

FAIR ISAAC CORP  
Form 10-K  
November 28, 2007

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-K**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended September 30, 2007**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]  
For the transition period from        to**

**Commission File Number 0-16439**

**Fair Isaac Corporation**

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

**Delaware**

*(State or other jurisdiction of incorporation or organization)*

**94-1499887**

*(I.R.S. Employer Identification No.)*

**901 Marquette Avenue, Suite 3200  
Minneapolis, Minnesota**

*(Address of principal executive offices)*

**55402-3232**

*(Zip Code)*

**Registrant's telephone number, including area code:**

**612-758-5200**

**Securities registered pursuant to Section 12(b) of the Act:**

**(Title of Class)**

**(Name of Each Exchange on which Registered)**

Common Stock, \$0.01 par value per share  
Preferred Stock Purchase Rights

New York Stock Exchange, Inc.  
New York Stock Exchange, Inc.

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

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

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

Edgar Filing: FAIR ISAAC CORP - Form 10-K

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

Indicate by check mark 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):  
Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

As of March 31, 2007, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$1,480,955,703 based on the last transaction price as reported on the New York Stock Exchange on such date. This calculation does not reflect a determination that certain persons are affiliates of the registrant for any other purposes.

The number of shares of common stock outstanding on November 16, 2007 was 50,299,240 (excluding 38,557,543 shares held by the Company as treasury stock).

Items 10, 11, 12, 13 and 14 of Part III incorporate information by reference from the definitive proxy statement for the Annual Meeting of Stockholders to be held on February 4, 2008.

---

**TABLE OF CONTENTS**

**PART I**

<u>Item 1.</u>	<u>Business</u>	2
<u>Item 1A.</u>	<u>Risk Factors</u>	15
<u>Item 1B.</u>	<u>Unresolved Staff Comments</u>	25
<u>Item 2.</u>	<u>Properties</u>	25
<u>Item 3.</u>	<u>Legal Proceedings</u>	26
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	26
<u>Executive Officers of the Registrant</u>		26

**PART II**

<u>Item 5.</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	28
<u>Item 6.</u>	<u>Selected Financial Data</u>	31
<u>Item 7.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	32
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	50
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>	52
<u>Item 9.</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	90
<u>Item 9A.</u>	<u>Controls and Procedures</u>	90
	<u>Management's Report on Internal Control Over Financial Reporting</u>	90
<u>Item 9B.</u>	<u>Other Information</u>	90

**PART III**

<u>Item 10.</u>	<u>Directors, Executive Officers and Corporate Governance</u>	91
<u>Item 11.</u>	<u>Executive Compensation</u>	91
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	91
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	91
<u>Item 14.</u>	<u>Principal Accountant Fees and Services</u>	91

**PART IV**

<u>Item 15.</u>	<u>Exhibits and Financial Statement Schedules</u>	92
<u>Signatures</u>		96
<u>Form of Management Agreement</u>		
<u>1992 Long-Term Incentive Plan as Amended Effective December 3, 2006</u>		
<u>Management Incentive Plan, Fiscal 2008</u>		
<u>Computations of Ratios of Earnings to Fixed Charges</u>		
<u>List of Company's Subsidiaries</u>		
<u>Consent of Deloitte &amp; Touche LLP</u>		
<u>Certification of CEO</u>		
<u>Certification of CFO</u>		
<u>Section 1350 Certification of CEO</u>		
<u>Section 1350 Certification of CFO</u>		

**Table of Contents**

**FORWARD LOOKING STATEMENTS**

*Statements contained in this Report that are not statements of historical fact should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Act ). In addition, certain statements in our future filings with the Securities and Exchange Commission ( SEC ), in press releases, and in oral and written statements made by us or with our approval that are not statements of historical fact constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenue, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other statements concerning future financial performance; (ii) statements of our plans and objectives by our management or Board of Directors, including those relating to products or services; (iii) statements of assumptions underlying such statements; (iv) statements regarding business relationships with vendors, customers or collaborators; and (v) statements regarding products, their characteristics, performance, sales potential or effect in the hands of customers. Words such as believes, anticipates, expects, intends, targeted, sh potential, goals, strategy, and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to, those described in Item 1A of Part I, Risk Factors, below. The performance of our business and our securities may be adversely affected by these factors and by other factors common to other businesses and investments, or to the general economy. Forward-looking statements are qualified by some or all of these risk factors. Therefore, you should consider these risk factors with caution and form your own critical and independent conclusions about the likely effect of these risk factors on our future performance. Such forward-looking statements speak only as of the date on which statements are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events or circumstances. Readers should carefully review the disclosures and the risk factors described in this and other documents we file from time to time with the SEC, including our reports on Forms 10-Q and 8-K to be filed by the Company in fiscal 2008.*

**Table of Contents**

**PART I**

**Item 1. Business**

**GENERAL**

Fair Isaac Corporation (NYSE: FIC) (together with its consolidated subsidiaries, the Company), which may also be referred to in this report as we, us, our, and Fair Isaac) provides products and services that enable businesses to automate, improve and connect decisions to enhance business performance. Our predictive analytics and decision management systems power hundreds of billions of customer decisions each year.

We were founded in 1956 on the premise that data, used intelligently, can improve business decisions. Today, we help thousands of companies in 80 countries use our Enterprise Decision Management technology to target and acquire customers more efficiently, increase customer value, reduce fraud and credit losses, lower operating expenses, and enter new markets more profitably. Most leading banks and credit card issuers rely on our solutions, as do insurers, retailers, telecommunications providers, healthcare organizations, pharmaceutical companies and government agencies. We also serve consumers through online services that enable people to purchase and understand their FICO® scores, the standard measure in the United States of credit risk, empowering them to manage their financial health.

More information about us can be found on our principal website, [www.fairisaac.com](http://www.fairisaac.com). We make our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q and our Current Reports on Form 8-K, as well as amendments to those reports, available free of charge through our website as soon as reasonably practicable after we electronically file them with the SEC. Information on our website is not part of this report.

**PRODUCTS AND SERVICES**

We help businesses automate, improve and connect decisions across the enterprise, an approach we commonly refer to as Enterprise Decision Management, or EDM. Most of our solutions address customer decisions, including customer targeting and acquisition, account origination, customer management, fraud, collections and recovery. We also help businesses improve noncustomer decisions such as transaction and claims processing, and network integrity review. Our solutions enable users to make decisions that are more precise, consistent and agile, and that systematically advance business goals. This helps our clients to reduce the cost of doing business, increase revenues and profitability, reduce losses from risks and fraud, and increase customer loyalty.

**Our Segments**

We deliver EDM through products and services that we categorize into the following four operating segments:

*Strategy Machine® Solutions.* These are preconfigured EDM applications designed for a specific type of business problem or process, such as marketing, account origination, customer management, fraud and insurance claims management. This segment also includes our myFICO solutions for consumers.

*Scoring Solutions.* Our scoring solutions give our clients access to analytics that can be easily integrated into their transaction streams and decision-making processes. Our scoring solutions are distributed through major credit reporting agencies, and we also offer services that provide our scores to clients directly.

*Professional Services.* Through our professional services, we tailor our EDM products to our clients environments, and we design more effective decisioning environments for our clients. This segment includes

Edgar Filing: FAIR ISAAC CORP - Form 10-K

revenues from custom engagements, business solution and technical consulting services, systems integration services, and data management services.

*Analytic Software Tools.* This segment is composed of software tools that clients can use to create their own custom EDM applications.

Comparative segment revenues, operating income and related financial information for fiscal 2007, 2006 and 2005 are set forth in Note 17 to the accompanying consolidated financial statements.

**Table of Contents**

***Key Products and Services by Operating Segment***

<b>Operating Segment</b>	<b>Key Products and Services</b>
Strategy Machine Solutions	
Marketing	Fair Isaac MarketSmart Decision System® solution
Originations	LiquidCredit® decision engine LiquidCredit® service Capstone® Decision Manager Capstone® Decision Accelerator
Customer Management	TRIAD™ adaptive control system TRIAD™ Transaction Scores TelAdaptive® account management service
Fraud	Falcon™ Fraud Manager Fraud Predictor with Merchant Profiles Falcon™ ID solution CardAlert Fraud Manager Fraud/Risk Analytics for Telecom (including Revenue and Network Assurance) RoamEx® Roamer Data Exchanger
Collections & Recovery	Debt Manager™ solution Recovery Management System™ solution (RMS) ScoreNet® network PlacementsPlus® service Placement Optimizer <sup>SM</sup> service
Insurance and Healthcare	Fair Isaac SmartAdvisor® medical bill review Payment Optimizer® solution VeriComp® Fraud Manager MIRA™ Claims Advisor
Consumer	myFICO® service Score Watch™ subscription
Scoring Solutions	FICO® scores NextGen FICO® scores FICO® Expansion® scores Global FICO™ scores Marketing and bankruptcy scores Commercial credit risk scores Credit-based insurance scores Property PredictR™ scores FICO® score delivery PreScore® Service



Professional Services

Solution and technology consulting  
Data management services  
Industry consulting  
Analytic consulting  
Fraud consulting  
Medical bill review services

Analytic Software Tools

Blaze Advisor™ business rules management system  
Model Builder for Predictive Analytics  
Model Builder for Decision Trees  
Decision Optimizer  
Vectus® software

## **Table of Contents**

### **Our Solutions**

Our solutions involve three fundamental disciplines:

Analytics to identify the risks and opportunities associated with individual clients, prospects and transactions, in order to detect patterns such as fraud, and to improve the design of decision logic or strategies ;

Data management, profiling and text recognition that bring extensive customer information to every decision; and

Software such as rules management systems that implement business rules, models and decision strategies, often in a real-time environment.

All of our solutions are designed to help businesses make decisions that are faster, more precise, more consistent and more agile, while reducing costs and risks incurred in making decisions.

### ***Strategy Machine Solutions***

We develop industry-tailored EDM applications, which we call Strategy Machine Solutions, that apply analytics, data management and decision management software to specific business challenges and processes. These include credit offer prescreening, insurance claims management, telecommunications fraud prevention and others. Our Strategy Machine Solutions primarily serve clients in the financial services, insurance, healthcare, retail and telecommunications sectors.

#### ***Marketing Strategy Machine Solutions***

The chief Strategy Machine offering for marketing is our Fair Isaac MarketSmart Decision System<sup>®</sup> solution ( MarketSmart ). The MarketSmart solution is a suite of products, capabilities and services designed to integrate all of the technology and analytic services needed to perform context-sensitive customer acquisition, cross-selling and retention programs. The MarketSmart solution enables companies that offer multiple products and use multiple channels (companies such as large financial institutions, consumer branded goods companies, pharmaceutical companies, retail merchants and hospitality companies) to execute more efficient and profitable customer interactions. Services offered under the MarketSmart brand name include SmartLink customer data integration services; services that use transaction analytics to identify customer patterns and help clients target their marketing activities; services that enable real-time marketing through direct consumer interaction channels; campaign management and optimization services; interactive tools that automate the design, execution and collection of customer response data across multiple channels; and customer data collection, management and profiling services.

A number of our marketing services are designed for specific industries, such as retail and pharmaceuticals. For example, our services for retailers include using analytics to help retailers identify and market to their store shoppers; analyzing transaction data to provide insights into store customer activity and compare it with sales pattern activity across the marketplace; and analyzing a retailer's purchase transaction data to help them understand buying patterns, sequences and contexts.

#### ***Originations Strategy Machine Solutions***

We provide solutions that enable banks, credit unions, finance companies, installment lenders, telecommunications service providers and other companies to automate and improve the processing of requests for credit or service. These solutions increase the speed and efficiency with which requests are handled, reduce losses and increase approval rates

through analytics that assess applicant risk, and reduce the need for manual review by loan officers.

Our solutions include the web-based LiquidCredit® decision engine and LiquidCredit® service, which are primarily focused on the credit decision and offered largely to mid-tier financial services institutions, e-commerce providers and telecommunications providers; and Capstone® Decision Manager, a complete end-user software solution for application decisioning and processing. We also offer Capstone Decision Accelerator, which is a rules-based application based on our Blaze Advisor™ business rules management system. We also offer custom and consortium-based credit risk and application fraud models.

## **Table of Contents**

### *Customer Management Strategy Machine Solutions*

Our customer management products and services enable businesses to automate and improve decisions on their existing customers. These solutions help businesses decide which customers to cross-sell, what additional products and services to offer, whether customer risk levels have increased or decreased, when and how much to change a customer's credit line, what pricing adjustments to make in response to account performance or promotional goals, and how to treat delinquent and high-risk accounts.

We provide customer management solutions for:

*Financial Services.* In financial services, our leading account and customer management product is the TRIAD™ adaptive control system. Our adaptive control systems are so named because they enable businesses to rapidly adapt to changing business and internal conditions by designing and testing new strategies in a champion/challenger environment. The TRIAD system is the world's leading credit account management system, and our adaptive control systems are used by more than 250 issuers worldwide to manage approximately 65% of the world's credit card accounts. Our latest version of the TRIAD system enables users to manage risk and communications at both the account and borrower level from a single platform. We also offer transaction-based neural network models (the term neural network is defined under Technology later in this section) called TRIAD Transaction Scores that help card issuers identify high-risk behavior more quickly and thus manage their credit card accounts more profitably. We market and sell TRIAD end-user software licenses, maintenance, consulting services, and strategy design and evaluation. Additionally, we provide TRIAD services and similar credit account management services through 12 third-party credit card processors worldwide, including the two largest processors in the U.S., First Data Resources, Inc. and Total System Services, Inc. We also provide the TRIAD system as a hosted service in Application Service Provider (ASP) mode.

*Telecommunications.* The TelAdaptive® account management service offers telecommunications service providers account management functionality similar to the TRIAD system, including receivables risk management, account spending limits, churn management and cross-sell communications.

*Insurance.* We provide property and casualty insurers with decision management solutions that enable them to create, test and implement decision strategies for areas such as cross-selling, pricing, claims handling, retention, prospecting and underwriting.

### *Fraud Strategy Machine Solutions*

Our fraud products improve our clients' profitability by predicting the likelihood that a customer account is experiencing fraud. Our fraud products analyze customer transactions in real time and generate recommendations for immediate action, which is critical to stopping fraud and abuse. These applications can also detect some organized fraud schemes that are too complex and well-hidden to be identified by other methods.

Our solutions are designed to detect and prevent a wide variety of fraud and risk types across multiple industries, including credit and debit payment card fraud; identity fraud; telecommunications subscription fraud, technical fraud and bad debt; healthcare fraud; Medicaid and Medicare fraud; and property and casualty insurance fraud, including workers' compensation fraud. Fair Isaac fraud solutions protect merchants, financial institutions, insurance companies, telecommunications carriers, government agencies and employers from losses and damaged customer relationships caused by fraud.

Our leading fraud detection solution is Falcon® Fraud Manager, recognized as the leader in global payment card fraud detection. Falcon Fraud Manager's neural network predictive models and patented profiling technology, both further described below in the Technology section, examine transaction, cardholder and merchant data to detect a wide range of credit and debit card fraud quickly and accurately. Falcon Fraud Manager analyzes card transactions in real time, assesses the risk of fraud, and takes the user-defined steps to prevent fraud while expediting legitimate transactions. Falcon Fraud Manager protects hundreds of millions of credit and debit card accounts and is used in approximately 65% of all credit card transactions worldwide.

## **Table of Contents**

Fraud Predictor with Merchant Profiles is used in conjunction with Falcon Fraud Manager to improve fraud detection rates by analyzing merchant profile data. The merchant profiles include characteristics that reveal, for example, merchants that have a history of higher fraud volumes, and which purchase types and ticket sizes have most often been fraudulent at a particular merchant.

Falcon ID solution enables lenders and telecommunications service providers to control identity fraud across the customer lifecycle. Falcon ID relies on multiple sources of data and complex statistical modeling techniques to identify activity that is at high risk of stemming from identity theft. It also provides business rules management that companies can use to identify and resolve cases that appear to involve identity theft.

In addition to the Falcon products for financial services institutions, we offer CardAlert Fraud Manager. CardAlert Fraud Manager is a solution for fighting debit and ATM fraud in the U.S. The CardAlert service identifies and reports counterfeit payment cards to issuers before the majority of them incur fraud losses. The service analyzes daily transactions across multiple financial institutions, and uses this data to pinpoint multi-card fraud and identify common points of compromise.

We also provide a set of Fraud/Risk Analytics for Telecom solutions that are specifically designed to help telecommunications service providers reduce losses in four key areas. The bad debt solution is used to mitigate early-life and ongoing bad debt. The fraud solution is used to reduce complex types of fraud such as subscription fraud, technical fraud, network fraud, internal fraud, dealer/agent fraud, calling card fraud, cloning and clip-on fraud. The revenue assurance solution predicts revenue leakage in the switch data collection, data mediation and billing/rating system phases. And the network assurance solution predicts problems in a telecommunications network by detecting intrusion, abuse or network integrity compromises. In addition, we offer RoamEx™ Roamer Data Exchanger, which delivers near real-time exchange of roamer call records that occur when subscribers roam outside a carrier's home network. RoamEx Roamer Data Exchanger is used to exchange more than 90% of North American wireless carriers' roamer call detail records.

### *Collections & Recovery Strategy Machine Solutions*

Our leading solutions in this area are the Debt Manager™ solution and the Recovery Management System™ (RMS®) solution. The Debt Manager solution automates the full cycle of collections and recovery, including early collections, late collections, asset disposal, agency placement, recovery, litigation, bankruptcy, asset management and residual balance recovery. The RMS solution is focused on the later phases of distressed debt management, including bankruptcy and agency management. Companies using the Debt Manager and RMS solutions can access partner services such as collection agencies and attorneys via the ScoreNet® network, which provides web-based access to and from thousands of third-party collections and recovery service providers, as well as access to multiple data sources and Fair Isaac solutions hosted in ASP mode.

Other solutions for collections and recovery include the PlacementsPlus® service, an account placement optimization and management system; the Placement OptimizerSM service, which uses artificial intelligence-based analytics used to identify the agency that is likely to collect the most for each account; and custom collection and recovery models implemented in an ASP environment. Those analytic-based solutions can also be delivered via the ScoreNet network.

### *Insurance and Healthcare Strategy Machine Solutions*

We provide software solutions and services that automate the review and repricing of medical bills for workers compensation and automobile medical injuries. Using these solutions, property and casualty insurers can automatically review and reprice a significant percentage of medical bills without human intervention. This allows for greater consistency and accuracy, which are important factors for regulatory compliance.

Our principal solution in this area is the Fair Isaac SmartAdvisor<sup>®</sup> medical bill review software. This solution provides medical bill review and repricing for workers compensation and automobile medical injury claims. It checks each bill against an extensive database of state fee schedules, automated contracts and user-defined policies to help insurers and others get the maximum savings on every bill reviewed. The SmartAdvisor software uses our

## **Table of Contents**

business rules management technology to increase the speed, accuracy and consistency of decisions and reduce labor costs. It is available in both licensed client/server and ASP versions.

We also provide fraud solutions for different segments of the insurance healthcare market. Our principal solutions in this area are:

Payment Optimizer<sup>®</sup> fraud detection system, which provides both prepayment claims scoring and retrospective analysis to help payers reduce fraud losses and ensure payment integrity.

VeriComp<sup>®</sup> Fraud Manager software, which uses neural networks and data analysis to identify potentially fraudulent workers' compensation claims that need investigation or special handling.

