Monotype Imaging Holdings Inc.
Form 10-K
March 01, 2013
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2012**

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from to**

**Commission File Number 001-33612**

# MONOTYPE IMAGING HOLDINGS INC.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **20-3289482** |
| **(State of incorporation)** | **(I.R.S. Employer Identification No.)** |
| **500 Unicorn Park Drive** | |
| **Woburn, Massachusetts** | **01801** |
| **(Address of principal executive offices)** | **(Zip Code)** |

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

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

| Title of Each Class | Name of Exchange on Which Registered |
|---|---|
| **Common Stock, $0.001 par value** | **The NASDAQ Stock Market LLC** |

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

**None**

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

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

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

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

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

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

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

The aggregate market value of the registrant s common stock held by non-affiliates of the registrant, computed by reference to the last reported sale price of the common stock as reported on the NASDAQ Global Select Market on June 30, 2012 was approximately $382,492,726 (assumes officers, directors, and all shareholders beneficially owning 5% or more of the outstanding common shares are affiliates).

The number of shares outstanding of the registrant s common stock as of February 21, 2013 was approximately 37,469,227.

**DOCUMENTS INCORPORATED BY REFERENCE.**

Portions of the registrant s definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2013 Annual Meeting of Stockholders are incorporated herein by reference into Part III of this report.

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**MONOTYPE IMAGING HOLDINGS INC.**

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

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

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

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## PART I

### Item 1. *Business*

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

**Overview**

Monotype Imaging Holdings Inc. is a leading provider of type, technology and expertise for creative applications and consumer electronics, or CE, devices. Our vision is that our fonts and technologies will empower every word and experience, as we strive to enable the best user experience and ensure brand integrity, regardless of device, platform or language. We help CE device manufacturers, independent software vendors, or ISVs, and creative professionals connect their products, services, content and brands to consumers and businesses everywhere-by enabling content creation, deployment and consumption. Monotype is home to one of the world s best known collections of type and, along with our custom type services, our offerings allow our customers to express their creativity and brand, while our tools and technologies improve creative workflows and maximize efficiency as content is published or distributed. Our solutions provide worldwide language coverage and delivery of high-quality text and our embedded solutions ensure brand integrity by providing for the reproduction of content on any device or platform, as the author intended.

To best serve our customers, our business is organized as follows:

**Creative Professional** The focus of our Creative Professional business is to help content creators deliver high-quality, branded communications to global markets across multiple media. Our solutions, which include type, custom design services and tools that enable the creative process, are licensed through direct sales channels, including our e-commerce platforms and indirect sales channels. We work with a wide range of customers, including publishers, agencies, corporations, enterprises, small businesses and individuals.

Our e-commerce websites, including *myfonts.com, fonts.com* and *linotype.com,* attracted more than 68 million visits in 2012 from over 200 countries and territories. Our creative tools include a first-of-its kind font rental service through our *skyfonts.com* website, where customers can try fonts for free and then rent them for as long as needed. In addition, we have made fully functional web fonts available for beautifying web design, improving brand consistency and functionality in areas such as search engine optimization and accessibility. Our web fonts also offer a high level of font display quality through the use of our hand-hinted web fonts, in addition to quick response time when displaying multilingual fonts.

**OEM** Our focus is to provide CE device manufacturers and ISVs, together OEMs, with the right type, technology and expertise for delivering consistent, compelling user experiences. Our solutions power the visual expression of the leading makers of a wide range of devices, including laser printers, copiers, mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, digital televisions, set-top boxes and consumer appliances, as well as provide a quality text experience in numerous software applications and operating systems. We combine our proprietary technologies with access to one of the world s best known type libraries.

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Our OEM business meets the needs of two market areas: Printer Imaging, which serves the laser printer market, where our type, technology and expertise have enabled industry leaders to meet evolving technology requirements and printer standards for more than 20 years; and Display Imaging, where our screen imaging technologies are designed to ensure brand integrity, legibility and worldwide language support in a quick, seamless and consistent manner on any display or device. Our Display Imaging business also serves ISVs, including industry leaders who turn to Monotype to support evolving, multi-device, global experiences.

Across our OEM business, our solutions are designed to render fonts quickly and efficiently, as well as to allow our fonts to be tuned for optimal display in different environments. Further, our solutions are engineered to support value-added special effects and advanced features, such as 3D.

Our principal office is located in Woburn, Massachusetts, with regional offices in San Mateo, California; Boulder, Colorado; Elk Grove Village, Illinois; New York City, New York; Belfast, Northern Ireland; Salfords, United Kingdom; London, United Kingdom; Bad Homburg, Germany (Linotype GmbH); Berlin, Germany; Noida, India; Hong Kong, China; Seoul, South Korea; and Tokyo, Japan.

On December 8, 2010, we acquired Ascender Corporation and Font Commerce LLC, together Ascender, a privately held font provider for approximately $11.0 million. The acquisition enabled us to broaden our font intellectual property offerings, strengthen our relationship with key technology vendors and gain significant type design and development talent.

On March 19, 2012, we acquired all of the outstanding shares of Bitstream Inc. in an all cash merger for $49.6 million. We used approximately $24.6 million in cash and borrowed $25.0 million from our revolving Credit Facility. In connection with the merger, on March 14, 2012, Bitstream spun off its mobile browsing and variable data publishing businesses into a separate entity that we did not acquire.

Bitstream Inc., a Delaware corporation, and its wholly owned subsidiary, Bitstream India Pvt. Ltd., became wholly owned subsidiaries of Monotype Imaging Holdings Inc. following the acquisition. Included in the acquisition was the MyFonts.com℠ website, featuring 89,000 fonts from nearly 900 foundries, in addition to the widely used WhatTheFont℠ identification service. The transaction also included the Bitstream® type library, Font Fusion® and a range of fonts for embedded and mobile environments, and 10 patents. Twelve employees from Bitstream s U.S. operations and 42 engineers and type designers from Bitstream s India operations joined the Company in connection with the acquisition. On December 3, 2012, Bitstream was renamed MyFonts Inc. and on February 23, 2013, Bitstream India Pvt. Ltd. was renamed Monotype Solutions India Private Ltd.

On October 29, 2012, the Company acquired all of the outstanding shares of Design by Front Limited, a privately held web strategy, design and technology studio located in Belfast, Northern Ireland, for approximately $4.6 million. The Company paid $2.5 million in cash upon closing, $0.1 million was accrued pending final adjustments, with the remainder of the purchase price to be paid contingent on attainment of certain criteria through 2014. In connection with this acquisition, 13 Design by Front Limited employees joined the Company. Design by Front Limited s Typecast browser-based web authoring tool allows easy use of web fonts when designing web sites.

**Industry Overview and Market Opportunity**

Individuals and businesses face a world of unparalleled access to content. News, blogs, social media, photos, videos, movies and television shows can be consumed across a growing number of CE devices as screens and internet connectivity become ubiquitous. For those creating and distributing this content, an important challenge is creating content once and having it distributed seamlessly and consistently to all consumers, in all geographies, regardless of their choice of consumption medium. For device manufacturers, the corollary challenge is creating a way to access and consume that content easily and in

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the form that the author intended. In both cases, the goal is to provide a great user experience to the consumer. We serve these markets of content creation and distribution and consumption with a range of products, technologies and services that make workflows more efficient, provide a choice of fonts for creativity and language coverage, and result in a great user experience.

Our customers turn to us for comprehensive, powerful and easy-to-use solutions based on our type, technology and expertise. Our Creative Professional and OEM offerings address the needs of three types of customers: content creators; CE device manufacturers; and independent software vendors. These customers use our products to enhance the creation, distribution, display and consumption of digital and print content.

*Content Creators*

Content creators include Creative Professionals (such as leading corporate brands, graphic designers, advertising agencies, printers, publishers and bloggers) and non-professional creators of content (such as social media users, designers, individual bloggers and self-publishers). Both types of content creators produce digital and/or printed material for distribution, and they seek creative ways to convey meaning and differentiate identity. Fonts are an important tool for this differentiation. For example, creative professionals at multinational corporations are increasingly tasked with creating solutions that extend branding and communications into new markets around the world. Their challenge is ensuring that these branding efforts are consistently reflected in every communication, regardless of media. Digital and print assets need to look the same in print and across the various screens on which a consumer may choose to access the content. In addition, creative professionals need design tools that integrate seamlessly into their workflows, making them more efficient. Web fonts, which are independent of a consumer s operating system and travel with the content to a user s device for consistent viewing regardless of the environment, and responsive design tools, which allow a designer to create a flexible piece of content that re-scales depending on screen size, are examples of technologies that address the needs of our creative professional customers.

*CE Device Manufacturers*

CE devices have become content consumption platforms. These devices are marketed globally and increasingly require robust multi-media functionality, as consumers create rich digital content and/or access such content from service providers, over the Internet, as packaged media and from other users. CE device manufacturers must display multi-media content, including text, from these different sources, while being expected to provide a consistent look-and-feel across global CE devices, support worldwide languages, and in many cases support enhanced personalization. As technologies enable media to move seamlessly from one CE device to another, scalable, multilingual type and related display solutions that are optimized for these CE devices, become ever more critical. For example:

- PC-like rich media functionality has moved to the mobile phone platform and tablets, driving the adoption of robust scalable text on those devices.
- Digital televisions are incorporating scalable text for menu navigation, content delivery and connectivity.
- Appliance manufacturers worldwide are adding control panels with enhanced graphical user interfaces to improve the user experience and to provide consumers with additional control and functionality.
- The automotive industry is quickly moving towards digital displays with complex, worldwide language requirements and improved legibility for driver safety.
- Electronic publishing and the growth in e-book readers are driving the publishing industry s need for robust, global text-display solutions.

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The market for laser printers and digital copiers is generally more mature than the rest of the CE device market. As a result, the least expensive end of the market is becoming more commoditized. Laser printer manufacturers are responding by increasing the functionality of their products with advances such as a larger number of embedded fonts, enhanced control panel functionality, and creating new printing paradigms and services offerings, including mobile printing and managed print services. The increased capabilities are in turn driving the advancement of the printer industry, particularly the laser printer industry in emerging markets such as Asia. Thus, increased reliance by laser printer manufacturers on enhancing technologies to drive value, together with advancing capabilities and functionality of multimedia CE devices, favor comprehensive global text solutions and related screen imaging technologies.

