, excluding amortization of acquired technology, increased \$3.1 million, or 17.2%, to \$21.1 million for the nine months ended September 30, 2014, as compared to \$18.0 million for the nine months ended September 30, 2013. As a percentage of total revenue, cost of revenue, excluding amortization of acquired technology, was 15.2% and 14.5% for the nine months ended September 30, 2014 and 2013, respectively. The increases, in both in dollars and as a percentage of revenue, are predominantly due to variations in product mix. Our creative professional revenue typically has a higher associated cost than our OEM revenue. In the nine months ended September 30, 2014, creative professional revenue was 40.6% of total revenue, as compared to 37.6% of total revenue in the same period in 2013. The increase in dollars is partially a result of increased sales volume and partially the result of a product mix change, period over period.

Amortization of acquired technology was unchanged at \$3.4 million for the nine months ended September 30, 2014 and 2013, respectively.

Gross profit decreased 0.4 percentage points to 82.3% in the nine months ended September 30, 2014, as compared to 82.7% in the nine months ended September 30, 2013, due to variations in product mix, as detailed above.

Operating Expenses

Marketing and Selling. Marketing and selling expense increased \$5.5 million, or 17.9%, to \$36.5 million in the nine months ended September 30, 2014, as compared to \$30.9 million in the same period in 2013. Personnel expenses increased \$3.9 million due to additional headcount mainly from our acquisition of FontShop, increased variable compensation and share based compensation in the nine months ended September 30, 2014, as compared to the same period in 2013. Increased marketing activities, such as trade shows, online advertising and use of consultants increased \$1.6 million, period over period.

Research and Development. Research and development expense was \$15.9 million and \$14.5 million for the nine months ended September 30, 2014 and 2013, respectively, an increase of \$1.4 million, or 9.5%, mainly a result of personnel expenses. Personnel and personnel related expenses increased \$1.0 million in the nine months ended September 30, 2014, as compared to the same period in 2013, a result of increased headcount, including additions from our acquisition of FontShop, increased variable compensation and share based compensation.

General and Administrative. General and administrative expense increased \$3.5 million, or 23.7%, to \$18.1 million in the nine months ended September 30, 2014, as compared to \$14.6 million in the nine months ended September 30, 2013. Legal and professional services expenses increased \$3.0 million in the nine months ended September 30, 2014, as compared to the same period in 2013, primarily the result of FontShop acquisition related expenses. Personnel and personnel related expenses increased \$1.0 million in the nine months ended September 30, 2014, as compared to the same period in 2013, mainly due to increased share based compensation and travel expenses. These increases were partially offset by a \$1.2 million reduction in expense recognized due to an estimate revision for contingent acquisition consideration.

Amortization of Other Intangible Assets. Amortization of other intangible assets was unchanged at \$4.5 million for the nine months ended September 30, 2014 and 2013, respectively.

Interest Expense, Net

Interest expense, net of interest income, decreased \$0.2 million, or 20.2%, to \$0.8 million for the nine months ended September 30, 2014, as compared to \$1.0 million for the nine months ended September 30, 2013. There was no debt outstanding during the nine months ended September 30, 2014. Interest expense in the nine months ended September 30, 2014 consists mainly of unused line fees in connection with our Credit Facility. By contrast, interest expense in the same period in 2013 primarily related to outstanding debt. The average debt balance in the nine months ended September 30, 2013 was \$6.1 million.

Table of Contents*Loss on Foreign Exchange*

Losses on foreign exchange were \$1.0 million and \$0.9 million for the nine months ended September 30, 2014 and 2013, respectively, an increase of \$0.1 million, or 5.2%, mainly due to the revaluation of foreign denominated liabilities and the weakening of the Japanese Yen, as compared to the US dollar.

(Gain) Loss on Derivatives

(Gain) loss on derivatives was a gain of \$33 thousand for the nine months ended September 30, 2014, as compared to a loss of \$0.2 million for the nine months ended September 30, 2013, resulting from our short term forward contracts.