Additionally, we serve the insurance claims management market through our MIRA<sup>™</sup> Claims Advisor product which uses predictive models to forecast appropriate claims reserves based on individual claim data. We also provide services that help healthcare payers reduce claims leakage and detect fraud, and that help hospitals determine payment strategies for patients during the admission process.

### *Consumer Strategy Machine Solutions*

Through our myFICO<sup>®</sup> service, we provide solutions based on our analytics to consumers, sold directly by us or through distribution partners. Consumers can use the myfico.com website to purchase their FICO<sup>®</sup> scores, the credit reports underlying the scores, explanations of the factors affecting their scores, and customized advice on how to manage their scores. Customers can also use the myFICO<sup>®</sup> service to simulate how taking specific actions would affect their FICO<sup>®</sup> score. The myfico.com website is the only source for consumers to obtain their FICO<sup>®</sup> scores and credit reports from all three of the major U.S. credit reporting agencies. Consumers can also purchase Score Watch<sup>™</sup> subscriptions, which deliver alerts via email and SMS or text messages when the user's scores or balances change. The myFICO<sup>®</sup> products and subscription offerings are available online at [www.myfico.com](http://www.myfico.com) in partnership with the three major U.S. credit reporting agencies: Equifax Inc. ( Equifax ), TransUnion Corporation ( TransUnion ) and Experian Information Solutions, Inc. ( Experian ). The myFICO<sup>®</sup> products and subscription offerings are also available to consumers through lenders, financial portals and numerous other partners.

### *Scoring Solutions*

We develop the world's leading scores based on third-party data. Our FICO<sup>®</sup> credit scores are used in most U.S. credit decisions, by most of the major financial service and credit card organizations as well as by mortgage and auto loan originators. These scores provide a consistent and objective measure of an individual's credit risk. Credit grantors use the FICO<sup>®</sup> scores to prescreen solicitation candidates, to evaluate applicants for new credit and to review existing accounts. The FICO<sup>®</sup> scores are calculated based on proprietary scoring models. The scores produced by these models are available through each of the three major credit reporting agencies in the United States: TransUnion, Experian and Equifax. Users generally pay the credit reporting agencies scoring fees based on usage, and the credit reporting agencies share these fees with us.

In fiscal 2007, we released upgraded versions of the FICO<sup>®</sup> score in Canada that we deliver through Equifax and TransUnion and provide credit grantors with additional predictive strength. In addition, we completed work on a substantially upgraded version of the FICO<sup>®</sup> score for U.S. lenders. This release will include enhancements that increase its predictive power. It is expected to be installed at the three major credit reporting agencies beginning in fiscal 2008. We also offer the NextGen FICO<sup>®</sup> score to U.S. credit grantors desiring an even stronger risk predictor than the classic FICO<sup>®</sup> scores. FICO<sup>®</sup> scores are also delivered through TransUnion ITC in South Africa and CallCredit in the UK.



Our scoring portfolio also includes the FICO® Expansion® score, which provides scores on U.S. consumers who do not have traditional FICO® scores, generally because they have too few credit accounts being reported to the credit reporting agencies. The score analyzes multiple sources of non-traditional credit data accessed by our subsidiary, Fair Isaac Network, Inc., and the score and associated reports are provided to lenders through a subsidiary called Fair Isaac Credit Services, Inc.

## **Table of Contents**

Outside of North America, we offer the Global FICO® score, which extends our thorough analysis of multiple-lender credit data to countries around the world that have established and emerging credit bureaus. Like FICO® scores in North America, Global FICO® scores help lenders in multiple countries leverage the FICO® score's predictive analysis to assess the risk of prospects, applicants and borrowers, and are particularly valuable in markets where there is not a dominant credit bureau risk score available. Global FICO® scores are in use or being implemented in more than 16 different countries across four continents. In fiscal 2007 we extended the score to Korea through a multi-year agreement with Korea Credit Bureau.

In addition to the scoring noted above, we also offer marketing and bankruptcy scores through the U.S. credit reporting agencies; an application fraud, revenue and bankruptcy score available in Canada; consumer risk scores through credit reporting agencies in Canada, South Africa and the U.K.; commercial credit scores delivered by both U.S. and U.K. credit reporting agencies; and a bankruptcy scoring service offered through ISC, a subsidiary of Visa USA.

We have developed scoring systems for insurance underwriters and marketers. Such systems use the same underlying statistical technology as our FICO® risk scores, but are designed to predict applicant or policyholder insurance loss risk for automobile or homeowners' coverage. Our insurance scores are available in the U.S. from TransUnion, Experian, Equifax and ChoicePoint, Inc., and in Canada from Equifax. We also offer an insurance score called the Property PredictR™ score, which analyzes property inspection database data from an insurance services provider, Millennium Information Services, Inc., to calculate the loss risk of a property.

We provide credit bureau scoring services and related consulting directly to users in financial services through two U.S.-based services: PreScore® Service for prescreening solicitation candidates, and the FICO® score delivery service (formerly known as ScoreNet® Network) for customer account management.

### ***Professional Services***

We provide a variety of custom offerings, business solution and technology consulting services, and data management services to clients worldwide. The focus is on leveraging our industry experience and technical expertise, typically on a custom basis, to help clients address unique business challenges, to support the usage of our Strategy Machine® solutions and our analytic software tools, and to create new sales opportunities for our other offerings. This group also performs consultative selling, developing customized solution sets combining various products and capabilities to meet unique client or industry opportunities. These services are generally offered on an hourly or fixed fee basis.

Our services include:

*Solution and technology consulting.* We help clients implement and use our solutions and technologies. These projects draw on our product knowledge, industry expertise and technical skills. Each project is delivered using our EDM consulting methodology.

*Data management services.* We help clients gain insight into their customers by enabling the access, analysis and application of corporate data and information. This work involves implementing enterprise-level data and decision management systems, including data warehouses and marts, campaign management tools, database marketing engines, rules-based decision engines and analytical applications.

*Industry consulting.* We combine our knowledge of EDM technology with our consultants' experience to address the specific needs of companies in the financial services, retail, pharmaceuticals, telecommunications, insurance and healthcare industries. Our industry consultants provide a wide range of consulting services, including business strategy consulting and custom solutions development. Another focus of this work is

helping companies comply with regulations, such as the New Basel Capital Accord or Solvency II.

*Analytic consulting.* We perform custom predictive modeling and related analytic projects for clients in multiple industries. This work leverages our analytic methodologies and expertise to solve risk management and marketing challenges for a single business, using that business's data and industry best practices to develop a highly customized solution. Most of this work falls under our heading of Predictive Science engagements, which provide greater insight into customer preferences and future customer behavior. We also perform broader strategy optimization projects using our Strategy Science technology and related

**Table of Contents**

advanced analytic methodologies. These projects apply data and proprietary algorithms to the design of customer treatment strategies.

*Fraud consulting.* We complement our fraud products with consulting engagements that help businesses benchmark their performance, assess areas to improve and adopt best practices and solutions aimed at reducing fraud losses. These engagements draw on Fair Isaac's experience helping lenders and other parties worldwide bring fraud losses under control and implement more successful anti-fraud programs.

*Medical bill review services.* Using Fair Isaac's medical bill review software, we provide turnkey insurance bill review services at selected locations across the country. These service bureau operations offer expert medical bill and preferred provider review for workers' compensation and auto medical insurance bills, including the additional review of complex medical, hospital and surgical bills.

***Analytic Software Tools***

We provide end-user software products that businesses use to build their own tailored EDM applications. In contrast to our packaged Strategy Machine solutions developed for specific industry applications, our analytic software tools support the addition of EDM capabilities to virtually any application or operational system. These tools are sold as licensed software, and can be used by themselves or together to advance a client's Enterprise Decision Management. We use these tools as common software components for our own EDM applications, described above in the Strategy Machine Solutions section. They are also key components of our EDM architecture, described in the Technology section. We also partner with third-party providers within given industry markets and with major software companies to embed our tools within existing applications.

The principal products offered are software tools for:

*Rules Management.* The Blaze Advisor™ business rules management system is used to design, develop, execute and maintain rules-based business applications. The Blaze Advisor system enables businesses to more quickly develop complex decision making applications, respond to changing customer needs, implement regulatory compliance and reduce the total cost of day-to-day operations. The Blaze Advisor system is sold as an end-user tool and is also the rules engine within several of our Strategy Machine solutions. A related software offering called SmartForms for Blaze Advisor system is used to create and manage dynamic, web-based forms that improve the completeness and accuracy of customer data collected online. The Blaze Advisor system, available in six languages, is a multi-platform solution that supports Web Services and SOA, Java 2 Enterprise Edition (J2EE) platforms, Microsoft .NET and COBOL for z/OS mainframes, and is the first rules engine to support Java, .NET and COBOL deployment of the same rules. It also incorporates the exclusive Rete III rules execution technology, which improves the efficiency and speed with which the Blaze Advisor system is able to process and execute complex, high-volume business rules. The latest version of Blaze Advisor, released in fiscal 2007, focuses on rules lifecycle management to help customers uniquely address governance, proactively detect errors and accelerate time-to-production. This version also includes tight integration with Model Builder for Predictive Analytics and support for PMML (Predictive Modeling Markup Language).

*Model Development.* Model Builder for Predictive Analytics enables the user to develop and deploy sophisticated predictive models for use in automated decisions. This software is based on the methodology and tools Fair Isaac uses to build both client-level and industry-level predictive models, and which we have evolved over nearly 40 years. The predictive models produced can be embedded in custom production applications or one of our Strategy Machine Solutions and can also be executed in Blaze Advisor. The latest version of Model Builder, released in fiscal 2007, includes several enhancements to improve data import and sampling, as well

as a scorecard creation wizard that makes building a new scorecard faster.

*Data-Driven Strategy Design.* Model Builder for Decision Trees enables the user to create empirical strategies, augmenting the user's expert judgment by applying data-driven analytics to discover patterns empirically. In designing the steps and criteria of a decision strategy, the user can segment the customer base for targeted action based on the results of different performance measures, and can simulate the performance of the designed strategy. Decision Optimizer, a key component in our Strategy Science offerings, uses an

## **Table of Contents**

optimization algorithm to deliver customer treatment strategies or rule sets that improve results along one or more specified business objectives, while meeting stated constraints. The data-driven strategies produced by these tools can be executed by Blaze Advisor or one of our Strategy Machine® solutions.

*Case Management.* Vectus® software allows organizations to build and deliver enterprise-class applications for handling complex case management and relationships across customer, supplier and partner chains. It supports many types of business solutions, including account recruitment, customer servicing, complaints management and legal process. Vectus software provides a complete environment for developing, maintaining and executing process-oriented solutions.

## **COMPETITION**

The market for our advanced solutions is intensely competitive and is constantly changing. Our competitors vary in size and in the scope of the products and services they offer. We encounter competition from a number of sources, including:

in-house analytic and systems developers;

scoring model builders;

enterprise resource planning ( ERP ) and customer relationship management ( CRM ) packaged solutions providers;

business intelligence solutions providers;

business process management and business rules management providers;

providers of credit reports and credit scores;

providers of automated application processing services;

data vendors;

neural network developers and artificial intelligence system builders;

third-party professional services and consulting organizations;

providers of account/workflow management software;

managed care organizations; and

software companies supplying modeling, rules, or analytic development tools.

We believe that none of our competitors offers the same mix of products as we do, has the same expertise in predictive analytics and their integration with decision management software, and can offer the enhanced lifecycle management capabilities we offer in areas like financial services. However, certain competitors may have larger shares of particular geographic or product markets.

## **Strategy Machine® Solutions**

The competition for our Strategy Machine Solutions varies by both application and industry.

In the customer acquisition market, we compete with Acxiom, Experian, SAS, SPSS, Epsilon, Harte-Hanks, and Oracle, among others. We also compete with traditional advertising agencies and companies' own internal information technology and analytics departments.

In the origination market, we compete with Experian, CGI/AMS, Equifax, Provenir and Lightbridge, among others.

In the customer management market, we compete with CGI/AMS and Experian, among others.

In the fraud solutions market, we mainly compete with Fortent, ID Analytics, Experian, SAS, Retail Decisions plc and ACI Worldwide, a division of Transaction Systems Architects, in the financial services market; ECTel,

## **Table of Contents**

Hewlett-Packard, Subex Azure and Neural Technologies in the telecommunications market; IBM and ViPS in the healthcare segment; and SAS, Infoglide Software Corporation, NetMap Analytics and Magnify in the property and casualty and workers' compensation insurance market.

In the collections and recovery solutions market, we mainly compete with CGI/AMS, Columbia Ultimate, Ontario Systems, Austin Logistics, Experian, Attentiv Systems and various boutique firms for software and ASP servicing and in-house scoring and computer science departments, along with the three major U.S. credit reporting agencies and Experian-Scorex for scoring and optimization projects.

In the insurance and healthcare solutions market, we mainly compete with Ingenix, First Health, CorVel Corporation, SAS, ISO, IBM, Mitchell International, Inc., and Concentra Managed Care.

For our direct-to-consumer services that deliver credit scores, credit reports and consumer credit education services, we compete with our credit reporting agency partners and their affiliated companies, as well as with Trilegiant, InterSections and others.

## **Scoring Solutions**

In this segment, we compete with both outside suppliers and in-house analytics and computer systems departments for scoring business. Major competitors among outside suppliers of scoring models include the three major credit reporting agencies in the U.S. and Canada, which are also our partners in offering our scoring solutions; Experian and Experian-Scorex (U.S. partner), TransUnion and TransUnion International, Equifax, VantageScore (a joint partnership established by the major U.S. credit reporting agencies), CRIF and other credit reporting agencies outside the United States; and other data providers like LexisNexis and ChoicePoint, some of which also represent Fair Isaac partners.

## **Professional Services**

We compete with a variety of organizations that offer consulting services, primarily specialty technology and consulting firms. In addition, a client may use its own resources rather than engage an outside firm for these services. Our competitors include information technology product and services vendors, management and strategy consulting firms, smaller specialized information technology consulting firms and analytical services firms.

## **Analytic Software Tools**

Our primary competitors in this segment include SAS, SPSS, Angoss, ILOG, Computer Associates International and Pegasystems.

## **Competitive Factors**

We believe the principal competitive factors affecting our markets include: technical performance; access to unique proprietary databases; availability in ASP format; product attributes like adaptability, scalability, interoperability, functionality and ease-of-use; product price; customer service and support; the effectiveness of sales and marketing efforts; existing market penetration; and our reputation. Although we believe our products and services compete favorably with respect to these factors, we may not be able to maintain our competitive position against current and future competitors.

## **MARKETS AND CUSTOMERS**



Our products and services serve clients in multiple industries, including financial services, insurance, retail, telecommunications, healthcare, pharmaceuticals and governmental agencies. During fiscal 2007, end users of our products included 90 of the 100 largest financial institutions in the United States; approximately two-thirds of the largest 100 banks in the world; and the 100 largest U.S. credit card issuers. Our clients also include more than 300 insurers and healthcare payers, including the top 10 U.S. property and casualty insurers; more than 100 retailers and general merchandisers, including about half of the top 50 U.S. retailers; more than 100 government or public agencies; more than 100 telecommunications providers, including seven of the top ten global providers; and more than 150 healthcare and

## **Table of Contents**

pharmaceuticals companies, including eight of the world's top ten pharmaceuticals companies. Nine of the top ten companies on the 2007 *Fortune* 500 list use Fair Isaac's solutions.

In addition, our consumer services are marketed to an estimated 200 million U.S. consumers whose credit relationships are reported to the three major credit reporting agencies.

In the United States, we market our products and services primarily through our own direct sales organization that is organized around Integrated Client Networks, or ICNs, which are sales teams that focus on customer segments typically aligned by vertical market and geography. Sales groups are based in our headquarters and in field offices strategically located both in and outside the United States. We also market our products through indirect channels, including alliance partners and other resellers.

During fiscal 2007, 2006 and 2005, revenues generated from our agreements with Equifax, TransUnion and Experian collectively accounted for 19%, 18% and 17% of our total revenues, respectively.

Outside the United States, we market our products and services primarily through our subsidiary sales organizations. Our subsidiaries license and support our products in their local countries as well as within other foreign countries where we do not operate through a direct sales subsidiary. We also market our products through resellers and independent distributors in international territories not covered by our subsidiaries' direct sales organizations.

Our largest market segments outside the United States are the United Kingdom and Canada. In addition, we have delivered products to users in over 80 countries.

Revenues from international customers, including end users and resellers, amounted to 29%, 28% and 25% of our total revenues in fiscal 2007, 2006 and 2005, respectively. See Note 17 to the accompanying consolidated financial statements for a summary of our operating segments and geographic information.

## **TECHNOLOGY**

We specialize in analytics, software and data management technologies that analyze data and drive business processes and decision strategies. We maintain active research in a number of fields for the purposes of deriving greater insight and predictive value from data, making various forms of data more usable and valuable to the model-building process, and automating and applying analytics to the various processes involved in making high-volume decisions in real time.

Because of our pioneering work in credit scoring and fraud detection, we are widely recognized as the leader in predictive analytics. In addition, our Blaze Advisor software is consistently ranked as a leader in rules management systems. In all our work, we believe that our tools and processes are among the very best commercially available, and that we are uniquely able to integrate advanced analytic, software and data technologies into mission-critical business solutions that offer superior returns on investment.

In 2007, we began the development of an integrated technical architecture for Enterprise Decision Management, which will ensure interoperability across Fair Isaac systems. Our intention is to bring greater flexibility, higher analytic performance and better decisions across the lifecycle. Building on Fair Isaac's broad and deep experience in developing EDM applications, the architecture is service-oriented, designed for easy standards-based integration with our clients' core systems and will support and deliver ever more powerful analytics that operate both within specific stages of the customer lifecycle and across them. This EDM architecture will contain capabilities from existing Fair Isaac products, from new and existing components and from third-party providers. Over the next three years, we will develop the architecture's components while simultaneously migrating our software products onto the architecture.

This migration will take the form of successive product releases that also provide immediate client value through added functionality.

The technologies listed below are all supported by the EDM architecture, which will create tighter integration between our Strategy Machine solutions, as well as our Analytic Software Tools.

**Table of Contents****Principal Areas of Expertise**

*Predictive Modeling.* Predictive modeling identifies and mathematically represents underlying relationships in historical data in order to explain the data and make predictions or classifications about future events. Our models summarize large quantities of data to amplify its value. Predictive models typically analyze current and historical data on individuals to produce easily understood metrics such as scores. These scores rank-order individuals by likely future performance, e.g., their likelihood of making credit payments on time, or of responding to a particular offer for services. We also include in this category models that detect the likelihood of a transaction being fraudulent. Our predictive models are frequently operationalized in mission-critical transactional systems and drive decisions and actions in near real time. A number of analytic methodologies underlie our products in this area. These include proprietary applications of both linear and nonlinear mathematical programming algorithms, in which one objective is optimized within a set of constraints, and advanced neural systems, which learn complex patterns from large data sets to predict the probability that a new individual will exhibit certain behaviors of business interest. We also apply various related statistical techniques for analysis and pattern detection within large datasets. For example, we recently developed Peacock™, a technology, which can analyze large-scale purchase transaction data to reveal product relationships, purchase patterns and sequences.

*Decision Analysis and Optimization.* Decision analysis refers to the broad quantitative field that deals with modeling, analyzing and optimizing decisions made by individuals, groups and organizations. Whereas predictive models analyze multiple aspects of individual behavior to forecast future behavior, decision analysis analyzes multiple aspects of a given decision to identify the most effective action to take to reach a desired result. We have developed an integrated approach to decision analysis that incorporates the development of a decision model that mathematically maps the entire decision structure; proprietary optimization technology that identifies the most effective strategies, given both the performance objective and constraints; the development of designed testing required for active, continuous learning; and the robust extrapolation of an optimized strategy to a wider set of scenarios than historically encountered. This technology is behind our Strategy Science solutions.