*Independent Software Vendors*

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

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

**Our Products**

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

***Type***

Comprising the core of our business, the Monotype Libraries are one of the largest and most trusted inventories of type in the world. Included are the continuously expanding Monotype, Linotype, ITC, Ascender and Bitstream typeface collections, which contain more than 18,000 typefaces and include some of the world s most widely used designs, such as the Times New Roman®, Helvetica®, ITC Franklin Gothic and Droid typefaces.

Our e-commerce websites including *myfonts.com, fonts.com and linotype.com,* offer thousands of high-quality font products, in some cases more than 150,000, including our own libraries as well as fonts from third parties.

Our Fonts.com Web Fonts service, accessible from *fonts.com*, features more than 20,000 high-quality web fonts for website design. Fonts.com Web Fonts offers a superior range of fonts, language support and workflow capabilities, in addition to multiple licensing options, including subscription plans and self-hosting opportunities. Our hinted Web fonts are designed especially for the online environment, providing Web designers and content developers with type that upholds a high display quality in any browser.

Our font solutions for the CE device manufacturers, including our Edge™ and SmartHint™ technologies, enable precise pixel adjustments to enable fonts to display with optimal quality in suboptimal display environments.

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Our core sets of fonts for printer manufacturers consist of the PCL® (Printer Command Language) 6 and PostScript® 3 font collections. These fonts are designed for compatibility with Hewlett Packard, or HP, and Adobe Systems Incorporated, or Adobe, font specifications.

Our SkyFonts™ product is a revolutionary cloud-based font rental service. With patent-pending technology, SkyFonts provides access to thousands of fully functioning fonts for use within all applications and licensed workstations. Users can try fonts for free and rent a font for as long as needed.

***Technology***

*Screen Imaging Technologies*

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

Our iType Connects plug-ins streamline the process of integrating iType by providing a pre-integrated solution for common CE platforms.

Our WorldType Layout Engine enables CE devices to accurately compose, position and render multilingual text, including text composed in complex writing systems such as Indic, Arabic and Hebrew scripts.

Our WorldType Shaper product provides customers with existing layout systems the ability to integrate intelligent shaping and bi-directional capabilities to support complex scripts.

Our Edge rendering technologies preserve the look of high-quality text on a wide range of displays, even at small text sizes. Resolution and display technology such as LCD or e-paper can significantly affect the visual display of rendered text. Edge Technology encompasses Edge Tuner, the ability to tune the rendered output, and Edge Hinting, a method for fine-tuning individual characters. Edge Tuning and Edge Hinting help customers achieve superior visual results using scalable fonts in a low memory footprint.

Our Edge360™ technology brings advanced textual effects to 2D and 3D user interfaces, applications and games. For example, text can be zoomed in and out very quickly without having to re-render the text at the end of the zoom process. Text can be rotated in three dimensions all while retaining clarity throughout the process.

Our SmartHint technology maintains the clarity of East Asian stroke-based fonts at any size. At small sizes, SmartHint technology preserves spatial relationships and removes strokes, if necessary, without changing the meaning of characters.

Our Type Enhancements for Android® products bring rich, high-quality text and worldwide language support to Android 4.0 devices. OEMs are able to meet a wide range of requirements, including the ability to deliver crisp, readable text in multiple languages, superior web browsing experiences and end-user personalization through user-selected fonts.

Our FlipFont™ mobile font download solution allows users to personalize and enhance their phones, making them more appealing and fun to use. FlipFont lets users easily connect to an online selection of fonts, choose a typeface to use within the phone s user interface, purchase the font, and safely download and install it.

*Printer Imaging Technologies*

Our UFST® font scaling engine, or Universal Font Scaling Technology, and our MicroType® font compression technology are our primary solutions for laser printer manufacturers. Our

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font scaling engine and font compression technologies are compatible with virtually all font formats and industry standards, including the PostScript and PCL printing languages. We currently license UFST and MicroType to 49 laser printer manufacturers worldwide.

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

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

*Creative Tools*

Unique to our Fonts.com Web Fonts service, a selection of desktop fonts may be downloaded each month by professional-tier subscribers for creating website mockups, and users of our SkyFonts product can test fonts for free and rent fonts for as long as they need during the design process.

Our web fonts extension for Adobe® Photoshop® version CS5 or higher enables users to proof and prototype their work without leaving their application. The extension allows the use of our high-quality web fonts for greater quality and accuracy, and is accessible within the Photoshop canvas.

Our FontGazer™ plug-in allows users to search, purchase and install new typefaces without having to close or turn away from an open Adobe InDesign® file.

Our Typecast™ application is a comprehensive typographic toolbox in one easy-to-use, browser-based application. As creative professionals create websites, they are able to make precise adjustments to web fonts and employ distinguishing features such as ligatures, old-style figures and swash characters using simple visual controls all within the browser; no coding is required.

*Font Management*

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

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

***Expertise***

Our Monotype Studio provides expert consultation and custom type design services to help customers articulate their distinctive brand value through type. We have strong relationships with a broad network of highly talented font designers. Working directly with clients and through branding agencies, our type design experts have developed the branding fonts used by many Fortune 1000 companies.

**Competitive Strengths**

We are a leading global provider of type, technology and expertise that enable the best user experiences and ensure brand integrity. Our core strengths include:

*Type.* Our Monotype Libraries comprised of the Monotype, Linotype, ITC, Ascender and Bitstream type collections, are one of the world s best known inventories of type. We are continuously expanding our selection of fonts from some of the world s greatest type designers, and today we offer more than 18,000 typeface designs, including a rich blend of timeless classics and innovative modern designs, which support more than 200 Latin and non-Latin languages. For example, our hinted web fonts provide web designers and content developers with type that displays with high quality in any browser. Our hinting and rendering technologies for CE devices ensure high-quality display on any screen, regardless of text size or language used. Our solutions for printer manufacturers ensure high-quality output and flexibility to meet specific requirements.

*Technological and Intellectual Property Leadership*. By combining our proprietary technologies with the extensive Monotype Libraries, we have become a leading global provider of type, technology and expertise. Our technologies play a key role in enabling us to deliver unique, flexible and comprehensive solutions to our customers, and we continue to invest in extending our technology and market leadership positions. For example, we leverage our unique hinting and cloud-based font distribution technologies to deliver a high-quality user experience on the web with web fonts. We also continue to extend our patented Edge technology to enable our OEM customers to ensure highly tuned text display across all of their devices and to explore the use of type in 3D environments to enrich the user experience. On the market side, we are leveraging our extensive expertise to study how vehicle and device manufacturers can improve the usability of their products and lessen the potential for driver distraction. As a result of these continued efforts, we now offer the Monotype Portfolio for Automotive which is a unique combination of type, technology and expert consultation to the automotive industry.

*Expertise, Experienced Leadership and Employee Base.* Our expertise in font design and font engineering provides us with a foundation of strength to meet the challenges inherent in today s consumer environments. Our Monotype Studio is home to some of the world s top type designers, who provide expert consultation and custom type design services to help customers articulate their distinctive brand values through type. Our Monotype Studio experts work closely with customers to achieve such goals as developing successful brand identities, expanding brands into global markets and managing the consistent use of a brand across an organization. Our employee base, including our senior management, are some of the world s most experienced professionals in the typographic community and software industries. Many of the members of our sales, engineering and support staff have been with us since we began serving creative and business professionals, and OEMs. As a result, there is significant continuity between our team and our key customers.

*Established Relationships with Market Leaders.* We benefit from established relationships with our customers, many of which date back 20 years or more, particularly our relationships with OEM printer manufacturers. Our OEM customers include many of the largest and most successful companies in each of the markets that we serve. In the CE device space, we provide technologies to market leaders such as Microsoft, Google, Apple and Amazon. In the laser printer market our customers include eight of the top ten laser printer manufacturers based on the volume of units shipped worldwide. Because our technologies and fonts are embedded in the hardware of our customers CE devices, it would be costly and time-consuming to replace these solutions. Our Creative Professional customers include major international media, publishing and marketing solutions companies, such as Gannett, large publishers and major design firms.

*Global and Multi-Channel Presence.* In 2012 and in 2011, 47.5% and 53.9% of our revenue, respectively, was derived from sales by our operating subsidiaries located in the United Kingdom, Germany, China and Japan. Our customers are located throughout the world, and we have built an extensive customer base of creative and business professionals to whom we license fonts. Our websites including *myfonts.com*, *fonts.com*, and *linotype.com* provide us with a substantial online presence offering more than 150,000 unique font products. Our technologies and font IP are crucial to our OEM customers who manufacture high-volume CE devices that have multimedia functionality and multinational distribution. We support all of the world s major languages and we have specifically designed our solutions for displaying rich content in Asian and other non-Latin languages. We enable OEM customers to engineer a common platform supporting multiple languages, reducing costs and time to market, and increasing product flexibility. China, Japan and Korea are increasingly becoming centers of design, manufacturing and consumption of CE devices, and we have over 20 years of experience partnering with leading Asian companies such as Ricoh, Toshiba and Kyocera Mita.

*Attractive Business Model.* We have a significant, recurring base of licensing revenues that is based, in part, on multi-year financial commitments by our OEM customers. In addition, our revenues are highly predictable because of our established relationships with OEM customers and due to quarterly royalty reports we receive from those customers. Other revenue contracts have renewable term licenses, and in the Creative Professional market, our web font services is primarily a subscription-based model providing a recurring stream of revenue. In addition, the high volume of low-dollar web transactions runs at a predictable rate which together lends to an overall recurring and predictable revenue base of approximately 85% of our total revenue. As a technology licensing business, we generate significant cash flows from incremental OEM revenue. We have a relatively low cash tax rate, due primarily to the tax deductibility of Linotype goodwill, which increases our cash flows. We have low capital requirements, which drive high returns on invested capital.