Provision for Income Taxes

Our effective tax rate was 37.2% and 35.3% for the nine months ended September 30, 2014 and 2013, respectively. During the nine months ended September 30, 2013, the effective tax rate included a 1.2% benefit for research credits. The federal research tax credit expired as of December 31, 2013, and as of September 30, 2014, the legislation extending the credit had not been passed and as such this benefit did not exist at September 30, 2014. The effective tax rate for the nine months ended September 30, 2013 also included a benefit of 0.6% for disqualifying dispositions on incentive stock options, as compared to a benefit of 0.3% in the same period in 2014. In addition, an increase in state and local income taxes, net of federal benefit resulted in a 0.3% increase in the effective tax rate for the nine months ended September 30, 2014, as compared to 2013.

Liquidity and Capital Resources*Cash Flows for the Nine Months Ended September 30, 2014 and 2013*

Since our inception, we have financed our operations primarily through cash from operations, private and public stock sales and long-term debt arrangements, as described below. We believe our existing cash and cash equivalents, our cash flow from operating activities and available bank borrowings will be sufficient to meet our anticipated cash needs for at least the next twelve months. At September 30, 2014, our principal sources of liquidity were cash and cash equivalents totaling \$82.6 million and a \$120.0 million revolving credit facility, of which there were no outstanding borrowings at September 30, 2014. Our future working capital requirements will depend on many factors, including the operations of our existing business, our potential strategic expansion and future acquisitions we might undertake.

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

| | Nine Months Ended September 30, | |
|---|--|------------------|
| | 2014 | 2013 |
| Net cash provided by operating activities | \$ 46,398 | \$ 36,026 |
| Net cash used in investing activities | (15,195) | (1,445) |
| Net cash used in financing activities | (26,439) | (9,547) |
| Effect of exchange rates on cash and cash equivalents | (587) | (39) |
| Increase in cash and cash equivalents | \$ 4,177 | \$ 24,995 |

Operating Activities

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

We generated \$46.4 million in cash from operations during the nine months ended September 30, 2014. Net income, after adjusting for depreciation and amortization, adjustment to contingent consideration, loss on retirement of fixed assets, amortization of deferred financing costs and accretion of interest, share based compensation, excess tax benefit on stock options, provision for doubtful accounts, deferred income taxes and unrealized currency gain on foreign denominated intercompany transactions generated \$39.1 million in cash. A decrease in accrued expenses and other liabilities used \$0.8 million, primarily a result of the payment of 2013 accrued variable compensation amounts. Accrued income taxes generated \$6.5 million during the nine months ended September 30, 2014. Increases in accounts receivable, deferred revenue and accounts payable combined with decreases in prepaid expenses and other assets generated \$1.6 million in cash, which is mainly due to the timing of payments.

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We generated \$36.0 million in cash from operations during the nine months ended September 30, 2013. Net income after adjusting for depreciation and amortization, loss on retirement of fixed assets, amortization of deferred financing costs, amortization of imputed interest, share based compensation, excess tax benefit on stock options, provision for doubtful accounts, deferred income taxes and unrealized currency loss on foreign denominated intercompany transactions generated \$37.7 million in cash. Increased deferred revenue and accounts receivable used \$1.9 million in cash, mainly due to timing of customer payments. Increases in accrued income taxes generated \$1.1 million in cash. Increases in prepaid expenses and other assets and decreases in accrued expense and other liabilities, net of increased accounts payable used \$0.8 million in cash.

Investing Activities

During the nine months ended September 30, 2014, we used \$15.2 million in investing activities mainly for the purchase of \$4.5 million of property and equipment and \$10.7 million for acquisitions. During the nine months ended September 30, 2013, we used \$1.4 million in investing activities, mainly for the purchase of property and equipment.

Financing Activities

Cash used in financing activities for the nine months ended September 30, 2014 was \$26.4 million. We received cash from the exercises of stock options of \$5.3 million and the excess tax benefit on stock options provided \$3.0 million. We paid cash dividends of \$8.7 million. We also purchased \$26.1 million in treasury stock in the nine months ended September 30, 2014.

Cash used in financing activities for the nine months ended September 30, 2013 was \$9.5 million. All outstanding borrowings against our revolving credit facility were repaid resulting in a \$22.3 million use of cash and we paid cash dividends of \$6.1 million. There was also a significant amount of employee stock option exercises during the nine months ended September 30, 2013, which resulted in \$13.6 million in proceeds from the exercise of stock options and the excess tax benefit on stock options provided \$5.2 million.