*Transaction Profiling.* Transaction profiling is a patent-protected technique used to extract meaningful information and reduce the complexity of transaction data used in modeling. Many of our products operate using transactional data, such as credit card purchase transactions, or other types of data that change over time. In its raw form, this data is very difficult to use in predictive models for several reasons: First, an isolated transaction contains very little information about the behavior of the individual who generated the transaction. In addition, transaction patterns change rapidly over time. Finally, this type of data can often be highly complex. To overcome these issues, we have developed a set of proprietary techniques that transform raw transactional data into a mathematical representation that reveals latent information, and which make the data more usable by predictive models. This profiling technology accumulates data across multiple transactions of many types to create and update profiles of transaction patterns. These profiles enable our neural network models to efficiently and effectively make accurate assessments of, for example, fraud risk and credit risk within real-time transaction streams.

*Customer Data Integration.* Decisions made on customers or prospects can benefit from data stored in multiple sources, both inside and outside the enterprise. We have focused on developing data integration processes that are able to assemble and integrate those disparate data sources into a unified view of the customer or household, through the application of persistent keying technology.

*Decision Management Software.* In order to make a decision strategy operational, the various steps and rules need to be programmed or exported into the business software infrastructure, where it can communicate with front-end, customer-facing systems and back-end systems such as billing systems. We have developed software systems, sometimes known as decision engines and business rules management systems, that perform the necessary functions to execute a decision strategy. Our software includes very efficient programs for these functions, facilitating, for

example, business user definition of extremely complex decision strategies using graphic user interfaces; simultaneous testing of hundreds of decision strategies in champion/challenger (test/control) mode; high-volume processing and analysis of transactions in real time; integration of multiple data sources; and execution of predictive models for improved behavior forecasts and finer segmentation. Decision management software is an integral part of our Strategy Machine solutions, described earlier.

**Table of Contents**

**Research and Development Activities**

Our research and development expenses were \$70.6 million, \$85.0 million and \$81.3 million in fiscal 2007, 2006 and 2005, respectively. We believe that our future success depends on our ability to continually maintain and improve our core technologies, enhance our existing products, and develop new products and technologies that meet an expanding range of markets and customer requirements. In the development of new products and enhancements to existing products, we use our own development tools extensively.

We have traditionally relied primarily on the internal development of our products. Based on timing and cost considerations, however, we have acquired, and in the future may consider acquiring, technology or products from third parties.

**PRODUCT PROTECTION AND TRADEMARKS**

We rely on a combination of patent, copyright, trademark and trade secret laws and confidentiality agreements and procedures to protect our proprietary rights.

We retain the title to and protect the suite of models and software used to develop scoring models as a trade secret. We also restrict access to our source code and limit access to and distribution of our software, documentation and other proprietary information. We have generally relied upon the laws protecting trade secrets and upon contractual nondisclosure safeguards and restrictions on transferability to protect our software and proprietary interests in our product and service methodology and know-how. Our confidentiality procedures include invention assignment and proprietary information agreements with our employees and independent contractors, and nondisclosure agreements with our distributors, strategic partners and customers. We also claim copyright protection for certain proprietary software and documentation.

We have patents on many of our technologies and have patent applications pending on other technologies. The patents we hold may not be upheld as valid and may not prevent the development of competitive products. In addition, patents may never be issued on our pending patent applications or on any future applications that we may submit. We currently hold 50 U.S. and 11 foreign patents with 146 applications pending.

Despite our precautions, it may be possible for competitors or users to copy or reproduce aspects of our software or to obtain information that we regard as trade secrets. In addition, the laws of some foreign countries do not protect proprietary rights to the same extent as do the laws of the United States. Patents and other protections for our intellectual property are important, but we believe our success and growth will depend principally on such factors as the knowledge, ability, experience and creative skills of our personnel, new products, frequent product enhancements and name recognition.

We have developed technologies for research projects conducted under agreements with various United States government agencies or their subcontractors. Although we have acquired commercial rights to these technologies, the United States government typically retains ownership of intellectual property rights and licenses in the technologies that we develop under these contracts. In some cases, the United States government can terminate our rights to these technologies if we fail to commercialize them on a timely basis. In addition, under United States government contracts, the government may make the results of our research public, which could limit our competitive advantage with respect to future products based on funded research.

We have used, registered and/or applied to register certain trademarks and service marks for our technologies, products and services. We currently have 41 trademarks registered in the U.S. and select foreign countries.



**Table of Contents**

**PERSONNEL**

As of September 30, 2007, we employed 2,824 persons worldwide. Of these, 444 full-time employees were located in our Minneapolis and Arden Hills, Minnesota offices, 382 full-time employees were located in our San Rafael, California office, 408 full-time employees were located in our San Diego, California office, 250 full-time employees were located in our India-based office and 235 full-time employees were located in our United Kingdom-based offices. None of our employees is covered by a collective bargaining agreement, and no work stoppages have been experienced.

Information regarding our officers is included in Executive Officers of the Registrant at the end of Part I of this report.

**Item 1A. Risk Factors**

**Risks Related to Our Business**

***We have expanded the pursuit of our EDM strategy, and we may not be successful, which could cause our growth prospects and results of operations to suffer.***

We have expanded the pursuit of our business objective to become a leader in helping businesses automate and improve decisions across their enterprises, an approach that we commonly refer to as Enterprise Decision Management, or EDM. Our EDM strategy is designed to enable us to increase our business by selling multiple products to clients, as well as to enable the development of custom client solutions that may lead to opportunities to develop new proprietary scores or other new proprietary products. The market may be unreceptive to this general EDM business approach, including being unreceptive to purchasing multiple products from us or unreceptive to our customized solutions. If our EDM strategy is not successful, we may not be able to grow our business, growth may occur more slowly than we anticipate or our revenues and profits may decline.

***In mid-2006, we restructured the method by which we sell our products and services, and if this sales strategy is not successful, our business will be harmed.***

We previously sold our products and services in a product-focused manner. As part of our expanded EDM strategy, in mid-2006, we changed our sales model to sell our products and services using a client-centric approach which focuses on delivering complete solutions involving multiple products or suites of products for our customers through various means, including the use of client teams called Integrated Client Networks (or ICNs) that focus on customers by vertical market and geography, and the use of an integrated consulting and sales approach. If our employees are not able to adjust rapidly enough to this ICN approach, then we may be unable to maintain or increase our revenues. Further, there can be no assurance that our customers and potential customers will react positively to EDM or this new selling approach and, as a result, that we will continue to maintain or increase revenues. If revenues eventually increase as a result of this change, there is no assurance that any increase will occur as quickly as we might anticipate.

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

As we implement our EDM strategy, we expect that revenues derived from our scoring solutions, account management solutions, fraud solutions, originations, collections and insurance solutions products and services will continue to account for a substantial portion of our total revenues for the foreseeable future. Our revenues will decline if the market does not continue to accept these products and services. Factors that might affect the market acceptance of these products and services include the following:



changes in the business analytics industry;

changes in technology;

our inability to obtain or use state fee schedule or claims data in our insurance products;

saturation of market demand;

**Table of Contents**

loss of key customers;

industry consolidation;

failure to execute our client-centric selling approach; and

inability to successfully sell our products in new vertical markets.

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

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

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

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

***We rely on relatively few customers, as well as our contracts with the three major credit reporting agencies, for a significant portion of our revenues and profits. If the terms of these relationships change, our revenues and operating results could decline.***

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

We also derive a substantial portion of our revenues and operating income from our contracts with the three major credit reporting agencies, TransUnion, Equifax and Experian, and other parties that distribute our products to certain markets. We are also currently involved in litigation with TransUnion, Equifax and Experian arising from their development and marketing of a credit scoring product competitive with our products. We have asserted various

claims, including unfair competition, antitrust, and trade secret misappropriation against each of the credit reporting agencies and their collective joint venture entity, VantageScore, LLC. This litigation could have a material adverse effect on our relationship with one or more of the major credit reporting agencies, or with major customers.

The loss of or a significant change in a relationship with a major customer, the loss of or a significant change in a relationship with one of the major credit reporting agencies with respect to their distribution of our products or with respect to our myFICO® offerings, the loss of or a significant change in a relationship with a significant third-

**Table of Contents**

party distributor or the delay of significant revenues from these sources, could have a material adverse effect on our revenues and results of operations.

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

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

***If we do not engage in acquisition activity to the extent we have in the past, we may be unable to increase our revenues at historical growth rates.***

Our historical revenue growth has been augmented by numerous acquisitions, and we anticipate that acquisitions may continue to be an important part of our revenue growth. Our future revenue growth rate may decline if we do not make acquisitions of similar size and at a comparable rate as in the past.

***If we engage in acquisitions, significant investments in new businesses, or divestitures of existing businesses, we will incur a variety of risks, any of which may adversely affect our business.***

We have made in the past, and may make in the future, acquisitions of, or significant investments in, businesses that offer complementary products, services and technologies. Any acquisitions or investments will be accompanied by the risks commonly encountered in acquisitions of businesses, which may include:

- failure to achieve the financial and strategic goals for the acquired and combined business;
- overpayment for the acquired companies or assets;
- difficulty assimilating the operations and personnel of the acquired businesses;
- product liability and other exposure associated with acquired businesses or the sale of their products;
- disruption of our ongoing business;
- dilution of our existing stockholders and earnings per share;
- unanticipated liabilities, legal risks and costs;
- retention of key personnel;
- distraction of management from our ongoing business; and

impairment of relationships with employees and customers as a result of integration of new management personnel.

We have also divested ourselves of businesses in the past and may do so again in the future. Any divestitures will be accompanied by the risks commonly encountered in the sale of businesses, which may include:

disruption of our ongoing business;

reductions of our revenues or earnings per share;

unanticipated liabilities, legal risks and costs;

**Table of Contents**

the potential loss of key personnel;

distraction of management from our ongoing business; and

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

These risks could harm our business, financial condition or results of operations, particularly if they occur in the context of a significant acquisition. Acquisitions of businesses having a significant presence outside the U.S. will increase our exposure to the risks of conducting operations in international markets.

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

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

variability in demand from our existing customers;

failure to meet the expectations of market analysts;

changes in recommendations by market analysts;

the lengthy and variable sales cycle of many products, combined with the relatively large size of orders for our products, increases the likelihood of short-term fluctuation in revenues;

consumer dissatisfaction with, or problems caused by, the performance of our products;

the timing of new product announcements and introductions in comparison with our competitors;

the level of our operating expenses;

changes in competitive conditions in the consumer credit, financial services and insurance industries;

fluctuations in domestic and international economic conditions;

our ability to complete large installations on schedule and within budget;

acquisition-related expenses and charges; and

timing of orders for and deliveries of software systems.

In addition, the financial markets have experienced significant price and volume fluctuations that have particularly affected the stock prices of many technology companies, and these fluctuations sometimes have been unrelated to the operating performance of these companies. Broad market fluctuations, as well as industry-specific and general economic conditions may adversely affect the market price of our common stock.

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

We experience difficulty in forecasting our revenues accurately because the length of our sales cycles makes it difficult for us to predict the quarter in which sales will occur. In addition, our ICN selling approach is more complex than our prior sales approach because it emphasizes the sale of complete EDM solutions involving multiple products or services across our customers' organizations. This makes forecasting of revenues in any given period more difficult. As a result of our ICN approach and lengthening sales cycles, revenues and operating results may vary significantly from period to period. For example, the sales cycle for licensing our products typically ranges from 60 days to 18 months. Customers are often cautious in making decisions to acquire our products, because purchasing our products typically involves a significant commitment of capital, and may involve shifts by the customer to a new software and/or hardware platform or changes in the customer's operational procedures. Since our EDM strategy contemplates the sale of multiple decision solutions to a customer, expenditures by any

**Table of Contents**

given customer are expected to be larger than with our prior sales approach. This may cause customers to make purchasing decisions more cautiously. Delays in completing sales can arise while customers complete their internal procedures to approve large capital expenditures and test and accept our applications. Consequently, we face difficulty predicting the quarter in which sales to expected customers will occur and experience fluctuations in our revenues and operating results. If we are unable to accurately forecast our revenues, our stock price could be adversely affected.

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

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

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

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

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

We must develop or obtain a reliable source of sufficient amounts of current and statistically relevant data to analyze transactions and update our products. In most cases, these data must be periodically updated and refreshed to enable our products to continue to work effectively in a changing environment. We do not own or control much of the data that we require, most of which is collected privately and maintained in proprietary databases. Customers and key business alliances provide us with the data we require to analyze transactions, report results and build new models. Our EDM strategy depends in part upon our ability to access new forms of data to develop custom and proprietary analytic tools. If we fail to maintain sufficient data sourcing relationships with our customers and business alliances, or if they decline to provide such data due to legal privacy concerns, competition concerns, prohibitions or a lack of permission from their customers, we could lose access to required data and our products, and the development of new products might become less effective. In addition, certain of our insurance solutions products use data from state



workers' compensation fee schedules adopted by state regulatory agencies. Third parties have asserted copyright interests in these data, and these assertions, if successful, could prevent us from using these data. Any interruption of our supply of data could seriously harm our business, financial condition or results of operations.

**Table of Contents**

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

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

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

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

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

incur significant defense costs or substantial damages;

be required to cease the use or sale of infringing products;

expend significant resources to develop or license a substitute noninfringing technology;

discontinue the use of some technology; or

be required to obtain a license under the intellectual property rights of the third party claiming infringement, which license may not be available or might require substantial royalties or license fees that would reduce our margins.

***Breaches of security, or the perception that e-commerce is not secure, could harm our business.***

Our business requires the appropriate and secure utilization of consumer and other sensitive information. Internet-based electronic commerce requires the secure transmission of confidential information over public networks, and several of our products are accessed through the Internet, including our consumer services accessible through the www.myfico.com website. Security breaches in connection with the delivery of our products and services, including

products and services utilizing the Internet, or well-publicized security breaches, and the trend toward broad consumer and general public notification of such incidents, could significantly harm our business, financial condition or results of operations. We cannot be certain that advances in criminal capabilities, discovery of new vulnerabilities, attempts to exploit vulnerabilities in our systems, data thefts, physical system or network break-ins or inappropriate access, or other developments will not compromise or breach the technology protecting the networks that access our net-sourced products, consumer services and proprietary database information.

## **Table of Contents**

***Protection from system interruptions is important to our business. If we experience a sustained interruption of our telecommunication systems, it could harm our business.***

Systems or network interruptions could delay and disrupt our ability to develop, deliver or maintain our products and services, causing harm to our business and reputation and resulting in loss of customers or revenue. These interruptions can include fires, floods, earthquakes, power losses, equipment failures and other events beyond our control.

## **Risks Related to Our Industry**

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

We have a significant share of the available market in portions of our Scoring Solutions segment and for certain services in our Strategy Machine Solutions segment, specifically, the markets for account management services at credit card processors and credit card fraud detection software. To increase our revenues, we must enhance and improve existing products and continue to introduce new products and new versions of existing products that keep pace with technological developments, satisfy increasingly sophisticated customer requirements and achieve market acceptance. We believe much of the future growth of our business and the success of our EDM strategy will rest on our ability to continue to expand into newer markets for our products and services, such as direct marketing, healthcare, insurance, small business lending, retail, telecommunications, personal credit management, the design of business strategies using Strategy Science technology and Internet services. These areas are relatively new to our product development and sales and marketing personnel. Products that we plan to market in the future are in various stages of development. We cannot assure you that the marketplace will accept these products. If our current or potential customers are not willing to switch to or adopt our new products and services, our revenues will decrease.

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

In our markets, technology changes rapidly, and there are continuous improvements in computer hardware, network operating systems, programming tools, programming languages, operating systems, database technology and the use of the Internet. If we fail to enhance our current products and develop new products in response to changes in technology or industry standards, or if we fail to bring product enhancements or new product developments to market quickly enough, our products could rapidly become less competitive or obsolete. For example, the rapid growth of the Internet environment creates new opportunities, risks and uncertainties for businesses, such as ours, which develop software that must also be designed to operate in Internet, intranet and other online environments. Our future success will depend, in part, upon our ability to:

innovate by internally developing new and competitive technologies;

use leading third-party technologies effectively;

continue to develop our technical expertise;

anticipate and effectively respond to changing customer needs;

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

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

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

We may not be able to compete successfully against our competitors, and this inability could impair our capacity to sell our products. The market for business analytics is new, rapidly evolving and highly competitive, and

**Table of Contents**

we expect competition in this market to persist and intensify. Our regional and global competitors vary in size and in the scope of the products and services they offer, and include:

in-house analytic and systems developers;

scoring model builders;

enterprise resource planning (ERP) and customer relationship management (CRM) packaged solutions providers;

business intelligence solutions providers;

credit report and credit score providers;

business process management solution providers;

process modeling tools providers;

automated application processing services providers;

data vendors;

neural network developers and artificial intelligence system builders;

third-party professional services and consulting organizations;

account/workflow management software providers;

managed care organizations; and

software tools companies supplying modeling, rules, or analytic development tools.

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

Our competitors may be able to sell products competitive to ours at lower prices individually or as part of integrated suites of several related products. This ability may cause our customers to purchase products that directly compete with our products from our competitors. Price reductions by our competitors could negatively impact our margins, and

could also harm our ability to obtain new long-term contracts and renewals of existing long-term contracts on favorable terms.

***Legislation that is enacted by the U.S. Congress, the states, Canadian provinces, and other countries, and government regulations that apply to us or to our customers may expose us to liability, affect our ability to compete in certain markets, limit the profitability of or demand for our products, or render our products obsolete. If these laws and regulations require us to change our current products and services, it could adversely affect our business and results of operations.***

Legislation and governmental regulation affect how our business is conducted and, in some cases, subject us to the possibility of future lawsuits arising from our products and services. Globally, legislation and governmental

**Table of Contents**

regulation also influence our current and prospective customers' activities, as well as their expectations and needs in relation to our products and services. Both our core businesses and our newer initiatives are affected globally by federal, regional, provincial, state and other jurisdictional regulations, including those in the following significant regulatory areas:

Use of data by creditors and consumer reporting agencies. Examples in the U.S. include the Fair Credit Reporting Act ( FCRA ), the Fair and Accurate Credit Transactions Act ( FACTA ), which amends FCRA, and certain proposed regulations and studies mandated by FACTA, under consideration;

Laws and regulations that limit the use of credit scoring models such as state mortgage trigger laws, state inquiries laws, state insurance restrictions on the use of credit based insurance scores, and the Consumer Credit Directive in the European Union.

Fair lending practices, such as the Equal Credit Opportunity Act ( ECOA ) and Regulation B.

Privacy and security laws and regulations that limit the use and disclosure of personally identifiable information or require security procedures, including but not limited to the provisions of the Financial Services Modernization Act of 1999, also known as the Gramm Leach Bliley Act ( GLBA ); FACTA; the Health Insurance Portability and Accountability Act of 1996 ( HIPAA ); the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ( USA Patriot Act ); identity theft, file freezing, security breach notification and similar state privacy laws;

Extension of credit to consumers through the Electronic Fund Transfers Act, as well as nongovernmental VISA and MasterCard electronic payment standards;

Regulations applicable to secondary market participants such as Fannie Mae and Freddie Mac that could have an impact on our products;

Insurance laws and regulations applicable to our insurance clients and their use of our insurance products and services;

The application or extension of consumer protection laws, including, laws governing the use of the Internet and telemarketing, and credit repair;

Laws and regulations applicable to operations in other countries, for example, the European Union's Privacy Directive and the Foreign Corrupt Practices Act; and

Sarbanes-Oxley Act ( SOX ) requirements to maintain and verify internal process controls, including controls for material event awareness and notification.