**Our Strategy**

From content creation to consumption, we strive to be the first place to turn for the type, technology and expertise that enable the best user experiences and ensure brand integrity, regardless of device, platform or language. Following are the key components of our strategy:

***Creative Professional***

*Build a Bridge for the Creative Professional as Publishing Needs Shift from Print to Mobile, Web and Applications.* Our focus is to help customers succeed as publishing environments become more complex, while building strategic, long-term relationships. To remain competitive, customers such as publishers, agencies and corporations are diversifying to support a broad range of content publishing environments, including the web, mobile devices, applications as well as print. We provide a comprehensive selection of typeface designs, custom typefaces, worldwide language support, and fonts that are tuned to display in the highest quality, regardless of the output medium. Our licensing options provide flexible coverage to meet our customers unique and evolving requirements.

*Position and Deliver our Solutions to Fulfill Evolving Requirements.* The cornerstone of our e-commerce business is the Monotype Library, which comprises individual collections from Monotype, Linotype, ITC, Ascender and Bitstream, in addition to fonts from independent foundries and individuals. These fonts are licensed to creative professionals and casual users through our e-commerce sites, including myfonts.com, fonts.com, linotype.com and skyfonts.com, which is based on a revolutionary business model that comprises free trialing of fully functional fonts that can be rented for as long as necessary. Our strong online presence, which represents more than 150,000 fonts, also includes access to web fonts, where our inventory of more than 20,000 high-quality web fonts continues to grow. We are continually enhancing our web font services to meet evolving requirements, such as designing high-quality websites using our Typecast application. In 2012, our websites attracted more than 68 million visits from over 200 countries and territories. In addition to e-commerce channels, fonts from our libraries as well as custom fonts are also licensed through our direct and indirect sales channels.

***OEM***

*Display Imaging*

*Develop Innovative Solutions to Optimize the Deployment and Consumption of Text on all Digital Displays.* Through our type, technology and expertise, we strive to enhance digital lifestyles, regardless of media or platform. Whether off-the-shelf or customized, our solutions are designed to help customers maintain brand integrity by incorporating text that is highly legible, brand faithful and supports the world s languages.

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*Increase Penetration of our Technologies and Fonts into High-Growth CE Device Categories.* Our technologies and fonts are increasingly vital to the mass-market success of device categories such as mobile phones, e-book readers, tablets, automotive displays, digital cameras and navigation devices. We have an established base of customers in these categories, and we will seek to expand within existing accounts as new models are added, or as new product lines are introduced. We intend to continue to pursue new design wins, in addition to emerging devices, such as next-generation in-vehicle displays.

*Printer Imaging*

*Leverage Our Long-Term Relationships.* We constantly strive to strengthen these relationships by continuing to work closely with OEMs to fulfill unique, evolving requirements, such as providing value-added solutions that reduce cost or capitalize on new printing paradigms. For example, using our flexible, high-performance printer driver tool kits that support popular operating systems, OEMs can integrate and customize robust printing capabilities in order to gain a competitive edge. Our flexible architecture, support for multiple print languages and extensive use of common code enables manufacturers to speed products to market while reducing development time and costs. Using our solution to support multiple page description languages, in combination with our fonts and drivers, provides a more complete solution. By providing additional technologies and fonts, we seek to increase our value to customers and to expand our presence within our existing customer base.

*Extend our Leadership Position with Enhanced Technologies*. While the laser printer market has been growing at a slower pace than the market for other CE devices, we have historically sustained consistent growth by anticipating and rapidly adapting to changes in the market. For example, we support the increased font offering that is part of Microsoft® Windows® operating systems, and fonts to support global and cloud printing. As laser printers evolve from analog and monochrome to digital and color printers and to multi-function peripherals, we also enhanced our existing compression technologies and imaging tools to maintain the high-quality rendering of printed text in these new CE devices. Going forward, we intend to expand our offerings to provide additional technologies to the laser printer market, while leveraging our extensive experience and long-standing customer relationships.

***We will also seek to:***

*Expand and Deepen our Global Presence, Particularly in Asia.* We intend to drive our revenue growth by leveraging our knowledge of global markets and through our global operations. We believe that economic growth in Asia will further the demand throughout Asia for our solutions. Through this organic expansion and possible acquisitions, we intend to increase our ability to service CE device manufacturers and content creators throughout the world, as significant growth opportunities exist in these markets.

*Selectively Pursue Complementary Acquisitions, Strategic Partnerships and Third-Party Intellectual Property.* We intend to continue to selectively pursue acquisitions, strategic partnerships and third-party intellectual property to accelerate our time to market with complementary solutions, penetrate new geographies and enhance our intellectual property portfolio. We believe that the market for our solutions is still fragmented. We have a demonstrated track record of identifying, acquiring and integrating companies that enhance our intellectual property portfolio. On October 29, 2012, we acquired Design By Front Limited, a privately held web strategy, design and technology studio. On March 19, 2012, we acquired Bitstream Inc., a publicly owned Delaware corporation primarily known for its myfonts.com website, in addition to the widely used WhatTheFont℠ identification service. In 2010, we acquired Ascender Corporation, a privately held font provider with long-standing relationships with several leading brands including Google and Microsoft.

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**Our Customers**

We are committed to serving the typographic needs of our customers. In today s global marketplace, where brands and technologies cross borders and industries seemingly in nanoseconds, we remain a trusted source for creative professionals, enterprises, application developers, device manufacturers and others who value and desire the highest-quality type available. Our technologies and services are sold to customers in two principal markets: Creative Professional and OEM. Our Creative Professional customers include branding and design agencies, as well as leading marketers and publishers. The OEM market consists of both CE device manufacturers and independent software vendors. In 2012, 2011 and 2010 our revenue in these two markets was as follows (in thousands):

| | 2012 | | 2011 | | 2010 | |
|---|---|---|---|---|---|---|
| **Principal Markets** | **Revenue** | **Percentage of Total Revenue** | **Revenue** | **Percentage of Total Revenue** | **Revenue** | **Percentage of Total Revenue** |
| Creative Professional | $ 51,751 | 35% | $ 31,556 | 26% | $ 26,659 | 25% |
| OEM | 98,110 | 65% | 91,656 | 74% | 80,000 | 75% |
| Total | $ 149,861 | 100% | $ 123,212 | 100% | $ 106,659 | 100% |

Our solutions are embedded in a broad range of CE devices and are compatible with most major operating environments and those developed by CE device manufacturers. We partner with operating system and software application vendors Microsoft, Google, Apple, Oracle and Access, and have made our patented iType scalable font engine available as a plug-in for open source Linux® environments. Additionally, we are an active participant in the development of industry standards which pave the way for emerging capabilities, such as e-book fonts that support advanced typographic and styling capabilities across devices. We are active in the development of various technology standards, including the EPUB e-book standard, hardware accelerated vector graphic (Khronos Group), Java ME platforms for mobile devices (JSR-271 and JSR-287), DVB Multimedia Home Platform, OMA Rich Media Environment, MPEG video compression, and core font technology standardization at the ISO/IEC. We also serve as the chair of the W3C Web Fonts Working Group, demonstrating our commitment of ensuring that industry standards effectively support fonts and font technologies, ultimately bringing to end users the highest level of text quality, performance and flexibility.

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

- eight of the top ten laser printer manufacturers based on the volume of units shipped worldwide;
- eight of the top ten mobile phone manufacturers including Nokia, Motorola, Sony Ericsson, ZTE and RIM;
- major software companies including Microsoft, Google and Apple;
- other multinational corporations such as UBS, Barclays Bank, Lloyds TSB, Sony Computer Entertainment of America, Nintendo, Activision, Tivo, Ubisoft, Adidas and Nike;
- major international media and marketing solutions companies including Gannett;
- e-book readers, including Amazon and Kobo;
- digital camera manufacturers;

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

many of the top automotive brands including Honda, Ford, Hyundai; and

major home appliance manufacturers.

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In 2012, 2011 and 2010, our top ten licensees by revenue accounted for approximately 41.0%, 46.0% and 50.8% of our total revenue, respectively. In 2012, 2011 and 2010, no one customer accounted for more than 10% of our total revenue.

**Sales and Marketing**

Our Creative Professional sales representatives directly target prospective clients, primarily publishers, agencies and corporate customers. Our e-commerce websites, *myfonts.com, fonts.com, linotype.com and skyfonts.com,* drive sales from professional and casual users. Our web font services offer web fonts by subscription or through self-hosting options to provide for the ability to use fonts in web page design. Our OEM sales efforts are focused primarily on establishing relationships with leading CE device manufacturers and independent software vendors with whom we seek to establish long-term relationships.

Our marketing organization works to deliver a consistent message detailing our capabilities and to develop new avenues for presenting our solutions. We promote our solutions through a combination of web content, social media outlets, public relations activities, opt-in e-mail newsletters, blogs, editorial articles, brochures, print advertising, case studies, collateral, speaking engagements, special events, exhibitions, educational programs, and attendance and participation at industry conferences and trade shows. Our e-commerce websites, *myfonts.com, fonts.com, linotype.com and skyfonts.com* are also promoted through a combination of affiliate programs, search engine optimization, e-mail marketing and crowdsourcing opportunities.

**Research and Development**

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

In 2012, 2011 and 2010, we incurred research and development expenses of $18.0 million, or 12.0% of sales, $16.5 million, or 13.4% of sales and $15.4 million, or 14.4% of sales, respectively. Further information on research and development expenses may be found in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

**Intellectual Property**

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

We apply for U.S. and international patents with respect to our technologies, and seek copyright registration of our software and U.S. and international trademark registration in those instances which we determine are competitively advantageous and cost effective to do so. We have been granted a total of 18 patents and have 17 patents pending with the U.S. Patent and Trademark Office. Some of our most important patents are related to our subpixel rendering technology, our ACT™ compression technology and dynamic subsetting technology. We have unregistered trademarks and, where appropriate, registered trademarks on the key fonts in our font libraries. We intend to continue our policy of taking all measures we deem necessary to protect our patent, copyright, trade secret and trademark rights.