Dividends

On July 25, 2014 our Board of Directors approved a \$0.08 per share or \$3.1 million, quarterly cash dividend on our outstanding common stock. The record date was October 1, 2014 and the dividend was paid to shareholders of record on October 21, 2014. We anticipate this to be a recurring quarterly dividend with future payments and record dates, subject to board approval. On October 28, 2014, the Company's Board of Directors approved a \$0.08 per share quarterly cash dividend on our outstanding common stock. The record date is set for January 2, 2015 and the dividend is payable to shareholders of record on January 22, 2015.

Credit Facility

On July 13, 2011 we entered into a five-year \$120.0 million revolving credit facility, or the Credit Facility. Borrowings under the Credit Facility bear interest based on the leverage ratio at either (i) the prime rate plus 0.5%, as defined in the credit agreement, or (ii) LIBOR plus 1.5%. The Company is required to pay an unused line fee equal to 0.375% per annum on the undrawn portion available under the revolving credit facility and variable per annum fees in respect of outstanding letters of credit. As of September 30, 2014 our rate, inclusive of applicable margins, was 3.75% for prime and we had no outstanding debt under the Credit Facility. There are no required repayments. The Company, in accordance with the Credit Facility, is permitted to request that the Lenders, at their election, increase the secured credit facility to a maximum of \$140.0 million.

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In addition, the Credit Facility provides that we not exceed a maximum leverage ratio. The leverage ratio is defined as the ratio of aggregate outstanding indebtedness to trailing twelve months Adjusted EBITDA. Adjusted EBITDA is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation expense, plus restructuring, issuance costs, cash non-operating costs and other expenses or losses minus cash non-operating gains and other non-cash gains; provided however that the aggregate of all cash non-operating expense shall not exceed \$250 thousand and all such fees, costs and expenses shall not exceed \$1.5 million on a trailing twelve months basis.

Additional limits are imposed on acquisition related expenses. We also must maintain a minimum fixed charge ratio. As of September 30, 2014, the maximum leverage ratio permitted was 3.00:1.00 and our leverage ratio was 0.00:1.00 and the minimum fixed charge coverage ratio was 1.25:1.00 and our fixed charge ratio was 3.69:1.00. Failure to comply with these covenants, or the occurrence of an event of default, could permit the lenders under the Credit Facility to declare all amounts borrowed under the Credit Facility, together with accrued interest and fees, to be immediately due and payable. In addition, the Credit Facility is secured by substantially all of our assets and places limits on the Company's and its subsidiaries' ability to incur debt or liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, engage in mergers, acquisitions and asset sales, transact with affiliates and alter its business.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|------------------|--|------------------|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | \$ 7,039 | \$ 7,064 | \$ 23,175 | \$ 22,991 |
| Provision for income taxes | 4,102 | 4,037 | 13,759 | 12,567 |
| Interest expense, net | 265 | 266 | 791 | 992 |
| Depreciation and amortization | 3,177 | 3,017 | 9,147 | 9,036 |
| EBITDA | \$ 14,583 | \$ 14,384 | \$ 46,872 | \$ 45,586 |
| Share based compensation | 2,819 | 2,159 | 7,835 | 5,994 |
| Non-cash add backs | (600) | | (1,152) | |
| Restructuring, issuance and cash non-operating costs ⁽²⁾ | 753 | 149 | 792 | 319 |
| Acquisition expenses | 986 | | 1,384 | |
| Adjusted EBITDA⁽¹⁾ | \$ 18,541 | \$ 16,692 | \$ 55,731 | \$ 51,899 |

- (1) Adjusted EBITDA is not a measure of operating performance under GAAP and should not be considered as an alternative or substitute for GAAP profitability measures such as income (loss) from operations and net income (loss). Adjusted EBITDA as an operating performance measure has material limitations since it excludes the statement of income impact of depreciation and amortization expense, interest expense, net, the provision (benefit) for income taxes and share based compensation and therefore does not represent an accurate measure of

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

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

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The Credit Facility also contains provisions for an increased interest rate during periods of default. We do not believe that these covenants will affect our ability to operate our business, and we were in compliance with the covenants under our Credit Facility as of September 30, 2014.