In making credit evaluations of consumers, or in performing fraud screening or user authentication, our customers are subject to requirements of multiple jurisdictions, which may impose onerous and contradictory requirements. Privacy legislation such as GLBA or the European Union's Privacy Directive may also affect the nature and extent of the products or services that we can provide to customers, as well as our ability to collect, monitor and disseminate information subject to privacy protection. In addition to existing regulation, changes in legislative, judicial, regulatory or consumer environments could harm our business, financial condition or results of operations. These regulations and amendments to them could affect the demand for or profitability of some of our products, including scoring and consumer products. New regulations pertaining to financial institutions could cause them to pursue new strategies, reducing the demand for our products. In addition, legislative reforms of workers' compensation laws that aim to



simplify this area of regulation and curb abuses could diminish the need for, and the benefits provided by, certain of our insurance solutions products and services.

***Our revenues depend, to a great extent, upon conditions in the consumer credit, financial services and insurance industries. If any of our clients industries experiences a downturn, it could harm our business, financial condition or results of operations.***

During fiscal 2007, 74% of our revenues were derived from sales of products and services to the consumer credit, financial services and insurance industries. A downturn in the consumer credit, the financial services or the insurance industry, including a downturn caused by increases in interest rates or a tightening of credit, among other

## **Table of Contents**

factors, could harm our business, financial condition or results of operations. While the rate of account growth in the U.S. bankcard industry has been slowing and many of our large institutional customers have merged and consolidated in recent years, we have generated most of our revenue growth from our bankcard-related scoring and account management businesses by selling and cross-selling our products and services to large banks and other credit issuers. As this industry continues to consolidate, we may have fewer opportunities for revenue growth due to changing demand for our products and services that support customer acquisition programs of our customers. In addition, industry consolidation could affect the base of recurring revenues derived from contracts in which we are paid on a per-transaction basis if consolidated customers combine their operations under one contract. There can be no assurance that we will be able effectively to promote future revenue growth in our businesses.

While we are expanding our sales of consumer credit, financial services and insurance products and services into international markets, the risks are greater as we are less well-known, and some of these markets are in their infancy.

### **Risk Related to External Conditions**

*If any of a number of material adverse developments occurs in general economic conditions and world events, such developments could affect demand for our products and services and harm our business.*

Purchases of technology products and services and decisioning solutions are subject to adverse economic conditions. When an economy is struggling, companies in many industries delay or reduce technology purchases, and we experience softened demand for our decisioning solutions and other products and services. If the current improvement in global economic conditions slows or reverses, or if there is an escalation in regional or continued global conflicts or terrorism, we may experience reductions in capital expenditures by our customers, longer sales cycles, deferral or delay of purchase commitments for our products and increased price competition, which may adversely affect our business and results of operations.

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

A growing portion of our revenues is derived from international sales. During fiscal 2007, 29% of our revenues were derived from business outside the United States. As part of our growth strategy, we plan to continue to pursue opportunities outside the United States, including opportunities in countries with economic systems that are in early stages of development and that may not mature sufficiently to result in growth for our business. Accordingly, our future operating results could be negatively affected by a variety of factors arising out of international commerce, some of which are beyond our control. These factors include:

general economic and political conditions in countries where we sell our products and services;

difficulty in staffing and efficiently managing our operations in multiple geographic locations and in various countries;

effects of a variety of foreign laws and regulations, including restrictions on access to personal information;

import and export licensing requirements;

longer payment cycles;

reduced protection for intellectual property rights;

currency fluctuations;

changes in tariffs and other trade barriers; and

difficulties and delays in translating products and related documentation into foreign languages.

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

## **Table of Contents**

However, an increase in our foreign revenues could subject us to increased foreign currency transaction risks in the future.

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

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

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

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

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

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

Not applicable.

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

Our properties consist primarily of leased office facilities for sales, data processing, research and development, consulting and administrative personnel. Our principal office is located in Minneapolis, Minnesota.

Our leased properties include:

Edgar Filing: FAIR ISAAC CORP - Form 10-K

approximately 243,000 square feet of office, data center, and data processing space in Arden Hills and Minneapolis, Minnesota, in six buildings under leases expiring in 2011 or later; 66,000 square feet of this space is subleased to a third party;

approximately 245,000 square feet of office space in San Rafael, California in two buildings under leases expiring in 2012 or later; 47,000 square feet of this space is subleased to a third party;

approximately 130,000 square feet of office space in San Diego, California in one building under a lease expiring in 2010; and

**Table of Contents**

an aggregate of approximately 518,000 square feet of office and data center space in; Arlington, VA; Atlanta, GA; Austin, TX; Bangalore, India; Beijing, China; Birmingham, United Kingdom; Boston, MA; Chicago, IL; Coppell, TX; Cranbury, NJ; Davis, CA; Emeryville, CA; Hong Kong, China; Gauteng, Malaysia; Indianapolis, IN; Irvine, CA; London, United Kingdom; Madrid, Spain; Melbourne, Australia; New Castle, DE; New York, NY; Norcross, GA; Oakbrook Terrace, IL; San Jose, CA; Sao Paulo, Brazil; Sarasota, FL; Seoul, Korea; Shanghai, China; Sherborn, MA; Singapore, Singapore; Sydney, Australia; Tokyo, Japan; Toronto, Canada; Tulsa, OK; Wellsbourne, United Kingdom; Westminster, CO; and White Marsh, MD.

See Note 18 to the accompanying consolidated financial statements for information regarding our obligations under leases. We believe that suitable additional space will be available to accommodate future needs.

**Item 3. *Legal Proceedings***

We were a defendant in a lawsuit captioned as Robbie Hillis v. Equifax Consumer Services, Inc. and Fair Isaac, Inc., filed in the U.S. District Court for the Northern District of Georgia. The plaintiff claimed that the defendants jointly sold the Score Power® credit score product in violation of certain procedural requirements under the Credit Repair Organizations Act ( CROA ), and in violation of the antifraud provisions of that statute. On June 13, 2007, the Court granted final approval of a settlement agreed to by the parties and directed that final judgment be entered. An appeal was filed on July 11, 2007. The appeal was dismissed, and the settlement agreement is final.

We were a defendant in a lawsuit captioned as Christy Slack v. Fair Isaac Corporation and MyFICO Consumer Services, Inc., which was filed in the United States District Court for the Northern District of California. As in the Hillis matter, the plaintiff is claiming that the defendants violated certain procedural requirements of CROA, and violated the antifraud provisions of CROA, with respect to the sale of credit score products on our myfico.com website. This matter was covered by the settlement agreement in the Robbie Hillis lawsuit, as described above.

**Item 4. *Submission of Matters to a Vote of Security Holders***

Not applicable.

**EXECUTIVE OFFICERS OF THE REGISTRANT**

Our current executive officers are as follows:

<b>Name</b>	<b>Positions Held</b>	<b>Age</b>
Mark N. Greene	February 2007-present, Chief Executive Officer of the Company. 1995-2007, various executive positions at IBM Corporation including Vice President, Financial Services-Sales and Distribution, General Manager, Global Banking Industry-Sales and Distribution, Vice President, Financial Services Strategy and Solutions-Sales and Distribution, Vice President, SecureWay-Software Group, and Vice President, Electronic Commerce-Software Group. 1993-1994, Vice President and Practice Area Leader-Capital Markets, Technology Solutions Company. 1989-1992, Senior Vice President, Trading Products and Consulting, Berkeley Investment Technologies. 1987-1989, Director, Fixed Income Products, CitiCorp. 1982-1986, various positions at the Federal Reserve Board.	53

Michael H. Campbell	August 2007-present, Executive Vice President, Chief Operating Officer of the Company. July 2006-July 2007, Vice President ICN Leader Financial Services of the Company. April 2005-July 2006, Vice President, Chief Operating Officer, Products of the Company. 2003-2005, CEO of TempoSoft, Inc. 1999-2001, held a variety of senior management positions at SAP America, Inc., including Senior Vice President, Solutions and Marketing Organization, Senior Vice President, Solutions Management Organization, and Senior Vice President, Professional Services Organization. 1989-1999, CEO and Chairman, Campbell Software, Inc. Earlier, he was co-founder of General Optimization, Inc., an optimization software developer.	46
---------------------	--	----

**Table of Contents**

<b>Name</b>	<b>Positions Held</b>	<b>Age</b>
Richard S. Deal	August 2007-present, Senior Vice President, Chief Human Resources Officer of the Company. January 2001-July 2007, Vice President, Human Resources of the Company. 1998-2001, Vice President, Human Resources, Arcadia Financial, Ltd. 1993-1998, managed broad range of human resources corporate and line consulting functions with U.S. Bancorp.	40
Andrew N. Jennings	October 2007--present, Senior Vice President, Chief Research Officer of the Company. May 2007--September 2007, Vice President, Analytic Research and Development of the Company. May 2006 May 2007, Vice President, EDM Applications of the Company. October 1994 May 2006, various senior management positions of the Company including Vice President of International Operations, Vice President European Operations, Vice President Analytic, Customer Management and Collections Business units. 1991-1994, Head of Credit Risk Management, Abbey National plc. 1987 1991, Head of Credit Risk, Barclaycard, Barclays Bank plc. 1980 1987, Lecturer Economic and Econometrics University of Nottingham.	52
Bernhard Nann	August 2007-present, Senior Vice President, Chief Technology Officer of the Company. March 2007-July 2007, Vice President, Chief Technology Officer of the Company. May 2006-February 2007, Vice President, Product Development, Product Services, ASP Operations and Technology Solutions and Infrastructure of the Company. July 2003-April 2006, variety of senior management positions with the Company including positions in Mortgage Solutions, Collections and Recovery, Customer Management, and Bill Review Services. 1995-June 2003, CEO and co-founder of Narex Inc. (acquired by Fair Isaac). January 1990-January 1996, various management positions at TRW, Inc., including Director of International Operations.	45
Charles M. Osborne	August 2007-present, Executive Vice President, Chief Financial Officer of the Company. March 2007-July 2007, Vice President, Chief Financial Officer of the Company. November 2006-February 2007, Interim Chief Executive Officer and Vice President, Chief Financial Officer of the Company. May 2004-November 2006, Vice President, Chief Financial Officer of the Company. 1999-2003, partner and investor, Gateway Alliance venture capital partnership. July-December 2000, Executive Vice President and CFO, 21 North Main, Inc. March 2000-present, Interim CFO and Vice President, Finance, University of Minnesota Foundation. 1998-2000, various executive positions with McLeod USA/Ovation Communications, including Vice President, Corporate, General Manager and Chief Financial Officer. April 1997-May 1998, President and Chief Operating Officer, Graco Inc. 1981-1997, various senior financial executive positions with Deluxe Corporation, including Senior Vice President and CFO and Vice President, Finance. 1975-1981, various accounting positions with Deloitte & Touche LLP.	54
Michael J. Pung	August 2004-present, Vice President, Finance of the Company. 2000-August 2004, Vice President and Controller, Hubbard Media Group, LLC. 1999-2000, Controller, Capella Education, Inc. 1998-1999, Controller, U.S. Satellite Broadcasting, Inc. 1992-1998, various financial management positions with Deluxe Corporation. 1985-1992, various audit positions, including audit manager, at Deloitte & Touche LLP.	44



Mark R. Scadina

June 2007-present, Senior Vice President and General Counsel and Corp Secretary of the Company. 2003-2007, various senior positions including Executive Vice President, General Counsel and Corporate Secretary of Liberate Technologies, Inc. 1999-2003, various senior positions including Vice President and General Counsel of Intertrust Technologies Corporation. 1994-1999, Associate at Pennie and Edmonds LLP.

38

27

---

**Table of Contents**

<b>Name</b>	<b>Positions Held</b>	<b>Age</b>
Tracey H. Stout	September 2007-present, Senior Vice President and Chief Marketing Officer of the Company. 2003-2007, Vice President, Worldwide Marketing at Autodesk, Inc. 1996-2002, executive positions at Sun Microsystems Computer Company including Vice President, Marketing Java and KML Software and Vice President, Worldwide Brand Marketing. 1992-1996, Vice President, Account Director at Saatchi and Saatchi Advertising. 1981-1991, various Account Management positions at McCann-Erickson, Knoth & Meads Advertising, and Batten, Barton, Durstine & Osborn.	50

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

Our common stock trades on the New York Stock Exchange under the symbol: FIC. According to records of our transfer agent, at September 30, 2007, we had 495 shareholders of record of our common stock.

The following table shows the high and low closing prices for our stock, as listed on the New York Stock Exchange for each quarter in the last two fiscal years:

	<b>High</b>	<b>Low</b>
<b>Fiscal 2006</b>		
October 1 – December 31, 2005	\$ 48.21	\$ 40.21
January 1 – March 31, 2006	\$ 47.77	\$ 38.77
April 1 – June 30, 2006	\$ 41.11	\$ 34.30
July 1 – September 30, 2006	\$ 37.20	\$ 33.25
<b>Fiscal 2007</b>		
October 1 – December 31, 2006	\$ 42.97	\$ 35.61
January 1 – March 31, 2007	\$ 41.84	\$ 37.45
April 1 – June 30, 2007	\$ 40.83	\$ 34.98
July 1 – September 30, 2007	\$ 40.60	\$ 35.33

**Dividends**

We paid quarterly dividends of two cents per share, or eight cents per year, during each quarter of fiscal 2007, 2006 and 2005. Our dividend rate is set by the Board of Directors on a quarterly basis taking into account a variety of factors, including among others, our operating results and cash flows, general economic and industry conditions, our obligations, changes in applicable tax laws and other factors deemed relevant by the Board. Although we expect to continue to pay dividends at the current rate, our dividend rate is subject to change from time to time based on the Board's business judgment with respect to these and other relevant factors.

**Table of Contents****Issuer Purchases of Equity Securities (1)**

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs</b>
July 1, 2007 through July 31, 2007	316,500	\$ 39.29	316,500	\$ 205,455,495
August 1, 2007 through August 31, 2007	2,391,750	\$ 37.12	2,391,750	\$ 116,679,052
September 1, 2007 through September 30, 2007	1,802,900	\$ 37.42	1,802,900	\$ 49,210,929
	4,511,150	\$ 37.39	4,511,150	\$ 49,210,929

(1) In November 2007, our Board of Directors approved a new common stock repurchase program that replaces our previous program and allows us to purchase shares of our common stock up to an aggregate cost of \$250.0 million in the open market or through negotiated transactions. The November 2007 program does not have a fixed expiration date.

**Table of Contents**

**Performance Graph**

The follow graph shows the total stockholder return of an investment of \$100 in cash on September 30, 2002, in (a) the Company's Common Stock, (b) the Research Data Group Inc. indices for the Standard & Poor's 500 Stocks (U.S. Companies), and (c) the Standard & Poor's 500 Application Software Index, in each case with reinvestment of dividends. These indices relate only to stock prices and do not purport to afford direct comparison of the business or financial performance of the companies. We do not believe there are any publicly traded companies that compete with us across the full spectrum of our product and service offerings.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***  
**Among Fair Issac Corporation, The S&P 500 Index**  
**And the S&P Application Software Index**

\* \$100 invested on 9/30/02 in stock or index-including reinvestment of dividends. Fiscal year ending September 30.

Copyright© 2007, Standard & Poor's, a division of The McGraw-Hill Companies, Inc. All rights reserved.  
[www.researchdatagroup.com/S&P.htm](http://www.researchdatagroup.com/S&P.htm)

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

We acquired NAREX Inc. ( NAREX ) in July 2003, Diversified HealthCare Services, Inc. ( Diversified HealthCare Services ) in September 2003, Seurat Company ( Seurat ) in October 2003, London Bridge Software Holdings plc ( London Bridge ) in May 2004, Braun Consulting, Inc. ( Braun ) in November 2004 and RulesPower, Inc. ( RulesPower ) in September 2005. Results of operations from these acquisitions are included prospectively from the date of each acquisition. As a result of these acquisitions, the comparability of the data below is impacted.

	<b>Fiscal Years Ended September 30,</b>				
	<b>2007(1)(2)</b>	<b>2006(1)(3)</b>	<b>2005</b>	<b>2004(4)</b>	<b>2003</b>
<b>(In thousands, except per share data)</b>					
Revenues	\$ 822,236	\$ 825,365	\$ 798,671	\$ 706,206	\$ 629,295
Operating income	148,474	152,723	193,011	179,866	174,194
Income before income taxes	149,662	159,192	194,088	168,815	172,140
Net income	104,650	103,486	134,548	102,788	107,157
Earnings per share:					
Basic	\$ 1.87	\$ 1.63	\$ 2.02	\$ 1.47	\$ 1.48
Diluted	\$ 1.82	\$ 1.59	\$ 1.86	\$ 1.31	\$ 1.40
Dividends declared per share	\$ 0.08	\$ 0.08	\$ 0.08	\$ 0.08	\$ 0.08

	<b>At September 30,</b>				
	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>(In thousands)</b>					
Working capital (deficit)	\$ (103,173)	\$ (123,719)	\$ 274,523	\$ 345,785	\$ 569,510
Total assets	1,275,771	1,321,205	1,351,061	1,444,779	1,495,173
Senior convertible notes	390,963	400,000	400,000	400,000	400,000
Convertible subordinated notes, net of discount					141,364
Revolving line of credit	170,000				
Stockholders' equity	566,314	770,028	805,094	916,471	849,542

- (1) Results of operations for fiscal 2007 and 2006 include pre-tax share-based compensation expense of \$36.3 million and \$42.1 million respectively, after our adoption of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, on October 1, 2005.
- (2) Results of operations for fiscal 2007 include pre-tax charges of \$2.5 million in restructuring and acquisition-related expenses and a \$1.5 million gain on the sale of product line assets.
- (3) Results of operations for fiscal 2006 include \$19.7 million in restructuring and other acquisition related pre-tax charges.
- (4) Results of operations for fiscal 2004 include an \$11.1 million pre-tax loss on redemption of our convertible subordinated notes.



**Table of Contents**

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

**RESULTS OF OPERATIONS**

**Overview**

We are a leader in Enterprise Decision Management ( EDM ) solutions that enable businesses to automate, improve and connect decisions to enhance business performance. Our predictive analytics and decision management systems power hundreds of billions of customer decisions each year. We help companies acquire customers more efficiently, increase customer value, reduce fraud and credit losses, lower operating expenses and enter new markets more profitably. Most leading banks and credit card issuers rely on our solutions, as do many insurers, retailers, telecommunications providers, healthcare organizations, pharmaceutical and government agencies. We also serve consumers through online services that enable people to purchase and understand their FICO® scores, the standard measure in the United States of credit risk, empowering them to manage their financial health.