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

**Competition**

Our solutions compete with those offered by a variety of companies, including vendors of print and screen imaging technologies, printer drivers and design tools, as well as designers and distributors of fonts. We compete principally on the basis of our technical innovation, engineering and customer support expertise, the breadth of our font offerings and the overall performance of our solutions, including reliability and timely delivery. Competition with our solutions comes from a variety of sources, including companies that license technologies and fonts, such as Adobe, and local providers of solutions that are specific to a particular country s language requirements, such as Morisawa in Japan. We also compete with open source fonts and technologies, including FreeType, which is an open source collaborative organization that provides its Linux font rendering code for free, and Google, which provides open source fonts. In addition, we compete with printer driver provider Software Imaging, PDL provider Zoran and font management software vendors Extensis and Insider Software. The competition for our custom font design services generally comes from companies offering their own type libraries and custom type services, including boutique font foundries and independent professionals. We also compete with in-house resources of our OEM customers.

**Employees and Consultants**

At December 31, 2012, we employed 335 persons. In addition, we have an exclusive relationship with a consulting firm that provides font design and production services in China. The table below provides our employees by functional area.

| | Number of Employees | Percentage |
|---|---|---|
| Sales and marketing | 119 | 36% |
| Research and development | 152 | 45% |
| General and administration | 64 | 19% |
| Total | 335 | 100% |

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

**Segment Information**

Information concerning revenue from our two principal markets for the last three years may be found in Note 15 to our consolidated financial statements. We do not allocate expenses and assets to our two principal markets, Creative Professional and OEM, and operating results are assessed on an aggregate basis to make decisions about the allocation of resources. Further information about our principal markets and segment information, including geographic revenue, may be found in Note 15 to our consolidated financial statements.

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**Corporate and Investor Information**

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

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

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

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

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

We derive a substantial majority of our revenue from the licensing of our type and technologies to OEMs. For the years ended December 31, 2012, 2011 and 2010, our top ten licensees by revenue accounted for approximately 41.0%, 46.0% and 50.8% of our total revenue, respectively. Accordingly, if we are unable to maintain these relationships or establish relationships with new customers, our licensing revenue will be adversely affected. In addition, some of our license agreements are for a limited period of time and, upon expiration of their license agreements, these OEMs may not renew their agreements or may elect not to enter into new agreements with us on terms as favorable as our current agreements.

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

Because of their market position as industry leaders, the incorporation by Hewlett Packard, or HP, of our solutions in its laser printers and the incorporation of our solutions by Adobe in its PostScript product promote widespread adoption of our technologies by manufacturers seeking to maintain compatibility with HP and Adobe. If HP or Adobe were to stop using our solutions in their products, the market acceptance of our technologies by other CE device manufacturers would be materially and adversely affected, and this would in turn adversely affect our revenue.

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

The CE device markets are highly competitive and CE device manufacturers are continually looking for ways to reduce the costs of components included in their products in order to maintain or broaden

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consumer acceptance of those products. Because our type and technologies are a component incorporated into CE devices, when negotiating renewals of customer contracts, we face pressure from our customers to lower our license fees. In addition, our Creative Professional business is increasingly comprised of recurring revenue, including SaaS subscription-based licensing models. We have in the past, and may in the future, need to lower our recurring license fees, either immediately or over time, to preserve customer relationships or extend use of our type or technologies. To the extent contractual license fees for any particular customer are lower in the future, we cannot be certain that we will be able to achieve related increases in the use of our technologies or other benefits to fully offset the effects of these adjustments.

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

In our Creative Professional business, we expect that our future success will depend, in part, upon our ability to successfully penetrate both the desktop and digital publishing markets through our relationships with our e-commerce, business enterprise, agency and publishing customers. To date, we have penetrated only some of these markets. In our OEM business, we expect that our future success will depend, in part, upon our ability to successfully penetrate existing markets for CE devices, including laser printers, digital copiers, mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, digital televisions, set-top boxes and consumer appliances. Our ability to grow our revenue depends upon our ability to further penetrate these markets and to successfully penetrate those markets in which we currently have no presence. Demand for our solutions in any of these developing markets may not develop or grow, and a sufficiently broad base of Creative Professional and OEM customers may not adopt or continue to use products that employ our solutions. Because of our limited experience in some of these markets, we may not be able to adequately adapt our business and our solutions to the needs of these customers.

***Our success depends on the existence of a market for CE devices that incorporate our type and technologies.***

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

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

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

A significant portion of our revenue in 2012, 2011 and 2010 was derived from laser printer manufacturers. The laser printer market is a mature market and as a result, it has grown at a slower rate than other markets in which we operate. In both 2011 and 2009, the laser printer market experienced a decline and our revenue was adversely affected. If sales of printers incorporating our solutions level off, or decline, then our licensing revenue may be adversely affected.

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

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

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

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

**Risks Related to Our Type, Technology and Expertise**

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

The markets for our type, technology and expertise are characterized by rapid change and technological evolution and are intensely competitive and price sensitive. Our future success depends, to a great extent, on our ability to develop and deliver innovative type and technologies that are widely adopted in response to changes in our industry, that are compatible with the solutions introduced by other participants in our industry and for which our customers are willing to pay competitive prices. We rely on the introduction of new or expanded solutions with additional or enhanced features and functionality to allow us to maintain our value in the face of downward pressure on our pricing resulting from efforts by our Creative Professional and OEM customers to reduce costs. We may not correctly identify new or changing market trends at an early enough stage to capitalize on market opportunities. For example, our customers are participating in an increasingly global marketplace and we need to ensure our global type offering and related technologies meet these needs. Our failure to deliver such innovative type and technologies that allow us to stay competitive and for which we can maintain our pricing would adversely affect our revenue.

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

Open source refers to the free sharing of software code used to build applications in the software development community. Individual programmers may modify and create derivative works and distribute them at no cost to the end-user. To the extent that open source software that has the same or similar

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functionality as our technologies is developed or gains market share, demand for our technologies may decline, we may have to reduce the prices we charge for our technologies and our results of operations may be negatively affected. In addition, open source type software has become more widely available and to the extent such type is widely adopted, the demand for our type offerings may decrease and our revenue could be adversely affected.

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

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

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

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

***Our type and technologies compete with solutions offered by some of our customers, which have significant competitive advantages.***

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

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

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

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

Maintaining and strengthening the brand of the Monotype Libraries and our other brands is critical to maintaining and expanding our business, as well as to our ability to enter into new markets for our type, technology and expertise. If we fail to promote and maintain these brands successfully, our ability to sustain and expand our business and enter into new markets will suffer. Maintaining and strengthening our brands will depend heavily on our ability to continue to develop and provide innovative and high-quality solutions for our customers, as well as to continue to maintain our strong online presence and relationships with third-party type and technology providers. For example, we will need to ensure our type and technologies are as relevant for the evolving digital publishing needs of our Creative Professional customers. If we fail to adapt to changing consumer preferences or if we introduce solutions that our customers or potential customers reject, the strength of our brands could be adversely affected. Further, unauthorized third parties may use our brands in ways that may dilute or undermine their strength.

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

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

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

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

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

Disputes and litigation regarding the ownership of technologies and fonts and rights associated with solutions such as ours are common, and sometimes involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own patents may therefore provide little or no deterrence. Third parties have from time-to-time claimed, and in the future may claim, that our products and services infringe or violate their intellectual property rights. Any such claims could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages and prevent us from selling our products. We may be forced to litigate to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of other parties proprietary rights. Even if we were to prevail, any litigation regarding intellectual property could be costly and time-consuming and divert the attention of our management and key personnel from our business operations. We may also be obligated to indemnify our customers or business partners pursuant to any such litigation, which could further exhaust our resources. Furthermore, as a result of an intellectual property challenge, we may be required to enter into royalty, license or other agreements, and we may not be able to obtain such agreements at all or on terms acceptable to us. We have been in the past involved in litigation with third parties, including Adobe, to defend our intellectual property rights and have not always prevailed.

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

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

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

**Risks Related to Our Business Operations**

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

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

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

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

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

We face significant competition in the market for type and related technologies. We believe that our most significant competitive threat comes from companies that compete with some of our specific offerings. Those competitors currently include Adobe, Software Imaging, Extensis, Insider Software, FreeType and local providers of solutions whose products are specific to a particular country s language. We also compete with the internal resources of our customers to whom we license our solutions, most of which have greater financial, technical and other resources than we do. Similarly, we also face competition from font foundries, font-related websites and independent professionals.

Some of our current or future competitors may have significantly greater financial, technical, marketing and other resources than we do, may enjoy greater name recognition than we do or may have more experience or advantages than we have in the markets in which they compete. These advantages may include, among others:

- sales and marketing advantages;
- advantages in the recruitment and retention of skilled personnel;

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

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

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

substantially larger patent portfolios; and

operational advantages.

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

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

We have offices in six foreign countries and we are dedicating a significant portion of our sales efforts in countries outside North America. We are dependent on international sales for a substantial amount of our total revenue. In 2012, 2011 and 2010, approximately 47.5%, 53.9% and 62.8%, respectively, of our total revenue was derived from operations outside the U.S and we expect that international sales will continue to represent a substantial portion of our revenue for the foreseeable future. This future international revenue will depend on the continued use and expansion of our type and technologies, including the licensing of our solutions worldwide.

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

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

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

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

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

foreign labor laws, regulations and restrictions;

changes in diplomatic and trade relationships;

difficulty in staffing and managing foreign operations;

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

the strength of international economies.

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

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

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

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

- difficulties in assimilating acquired personnel, operations and technologies;
- unanticipated costs or liabilities associated with such acquisitions;
- incurrence of acquisition-related costs;
- diversion of management s attention from other business concerns;
- use of resources that are needed in other parts of our business; and
- use of substantial portions of our available cash to consummate such acquisitions.

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

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

Our license revenue is generated primarily from royalties and recurring revenues paid by customers who license our type and technologies. Under these arrangements, our customers typically pay us a fee based on usage of our solutions and we rely on our licensees to accurately report their usage. We calculate our license fees, prepare our financial reports, projections and budgets and direct our licensing and technology development efforts based in part on these reports. However, it is often difficult for us to independently determine whether or not our licensees are reporting accurately. We have implemented an audit program of our licensees records, but the effects of this program may be limited as audits are

generally expensive and time consuming, and initiating audits could harm our relationships with licensees. In addition, our audit rights are contractually limited. To the extent that our licensees understate or fail to report their usage of their solutions, we will not collect and recognize revenue to which we are entitled. Alternatively, we may encounter circumstances in which a customer may notify us that it previously reported inaccurate usage. In such cases, we may be required to give our licensee a credit which would result in a reduction in revenue in the period in which a credit is granted, and such a reduction could be material.