Non-GAAP Measures

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

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

| | Three Months Ended | | Nine Months Ended | |
|------------------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Income from operations | \$ 12,026 | \$ 11,689 | \$ 38,725 | \$ 37,675 |
| Depreciation and amortization | 3,177 | 3,017 | 9,147 | 9,036 |
| Share based compensation | 2,819 | 2,159 | 7,835 | 5,994 |
| Net adjusted EBITDA ⁽¹⁾ | \$ 18,022 | \$ 16,865 | \$ 55,707 | \$ 52,705 |

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

may differ from and therefore may not be comparable to similarly titled measures used by other companies, thereby limiting its usefulness as a comparative measure. Because of the limitations that net adjusted EBITDA has as an analytical tool, investors should not consider it in isolation, or as a substitute for analysis of our operating results as reported under GAAP.

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

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The following table presents a reconciliation from earnings per diluted share, which is the most directly comparable GAAP measure, to non-GAAP earnings per diluted share as used by management:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|---------|-------------------|---------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| GAAP earnings per diluted share | \$ 0.17 | \$ 0.18 | \$ 0.57 | \$ 0.58 |
| Amortization, net of tax | 0.04 | 0.04 | 0.13 | 0.13 |
| Share based compensation, net of tax | 0.06 | 0.03 | 0.13 | 0.11 |
| Non-GAAP earnings per diluted share ⁽¹⁾ | \$ 0.27 | \$ 0.25 | \$ 0.83 | \$ 0.82 |

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

Other Liquidity Matters**Contractual Obligations**

The table below summarizes our operating lease contractual obligations at September 30, 2014 and the effects of such obligations on liquidity and cash flow in future years (in thousands). There is no change in our other contractual obligations from those disclosed in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2013.

| Contractual Obligations | Total | Oct. 2014 - | Oct. 2015 - | Oct. 2017 - | Thereafter |
|-------------------------|-----------|-------------|-------------|-------------|------------|
| | | Sept. 2015 | Sept. 2017 | Sept. 2019 | |
| Operating leases | \$ 15,485 | \$ 3,191 | \$ 4,962 | \$ 3,235 | \$ 4,097 |

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update 2014-9, *Revenue from Contracts with Customers (Topic 606)*, which provides a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. This guidance is effective for annual reporting and interim periods beginning after December 15, 2016 and allows for either full retrospective or modified retrospective application, with early adoption not permitted. Accordingly, the standard is effective for the Company on January 1, 2017. The Company is currently evaluating the adoption method it will apply and the impact that this guidance will have on its financial statements and related disclosures.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Concentration of Revenue and Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables. Cash equivalents consist primarily of bank deposits and overnight repurchase agreements. Deposits of cash held outside the United States totaled approximately \$7.9 million and \$6.8 million at September 30, 2014 and December 31, 2013, respectively.

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We grant credit to customers in the ordinary course of business. Credit evaluations are performed on an ongoing basis to reduce credit risk, and no collateral is required from our customers. An allowance for uncollectible accounts is provided for those accounts receivable considered to be uncollectible based upon historical experience and credit evaluation. None of our customers individually accounted for 10% or more of our gross accounts receivable as of September 30, 2014 and December 31, 2013. Due to the nature of our quarterly revenue streams derived from royalty revenue, it is not unusual for our accounts receivable balances to include a few customers with large balances. Historically, we have not recorded material losses due to customers' nonpayment.

For the three and nine months ended September 30, 2014 and 2013, no one customer accounted for more than 10% of our revenue.

Derivative Financial Instruments and Interest Rate Risk

In the past we have used interest rate derivative instruments to hedge our exposure to interest rate volatility resulting from our variable rate debt. ASC Topic No. 815, *Derivatives and Hedging*, or ASC 815, requires that all derivative instruments be reported on the balance sheet at fair value and establishes criteria for designation and effectiveness of hedging relationships, including a requirement that all designations must be made at the inception of each instrument. As we did not make such initial designations, ASC 815 requires changes in the fair value of the derivative instrument to be recognized as current period income or expense.