Most of our revenues are derived from the sale of products and services within the consumer credit, financial services and insurance industries, and during the year ended September 30, 2007, 74% of our revenues were derived from within these industries. A significant portion of our remaining revenues is derived from the telecommunications, retail industries, as well as the government sector. Our clients utilize our products and services to facilitate a variety of business processes, including customer marketing and acquisition, account origination, credit and underwriting risk management, fraud loss prevention and control, and client account and policyholder management. A significant portion of our revenues is derived from transactional or unit-based software license fees, annual license fees under long-term software license arrangements, transactional fees derived under scoring, network service or internal hosted software arrangements, and annual software maintenance fees. The recurrence of these revenues is, to a significant degree, dependent upon our clients' continued usage of our products and services in their business activities. The more significant activities underlying the use of our products in these areas include: credit and debit card usage or active account levels; lending acquisition, origination and customer management activity; workers' compensation and automobile medical injury insurance claims; and wireless and wireline calls and subscriber levels. Approximately 75% of our revenues during fiscal 2007 were derived from arrangements with transactional or unit-based pricing. We also derive revenues from other sources which generally do not recur and include, but are not limited to, perpetual or time-based licenses with upfront payment terms, non-recurring professional service arrangements and gain-share arrangements where revenue is derived based on percentages of client revenue growth or cost reductions attributable to our products.

Within a number of our sectors there has been a sizable amount of industry consolidation. In addition, many of our sectors are experiencing increased levels of competition. As a result of these factors, we believe that future revenues in particular sectors may decline. However, due to the long-term customer arrangements we have with many of our customers, the near-term impact of these declines may be more limited in certain sectors.

One measure used by management as an indicator of our business performance is the volume of bookings achieved. We define a booking as estimated future contractual revenues, including agreements with perpetual, multi-year and annual terms. Bookings values may include: (i) estimates of variable fee components such as hours to be incurred under new professional services arrangements and customer account or transaction activity for agreements with transactional-based fee arrangements; (ii) additional or expanded business from renewals of contracts; and (iii) to a lesser extent, previous customers that have attrited and been resold only as a result of a significant sales effort. In the fourth quarter of fiscal 2007, we achieved bookings of \$94.5 million, including five deals with bookings values of \$3.0 million or more. In comparison, bookings in the fourth quarter of fiscal 2006 were \$112.6 million, including nine deals with bookings values of \$3.0 million or more.

Management regards the volume of bookings achieved, among other factors, as an important indicator of future revenues, but they are not comparable to, nor should they be substituted for, an analysis of our revenues, and they are subject to a number of risks and uncertainties, including those described in Item 1A Risk Factors , above, concerning timing and contingencies affecting product delivery and performance. Although many of our contracts have fixed noncancelable terms, some of our contracts are terminable by the client on short notice or without notice.



**Table of Contents**

Accordingly, we do not believe it is appropriate to characterize all of our bookings as backlog that will generate future revenue.

Our revenues derived from clients outside the United States continue to grow, and may in the future grow more rapidly than our revenues from domestic clients. International revenues totaled \$240.5 million, \$230.2 million and \$201.5 million in fiscal 2007, 2006 and 2005, respectively, representing 29%, 28% and 25% of total consolidated revenues in each of these years. In addition to clients acquired via our acquisitions, we believe that our international growth is a product of successful relationships with third parties that assist in international sales efforts and our own increased sales focus internationally, and we expect that the percentage of our revenues derived from international clients will increase in the future.

In March 2007, we sold the assets and products associated with our mortgage banking solutions product line, which was included in the Strategy Machines Solutions segment, for \$15.8 million in cash. We recognized a \$1.5 million pre-tax gain, but a \$0.4 million after-tax loss on the sale due to goodwill associated with the product line that was not deductible for income tax purposes. For fiscal 2007 and 2006, we recorded revenues from the mortgage banking solutions product line of \$7.7 million and \$19.9 million, respectively. The earnings contribution from the mortgage banking solutions product line was not significant to our fiscal 2007 or fiscal 2006 results of operations.

Our reportable segments are: Strategy Machine Solutions, Scoring Solutions, Professional Services and Analytic Software Tools. Although we sell solutions and services into a large number of end user product and industry markets, our reportable business segments reflect the primary method in which management organizes and evaluates internal financial information to make operating decisions and assess performance. Comparative segment revenues, operating income, and related financial information for the years ended September 30, 2007, 2006 and 2005 are set forth in Note 17 to the accompanying consolidated financial statements.

**Revenues**

The following tables set forth certain summary information on a segment basis related to our revenues for the fiscal years indicated.

Segment	Revenues			Period-to-Period Change	
	Fiscal Year		2005	2007	2006
	2007	2006		to 2006	to 2005
	(In thousands)			(In thousands)	
Strategy Machine Solutions	\$ 439,273	\$ 453,232	\$ 449,139	\$ (13,959)	\$ 4,093
Scoring Solutions	180,444	177,152	167,270	3,292	9,882
Professional Services	151,086	149,250	134,231	1,836	15,019
Analytic Software Tools	51,433	45,731	48,031	5,702	(2,300)
Total Revenues	\$ 822,236	\$ 825,365	\$ 798,671	(3,129)	26,694

**Period-to-Period  
Percentage**

Segment	Percentage of Revenues			Change	
	Fiscal Year			2007	2006
	2007	2006	2005	to 2006	to 2005
Strategy Machine Solutions	54%	55%	56%	(3)%	1%
Scoring Solutions	22%	21%	21%	2%	6%
Professional Services	18%	18%	17%	1%	11%
Analytic Software Tools	6%	6%	6%	12%	(5)%
Total Revenues	100%	100%	100%		3%

**Table of Contents*****Fiscal 2007 Revenues Compared to Fiscal 2006 Revenues***

Strategy Machine Solutions segment revenues decreased \$14.0 million due partially to the sale of our *mortgage banking solutions* product line, which resulted in a \$10.9 million decline in segment revenues. In addition, segment revenues declined due to a \$5.5 million decrease in revenues from our *customer management solutions*, a \$5.5 million decrease in revenues from our *originations solutions*, a \$4.0 million decrease in revenues from our *insurance and healthcare solutions* and a \$0.5 million decrease in revenues from our other strategy machine solutions. The revenue decrease was partially offset by a \$9.5 million increase in revenues from our *collection and recovery solutions*, a \$1.6 million increase in revenues from our *consumer solutions* and a \$1.3 million increase in revenues from our *fraud solutions*.

The decrease in *customer management solutions* revenues was the result of a decline in transactional-based revenues due to the loss of volumes from a significant customer, which resulted from industry consolidation. The decrease in *originations solutions* revenues was the result of a decline in transactional-based revenues, unfavorable pricing on a renewed customer contract and, to a lesser extent, a reduction in sales of software licenses. The decrease in *insurance and healthcare solutions* revenues was attributable primarily to a decline in bill review volumes associated with our existing customer base and loss of customer accounts. The increase in *collections and recovery solutions* revenues was attributable primarily to several large license sales and increased volumes associated with transactional-based agreements. The large license sales resulted from successful international sales efforts. The increase in *consumer solutions* revenues was attributable to increases in revenues derived from myfico.com and our strategic alliance partners. The increase in *fraud solutions* revenues was attributable primarily due to increased volumes associated with transactional-based agreements. However, we have experienced a delay in a product upgrade, which impacted current year bookings and revenues and may continue to impact *fraud solutions* bookings and revenues in future periods.

*Scoring Solutions* segment revenues increased \$3.3 million primarily due an increase in revenues derived from risk scoring services at the credit reporting agencies. We also had an increase in revenues derived from our FICO® Expansion® score product, which provides scores on U.S. consumers who do not have traditional FICO® scores because they do not have a sufficient number of credit accounts being reported to the credit reporting agencies. The revenue increase was partially offset by a decline in revenues derived from our own prescreening and account management services sold directly to users, which resulted from increased pricing pressures and an unfavorable impact on pricing from the merger of two customers. We expect that continued pricing and competitive pressures will adversely affect segment revenues in fiscal 2008.

During fiscal 2007 and 2006, revenues generated from our agreements with Equifax, TransUnion and Experian collectively accounted for approximately 19% and 18%, respectively, of our total revenues, including revenues from these customers that are recorded in our other segments.

*Professional Services* segment revenues increased \$1.8 million from consulting and implementation services for customer management products, for services to develop predictive models for a large customer and implementation services for Blaze Advisor. The increase was partially offset by a decline in implementation services for our collection and recovery products and fraud products and a decline in industry consulting services. The decline in implementation services for fraud products was partially the result of a delay in a product upgrade.

*Analytic Software Tools* segment revenues increased \$5.7 million primarily due to an increase in sales of perpetual and term licenses of Blaze Advisor and to a lesser extent sales of Model Builder software applications. This increase reflects a larger number of Blaze Advisor license sales that exceeded \$1.0 million in the United States and EMEA region. The increase in revenues was also partially the result of higher maintenance revenues, which resulted from the overall growth in our installed base of Blaze Advisor.

***Fiscal 2006 Revenues Compared to Fiscal 2005 Revenues***

*Strategy Machine Solutions* segment revenues increased \$4.1 million due to a \$12.9 million increase in revenues from our *fraud solutions*, a \$8.9 million increase in revenues from our *consumer solutions*, a \$5.2 million increase in revenues from our *collections and recovery solutions*, and a \$2.2 million increase in revenues from our other strategy machine solutions, partially offset by a \$16.5 million decrease in revenues from our *marketing solutions* and a \$8.6 million decrease in revenues from our *insurance and healthcare solutions*.

**Table of Contents**

The increase in *fraud solutions* revenues was attributable to an increase in license sales and an increase in transaction volumes. The increase in *consumer solutions* revenues was partially attributable to increases in revenues derived from myfico.com and our strategic alliance partners. The increase in *consumer solutions* revenues was also the result of a revision made during fiscal 2006 to the estimated period during which revenue is earned on sales of certain products that provide consumers access to multiple credit scores. The revision, which increased revenues by \$1.6 million in fiscal 2006, resulted from the completion of a study that showed that consumers were accessing their scores over a shorter period of time than initially estimated. The increase in *collections and recovery solutions* revenues was attributable primarily to an increase in perpetual license sales revenues. This increase was driven by higher international license sales due to increased sales efforts. The decrease in *marketing solutions* revenues was attributable primarily to the loss of two large financial services customers during fiscal 2005, which resulted from industry consolidation. The decrease in *insurance and healthcare solutions* revenues was attributable primarily to the loss of several customer accounts that primarily occurred in fiscal 2005.

*Scoring Solutions* segment revenues increased \$9.9 million primarily due to an increase in revenues derived from risk scoring services at the credit reporting agencies, resulting from increased sales of scores for prescreening activities, and an increase in revenues derived from our own prescreening services directly to users. We also achieved increased revenues from our FICO expansion score product.

During fiscal 2006 and 2005, revenues generated from our agreements with Equifax, TransUnion and Experian, collectively accounted for approximately 18% and 17%, respectively, of our total revenues, including revenues from these customers that are recorded in our other segments.

*Professional Services* segment revenues increased \$15.0 million from industry consulting services, implementation services for our Blaze Advisor products and predictive modeling services. The increase in industry consulting services revenue resulted from initiatives to expand our professional service offerings into additional industry markets.

*Analytic Software Tools* segment revenues decreased \$2.3 million primarily due to a decline in sales of perpetual licenses of Blaze Advisor. This decline reflects the timing of Blaze Advisor sales, which includes large individual contracts. The decline in revenues was partially offset by higher maintenance revenues and an increase in sales of Model Builder software applications.

**Operating Expenses and Other Income (Expense)**

The following tables set forth certain summary information related to our statements of income for the fiscal years indicated.

	2007	Fiscal Year 2006 (In thousands)	2005	Period-to-Period Change	
				2007 to 2006 (In thousands)	2006 to 2005
Revenues	\$ 822,236	\$ 825,365	\$ 798,671	\$ (3,129)	\$ 26,694
Operating expenses:					
Cost of revenues	293,482	281,977	275,065	11,505	6,912
Research and development	70,599	84,967	81,295	(14,368)	3,672

Edgar Filing: FAIR ISAAC CORP - Form 10-K

Selling, general and administrative	285,541	260,845	223,400	24,696	37,445
Amortization of intangible assets	23,226	25,191	25,900	(1,965)	(709)
Restructuring and acquisition-related	2,455	19,662		(17,207)	19,662
Gain on sale of product line assets	(1,541)			(1,541)	
Total operating expenses	673,762	672,642	605,660	1,120	66,982
Operating income	148,474	152,723	193,011	(4,249)	(40,288)
Interest income	13,527	15,248	8,402	(1,721)	6,846
Interest expense	(12,766)	(8,569)	(8,347)	(4,197)	(222)
Other income (expense), net	427	(210)	1,022	637	(1,232)
Income before income taxes	149,662	159,192	194,088	(9,530)	(34,896)
Provision for income taxes	45,012	55,706	59,540	(10,694)	(3,834)
Net income	\$ 104,650	\$ 103,486	\$ 134,548	1,164	(31,062)
Number of employees at fiscal year end	2,824	2,737	2,796	87	(59)

**Table of Contents**

	Percentage of Revenues Fiscal			Period-to-Period Percentage Change	
				2007	2006
	2007	Year 2006	2005	to 2006	to 2005
Revenues	100%	100%	100%		3%
Operating expenses:					
Cost of revenues	35%	34%	35%	4%	3%
Research and development	9%	10%	10%	(17)%	5%
Selling, general and administrative	35%	32%	28%	9%	17%
Amortization of intangible assets	3%	3%	3%	(8)%	(3)%
Restructuring and acquisition-related		2%		(88)%	
Gain on sale of product line assets					
Total operating expenses	82%	81%	76%		11%
Operating income	18%	19%	24%	(3)%	(21)%
Interest income	2%	2%	1%	(11)%	81%
Interest expense	(2)%	(1)%	(1)%	(49)%	(3)%
Other income (expense), net					
Income before income taxes	18%	20%	24%	(6)%	(18)%
Provision for income taxes	5%	7%	7%	(19)%	(6)%
Net income	13%	13%	17%	1%	(23)%

At the beginning of 2006, we adopted Statement of Financial Accounting Standards ( SFAS ) No. 123(R), *Share-Based Payment*, using the modified prospective transition method. Under this method, results for prior periods have not been restated to include share-based compensation expense for stock options or our Employee Stock Purchase Plan.

In accordance with SFAS No. 123(R), we recorded share-based compensation expense of \$36.3 million and \$42.1 million in fiscal 2007 and 2006, respectively. In comparison, we recorded share-based compensation expense of \$2.9 million during fiscal 2005. Share-based compensation expense was recorded in cost of revenues, research and development, and selling, general and administrative expense.

**Cost of Revenues**

Cost of revenues consists primarily of employee salaries and benefits for personnel directly involved in creating, installing and supporting revenue products; travel and related overhead costs; costs of computer service bureaus; internal network hosting costs; amounts payable to credit reporting agencies for scores; software costs; and expenses related to our consumer score services through myfico.com.

The fiscal 2007 over 2006 increase of \$11.5 million in cost of revenues includes a \$8.6 million increase in personnel and other labor-related costs, a \$2.2 million increase in third-party software and data, a \$1.8 million increase in facilities and infrastructure costs, and a \$1.1 million net decrease in various other expenditures. The increase in personnel and other labor-related costs was attributable primarily to an increase in salary and related benefit costs and an increase in outside consultant costs. The increase in third-party software and data costs was due to an increase in *consumer solutions* costs, which resulted from higher revenues, and a change in product mix. The increase in facilities and infrastructure costs was attributable to an increase in allocated costs associated with an increase in professional services activities.

The fiscal 2006 over 2005 increase of \$6.9 million in cost of revenues resulted from a \$15.5 million increase in personnel and other labor-related costs, a \$2.6 million increase in travel expenses and a \$0.6 million increase in



## **Table of Contents**

other costs. The increase was partially offset by an \$8.4 million decrease in facilities and infrastructure costs and a \$3.4 million decrease in third-party software and data costs. The increase in personnel and other labor-related costs was attributable partially to a \$10.3 million increase in share-based compensation expense due to the adoption of SFAS No. 123(R) and the remaining \$5.2 million increase was primarily due to higher outside consultant costs. The increase in travel costs reflects the increase in professional service projects in the current year and associated travel to client locations. The decrease in facilities and infrastructure costs was attributable primarily to a reduction in depreciation expense, lower outside costs for information systems, and because fiscal 2005 included system integration costs associated with our acquisition of London Bridge. The decline in third-party software and data costs was attributable to a decrease in *insurance and healthcare solutions* costs, which was a result of lower revenues for these products.

In fiscal 2008, we expect that cost of revenues as a percentage of revenues will be consistent with the cost of revenues incurred during fiscal 2007.

## ***Research and Development***

Research and development expenses include the personnel and related overhead costs incurred in development of new products and services, including primarily the research of mathematical and statistical models and the development of new versions of Strategy Machine Solutions and Analytic Software Tools.

The fiscal 2007 over 2006 decrease of \$14.4 million in research and development expenditures was attributable primarily to a decrease in personnel and related costs of \$11.1 million, a \$2.9 million decrease in facilities and infrastructure costs and a \$0.4 million decrease in other costs. The decrease in personnel and related costs was the result of lower salary and benefit costs due to the shift of employees to non-U.S. locations and staff reductions, which occurred in the prior year period. The decrease in facilities and infrastructure costs was attributable to the shift of employees to lower cost non-U.S. locations and a decline in allocated costs due to the staff reduction.

The fiscal 2006 over 2005 increase of \$3.7 million in research and development expenditures was partially attributable to an increase in personnel and related costs of \$2.4 million, which was driven by a \$6.3 million increase in share-based compensation expense due to the adoption of SFAS No. 123(R). The increase in personnel costs was partially offset by lower salary and benefit costs due to staff reductions and the shift of employees to non-U.S. locations. The increase in research and development expenditures was also the result of a \$1.5 million increase in facilities and infrastructure costs.

In fiscal 2008, we expect that research and development expenditures as a percentage of revenues will be consistent with those incurred during fiscal 2007.

## ***Selling, General and Administrative***

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

The fiscal 2007 over 2006 increase of \$24.7 million in selling, general and administrative expenses was attributable to a \$9.7 million increase in personnel and other labor-related costs, an \$8.7 million increase in legal fees and the settlement of lawsuits associated with our *insurance solutions* products, a \$2.8 million increase in our provision for doubtful accounts receivable and a \$3.5 million increase in other expenses. The increase in personnel and labor-related costs resulted primarily from an increase in sales staff and commissions, partially offset by a decline in third party staffing costs and share-based compensation expense. The decline in share-based compensation expense was due to an

overall decline in share-based grants and an increase in forfeitures in fiscal 2007. The increase in marketing costs was driven by programs to promote brand awareness and drive sales growth. The increase in the provision for doubtful accounts resulted from an overall increase in accounts receivable and a related shift in aging of balances due to internal process inefficiencies and slower collections associated with certain international clients.

**Table of Contents**

The fiscal 2006 over 2005 increase of \$37.4 million in selling, general and administrative expenses was attributable to a \$32.1 million increase in personnel and other labor-related costs and a \$5.9 million increase in facilities and infrastructure costs, slightly offset by a \$0.6 million net decrease in other expenses. The increase in personnel and labor-related costs resulted from a \$22.6 million increase in share-based compensation expense due to the adoption of SFAS No. 123(R) and the remaining \$9.5 million increase was primarily due to higher salary and commission costs. The increase in facilities and infrastructure was due to higher information systems costs.

In fiscal 2008, we expect that selling, general and administrative expenses as a percentage of revenues will be consistent with, or slightly lower than, those incurred during fiscal 2007.

***Amortization of Intangible Assets***

Amortization of intangible assets consists of amortization expense related to intangible assets recorded in connection with acquisitions accounted for by the purchase method of accounting. Our definite-lived intangible assets, consisting primarily of completed technology and customer contracts and relationships, are being amortized using the straight-line method or based on forecasted cash flows associated with the assets over periods ranging from two to fifteen years.