***Parties from whom we license fonts or components of our technology may challenge the basis for our calculations of the royalties due to them.***

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

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

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

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

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

- general economic conditions;
- demand for CE devices that include our solutions;
- demand for our fonts and custom font design services;
- delays in product shipment by our customers;
- industry consolidation;
- introduction, enhancement and market acceptance of type and technology offered by us and our competitors;
- price reductions by us or our competitors or changes in how type and related technologies are priced;

the mix of solutions offered by us and our competitors;

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

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

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

our ability to hire and retain qualified personnel.

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

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

Our future success depends in large part upon the continued services of key members of our senior management team. All of our executive officers and key employees are at-will employees. Douglas J. Shaw, Chief Executive Officer, has been with the Company and its predecessor in various senior management roles for 31 years. Mr. Shaw has been critical to the overall management of the Company, as well as the development of our solutions, our culture and our strategic direction. The loss of his services or of the services of other key members of our senior management could seriously harm our ability to execute our business strategy. We also may have to incur significant costs in identifying, hiring, training and retaining replacements for key employees.

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

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

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

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

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

We have a five-year, $120.0 million secured revolving credit facility with Wells Fargo Capital Finance LLC (the Credit Facility ). Borrowings under the Credit Facility bear interest at a variable rate based upon, at the Company s option, either London Interbank Offering Rate, ( LIBOR ) or the base rate, plus in each case, an applicable margin. The Credit Facility contains certain financial covenants and is secured by substantially all of our assets. In the event that we draw down on the Credit Facility more fully, it could have important consequences to our business or the holders of our common stock, including:

- limiting our ability to obtain additional financing in the future for working capital, capital expenditures or acquisitions;
- requiring a significant portion of our cash flow from operations to be dedicated to the payment of the principal of and interest on our indebtedness, thereby reducing funds available for other purposes; and
- making us more vulnerable to economic downturns and limiting our ability to withstand competitive pressures.

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

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

- announcements of new products, services or technologies, commercial relationships, acquisitions or other events by us or our competitors;
- fluctuations in stock market prices and trading volumes of similar companies;
- variations in our quarterly operating results;
- changes in our financial guidance or securities analysts estimates of our financial performance;
- changes in accounting principles;
- sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;
- additions or departures of key personnel;
- discussion of us or our stock price by the financial press and in online investor communities;

- general market or economic conditions, including factors unrelated to our operating performance or the operating performance of our competitors; and
- other risks and uncertainties described in these Risk Factors .

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

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

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

***We currently pay dividends on our common stock, but there is no guarantee that this will continue.***

Beginning in the third quarter of 2012, our Board of Directors approved a dividend to shareholders of our common stock. We expect this to be a recurring quarterly dividend with future payments and record dates being subject to board approval, however if our financial or operating conditions change, or if we fail to satisfy the restrictive covenants contained in the terms of our Credit Facility that limit our ability to make dividend payments, it may affect our ability to pay this dividend on a quarterly basis or at all.

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

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

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

None.

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**Item 2.** ***Properties***

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

| Location | Principal Use | Approximate Square Feet | Lease term |
|---|---|---|---|
| **Facilities Used in Current Operations** | | | |
| Bad Homburg, Germany | Software Development, Marketing, Sales and Administrative | 16,000 | Leased; expires in December 2017 |
| Woburn, Massachusetts, USA | Software Development, Marketing, Sales, Administrative and Corporate | 38,000 | Leased; expires April 2015 with one 5-year renewal option |

We also maintain eleven additional leased facilities in San Mateo, California; Boulder, Colorado; Elk Grove Village, Illinois; New York City, New York; Salfords and London, United Kingdom; Berlin, Germany; Noida, India; Tokyo, Japan; Hong Kong, China and Seoul, South Korea. These additional offices occupy approximately 25,000 square feet in the aggregate. We do not consider any specific leased facility to be material to our operations. We believe equally suited facilities are available in several other areas throughout the United States and abroad.

**Item 3.** ***Legal Proceedings***

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

**Item 4.** ***Mine Safety Disclosures***

Not applicable.

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# PART II

**Item 5.** ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

**Market Information and Related Stockholder Matters**

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

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

| | High | Low |
|---|---|---|
| **Period 2012:** | | |
| First Quarter | $ 15.97 | $ 13.73 |
| Second Quarter | 16.77 | 13.08 |
| Third Quarter | 16.54 | 12.56 |
| Fourth Quarter | 16.21 | 13.79 |
| **Period 2011:** | | |
| First Quarter | $ 14.50 | $ 10.98 |
| Second Quarter | 15.23 | 12.87 |
| Third Quarter | 14.54 | 10.10 |
| Fourth Quarter | 16.79 | 11.24 |

The closing price of our common stock, as reported by the NASDAQ Global Select Market, was $20.87 on February 21, 2013.

**Holders**

As of February 21, 2013, there were approximately 194 holders of record of our common stock.

**Dividends**

Our Board of Directors declared a quarterly cash dividend of $0.04 per share on our common stock on both July 25, 2012 and October 24, 2012. We anticipate paying cash dividends on a quarterly basis in the future, subject to approval by our Board of Directors. On February 12, 2013, our Board of Directors declared a $0.06 per share quarterly cash dividend on our outstanding common stock. There were no dividends declared in the first two quarters of 2012 or during 2011.

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

The following table sets forth information regarding securities authorized for issuance under the Company s equity compensation plans as of December 31, 2012. To date, the Company has not granted any warrants or rights.

| Plan Category | Number of securities to be issued upon exercise of outstanding options | Weighted-average exercise price of outstanding options | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column) (3) |
|---|---|---|---|
| Equity compensation plans approved by security holders (1) | 4,032,433 | $ 10.00 | 2,176,457 |
| | 206,969 | $ 12.05 | 370,622 |

| | | | |
|---|---|---|---|
| Equity compensation plans not approved by security holders (2) | | | |
| Total | 4,239,402 | $ 10.10 | 2,547,079 |

(1) Includes our 2004 Stock Option and Grant Plan, or 2004 Award Plan, and our Amended and Restated 2007 Stock Option and Incentive Plan, or 2007 Award Plan.

(2) Options issued in connection with our 2012 acquisition of Bitstream Inc. and 2010 acquisition of Ascender under Marketplace Rule 5635(c)(4) of the NASDAQ Global Select Market. 35,477 shares of restricted stock were also issued in connection with the Design By Front Limited acquisition. 15,648 shares of restricted stock were also issued in connection with the Bitstream Inc. acquisition. 53,763 shares of restricted stock were also issued in connection with the Ascender acquisition.

(3) Total shares allocated to the plans less the total number of awards granted through December 31, 2012.

**Listing Requirements**

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

**Performance Graph**

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

The following graph shows a comparison from December 31, 2007 through December 31, 2012 of the cumulative total return for our common stock, NASDAQ Composite Index and NASDAQ Computer Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the NASDAQ Composite Index and the NASDAQ Computer Index assumes that dividends, if any, were reinvested.

* Assumes $100 was invested on December 31, 2007 in our common stock and in the applicable indexes.

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**Unregistered Sales of Equity Securities**

On November 1, 2012 in connection with the Company s acquisition of Design By Front Limited, we issued an aggregate of 35,477 shares of our restricted common stock as inducement awards to thirteen employees of Design By Front who became employees of the Company. On March 19, 2012, in connection with our acquisition of Bitstream Inc., we issued an aggregate of 15,648 shares of restricted common stock and 44,273 non-qualified stock options as inducement awards to thirteen Bitstream employees who became employees of the Company. These issuances were made in compliance with NASDAQ Marketplace Rule 5635(c) and in reliance upon exemptions from registration provided by Section 4(2) of the Securities Act.

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

**Issuer Purchases of Securities**

Pursuant to the terms of our 2004 Award Plan, we have the right to repurchase unvested restricted shares from employees upon their termination, and it is generally our policy to do so. Pursuant to the terms of our 2007 Award Plan and 2010 Inducement Stock Plan, or 2010 Inducement Plan, we automatically reacquire any unvested restricted shares at their original price from the grantee upon termination of employment. The following table provides information about purchases by the Company during the quarter ended December 31, 2012 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 | Total 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 |
|---|---|---|---|---|
| October 1, 2012 to October 31, 2012 | | $ 0.00 | | |
| November 1, 2012 to November 30, 2012 | | 0.00 | | |
| December 1, 2012 to December 31, 2012(1) | 12,126 | 0.00 | | |
| Total | 12,126 | $ 0.00 | | |

(1) The Company repurchased unvested restricted stock in accordance with the 2007 Stock Option and Incentive Plan. The price paid by the Company was determined pursuant to the terms of the 2007 Stock Option and Incentive Plan and related restricted stock agreement.

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**Item 6. *Selected Financial Data***

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this report. The data presented for the years ended December 31, 2012, 2011 and 2010, and as of December 31, 2012 and 2011, are derived from our audited consolidated financial statements included elsewhere in this report. The data presented for the years ended December 31, 2009 and 2008, and as of December 31, 2010, 2009 and 2008, are derived from our consolidated financial statements not included in this report.