The fair value of derivative instruments is estimated based on the amount that we would receive or pay to terminate the agreements at the reporting date. Our exposure to market risk associated with changes in interest rates relates primarily to our long term debt. The interest rate on our Credit Facility fluctuates with either the prime rate or the LIBOR interest rate. At September 30, 2014 and December 31, 2013, the Company had no borrowings under our revolving Credit Facility. Historically, we have purchased interest rate swap instruments to hedge our exposure to interest rate fluctuations on our debt obligations.

Foreign Currency Exchange Rate Risk

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

We incur foreign currency exchange gains and losses related to certain customers that are invoiced in U.S. dollars, but who have the option to make an equivalent payment in their own functional currencies at a specified exchange rate as of a specified date. In the period from that date until payment in the customer's functional currency is received and converted into U.S. dollars, we can incur realized gains and losses. We also incur foreign currency exchange gains and losses on certain intercompany assets and liabilities denominated in foreign currencies. We are currently utilizing 30-day forward contracts to mitigate our exposure on these currency fluctuations. At both September 30, 2014 and December 31, 2013 there was one currency contract outstanding, to purchase and sell two different currencies, which was entered into on those dates, and accordingly, the fair value was materially equivalent to its book value.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2014. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our disclosure controls and procedures are designed to provide a reasonable assurance of achieving their objectives.

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Based on the evaluation of our disclosure controls and procedures as of September 30, 2014, our principal executive officer and principal financial officer concluded that, as of such date, the Company's disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended September 30, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There are no material changes in our risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013.

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

(a) Unregistered Sales of Equity Securities

None.

(b) Use of proceeds

Not applicable.

Table of Contents**(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following table provides information about purchases by the Company during the quarter ended September 30, 2014 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Monotype Imaging Holdings Inc. Purchases of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares that May Yet be Purchased Under the Plans or Programs |
|---|---|-------------------------------------|---|---|
| | | | | |
| July 14, 2014 to July 31, 2014 ⁽¹⁾⁽²⁾ | 29,868 | \$ 26.52 | 25,000 | \$ 23,212,760 |
| August 1, 2014 to August 31, 2014 ⁽¹⁾⁽²⁾ | 35,075 | 26.09 | 25,000 | 22,462,042 |
| September 2, 2014 to September 30, 2014 ⁽¹⁾⁽²⁾ | 27,297 | 25.23 | 24,900 | 21,741,580 |
| Total | 92,240 | \$ 25.95 | 74,900 | \$ 21,741,580 |

- (1) The Company purchased 16,262 and 1,078 shares of unvested restricted stock in accordance with the Second Amended and Restated 2007 Stock Option and Incentive Plan (the 2007 Stock Option Plan) and the 2010 Inducement Stock Plan, respectively. The price paid by the Company was determined pursuant to the terms of either the 2007 Stock Option Plan or 2010 Inducement Stock Plan and related restricted stock agreements.
- (2) The Company purchased shares of common stock in accordance with its share repurchase program announced on October 31, 2013. The Company purchased shares on the open market at prevailing market prices. The Company purchased 41,615 shares of common stock for \$1.1 million in the period of October 1 to October 20, 2014, at an average price per share of \$27.77. The Company purchased these shares on the open market at prevailing market prices and in accordance with the Plan. At October 20, 2014, \$20.6 million remains for future purchase under the Plan.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosure

None.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

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SIGNATURES

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

MONOTYPE IMAGING HOLDINGS INC.

Date: October 31, 2014

By: /s/ DOUGLAS J. SHAW
Douglas J. Shaw
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: October 31, 2014

By: /s/ SCOTT E. LANDERS
Scott E. Landers
Senior Vice President, Chief Financial Officer,
Treasurer and
Assistant Secretary (Principal Financial Officer)

Table of Contents**EXHIBIT INDEX**

Listed and indexed below are all exhibits filed as part of this report.

| Exhibit No. | Description |
|------------------------|--|
| 10.1 | Equity Award Grant Policy, as amended * |
| 14.1 | Code of Business Conduct and Ethics * |
| 31.1 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer. * |
| 31.2 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, by Chief Financial Officer. * |
| 32.1 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer and Chief Financial Officer. ** |
| 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.

** Furnished herewith.