The fiscal 2007 over 2006 decline of \$2.0 million in amortization expense was attributable to certain intangible assets associated with our fiscal 2002 acquisition of HNC Software Inc., becoming fully amortized during fiscal 2007.

In fiscal 2008, we expect amortization expense will be lower than the amortization expense incurred in 2007 due to intangible assets that were fully amortized during fiscal 2007.

***Restructuring and Acquisition-Related Expenses***

The following table sets forth certain summary information on restructuring and acquisition-related expenses.

	<b>2007</b>	<b>Fiscal Year 2006</b>	<b>2005</b>
	<b>(In thousands)</b>		
Severance costs	\$ 1,012	\$ 5,198	\$
Vacating excess lease space	1,443	12,954	
Abandoned acquisition		2,184	
Restructuring plan adjustment-leased space		(674)	
Total restructuring and acquisition related expense	\$ 2,455	\$ 19,662	\$

In fiscal 2007, we recorded a charge of \$1.0 million for severance costs associated with the elimination of 13 management positions. In addition, we recorded a charge of \$1.4 million to vacate excess leased space located in California and Maryland. Included in the \$1.4 million charge was \$0.2 million to write off fixed assets that were abandoned as part of this action. The remaining charge of \$1.2 million was for future cash lease obligations, net of estimated sublease income. Cash payments for the majority of these costs will be paid in fiscal 2008. We expect these actions to result in annualized savings of approximately \$4 million, which represents compensation costs for terminated employees and a reduction in rent expense for the vacated lease space.

In connection with a restructuring initiative in fiscal 2006, we incurred charges of \$5.1 million for severance costs associated with a reduction of 190 employees primarily in product management, delivery and development functions. Cash payments for the majority of these severance costs were paid in fiscal 2006. As part of this restructuring initiative, we also recognized a \$0.1 million charge associated with the abandonment of leased office space representing future cash obligations under the lease.

As a result of vacating excess leased space located in California in fiscal 2006, we incurred a charge of \$13.0 million, representing future cash lease obligations, net of estimated sublease income. We expect that the future lease obligations will be paid out over the next four years, which represents the remaining term of the lease.

## **Table of Contents**

In fiscal 2006, we recorded costs of \$2.2 million in connection with an abandoned acquisition, consisting of third-party legal, accounting and other professional fees.

We recorded a \$0.7 million gain in fiscal 2006 due to the sublease of office space that we had exited in fiscal 2002. The gain resulted from an adjustment to the liability established for the exit of the lease space and a refund received for past rent paid to the landlord.

### ***Gain on Sale of Product Line Assets***

In March 2007, we completed the sale of the assets and products associated with our *mortgage banking solutions* product line for \$15.8 million in cash. We recognized a \$1.5 million pre-tax gain on the sale.

### ***Interest Income***

Interest income is derived primarily from the investment of funds in excess of our immediate operating requirements.

The fiscal 2007 over 2006 decrease of \$1.7 million in interest income was attributable to lower average cash and investment balances. The decrease in cash and investment balances resulted principally from cash used to repurchase common stock, partially offset by cash provided by operating activities and proceeds received from the exercise of employee stock options.

The fiscal 2006 over 2005 increase of \$6.8 million in interest income was attributable to higher interest and investment income yields due to market conditions and to a lesser extent higher average cash and investment balances. The increase in cash and investment balances resulted principally from cash provided by operating activities and proceeds received from the exercise of employee stock options.

### ***Interest Expense***

Interest expense recorded in fiscal 2007 relates to our 1.5% Senior Convertible Notes ( *Senior Notes* ), including the amortization of debt issuance costs, and interest associated with borrowings under our revolving credit facility. Interest expense recorded in fiscal 2006 was only related to the Senior Notes. Accordingly, the increase in interest expense of \$4.2 million in fiscal 2007 resulted from interest associated with borrowings under our revolving credit facility.

Interest expense recorded in fiscal 2006 relates to our Senior Notes, including the amortization of debt issuance costs, and was consistent with the interest expense related to the Senior Notes recorded by us during fiscal 2005.

Noteholders may require us to repurchase all or part of the Senior Notes as of August 15, 2008. If the noteholders require us to repurchase all or part of these notes, our interest expense may increase substantially.

### ***Other Income (Expense), Net***

Other income (expense), net consists primarily of realized investment gains/losses, exchange rate gains/losses resulting from re-measurement of foreign-denominated receivable and cash balances held by our U.S. reporting entities into the U.S. dollar functional currency at period-end market rates, net of the impact of offsetting forward exchange contracts, and other non-operating items.

Other income, net was \$0.4 million in fiscal 2007, compared with other expense, net of \$0.2 million in fiscal 2006. The change was driven by fiscal 2007 dividend income of \$1.6 million, a decline in foreign exchange losses of

\$0.2 million, a \$0.5 million loss in fiscal 2007 from the sale of company owned aircraft and gains totaling \$0.7 million that were recognized in fiscal 2006 from the disposition of investments.

Other expense, net was \$0.2 million in fiscal 2006, compared with other income, net of \$1.0 million in fiscal 2005. The change in other income (expense), net was primarily due to net foreign exchange losses of \$0.9 million recognized in fiscal 2006, compared with a net foreign currency gain of \$0.4 million recognized in fiscal 2005. The foreign exchange losses in fiscal 2006 were the result of unfavorable currency positions.

**Table of Contents****Provision for Income Taxes**

Our effective tax rates were 30.1%, 35.0% and 30.7% in fiscal 2007, 2006 and 2005, respectively.

The decrease in our effective tax rate in fiscal 2007 compared with fiscal 2006 was due to the recognition in fiscal 2007 of \$8.2 million of tax benefits. The tax benefits included favorable settlements of the fiscal 1998 through 2001 U.S. federal examinations and the fiscal 1999 through 2002 California Franchise Tax Board examinations. Our effective tax rate, however, was adversely impacted by the sale of our mortgage banking solutions product line, due to \$3.3 million of goodwill associated with the product line that was not deductible for income tax purposes. These items reduced our effective tax rate in fiscal 2007 by 5.4%. Excluding these tax benefits, the effective tax rate for fiscal 2007 would have been 35.5%. In addition to the tax benefits, our effective tax rate in fiscal 2007 was also affected by the repeal of the Extraterritorial Income Exclusion ( EIE ), which was effective December 31, 2006. The EIE deduction reduced income tax expense by \$0.5 million in fiscal 2007 compared with \$4.6 million in fiscal 2006.

The increase in our effective tax rate in fiscal 2006 compared with fiscal 2005 was due to the recognition in fiscal 2005 of \$10.6 million of tax benefits. These benefits were determined in conjunction with tax studies we performed with outside advisors that identified additional U.S. federal and state tax credits and other deductions related to prior years tax returns. The tax benefits recognized reflect our estimate of the effect of amended tax returns filed for fiscal 1998 through 2004. These tax benefits reduced our effective tax rate in fiscal 2005 by 5.5%. Excluding these tax benefits, the effective tax rate for fiscal 2005 would have been 36.2%.

**Operating Income**

The following table sets forth certain summary information on a segment basis related to our operating income for the fiscal years indicated.

Segment	Fiscal Year			Period-to-Period Change		Period-to-Period Percentage Change	
	2007	2006	2005	2007 to 2006	2006 to 2005	2007 to 2006	2006 to 2005
	(In thousands)			(In thousands)			
Strategy Machine Solutions	\$ 62,205	\$ 85,578	\$ 63,443	\$ (23,373)	\$ 22,135	(27)%	35%
Scoring Solutions	115,317	112,413	100,520	2,904	11,893	3%	12%
Professional Services	7,056	13,730	18,856	(6,674)	(5,126)	(49)%	(27)%
Analytic Software Tools	1,071	2,749	13,119	(1,678)	(10,370)	(61)%	(79)%
Segment operating income	185,649	214,470	195,938	(28,821)	18,532	(13)%	9%
Unallocated share-based compensation expense	(36,261)	(42,085)	(2,927)	5,824	(39,158)	14%	
Unallocated restructuring and	(2,455)	(19,662)		17,207	(19,662)	88%	

acquisition-related expense							
Unallocated gain on sale of product line assets		1,541		1,541			
Operating income	\$ 148,474	\$ 152,723	\$ 193,011	(4,249)	(40,288)	(3)%	(21)%

The fiscal 2007 over fiscal 2006 decrease of \$4.2 million in operating income was attributable to an increase in segment operating expenses, partially offset by the gain recognized on the sale of the mortgage banking solutions product line, lower share-based compensation expense and the impact of restructuring and acquisition-related costs that were recognized in fiscal 2006. At the segment level, the decrease in segment operating income was driven by decreases of \$23.4 million, \$6.7 million and \$1.7 million in segment operating income within our Strategy Machine Solutions, Professional Services and Analytic Software Tools segments, respectively. The decline was partially offset by a \$2.9 million increase in segment operating income within our Scoring Solutions segment. The decrease in Strategy Machine Solutions segment operating income was attributable to a decline in sales of *customer*



**Table of Contents**

*management solutions* and *originations solutions* products and higher operating expenses. The operating expense increase was driven by higher legal fees and settlement costs, an increase in marketing costs and higher third party data and software costs. The decrease in Professional Services segment operating income was the result of higher personnel costs to support increased professional services activities, which more than offset the increase in segment revenues. In our Analytic Software Tools segment, the decrease in segment operating results was due to increased personnel costs, partially offset by an increase in sales of licenses of our EDM products. The increase in Scoring Solutions segment operating income was attributable primarily to an increase in revenues derived from risk scoring services at the credit reporting agencies, partially offset by higher legal expenses.

The fiscal 2006 over fiscal 2005 decrease of \$40.3 million in operating income was attributable primarily to an increase in share-based compensation expense due to the adoption of SFAS No. 123(R) and restructuring and acquisition-related charges. The decrease in operating income was partially offset by an increase in segment revenues. At the segment level, the increase in segment operating income was driven by increases of \$22.1 million and \$11.9 million in segment operating income within our Strategy Machine Solutions and Scoring Solutions segments, respectively, partially offset by a \$10.4 million and \$5.1 million decrease in segment operating income within our Analytic Software Tools and Professional Services segments. The increase in Strategy Machine Solutions segment operating income was attributable to increases in sales of higher margin product offerings and a decline in operating expenses, partially offset by the impact of revenue declines we experienced in *marketing solutions* and *insurance and healthcare solutions*. The increase in Scoring Solutions segment operating income was attributable primarily to an increase in revenues derived from risk scoring services at the credit reporting agencies and an increase in revenues derived from our own prescreening services. In our Analytic Software Tools segment, the decline in segment operating income was due to a decrease in sales of perpetual licenses as well as increased product development and sales costs. The decrease in Professional Services segment operating income was the result of higher personnel and outside consultant costs.

**Capital Resources and Liquidity*****Cash Flows from Operating Activities***

Our primary method for funding operations and growth has been through cash flows generated from operating activities. Net cash provided by operating activities decreased from \$199.0 million in fiscal 2006 to \$179.2 million in fiscal 2007. Operating cash flows were negatively impacted by an increase in trade receivables of \$15.8 million and unfavorable working capital changes. The increase in trade receivables resulted from internal process inefficiencies, slower collections associated with certain international clients and longer payment terms on certain customer contracts. Operating cash flows were also negatively impacted by \$6.1 million paid for restructuring-related liabilities.

Net cash provided by operating activities decreased from \$214.1 million in fiscal 2005 to \$199.0 million in fiscal 2006. The comparison of fiscal 2006 to fiscal 2005 operating cash flows was impacted by a \$20.8 million prepayment received in fiscal 2005 from a single customer for future services. Operating cash flows in fiscal 2006 were also negatively affected by payments of \$11.3 million for restructuring and acquisition-related activities and the increase of \$9.7 million in receivables, which reflects the increase in revenues and longer payment terms in certain customer contracts. In addition, prior to the adoption of SFAS No. 123(R), we presented all tax benefits for deductions resulting from the exercise of stock options as operating cash flows within our consolidated statements of cash flows. SFAS No. 123(R) requires the cash flows resulting from the tax benefits for tax deductions in excess of the compensation expense recorded for those options (excess tax benefits) to be classified as financing cash flows. Accordingly, the \$7.1 million excess tax benefit that is classified as a financing cash inflow on the accompanying consolidated statements of cash flows in fiscal 2006 was classified as an operating cash inflow prior to the adoption of SFAS No. 123(R).

***Cash Flows from Investing Activities***

Net cash provided by investing activities totaled \$37.4 million in fiscal 2007, compared to net cash used in investing activities of \$17.0 million in fiscal 2006. The change in cash flows from investing activities was primarily attributable to \$15.8 million in cash received from the sale of our mortgage banking solutions product line in fiscal

**Table of Contents**

2007, a \$40.2 million increase in proceeds from sales and maturities of marketable securities, net of purchases, and an \$8.7 million decrease in property and equipment purchases. In addition, cash flows from investing activities also reflect a \$10.0 million investment we made in a company that is developing predictive analytics solutions for healthcare providers.

Net cash used in investing activities totaled \$17.0 million in fiscal 2006 compared to \$2.9 million in fiscal 2005. The change in cash flows from investing activities was attributable to a \$41.3 million decrease in cash paid for acquisitions, due to our acquisitions of Braun and RulesPower in fiscal 2005, \$22.7 million decrease in cash proceeds from a business disposition due to the sale in fiscal 2005 of London Bridge Phoenix Software, and an \$18.1 million decline in proceeds from sales and maturities of marketable securities, net of purchases. In addition, capital expenditures increased by \$15.0 million in fiscal 2006, which included spending on a new information systems data center.

***Cash Flows from Financing Activities***

Net cash used in financing activities totaled \$198.7 million in 2007, compared to \$190.3 million in fiscal 2006. The increase in cash flows used in financing activities was primarily due to a \$194.6 million increase in common stock repurchased and \$9.0 million to repurchase Senior Notes. The increase in cash used in financing activities was partially offset by a \$170.0 million in cash proceeds received from borrowings under a revolving credit facility, a \$19.9 million increase in proceeds from the issuance of common stock under employee stock plans and a \$5.5 million increase in excess tax benefits from share-based arrangements. We used cash provided by operations, borrowings under the revolving credit facility and proceeds from stock issued under employee stock plans to fund \$451.1 million in common stock repurchased in fiscal 2007.

Net cash used in financing activities totaled \$190.3 million in fiscal 2006, compared to \$262.0 million in fiscal 2005. The decrease in cash used in financing activities was due to a \$72.1 million decline in common stock repurchased. In addition, prior to the adoption of SFAS No. 123(R), we presented all tax benefits for deductions resulting from the exercise of stock options as operating cash flows within our consolidated statements of cash flows. SFAS No. 123(R) requires the cash flows resulting from the tax benefits for tax deductions in excess of the compensation expense recorded for those options (excess tax benefits) to be classified as financing cash flows. Accordingly, the \$7.1 million excess tax benefit that is classified as a financing cash inflow on the accompanying consolidated statements of cash flows in fiscal 2006 was classified as an operating cash inflow prior to the adoption of SFAS No. 123(R). The decrease in cash used in financing activities was partially offset by a \$7.7 million decline in proceeds from issuances of common stock under employee stock option and purchase plans.

***Repurchases of Common Stock***

From time to time, we repurchase our common stock in the open market pursuant to programs approved by our Board of Directors. During fiscal 2007, 2006 and 2005, we expended \$451.1 million, \$256.5 million and \$328.5 million, respectively, in connection with our repurchase of common stock under such programs. In November 2007, our Board of Directors approved a new common stock repurchase program that replaces our previous program and allows us to purchase shares of our common stock up to an aggregate cost of \$250.0 million.

***Dividends***

We paid quarterly dividends of two cents per share, or eight cents per year, during each of fiscal 2007, 2006 and 2005. Our dividend rate is set by the Board of Directors on a quarterly basis taking into account a variety of factors, including among others, our operating results and cash flows, general economic and industry conditions, our obligations, changes in applicable tax laws and other factors deemed relevant by the Board. Although we expect to

continue to pay dividends at the current rate, our dividend rate is subject to change from time to time based on the Board's business judgment with respect to these and other relevant factors.

***1.5% Senior Convertible Notes***

In August 2003, we issued \$400.0 million of Senior Notes that mature on August 15, 2023. The Senior Notes become convertible into shares of Fair Isaac common stock, subject to the conditions described below, at an initial

**Table of Contents**

conversion price of \$43.9525 per share, subject to adjustments for certain events. The initial conversion price is equivalent to a conversion rate of approximately 22.7518 shares of Fair Isaac common stock per \$1,000 principal amount of the Senior Notes. Holders may surrender their Senior Notes for conversion, if any of the following conditions is satisfied: (i) prior to August 15, 2021, during any fiscal quarter, if the closing price of our common stock for at least 20 trading days in the 30 consecutive trading day period ending on the last day of the immediately preceding fiscal quarter is more than 120% of the conversion price per share of our common stock on the corresponding trading day; (ii) at any time after the closing sale price of our common stock on any date after August 15, 2021 is more than 120% of the then current conversion price; (iii) during the five consecutive business day period following any 10 consecutive trading day period in which the average trading price of a Senior Note was less than 98% of the average sale price of our common stock during such 10 trading day period multiplied by the applicable conversion rate; provided, however, if, on the day before the conversion date, the closing price of our common stock is greater than 100% of the conversion price but less than or equal to 120% of the conversion price, then holders converting their notes may receive, in lieu of our common stock based on the applicable conversion rate, at our option, cash or common stock with a value equal to 100% of the principal amount of the notes on the conversion date; (iv) if we have called the Senior Notes for redemption; or (v) if we make certain distributions to holders of our common stock or we enter into specified corporate transactions. The conversion price of the Senior Notes will be adjusted upon the occurrence of certain dilutive events as described in the indenture, which include but are not limited to: (i) dividends, distributions, subdivisions, or combinations of our common stock; (ii) issuance of rights or warrants for the purchase of our common stock under certain circumstances; (iii) the distribution to all or substantially all holders of our common stock of shares of our capital stock, evidences of indebtedness, or other non-cash assets, or rights or warrants; (iv) the cash dividend or distribution to all or substantially all holders of our common stock in excess of certain levels; and (v) certain tender offer activities by us or any of our subsidiaries.

The Senior Notes are senior unsecured obligations of Fair Isaac and rank equal in right of payment with all of our unsecured and unsubordinated indebtedness. The Senior Notes are effectively subordinated to all of our existing and future secured indebtedness and existing and future indebtedness and other liabilities of our subsidiaries. The Senior Notes bear regular interest at an annual rate of 1.5%, payable on August 15 and February 15 of each year until August 15, 2008. Beginning August 15, 2008, regular interest will accrue at the rate of 1.5%, and be due and payable upon the earlier to occur of redemption, repurchase, or final maturity. In addition, the Senior Notes bear contingent interest during any six-month period from August 15 to February 14 and from February 15 to August 14, commencing with the six-month period beginning August 15, 2008, if the average trading price of the Senior Notes for the five trading day period immediately preceding the first day of the applicable six-month period equals 120% or more of the sum of the principal amount of, plus accrued and unpaid regular interest on, the Senior Notes. The amount of contingent interest payable on the Senior Notes in respect to any six-month period will equal 0.25% per annum of the average trading price of the Senior Notes for the five trading day period immediately preceding such six-month period.