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| **Condensed Consolidated Statement of Income Data:** | | | | | |
| Revenue | $ 149,861 | $ 123,212 | $ 106,659 | $ 94,005 | $ 110,861 |
| Cost of revenue | 21,005 | 10,155 | 7,477 | 6,861 | 9,101 |
| Cost of revenue amortization of acquired technology | 4,051 | 3,169 | 3,488 | 3,383 | 3,392 |
| Total cost of revenue | 25,056 | 13,324 | 10,965 | 10,244 | 12,493 |
| Gross profit | 124,805 | 109,888 | 95,694 | 83,761 | 98,368 |
| Marketing and selling | 35,953 | 32,622 | 25,935 | 23,645 | 22,911 |
| Research and development | 18,007 | 16,540 | 15,404 | 14,142 | 14,867 |
| General and administrative | 18,908 | 17,413 | 16,488 | 14,674 | 19,882 |
| Amortization of other intangibles | 5,469 | 5,071 | 4,795 | 4,744 | 6,924 |
| Total operating expenses | 78,337 | 71,646 | 62,622 | 57,205 | 64,584 |
| Income from operations | 46,468 | 38,242 | 33,072 | 26,556 | 33,784 |
| Other (income) expense: | | | | | |
| Interest expense, net | 1,725 | 2,754 | 4,405 | 4,435 | 8,077 |
| Loss on extinguishment of debt | | 422 | | | |
| Other expense, net | 563 | 446 | 1,687 | 1,144 | 556 |
| Total other expense | 2,288 | 3,622 | 6,092 | 5,579 | 8,633 |
| Income before provision for income taxes | 44,180 | 34,620 | 26,980 | 20,977 | 25,151 |
| Provision for income taxes | 15,215 | 11,951 | 8,620 | 7,575 | 9,770 |
| Net income | $ 28,965 | $ 22,669 | $ 18,360 | $ 13,402 | $ 15,381 |
| Net income available to common stockholders basic | $ 28,496 | $ 22,302 | $ 18,237 | $ 13,315 | $ 15,130 |
| Net income available to common stockholders diluted | $ 28,510 | $ 22,302 | $ 18,237 | $ 13,315 | $ 15,130 |
| Net income per common share: | | | | | |
| Basic | $ 0.78 | $ 0.63 | $ 0.52 | $ 0.39 | $ 0.45 |
| Diluted | $ 0.76 | $ 0.61 | $ 0.51 | $ 0.38 | $ 0.43 |
| Weighted average number of common shares outstanding basic | 36,311,835 | 35,357,630 | 34,762,919 | 34,365,544 | 33,818,508 |
| Weighted average number of common shares outstanding diluted | 37,561,953 | 36,817,379 | 35,990,295 | 35,288,126 | 35,304,794 |
| Cash dividend per common share | $ 0.08 | $ | $ | $ | $ |

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| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| **Condensed Consolidated Summary Balance Sheet Data:** | | | | | |
| Cash and cash equivalents | $ 39,340 | $ 53,850 | $ 42,786 | $ 34,616 | $ 31,941 |
| Total current assets | 53,217 | 64,905 | 50,676 | 43,190 | 41,191 |
| Total assets | 320,066 | 283,822 | 278,805 | 272,377 | 277,421 |
| Total current liabilities | 39,273 | 32,380 | 31,830 | 32,672 | 38,227 |
| Total debt | 22,321 | 37,321 | 65,859 | 91,353 | 113,596 |
| Additional paid-in capital | 179,094 | 167,448 | 155,791 | 148,273 | 142,676 |
| Total stockholders equity | 235,519 | 198,361 | 164,982 | 140,522 | 120,836 |

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

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

**Overview**

We are a leading 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 18,000 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 200 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 2012 from over 200 countries and territories, offer thousands of high-quality font products, in some cases more than 150,000, including our own fonts from the Monotype Libraries as well as fonts from third parties.

On October 29, 2012, we acquired all of the outstanding shares of Design by Front Limited, a privately-held web strategy, design and technology studio located in Belfast, Northern Ireland, for approximately $4.6 million. The Company paid $2.5 million in cash upon closing, $0.1 million was accrued pending final adjustments, with the remainder of the purchase price to be paid contingent on attainment of certain criteria through 2014. In connection with the acquisition, 13 employees have joined the Company. Design by Front Limited s Typecast browser-based web authoring tool allows easy use of web fonts when designing web sites.

On March 19, 2012, we acquired all of the outstanding shares of Bitstream Inc. in an all cash merger for $49.6 million pursuant to the Agreement and Plan of Merger ( Merger Agreement ) dated November 10, 2011. The Company used approximately $24.6 million in cash, of which approximately $58 thousand was recorded as restricted cash at December 31, 2012, and borrowed $25.0 million from its revolving credit facility. Bitstream Inc., a Delaware corporation, and its wholly owned subsidiary, Bitstream India Pvt. Ltd., following the acquisition became wholly-owned subsidiaries of Monotype

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Imaging Holdings Inc. Included in the acquisition is the popular MyFonts.com[sm] website, featuring 89,000 fonts from nearly 900 foundries, in addition to the widely used WhatTheFont[sm] identification service. The transaction also included the Bitstream® typeface library, Font Fusion® and a range of fonts for embedded and mobile environments, and 10 patents. Twelve employees from Bitstream s U.S. operations and 42 engineers and type designers from Bitstream s India operations have joined the Company in connection with the acquisition, which provides us with an expanded global presence. We believe the acquisition has strengthened our products and services, while providing customers with improved choice and flexibility.

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

**Sources of Revenue**

We derive revenue from two principal sources: licensing our fonts and font related services 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 custom revenue where spending is largely discretionary in nature, have historically been and we expect them to continue to be in the future, susceptible to weakening economic conditions.

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

| | 2012 | | 2011 | | 2010 | |
|---|---|---|---|---|---|---|
| | Sales | % of Total | Sales | % of Total | Sales | % of Total |
| | (In thousands of dollars, except %) | | | | | |
| United States | $ 78,653 | 52.5% | $ 56,728 | 46.1% | $ 39,671 | 37.2% |
| Asia | 46,277 | 30.9 | 44,127 | 35.8 | 44,935 | 42.1 |
| United Kingdom | 5,214 | 3.5 | 5,322 | 4.3 | 4,727 | 4.5 |
| Germany | 19,717 | 13.1 | 17,035 | 13.8 | 17,326 | 16.2 |
| Total | $ 149,861 | 100.0% | $ 123,212 | 100.0% | $ 106,659 | 100.0% |

For the years ended December 31, 2012, 2011 and 2010, sales by our subsidiaries located outside North America comprised 47.5%, 53.9% and 62.8%, respectively, of our total revenue. United States revenue, in the table above for 2012, increased in both dollars and as a percentage of revenue, as compared to 2011, primarily the result of our acquisition of Bitstream and growth in markets principally served by our U.S. subsidiaries. In 2011, revenue from the United States increased both in dollars and as a percent of revenue, as compared to 2010, as a result of several factors, including, contractual changes with an existing customer, growth in markets primarily served by our U.S. subsidiary and our acquisition of Ascender. We expect that sales by our international subsidiaries will continue to represent a substantial portion of our revenue for the foreseeable future. Future international revenue will depend on the continued use and expansion of our text imaging solutions worldwide.

We derive a majority of our revenue from a limited number of customers, in particular manufacturers of laser printers and mobile phones. For the years ended December 31, 2012, 2011 and 2010, our top ten licensees by revenue accounted for approximately 41.0%, 46.0% and 50.8% of our total revenue, respectively. No one customer accounted for more than 10% of our total revenue in 2012, 2011 or 2010.

**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.

**Marketing and Selling**

Our marketing and selling expense consists of salaries, bonuses, commissions and benefits related to our marketing and selling personnel, business travel expenses, advertising and trade show expenses, web-related expenses, allocated facilities costs and other overhead expenses. Sales commission expense varies as a function of revenue and goal achievement from period-to-period.

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**Research and Development**

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

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

**General and Administrative**

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

**Amortization of Intangible Assets**

We amortize intangible assets acquired as follows:

Customer relationships 7 to 16 years;

Acquired technology 8 to 15 years; and

Non-compete agreements 3 to 6 years.

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

**Critical Accounting Policies**

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

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

***Revenue Recognition***

We recognize revenue in accordance with ASC Topic No. 985-605, *Software Revenue Recognition*. Revenue is recognized when persuasive evidence of an agreement exists, the product has been delivered or services have been provided, the fee is fixed or determinable, and collection of the fee is probable.

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*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 latest acquisition, 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 are generally recognized upon delivery. Font related service revenue is mainly subscription based and, from time to time, it 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 is recognized upon payment by the customer and proof of font delivery. 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 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.

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

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

We assess the impairment of goodwill and indefinite-lived intangible assets annually, or more frequently if events or changes in circumstances indicate that the carrying value of such assets exceeds their fair value. We perform our annual goodwill and indefinite-lived intangible impairment tests as of

December 31. In September 2011, the FASB issued Accounting Standards Update, or ASU, No. 2012-02, *Intangibles-Goodwill and Other (Topic No. 350): Testing Goodwill for Impairment*. This ASU provides entities an option to perform a qualitative assessment to determine whether further impairment testing on goodwill is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. In July 2012, the FASB issued ASU, No. 2012-02, *Intangibles-Goodwill and Other (Topic No. 350): Testing Indefinite-Lived Intangible Assets for Impairment,* which amended its guidance on the testing of indefinite-lived intangible assets for impairment to simplify and improve consistency of impairment testing guidance among long-lived asset categories. This ASU provides entities an option to perform a qualitative assessment for determining whether an indefinite-lived intangible asset is impaired, similar to the goodwill impairment testing options permitted from September 2011 standard update. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, the quantitative test is optional. For both years presented, 2012 and 2011, we assessed qualitative factors of goodwill, as described below, to determine whether it was more likely than not that the fair value of our reporting unit was impaired and determined that the fair value was more likely than not higher than its carrying value. In 2012, we assessed qualitative factors of our indefinite-lived intangible assets and in 2011 we performed the quantitative two-step fair value impairment test on our indefinite-lived intangibles. We applied the relief from royalty method, a variation of the discounted cash flow method, to determine the fair value of these assets under the two-step test. In both years presented, we determined that the fair value was more likely than not higher that the carrying value.

With respect to both goodwill and indefinite-lived intangible assets, factors that could trigger an impairment review include significant negative industry or economic trends, exiting an activity in conjunction with a restructuring of operations, a sustained decrease in share price or current, historical or projected losses that demonstrate continuing losses associated with an asset. Impairment evaluations involve management estimates of useful lives and future cash flows, including assumptions about future conditions such as future revenue, operating expenses, the fair values of certain assets based on appraisals and industry trends. Actual useful lives and cash flows could be different from those estimated by our management. If this resulted in an impairment of goodwill and indefinite-lived intangible assets, it could have a material adverse effect on our financial position and results of operations.

***Share Based Compensation***

We account for share based compensation in accordance with ASC Topic No. 718, *Compensation Stock Compensation* or ASC 718, which requires the measurement of compensation costs at fair value on the date of grant and recognition of compensation expense over the service period for awards expected to vest.