We may redeem for cash all or part of the Senior Notes on and after August 15, 2008, at a price equal to 100% of the principal amount of the Senior Notes, plus accrued and unpaid interest. Holders may require us to repurchase for cash all or part of the remaining Senior Notes outstanding on August 15, 2008, August 15, 2013 and August 15, 2018, or upon a change in control, at a price equal to 100% of the principal amount of the Senior Notes being repurchased, plus accrued and unpaid interest.

On March 31, 2005, we completed an exchange offer for the Senior Notes, whereby holders of approximately 99.9% of the total principal amount of our Senior Notes exchanged their existing securities for new 1.5% Senior Convertible Notes, Series B ( New Notes ). The terms of the New Notes are similar to the terms of the Senior Notes described above, except that: (i) upon conversion, we will pay holders cash in an amount equal to the lesser of the principal amount of such notes and the conversion value of such notes, and to the extent such conversion value exceeds the principal amount of the notes, the remainder of the conversion obligation in cash or common shares or combination

thereof; (ii) in the event of a change of control, we may be required in certain circumstances to pay a make-whole premium on the New Notes converted in connection with the change of control and (iii) if the conversion condition in the first clause (iii) in the third paragraph preceding this paragraph is triggered and the closing price of our common stock is greater than 100% of the conversion price but less than or equal to 120% of the conversion price, the holders converting New Notes shall receive cash with a value equal to 100% of the principal amount of New Notes on the conversion date.

**Table of Contents**

The first date noteholders could require us to repurchase the Senior Notes was August 15, 2007. As a result, certain noteholders exercised their repurchase option and we repurchased \$9.0 million of the Senior Notes. As of September 30, 2007, \$391.0 million of the Senior Notes remain outstanding and are classified as short-term debt in our consolidated balance sheet, because noteholders may require us to repurchase for cash all or part of the Senior Notes on August 15, 2008.

**Credit Agreement**

In October 2006, we entered into a five-year unsecured revolving credit facility with a syndicate of banks. In July 2007, we entered into an amended and restated credit agreement that increased the revolving credit facility from \$300 million to \$600 million. Proceeds from the credit facility can be used for working capital and general corporate purposes and may also be used for the refinancing of existing debt, acquisitions, and the repurchase of the Company's common stock. Interest on amounts borrowed under the credit facility is based on (i) a base rate, which is the greater of (a) the prime rate and (b) the Federal Funds rate plus 0.50% or (ii) LIBOR plus an applicable margin. The margin on LIBOR borrowings ranges from 0.30% to 0.55% and is determined based on our consolidated leverage ratio. In addition, we must pay utilization fees if borrowings and commitments under the credit facility exceed 50% of the total credit facility commitment, as well as facility fees. The credit facility contains certain restrictive covenants, including maintenance of consolidated leverage and fixed charge coverage ratios. The credit facility also contains covenants typical of unsecured facilities. As of September 30, 2007, we had \$170.0 million of borrowings outstanding under the credit facility at an average interest rate of 5.9%.

**Capital Resources and Liquidity Outlook**

As of September 30, 2007, we had \$234.4 million in cash, cash equivalents and marketable security investments. We believe that these balances, as well as borrowings from our \$600 million revolving credit facility and anticipated cash flows from operating activities, will be sufficient to fund our working and other capital requirements and any repayment of existing debt, including the possible retirement of our Senior Notes, over the course of the next twelve months and for the foreseeable future. In the normal course of business, we evaluate the merits of acquiring technology or businesses, or establishing strategic relationships with or investing in these businesses. We may elect to use available cash and cash equivalents and marketable security investments to fund such activities in the future. In the event additional needs for cash arise, we may raise additional funds from a combination of sources, including the potential issuance of debt or equity securities. Additional financing might not be available on terms favorable to us, or at all. If adequate funds were not available or were not available on acceptable terms, our ability to take advantage of unanticipated opportunities or respond to competitive pressures could be limited.

**Contractual Obligations**

The following is a summary of our contractual obligations at September 30, 2007:

	2008	2009	2010	Fiscal Year 2011	2012	Thereafter	Total
	(In thousands)						
Senior Notes(1)	\$ 390,963	\$	\$	\$	\$	\$	\$ 390,963
Revolving line of credit					170,000		170,000
Operating lease obligations	23,601	22,671	20,852	15,469	11,923	29,143	123,659

Total commitments      \$ 414,564    \$ 22,671    \$ 20,852    \$ 15,469    \$ 181,923    \$ 29,143    \$ 684,622

(1) \$391.0 million represents the aggregate principal amount of the Senior Notes. Our Senior Notes are classified in short-term debt in our consolidated balance sheet at September 30, 2007, because holders may require us to purchase the Senior Notes upon delivery of a written purchase notice on specific dates, the earliest of which is August 2008. Refer to Note 9 to our accompanying consolidated financial statements for more detailed information regarding the Senior Notes.



## **Table of Contents**

### **Off-Balance Sheet Arrangements**

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

### **Critical Accounting Policies and Estimates**

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

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

#### ***Revenue Recognition***

Software license fee revenue is recognized when persuasive evidence of an arrangement exists, delivery of the product has occurred at our customer's location, the fee is fixed or determinable and collection is probable. We use the residual method to recognize revenue when an arrangement includes one or more elements to be delivered at a future date and vendor-specific objective evidence ( VSOE ) of the fair value of all undelivered elements exists. VSOE of fair value is based on the normal pricing practices for those products and services when sold separately by us and customer renewal rates for post-contract customer support services. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. If evidence of the fair value of one or more undelivered elements does not exist, the revenue is deferred and recognized when delivery of those elements occurs or when fair value can be established. The determination of whether fees are fixed or determinable and collection is probable involves the use of assumptions. We evaluate contract terms and customer information to ensure that these criteria are met prior to our recognition of license fee revenue. Changes to the elements in a software arrangement, the ability to identify VSOE for those elements, the fair value of the respective elements, and change to a product's estimated life cycle could materially impact the amount of earned and unearned revenue.

When software licenses are sold together with implementation or consulting services, license fees are recognized upon delivery provided that the above criteria are met, payment of the license fees is not dependent upon the performance of the services, and the services do not provide significant customization or modification of the software products and are not essential to the functionality of the software that was delivered. For arrangements with services that are essential to the functionality of the software, the license and related service revenues are recognized using contract accounting as described below.

If at the outset of an arrangement we determine that the arrangement fee is not fixed or determinable, revenue is deferred until the arrangement fee becomes fixed or determinable, assuming all other revenue recognition criteria have been met. If at the outset of an arrangement we determine that collectibility is not probable, revenue is deferred until

the earlier of when collectibility becomes probable or the receipt of payment. If there is uncertainty as to the customer's acceptance of our deliverables, revenue is not recognized until the earlier of receipt of customer acceptance, expiration of the acceptance period, or when we can demonstrate we meet the acceptance criteria.

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

**Table of Contents**

Revenues recognized from our credit scoring, data processing, data management and internet delivery services are recognized as these services are performed, provided persuasive evidence of an arrangement exists, fees are fixed or determinable, and collection is reasonably assured. The determination of certain of our credit scoring and data processing revenues requires the use of estimates, principally related to transaction volumes in instances where these volumes are reported to us by our clients on a monthly or quarterly basis in arrears. In these instances, we estimate transaction volumes based on preliminary customer transaction information, if available, or based on average actual reported volumes for an immediate trailing period. Differences between our estimates and actual final volumes reported are recorded in the period in which actual volumes are reported. We have not experienced significant variances between our estimates and actual reported volumes in the past and anticipate that we will be able to continue to make reasonable estimates in the future. If for some reason we were unable to reasonably estimate transaction volumes in the future, revenue may be deferred until actual customer data was received, and this could have a material impact on our results of operations during the period of time that we changed accounting methods.

Transactional or unit-based license fees under software license arrangements, network service and internally-hosted software agreements are recognized as revenue based on system usage or when fees based on system usage exceed monthly minimum license fees, provided persuasive evidence of an arrangement exists, fees are fixed or determinable and collection is probable. The determination of certain of our transactional or unit-based license fee revenues requires the use of estimates, principally related to transaction usage or active account volumes in instances where this information is reported to us by our clients on a monthly or quarterly basis in arrears. In these instances, we estimate transaction volumes based on preliminary customer transaction information, if available, or based on average actual reported volumes for an immediate trailing period. Differences between our estimates and actual final volumes reported are recorded in the period in which actual volumes are reported. We have not experienced significant variances between our estimates and actual reported volumes in the past and anticipate that we will be able to continue to make reasonable estimates in the future. If for some reason we were unable to reasonably estimate customer account or transaction volumes in the future, revenue would be deferred until actual customer data was received, and this could have a material impact on our consolidated results of operations.

We provide consulting, training, model development and software integration services under both hourly-based time and materials and fixed-priced contracts. Revenues from these services are generally recognized as the services are performed. For fixed-price service contracts, we apply the percentage-of-completion method of contract accounting to determine progress towards completion, which requires the use of estimates. In such instances, management is required to estimate the input measures, generally based on hours incurred to date compared to total estimated hours of the project, with consideration also given to output measures, such as contract milestones, when applicable. Adjustments to estimates are made in the period in which the facts requiring such revisions become known and, accordingly, recognized revenues and profits are subject to revisions as the contract progresses to completion. Estimated losses, if any, are recorded in the period in which current estimates of total contract revenue and contract costs indicate a loss. If substantive uncertainty related to customer acceptance of services exists, we apply the completed contract method of accounting and defer the associated revenue until the contract is completed. If we are unable to accurately estimate the input measures used for percentage-of-completion accounting, revenue would be deferred until the contract is complete, and this could have a material impact on our consolidated results of operations.

Revenue recognized under the percentage-of-completion method in excess of contract billings is recorded as an unbilled receivable. Such amounts are generally billable upon reaching certain performance milestones as defined by individual contracts. Billings collected in advance of performance and recognition of revenue under contracts are recorded as deferred revenue.

In certain of our non-software arrangements, we enter into contracts that include the delivery of a combination of two or more of our service offerings. Typically, such multiple element arrangements incorporate the design and development of data management tools or systems and an ongoing obligation to manage, host or otherwise run

solutions for our customer. Such arrangements are divided into separate units of accounting provided that the delivered item has stand-alone value and there is objective and reliable evidence of the fair value of the undelivered items. The total arrangement fee is allocated to the undelivered elements based on their fair values and to the initial delivered elements using the residual method. Revenue is recognized separately, and in accordance with our revenue recognition policy, for each element.

**Table of Contents**

As described above, sometimes our customer arrangements have multiple deliverables, including service elements. Generally, our multiple element arrangements fall within the scope of specific accounting standards that provide guidance regarding the separation of elements in multiple-deliverable arrangements and the allocation of consideration among those elements (e.g., American Institute of Certified Public Accountants Statement of Position ( SOP ) No. 97-2, *Software Revenue Recognition*, as amended). If not, we apply the separation provisions of Emerging Issues Task Force ( EITF ) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. The provisions of EITF Issue No. 00-21 require us to unbundle multiple element arrangements into separate units of accounting when the delivered element(s) has stand-alone value and fair value of the undelivered element(s) exists. When we are able to unbundle the arrangement into separate units of accounting, we apply one of the accounting policies described above to each unit. If we are unable to unbundle the arrangement into separate units of accounting, we apply one of the accounting policies described above to the entire arrangement. Sometimes this results in recognizing the entire arrangement fee when delivery of the last element in a multiple element arrangement occurs. For example, if the last undelivered element is a service, we recognize revenue for the entire arrangement fee as the service is performed, or if no pattern of performance is discernable, we recognize revenue on a straight-line basis over the term of the arrangement.

We record revenue on a net basis for those sales in which we have in substance acted as an agent or broker in the transaction.

***Allowance for Doubtful Accounts***

We make estimates regarding the collectibility of our accounts receivable. When we evaluate the adequacy of our allowance for doubtful accounts, we analyze specific accounts receivable balances, historical bad debts, customer creditworthiness, current economic trends and changes in our customer payment cycles. Material differences may result in the amount and timing of expense for any period if we were to make different judgments or utilize different estimates. If the financial condition of our customers deteriorates resulting in an impairment of their ability to make payments, additional allowances might be required. We have not experienced significant variances in the past between our estimated and actual doubtful accounts and anticipate that we will be able to continue to make reasonable estimates in the future. If for some reason we did not reasonably estimate the amount of our doubtful accounts in the future, it could have a material impact on our consolidated results of operations.

***Business Acquisitions; Valuation of Goodwill and Other Intangible Assets***

Our business acquisitions typically result in the recognition of goodwill and other intangible assets, and in certain cases non-recurring charges associated with the write-off of in-process research and development ( IPR&D ), which affect the amount of current and future period charges and amortization expense. Goodwill represents the excess of the purchase price over the fair value of net assets acquired, including identified intangible assets, in connection with our business combinations accounted for by the purchase method of accounting. We amortize our definite-lived intangible assets using the straight-line method or based on forecasted cash flows associated with the assets over the estimated useful lives, while IPR&D is recorded as a non-recurring charge on the acquisition date. Goodwill is not amortized, but rather is periodically assessed for impairment.

The determination of the value of these components of a business combination, as well as associated asset useful lives, requires management to make various estimates and assumptions. Critical estimates in valuing certain of the intangible assets include but are not limited to: future expected cash flows from product sales and services, maintenance agreements, consulting contracts, customer contracts, and acquired developed technologies and patents or trademarks; expected costs to develop the IPR&D into commercially viable products and estimating cash flows from the projects when completed; the acquired company's brand awareness and market position, as well as assumptions about the period of time the acquired products and services will continue to be used in our product portfolio; and discount rates. Management's estimates of fair value and useful lives are based upon assumptions

believed to be reasonable, but which are inherently uncertain and unpredictable. Unanticipated events and circumstances may occur and assumptions may change. Estimates using different assumptions could also produce significantly different results.

We continually review the events and circumstances related to our financial performance and economic environment for factors that would provide evidence of the impairment of our intangible assets. When impairment indicators are identified with respect to our previously recorded intangible assets, then we test for impairment using

**Table of Contents**

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

We test goodwill for impairment at the reporting unit level at least annually during the fourth quarter of each fiscal year and more frequently if impairment indicators are identified. We have determined that our reporting units are the same as our reportable segments. The first step of the goodwill impairment test is a comparison of the fair value of a reporting unit to its carrying value. We estimate the fair values of our reporting units using discounted cash flow valuation models and by comparing our reporting units to guideline publicly-traded companies. These methods require estimates of our future revenues, profits, capital expenditures, working capital, and other relevant factors, as well as selecting appropriate guideline publicly-traded companies for each reporting unit. We estimate these amounts by evaluating historical trends, current budgets, operating plans, industry data, and other relevant factors. The estimated fair value of each of our reporting units exceeded its respective carrying value in fiscal 2007, indicating the underlying goodwill of each reporting unit was not impaired as of our most recent testing date. Accordingly, we were not required to complete the second step of the goodwill impairment test. The timing and frequency of our goodwill impairment test is based on an ongoing assessment of events and circumstances that would more than likely reduce the fair value of a reporting unit below its carrying value. We will continue to monitor our goodwill balance and conduct formal tests on at least an annual basis or earlier when impairment indicators are present. There are various assumptions and estimates underlying the determination of an impairment loss, and estimates using different, but each reasonable, assumptions could produce significantly different results and materially affect the determination of fair value and/or goodwill impairment for each reporting unit. We believe that the assumptions and estimates utilized were appropriate based on the information available to management. The timing and recognition of impairment losses by us in the future, if any, may be highly dependent upon our estimates and assumptions.

***Share-Based Compensation***

Prior to October 1, 2005, we accounted for our share-based employee compensation plans under the measurement and recognition provisions of Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by Financial Accounting Standards Board ( FASB ) SFAS No. 123, *Accounting for Stock-Based Compensation*. We generally recorded no employee compensation expense for options granted prior to October 1, 2005 as options granted generally had exercise prices equal to the fair market value of our common stock on the date of grant. We also recorded no compensation expense in connection with our 1999 Employee Stock Purchase Plan as the purchase price of the stock was not less than 85% of the lower of the fair market value of our common stock at the beginning of each offering period or at the end of each offering period. In accordance with SFAS No. 123, we disclosed our net income and earnings per share as if we had applied the fair value-based method in measuring compensation expense for our share-based incentive awards.

Effective October 1, 2005, we adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, using the modified prospective transition method. Under that transition method, compensation expense that we recognize beginning on that date includes expense associated with the fair value of all awards granted on and after October 1, 2005, and expense for the unvested portion of previously granted awards outstanding on October 1, 2005. Results for prior periods have not been restated.

We estimate the fair value of options granted using the Black-Scholes option valuation model and the assumptions shown in Note 16 to the accompanying consolidated financial statements. We estimate the volatility of our common

stock at the date of grant based on a combination of the implied volatility of publicly traded options on our common stock and our historical volatility rate, consistent with SFAS No. 123(R) and Securities and Exchange Commission Staff Accounting Bulletin No. 107 ( SAB 107 ). Our decision to use implied volatility was based upon the availability of actively traded options on our common stock and our assessment that implied volatility is more representative of future stock price trends than historical volatility. We estimate expected term consistent with the



## **Table of Contents**

simplified method identified in SAB 107 for share-based awards. We elected to use the simplified method as we changed the contractual life for share-based awards from ten to seven years starting in fiscal 2006. The simplified method calculates the expected term as the average of the vesting and contractual terms of the award. Previously, we estimated expected term based on historical exercise patterns. The dividend yield assumption is based on historical dividend payouts. The risk-free interest rate assumption is based on observed interest rates appropriate for the term of our employee options. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For options granted, we amortize the fair value on a straight-line basis. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods. If factors change we may decide to use different assumptions under the Black-Scholes option valuation model in the future, which could materially affect our share-based compensation expense, net income and earnings per share.

## ***Income Taxes***

We use the asset and liability approach to account for income taxes. This methodology recognizes deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax base of assets and liabilities and operating loss and tax credit carryforwards. We then record a valuation allowance to reduce deferred tax assets to an amount that more likely than not will be realized. We consider future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, which requires the use of estimates. If we determine during any period that we could realize a larger net deferred tax asset than the recorded amount, we would adjust the deferred tax asset to increase income for the period or reduce goodwill if such deferred tax asset relates to an acquisition. Conversely, if we determine that we would be unable to realize a portion of our recorded deferred tax asset, we would adjust the deferred tax asset to record a charge to income for the period or increase goodwill if such deferred tax asset relates to an acquisition. Although we believe that our estimates are reasonable, there is no assurance that our the valuation allowance will not need to be increased to cover additional deferred tax assets that may not be realizable, and such an increase could have a material adverse impact on our income tax provision and results of operations in the period in which such determination is made. In addition, the calculation of tax liabilities also involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could also have a material impact on our income tax provision and results of operations in the period in which such determination is made.

## ***Contingencies and Litigation***

We are subject to various proceedings, lawsuits and claims relating to products and services, technology, labor, shareholder and other matters. We are required to assess the likelihood of any adverse outcomes and the potential range of probable losses in these matters. If the potential loss is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. If the potential loss is considered less than probable or the amount cannot be reasonably estimated, disclosure of the matter is considered. The amount of loss accrual or disclosure, if any, is determined after analysis of each matter, and is subject to adjustment if warranted by new developments or revised strategies. Due to uncertainties related to these matters, accruals or disclosures are based on the best information available at the time. Significant judgment is required in both the assessment of likelihood and in the determination of a range of potential losses. Revisions in the estimates of the potential liabilities could have a material impact on our consolidated financial position or consolidated results of operations.