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

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assumption for 2012 is based on our history of no expectation of paying dividends together with the actual yield of one quarterly dividend that was paid during the fourth quarter. Prior to 2012, the expected dividend yield assumption was based on our history up to that point, and the expectation of paying no dividends.

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

During the years ended December 31, 2012, 2011 and 2010, we recorded total share based compensation expense of $6.9 million, $7.0 million and $5.5 million, respectively. As of December 31, 2012, the Company had $12.3 million of unrecognized compensation expense related to employees and directors unvested stock options and restricted share awards that are expected to be recognized over a weighted average period of 1.8 years.

***Pension Plan***

We account for our defined benefit pension plan in accordance with ASC Subtopic No. 715-30, *Defined Benefit Plans Pension*. Our unfunded defined benefit pension plan was acquired in connection with our acquisition of Linotype on August 1, 2006. The pension plan was closed to new participants in 2006. The pension plan covers substantially all employees of our Linotype subsidiary who joined Linotype prior to the plan closing. Benefits under this plan are based on the employees years of service and compensation. We fund the plan sufficiently to meet current benefits only. There are no assets associated with the plan. In 2012 and 2011 we paid $79 thousand and $83 thousand, respectively, to the plan participants. At December 31, 2012 and 2011, our unfunded position was $4.9 million and $3.8 million, respectively. A significant portion of the pension benefit obligation is determined based on the rate of future compensation increases, inflation and interest rates. Given the fact that the pension plan is unfunded, changes in economic and market conditions may require us to increase cash contributions in future years. In addition, changes to our assumptions may materially impact the accrued pension liability.

***Provision for Income Taxes***

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

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

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

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

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax expense together with assessing the future impact of temporary differences resulting from differing treatment of items for tax and accounting purposes. The tax effect of these temporary differences is shown on our December 31, 2012 consolidated balance sheet (see Note 11 to our consolidated financial statements) and denotes these differences as a net deferred tax liability of $24.5 million. This consists of total deferred tax liabilities of $37.1 million and net deferred tax assets of $12.6 million after providing a valuation allowance of $2.3 million.

***Derivative Financial Instruments***

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

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**Results of Operations**

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| **Revenue:** | | | |
| Creative Professional | 34.5% | 25.6% | 25.0% |
| OEM | 65.5 | 74.4 | 75.0 |
| Total revenue | 100.0 | 100.0 | 100.0 |
| Cost of revenue | 14.0 | 8.2 | 7.0 |
| Cost of revenue amortization of acquired technology | 2.7 | 2.6 | 3.3 |
| Total cost of revenue | 16.7 | 10.8 | 10.3 |
| Gross profit | 83.3 | 89.2 | 89.7 |
| Marketing and selling | 24.1 | 26.5 | 24.3 |
| Research and development | 12.0 | 13.4 | 14.4 |
| General and administrative | 12.6 | 14.2 | 15.5 |
| Amortization of other intangible assets | 3.6 | 4.1 | 4.5 |
| Total operating expenses | 52.3 | 58.2 | 58.7 |
| Income from operations | 31.0 | 31.0 | 31.0 |
| Interest expense, net | 1.1 | 2.2 | 4.1 |
| Loss on foreign exchange | 0.4 | 0.2 | 2.0 |
| Loss (gain) on derivatives | | 0.2 | (0.4) |
| Loss on extinguishment of debt | | 0.3 | |
| Total other expenses | 1.5 | 2.9 | 5.7 |
| Income before provision for income taxes | 29.5 | 28.1 | 25.3 |
| Provision for income taxes | 10.2 | 9.7 | 8.1 |
| Net income | 19.3% | 18.4% | 17.2% |

**Year Ended December 31, 2012 as Compared to Year Ended December 31, 2011**

*Sales by Market.* We view our operations and manage our business as one segment; the development, marketing and licensing of technologies and fonts. Factors used to identify our single segment include the financial information available for evaluation by our chief operating decision maker, our president and chief executive officer, in determining how to allocate resources and assess performance. While our technologies and services are sold to customers in two principal markets Creative Professional and CE device manufacturers and independent software vendors, together 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 principal markets (in thousands):

| | **2012** | **2011** | **Increase** |
|---|---|---|---|
| Creative Professional | $ 51,751 | $ 31,556 | $ 20,195 |
| OEM | 98,110 | 91,656 | 6,454 |
| Total revenue | $ 149,861 | $ 123,212 | $ 26,649 |

***Revenue***

Revenue was $149.9 million and $123.2 million for the years ended December 31, 2012 and 2011, respectively, an increase of $26.6 million, or 21.6%, mainly due to increased Creative Professional revenue.

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Creative Professional revenue increased $20.2 million, or 64.0%, to $51.8 million for the year ended December 31, 2012 as compared to $31.6 million for the year ended December 31, 2011 mainly due to an increase in web revenue. Web revenue increased $16.1 million predominantly due to the acquisition of Bitstream, together with increased sales of our web font services. Non-web revenue, which accounted for the remainder of the increase, or $4.1 million, increased largely due to font licensing to our corporate customers and project-related revenue.

OEM revenue was $98.1 million and $91.7 million for the years ended December 31, 2012 and 2011, respectively, an increase of $6.5 million, or 7.0%, primarily due to an increase in display imaging revenue. Display imaging revenue increased as a result of increased volume of unit shipments of products by our customers, such as OEMs and independent software vendors who embed our fonts and technology solutions, increased license revenue due to the acquisition of Bitstream, and project-related revenue.

***Cost of Revenue***

Cost of revenue, excluding amortization of acquired technology, increased $10.8 million, or 106.8%, to $21.0 million from $10.2 million for the years ended December 31, 2012 and 2011, respectively. As a percentage of total revenue, cost of revenue was 14.0% and 8.2% for the years ended December 31, 2012 and 2011, respectively. The increase in cost of revenue, excluding amortization of acquired technology, was primarily due to our acquisition of Bitstream. Bitstream s web business licenses a higher proportion of third party fonts, which carries a higher cost of revenue.

The portion of cost of revenue consisting of amortization of acquired technology was $4.1 million and $3.2 million in the years ended December 31, 2012 and 2011, respectively, an increase of $0.9 million, or 27.8%, mainly due to our acquisition of Bitstream in March 2012. Going forward, we expect amortization of acquired technology to increase an additional $0.3 million and $0.3 million due to our acquisitions of Bitstream and Design by Front, respectively.

***Gross Profit***

Gross profit decreased 5.9 percentage points to 83.3% in the year ended December 31, 2012, compared to 89.2% of revenue for the year ended December 31, 2011, mainly the result of product mix. Creative Professional revenue, which typically has a higher cost than our OEM revenue, represented 34.5% of our total revenue in the year ended December 31, 2012, as compared to 25.6% in the year ended December 31, 2011, mainly due to our acquisition of Bitstream. We expect that our gross profit percentage will be in the range of 81% to 83% in 2013.

***Operating Expenses***

*Marketing and Selling.* Marketing and selling expense was $36.0 million and $32.6 million for the years ended December 31, 2012 and 2011, respectively, an increase of $3.3 million, or 10.2%. Personnel expenses increased $1.7 million in 2012, as compared to 2011, mainly due to the acquisition of Bitstream and higher variable compensation as a result of higher sales volume. Online advertising expense decreased $1.7 million in the year ended 2012, as compared to 2011, a direct result of a targeted reduction in discretionary spending. Increased discretionary spending on outside services, primarily for the Company s rebranding and new websites, travel and tradeshows together contributed $2.5 million to the overall increase. Other expenses increased $0.7 million, mainly related to the increased volume of sales, such as processing fees and other charges on web sales.

*Research and Development.* Research and development expense was $18.0 million and $16.5 million, in 2012 and 2011, respectively, an increase of $1.5 million, or 8.9%, mainly due to an increase in personnel expenses. Personnel expenses increased $1.4 million mainly due to incremental headcount related to our Bitstream acquisition. At December 31, 2012, as compared to December 31, 2011, headcount in our research and development area increased 44.8%.

*General and Administrative.* General and administrative expense was $18.9 million and $17.4 million for the years ended December 31, 2012 and 2011, respectively, an increase of $1.5 million, or 8.6%. Personnel expenses increased $0.6 million, mainly due to annual salary increases and increased headcount. Headcount increased 14.3% in 2012, as compared to 2011. Increased discretionary spending on professional service and travel expenses increased $0.4 million in 2012, as compared to 2011, due primarily to acquisition related activity.

*Amortization of Other Intangible Assets.* Amortization of other intangible assets was $5.5 million and $5.1 million for the years ended December 31, 2012 and 2011, respectively, an increase of $0.4 million, or 7.9%, primarily due to our acquisition of Bitstream. We expect amortization of other intangible assets to increase approximately $0.2 million annually going forward as a result of our acquisition of Bitstream. We expect amortization of other intangibles to increase $0.3 million in 2013 as a result of our Design By Front acquisition.

***Interest Expense, Net***

Interest expense, net of interest income decreased $1.0 million, or 37.4%, to $1.7 million in the year ended December 31, 2012, as compared to $2.8 million in the year ended December 31, 2011. The decrease in interest expense was the result of lower total debt outstanding. While interest rates remained similar throughout 2012 and 2011, our average total debt outstanding in 2012 was $37.3 million, as compared to an average balance of $54.6 million during 2011.

***Loss on Foreign Exchange***

Loss on foreign exchange was $0.6 million and $0.2 million in 2012 and 2011, respectively. The loss in 2012 was mainly due to currency fluctuations. Our Euro denominated intercompany note was paid in full during the fourth quarter of 2012.

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

Loss (gain) on derivatives were losses of $11 thousand and $0.2 million in 2012 and 2011, respectively, the net result of changes to the market value of our swap contracts. Our interest rate swap contract matured in July 2012 and our currency swap contract matured in December 2012. At December 31, 2012, we did not have any derivative contracts outstanding. In 2011, the loss was primarily related to our interest rate swap contract.

***Provision for Income Taxes***

Our effective tax rate was 34.4% and 34.5% for the year ended December 31, 2012 and 2011, respectively. The effective tax rate for the year ended December 31, 2012 included a larger income tax benefit received from the reversal of reserves for income taxes, as compared to the same period in 2011. The effective tax rate for 2011 included a benefit of 0.6% for research credits. The effective tax rate for 2012 did not include this benefit, as the tax credit had expired, and was not renewed until 2013.

As of December 31, 2012, the total amount of unrecognized tax benefits was $4.6 million. At December 31, 2011, we had $0.9 million of unrecognized tax benefits. The increase in unrecognized tax benefits in 2012 relates primarily to uncertainty concerning tax benefits of net operating loss and research credit carryforwards acquired in connection with the Bitstream acquisition. We classify potential interest and penalties as a component of tax expense. As of December 31, 2012 and 2011 we had $78 thousand and $0.3 million of accrued interest and penalties, respectively.

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

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

| | 2011 | 2010 | Increase |
|---|---|---|---|
| Creative Professional | $ 31,556 | $ 26,659 | $ 4,897 |
| OEM | 91,656 | 80,000 | 11,656 |
| Total revenue | $ 123,212 | $ 106,659 | $ 16,553 |

***Revenue***

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

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

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

***Cost of Revenue***

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

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

***Gross Profit***

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

***Operating Expenses***

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

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

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

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

***Interest Expense, Net***

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

***Loss on Foreign Exchange***

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

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

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

***Loss on Extinguishment of Debt***

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

***Provision for Income Taxes***

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

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

**Recently Issued Accounting Pronouncements**

***Indefinite-Lived Intangible Assets***

In July 2012, the Financial Accounting Standards Board, or FASB, issued ASU 2012-02, *Intangibles-Goodwill and Other (Topic No. 350): Testing for Indefinite-Lived Intangible Assets for Impairment,* which amended its guidance on the testing of indefinite-lived intangible assets for impairment to simplify and improve consistency of impairment testing guidance among long-lived asset categories. After an assessment of certain qualitative factors, if it is determined to be more likely than not that an indefinite-lived asset is impaired entities must perform the quantitative impairment test. Otherwise, the quantitative test is optional. The statement is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. We perform our annual testing in the fourth quarter. The Company has elected early adoption and has applied this guidance for its year ended December 31, 2012 and the adoption did not have a material impact on our financial statements.

***Comprehensive Income***

In June 2011, the FASB issued ASC Topic No. 220, *Comprehensive Income*, which amended its guidance on the presentation of comprehensive income in financial statements to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items that are recorded in other comprehensive income. The new accounting guidance requires entities to report components of comprehensive income in either (1) a single statement of comprehensive income immediately following the income statement, or (2) a separate statement of comprehensive income immediately following the income statement. Companies will no longer be allowed to present comprehensive income on the statement of changes in shareholders equity. In both options, companies must present the components of net income, total net income, the components of other comprehensive income, total other comprehensive income and total comprehensive income. In addition, in December 2011, the FASB issued an amendment to the standard which defers the requirement to present components of reclassifications of other comprehensive income on the face of the income statement. The provisions of both pieces of new guidance are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and required retrospective application for all periods presented. We adopted the new standard effective January 1, 2012, which impacted our presentation of comprehensive income, but did not otherwise impact our financial position or results of operations.

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**Liquidity and Capital Resources**

***Cash Flows for the Years Ended December 31, 2012, 2011 and 2010***

Since our inception, we have financed our operations primarily through cash from operations, private and public stock sales and long-term debt arrangements, as described below. We believe our existing cash and cash equivalents, our cash flow from operating activities and available bank borrowings will be sufficient to meet our anticipated cash needs for at least the next twelve months. At December 31, 2012, our principal sources of liquidity were cash and cash equivalents totaling $39.3 million and a $120.0 million revolving credit facility, of which $22.3 million was outstanding. Our future working capital requirements will depend on many factors, including the operations of our existing business, our potential strategic expansion, and future acquisitions we might undertake. On March 19, 2012 we acquired Bitstream for approximately $49.6 million, pursuant to the Merger Agreement. We used approximately $24.6 million in cash, of which approximately $58 thousand was recorded as restricted cash at December 31, 2012, and borrowed $25.0 million from our revolving Credit Facility. On October 29, 2012 we acquired Design by Front for approximately $4.6 million, of which we paid approximately $2.4 million in cash, net of cash acquired, $0.1 million was accrued pending final adjustments and recorded a liability of $2.1 million for future estimated contingent consideration.

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Net cash provided by operating activities | $ 50,428 | $ 39,313 | $ 43,658 |
| Net cash used in investing activities | (53,161) | (2,144) | (11,020) |
| Net cash used in financing activities | (11,753) | (26,096) | (24,728) |
| Effect of exchange rates on cash and cash equivalents | (24) | (9) | 260 |
| Total (decrease) increase in cash and cash equivalents | $ (14,510) | $ 11,064 | $ 8,170 |

***Operating Activities***

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

In 2012, we generated $50.4 million in cash from our operations. Net income after adjusting for depreciation and amortization, amortization of deferred financing costs, loss on retirement of fixed assets, share based compensation, provision for doubtful accounts, deferred income taxes, unrealized currency gain on foreign denominated intercompany and derivatives loss generated $50.1 million in cash. Accounts receivable and deferred revenue generated $1.2 million in cash, mainly due to increased sales in 2012. Prepaid expenses and other assets and accrued expenses and other liabilities, net of accounts payable, generated $1.3 million in cash mainly due to increases in accrued expense related to our Bitstream operation. Income tax refunds receivable, accrued income taxes and excess tax benefit on stock options used $2.2 million in cash during 2012.

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

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

***Investing Activities***

During 2012, we used $49.1 million for the acquisition of Bitstream and $2.4 million for the acquisition of Design by Front, net of cash acquired. As of December 31, 2012, $2.1 million of additional costs was accrued for final adjustments and contingent consideration. We also used $1.6 million for the purchase of property and equipment, exclusive license and other intangible assets during 2012. During 2011, we used $1.9 million for the purchase of property and equipment, and paid the final $0.2 million of costs associated with our acquisition of Ascender Corporation and Font Commerce LLC, which was accrued in 2010. During 2010, we acquired Ascender Corporation and Font Commerce LLC which used cash of $7.2 million. We accrued $0.2 million of additional costs at December 31, 2010 pending final adjustments. During 2010, we used $3.0 million for the purchase of a long-term exclusive license. The remainder of cash used in investing activities was for the purchase of property and equipment.

***Financing Activities***

Cash used by financing activities in 2012, was $11.8 million. Borrowings against our revolving Credit Facility amounted to $25.0 million to partially fund our acquisition of Bitstream, which was offset by $40.0 million in repayments in 2012. We received cash from exercises of stock options of $3.2 million and excess tax benefit on stock options provided $1.5 million. We also paid out a shareholder dividend of $1.5 million in 2012. During 2011, payments on long-term debt used $86.8 million in cash, offset by proceeds from the issuance of debt, net of issuance costs of $56.1 million as a result of the refinancing of our debt in July 2011. Proceeds from the exercise of stock options, combined with the excess tax benefit on stock options provided $4.7 million in cash during 2011. During 2010 we used $26.3 million in cash to pay down our long-term debt, which included a $10.0 million prepayment made in connection with the third amendment to our Amended and Restated Credit Agreement, as discussed in Credit Facility below. Proceeds received for the exercise of stock options, combined with the excess tax benefit on stock options, provided $1.6 million in cash.

***Dividend Paid***

On October 24, 2012 the Board of Directors approved a $0.04 per share or $1.5 million, quarterly cash dividend on our outstanding common stock. The record date was January 2, 2013 and the dividend was paid to shareholders on January 22, 2013. We anticipate this to be a recurring quarterly dividend with future payments and record dates subject to board approval. On February 12, 2013, our Board of Directors approved a $0.06 per share quarterly cash dividend on our outstanding common stock.

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**Credit Facility**

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

Borrowings under the Credit Facility bear interest based on the leverage ratio at either (i) the prime rate plus 1.25%, as defined in the credit agreement, or (ii) LIBOR plus 2.25%. The Company is required to pay an unused line fee equal to 0.375% per annum on the undrawn portion available under the revolving credit facility and variable per annum fees in respect of outstanding letters of credit. As of December 31, 2012, the blended interest rate on the Credit Facility was 3.0%. There are no required repayments. The Company, in accordance with the Credit Facility, is permitted to request that the Lenders, at their election, increase the secured credit facility to a maximum of $140.0 million. In addition, the Credit Facility provides that we maintain a maximum leverage ratio. The leverage ratio is defined as the ratio of aggregate outstanding indebtedness to trailing twelve months Adjusted EBITDA. Adjusted EBITDA is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation expense, plus restructuring, issuance costs, cash non-operating costs and other expenses or losses minus cash non-operating gains and other non-cash gains; provided however that the aggregate of all cash non-operating expense shall not exceed $250 thousand and all such fees, costs and expenses shall not exceed $1.5 million on a trailing twelve months basis. Additional limits are imposed on acquisition related expenses. We also must maintain a minimum fixed charge ratio. As of December 31, 2012, the maximum leverage ratio permitted was 3.00:1.00 and our leverage ratio was 0.35:1.00 and the minimum fixed charge coverage ratio was 1.25:1.00 and our fixed charge ratio was 3.79:1.00. Failure to comply with these covenants, or the occurrence of an event of default, could permit the Lenders under the Credit Facility to declare all amounts borrowed under the Credit Facility, together with accrued interest and fees, to be immediately due and payable. In addition, the Credit Facility is secured by substantially all of our assets and places limits on the Company s and its subsidiaries ability to incur debt or liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, engage in mergers, acquisitions and asset sales, transact with affiliates and alter its business.

In connection with the refinancing, the Company incurred closing fees of $0.8 million plus legal fees of approximately $0.5 million. In accordance with ASC Subtopic No. 470-50, *Modifications and Extinguishments of Debt*, these fees were accounted for as deferred financing costs and will be amortized to interest expense over the term of the Credit Facility. In addition, approximately $0.4 million of unamortized deferred financing costs associated with the pro-rata share of prior loan syndicate lenders that did not participate in the Credit Facility was written off as a debt extinguishment and charged to other expense in 2011.

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

| | Year Ended December 31, | |
|---|---|---|
| | **2012** | **2011** |