## ***New Accounting Pronouncements Not Yet Adopted***

In July 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*, which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain

tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for the Company beginning October 1, 2007. We are in the process of determining what effect, if any, the adoption of FIN 48 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value.

**Table of Contents**

The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are in the process of determining what effect, if any, the adoption of SFAS No. 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets & Financial Liabilities Including an Amendment of SFAS No. 115* ( SFAS 159 ). SFAS 159 permits companies to choose to measure certain financial instruments and other items at fair value. The standard requires that unrealized gains and losses are reported in earnings for items measured using the fair value option. SFAS 159 will become effective for fiscal years beginning after November 15, 2007. We are in the process of determining what effect, if any, the adoption of SFAS 159 will have on our consolidated financial statements.

In August 2007, the FASB proposed FASB Staff Position ( FSP ) APB 14-a, *Accounting for Convertible Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. The proposed FSP would require the proceeds from the issuance of such convertible debt instruments to be allocated between debt (at a discount) and an equity component. The debt discount would be amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense. The proposed change in accounting treatment would be effective for fiscal years beginning after December 15, 2007, and applied retrospectively to prior periods. If adopted as proposed, this FSP would change the accounting treatment for our Senior Notes, which were issued in August 2003. The new accounting treatment would require us to retrospectively record a significant amount of non-cash interest as the discount on the debt is amortized. We are in the process of determining the effect the adoption of the proposed FSP will have on our consolidated financial statements.

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

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

**Interest Rate Risk**

We maintain an investment portfolio consisting mainly of income securities with an average maturity of three years or less. These available-for-sale securities are subject to interest rate risk and will fall in value if market interest rates increase. We have the ability to hold our fixed income investments until maturity, and therefore we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on our securities portfolio. The following table presents the principal amounts and related weighted-average yields for our investments with interest rate risk at September 30, 2007 and 2006:

	September 30, 2007			September 30, 2006		
	Cost Basis	Carrying Amount	Average Yield	Cost Basis	Carrying Amount	Average Yield
			(In thousands)			
Cash and cash equivalents	\$ 95,286	\$ 95,284	4.43%	\$ 75,178	\$ 75,154	2.85%
Short-term investments	125,293	125,327	5.21%	152,446	152,141	4.79%
Long-term investments	7,517	7,530	5.33%	33,306	33,254	5.10%
	\$ 228,096	\$ 228,141	4.89%	\$ 260,930	\$ 260,549	4.27%

We are the issuer of 1.5% Senior Convertible Notes ( Senior Notes ) that mature in August 2023. The fair value of our Senior Notes, including the New Notes issued in the exchange offer completed on March 31, 2005, as determined based on quoted market prices, may increase or decrease due to various factors, including fluctuations in the market price of our common stock, fluctuations in market interest rates and fluctuations in general economic conditions. See Management's Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources and Liquidity, above, for additional information on these notes. The following table presents the principal amounts, carrying amounts, and fair values for our Senior Notes at September 30, 2007 and 2006:

	September 30, 2007			September 30, 2006		
	Principal	Carrying Amount	Fair Value	Principal	Carrying Amount	Fair Value
Senior Notes	\$ 390,963	\$ 390,963	\$ 391,452	\$ 400,000	\$ 400,000	\$ 407,000

**Table of Contents**

We have interest rate risk with respect to our five-year \$600 million unsecured revolving credit facility. Interest rates are applied to amounts outstanding under this facility at variable rates based on Federal Funds rate plus 0.50% or LIBOR plus margins that range from 0.30% to 0.55% based on our consolidated leverage ratio. A change in interest rates on this variable rate debt impacts the interest incurred and cash flows, but does not impact the fair value of the instrument. As of September 30, 2007 we had \$170.0 million of borrowings outstanding on this facility and we had no borrowings outstanding as of September 30, 2006.

**Forward Foreign Currency Contracts**

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

The following table summarizes our outstanding forward foreign currency contracts, by currency at September 30, 2007:

	Contract Amount		Fair Value US\$
	Foreign Currency	US\$ (In thousands)	
Sell foreign currency:			
EURO (EUR)	EUR 6,800	\$ 9,659	\$
Japanese Yen (YEN)	YEN 110,000	957	
Buy foreign currency:			
British Pound (GBP)	GBP 1,034	2,100	

The forward foreign currency contracts were all entered into on September 30, 2007, therefore, the fair value was \$0 on that date.

**Table of Contents**

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

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Fair Isaac Corporation  
Minneapolis, Minnesota

We have audited the accompanying consolidated balance sheets of Fair Isaac Corporation and subsidiaries (the Company ) as of September 30, 2007 and 2006, and the related consolidated statements of income, stockholders' equity and comprehensive income and cash flows for each of the three years in the period ended September 30, 2007. We have also audited the Company's internal control over financial reporting as of September 30, 2007 based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



**Table of Contents**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of September 30, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2007, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As discussed in Note 16 to the consolidated financial statements, the Company changed its method of accounting for share-based payments to conform to Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, as of October 1, 2005.

Minneapolis, Minnesota  
November 28, 2007



**Table of Contents**

**FAIR ISAAC CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

	<b>September 30,</b> <b>2007                      2006</b> <b>(In thousands, except par value data)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 95,284	\$ 75,154
Marketable securities available for sale, current portion	125,327	152,141
Accounts receivable, net	177,402	165,806
Prepaid expenses and other current assets	24,738	17,998
Deferred income taxes		2,211
Total current assets	422,751	413,310
Marketable securities available for sale, less current portion	13,776	38,318
Other investments	12,374	2,161
Property and equipment, net	52,157	56,611
Goodwill	692,922	695,162
Intangible assets, net	62,923	90,900
Deferred income taxes	14,828	20,010
Other assets	4,040	4,733
	\$ 1,275,771	\$ 1,321,205
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 16,300	\$ 12,162
Senior convertible notes	390,963	400,000
Accrued compensation and employee benefits	44,202	34,936
Other accrued liabilities	31,887	41,647
Deferred revenue	42,572	48,284
Total current liabilities	525,924	537,029
Revolving line of credit	170,000	
Other liabilities	13,533	14,148
Total liabilities	709,457	551,177
Commitments and contingencies		
Stockholders' equity:		
Preferred stock (\$0.01 par value; 1,000 shares authorized; none issued and outstanding)	511	594

Edgar Filing: FAIR ISAAC CORP - Form 10-K

Common stock (\$0.01 par value; 200,000 shares authorized, 88,857 shares issued and 51,064 and 59,369 shares outstanding at September 30, 2007 and 2006, respectively)		
Paid-in-capital	1,097,327	1,073,886
Treasury stock, at cost (37,793 and 29,488 shares at September 30, 2007 and 2006, respectively)	(1,290,393)	(952,979)
Retained earnings	745,054	644,836
Accumulated other comprehensive income	13,815	3,691
Total stockholders' equity	566,314	770,028
	\$ 1,275,771	\$ 1,321,205

See accompanying notes to consolidated financial statements.

**Table of Contents**

**FAIR ISAAC CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**

	<b>Years Ended September 30,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands, except per share data)</b>		
Revenues	\$ 822,236	\$ 825,365	\$ 798,671
Operating expenses:			
Cost of revenues(1)	293,482	281,977	275,065
Research and development	70,599	84,967	81,295
Selling, general and administrative(1)	285,541	260,845	223,400
Amortization of intangible assets(1)	23,226	25,191	25,900
Restructuring and acquisition-related	2,455	19,662	
Gain on sale of product line assets	(1,541)		
Total operating expenses	673,762	672,642	605,660
Operating income	148,474	152,723	193,011
Interest income	13,527	15,248	8,402
Interest expense	(12,766)	(8,569)	(8,347)
Other income (expense), net	427	(210)	1,022
Income before income taxes	149,662	159,192	194,088
Provision for income taxes	45,012	55,706	59,540
Net income	\$ 104,650	\$ 103,486	\$ 134,548
Earnings per share:			
Basic	\$ 1.87	\$ 1.63	\$ 2.02
Diluted	\$ 1.82	\$ 1.59	\$ 1.86
Shares used in computing earnings per share:			
Basic	56,054	63,579	66,556
Diluted	57,548	65,125	73,584

(1) Cost of revenues and selling, general and administrative expenses exclude the amortization of intangible assets. See Note 7 to consolidated financial statements.

See accompanying notes to consolidated financial statements.



Table of Contents

## FAIR ISAAC CORPORATION

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**  
**Years Ended September 30, 2007, 2006 and 2005**

	Common Stock Shares	Par Value	Paid-In- Capital	Treasury Stock	Unearned Compensation (In thousands)	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity	Comprehensive Income
<b>at September 30,</b>	<b>69,579</b>	<b>\$ 697</b>	<b>\$ 1,054,437</b>	<b>\$ (551,977)</b>	<b>\$ (1,814)</b>	<b>\$ 417,218</b>	<b>\$ (2,090)</b>	<b>\$ 916,471</b>	
of stock options	3,299	33	(35,145)	98,300				63,188	
profit from exercised options			12,711					12,711	
reversal of unearned compensation					2,927			2,927	
acquired in acquisition			2,417		(394)			2,023	
expiration of restricted stock options	(13)		35	(291)	256				
issuance of common stock	(102)	(1)		(2,201)				(2,202)	
repurchases of common stock	(9,225)	(94)		(328,443)				(328,537)	
issuance of ESPP shares	298	3	(190)	8,866				8,679	
conversion of convertible notes			1,000					1,000	
offer premium expense paid						(5,316)		(5,316)	
reversal of unearned compensation			2,259		(2,259)				
net income						134,548		134,548	\$ 134,548
net losses on derivatives, net of tax of							(172)	(172)	
foreign currency translation adjustments, net of tax of							(226)	(226)	
<b>at September 30,</b>	<b>63,836</b>	<b>638</b>	<b>1,037,524</b>	<b>(775,746)</b>	<b>(1,284)</b>	<b>546,450</b>	<b>(2,488)</b>	<b>805,094</b>	<b>\$ 805,094</b>
unvested compensation			42,085					42,085	
of stock options	2,104	21	(10,993)	65,888				54,916	
			10,571					10,571	

Profit from exercised options			(1,284)		1,284			
Amortization due to the effect of Section 123(R) on shares of restricted stock	(22)		51	(51)				
Expenses of common stock	(6,971)	(69)		(256,418)				(256,487)
Gain from ESPP shares								
Expenses of restricted stock	300	3	(185)	9,466				9,284
Expenses of restricted stock	122	1	(3,883)	3,882				
Expenses of restricted stock						(5,100)		(5,100)
Expenses of restricted stock						103,486		103,486
Expenses of restricted stock								
Expenses of restricted stock							368	368
Expenses of restricted stock								
Expenses of restricted stock							5,811	5,811
<b>At September 30,</b>	<b>59,369</b>	<b>594</b>	<b>1,073,886</b>	<b>(952,979)</b>		<b>644,836</b>	<b>3,691</b>	<b>770,028</b>
Expenses of restricted stock			36,261					36,261
Expenses of restricted stock	3,137	31	(29,262)	104,357				75,126
Expenses of restricted stock			16,684					16,684
Expenses of restricted stock	(23)		732	(732)				
Expenses of common stock	(11,716)	(117)		(450,971)				(451,088)
Expenses of ESPP shares								
Expenses of restricted stock	277	3	(328)	9,286				8,961
Expenses of restricted stock	20		(646)	646				
Expenses of restricted stock						(4,432)		(4,432)
Expenses of restricted stock						104,650		104,650
Expenses of restricted stock								
Expenses of restricted stock							261	261
Expenses of restricted stock								
Expenses of restricted stock							9,863	9,863
<b>At September 30,</b>	<b>51,064</b>	<b>\$ 511</b>	<b>\$ 1,097,327</b>	<b>\$ (1,290,393)</b>		<b>\$ 745,054</b>	<b>\$ 13,815</b>	<b>\$ 566,314</b>

See accompanying notes to consolidated financial statements.



**Table of Contents****FAIR ISAAC CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Years Ended September 30,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>		
<b>Cash flows from operating activities:</b>			
Net income	\$ 104,650	\$ 103,486	\$ 134,548
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	50,224	48,805	51,517
Share-based compensation	36,261	42,085	2,927
Deferred income taxes	3,800	1,125	13,279
Tax benefit from exercised stock options	16,684	10,571	12,711
Excess tax benefits from share-based payment arrangements	(12,623)	(7,094)	
Net amortization (accretion) of premium (discount) on marketable securities	(1,098)	(110)	420
Provision for doubtful accounts	4,972	2,200	3,691
Gain on sale of product line assets	(1,541)		
Net loss on sales of property and equipment	693	70	71
Changes in operating assets and liabilities, net of acquisition and disposition effects:			
Accounts receivable	(15,837)	(9,686)	(7,527)
Prepaid expenses and other assets	(3,400)	4,489	(2,485)
Accounts payable	1,584	126	(1,773)
Accrued compensation and employee benefits	8,864	3,326	(2,395)
Other liabilities	(9,492)	7,686	(8,665)
Deferred revenue	(4,578)	(8,037)	17,763
Net cash provided by operating activities	179,163	199,042	214,082
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment	(22,735)	(31,409)	(16,414)
Cash proceeds from sales of property and equipment	566		
Cash proceeds from sales of product line assets	15,758	500	750
Cash paid for acquisitions, net of cash acquired			(41,312)
Cash proceeds from disposition of London Bridge Phoenix Software, Inc.			22,672
Purchases of marketable securities	(180,951)	(176,251)	(241,273)
Proceeds from sales of marketable securities	14,250	53,390	118,472
Proceeds from maturities of marketable securities	220,763	136,743	154,804
Investment in cost-method investees	(10,213)		(600)
Net cash provided by (used in) investing activities	37,438	(17,027)	(2,901)
<b>Cash flows from financing activities:</b>			



Edgar Filing: FAIR ISAAC CORP - Form 10-K

Proceeds from revolving line of credit	170,000		
Payments for repurchases of senior convertible notes	(9,037)		
Debt issuance costs	(858)		
Proceeds from issuances of common stock under employee stock option and purchase plans	84,087	64,200	71,867
Dividends paid	(4,432)	(5,100)	(5,316)
Repurchases of common stock	(451,088)	(256,487)	(328,537)
Excess tax benefits from share-based payment arrangements	12,623	7,094	
Net cash used in financing activities	(198,705)	(190,293)	(261,986)
<b>Effect of exchange rate changes on cash</b>	2,234	552	(385)
Increase (decrease) in cash and cash equivalents	20,130	(7,726)	(51,190)
Cash and cash equivalents, beginning of year	75,154	82,880	134,070
Cash and cash equivalents, end of year	\$ 95,284	\$ 75,154	\$ 82,880
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid for income taxes, net of refunds of \$30, \$2,378 and \$2,951 during the years ended September 30, 2007, 2006 and 2005, respectively	\$ 38,127	\$ 37,586	\$ 23,932
Cash paid for interest	\$ 9,580	\$ 6,000	\$ 6,000

See accompanying notes to consolidated financial statements.

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Years Ended September 30, 2007, 2006 and 2005**

**1. Nature of Business and Summary of Significant Accounting Policies**

***Fair Isaac Corporation***

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

In these consolidated financial statements, Fair Isaac Corporation is referred to as we, us, our, and Fair Isaac.

***Principles of Consolidation and Basis of Presentation***

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

***Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. These estimates and assumptions include, but are not limited to, assessing the following: the recoverability of accounts receivable, goodwill and other intangible assets, software development costs and deferred tax assets; the ability to estimate hours in connection with fixed-fee service contracts, the ability to estimate transactional-based revenues for which actual transaction volumes have not yet been received, and the determination of whether fees are fixed or determinable and collection is probable or reasonably assured.

***Cash and Cash Equivalents***

Cash and cash equivalents consist of cash in banks and investments with a maturity of 90 days or less at time of purchase.

***Fair Value of Financial Instruments***

The fair value of certain of our financial instruments, including cash and cash equivalents, receivables, and other current assets, accounts payable, accrued compensation and employee benefits, other accrued liabilities and amounts outstanding under our revolving line of credit, approximate their carrying amounts because of the short-term maturity of these instruments. The fair values of our cash and cash equivalents, marketable security investments are disclosed in Note 4. The fair value of our cost-method investments approximate their recorded value. The fair value of our senior convertible notes is disclosed in Note 9.

***Investments***

Management determines the appropriate classification of our investments in marketable debt and equity securities at the time of purchase, and re-evaluates this designation at each balance sheet date. While it is our intent to hold debt securities to maturity, our investments in U.S. government obligations and marketable equity and debt securities that have readily determinable fair values are classified as available-for-sale, as the sale of such securities may be required prior to maturity to implement management strategies. Therefore, such securities are carried at fair value with unrealized gains or losses related to these securities included in comprehensive income (loss). Realized

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

gains and losses are included in other income (expense), net. The cost of investments sold is based on the specific identification method. Losses resulting from other than temporary declines in fair value are charged to operations. Investments with remaining maturities over one year are classified as long-term investments.

Our investments in equity securities of companies over which we do not have significant influence are accounted for under the cost method. Investments in which we own 20% to 50% and exercise significant influence over operating and financial policies are accounted for using the equity method. Under the equity method, the investment is originally recorded at cost and adjusted to recognize our share of net earnings or losses of the investee, limited to the extent of our investment in, advances to, and financial guarantees for the investee. Under the cost method, the investment is originally recorded at cost and adjusted for additional contributions or distributions. Management periodically reviews equity-method and cost-method investments for instances where fair value is less than the carrying amount and the decline in value is determined to be other than temporary. If the decline in value is judged to be other than temporary, the carrying amount of the security is written down to fair value and the resulting loss is charged to operations.

***Concentration of Risk***

Financial instruments that potentially expose us to concentrations of risk consist primarily of cash and cash equivalents, marketable securities and accounts receivable, which are generally not collateralized. Our policy is to place our cash, cash equivalents, and marketable securities with high credit quality financial institutions, commercial corporations and government agencies in order to limit the amount of credit exposure. We have established guidelines relative to diversification and maturities for maintaining safety and liquidity. We generally do not require collateral from our customers, but our credit extension and collection policies include analyzing the financial condition of potential customers, establishing credit limits, monitoring payments, and aggressively pursuing delinquent accounts. We maintain allowances for potential credit losses.

***Property and Equipment***

Property and equipment are recorded at cost less accumulated depreciation and amortization. Major renewals and improvements are capitalized, while repair and maintenance costs are expensed as incurred. Depreciation and amortization charges are calculated using the straight-line method over the following estimated useful lives:

	<b>Estimated Useful Life</b>
Data processing equipment and software	2 to 3 years
Office furniture, vehicles and equipment	3 to 7 years
Leasehold improvements	Shorter of estimated useful life or lease term

The cost and accumulated depreciation for property and equipment sold, retired or otherwise disposed of are removed from the accounts and resulting gains or losses are recorded in operations. Depreciation and amortization on property and equipment totaled \$27.0 million, \$23.6 million and \$24.3 million during fiscal 2007, 2006 and 2005, respectively.

*Internal-use Software*

Costs incurred to develop internal-use software during the application development stage are capitalized and reported at cost, subject to an impairment test as described below. Application development stage costs generally include costs associated with internal-use software configuration, coding, installation and testing. Costs of significant upgrades and enhancements that result in additional functionality are also capitalized whereas costs incurred for maintenance and minor upgrades and enhancements are expensed as incurred. Capitalized costs are amortized using the straight-line method over two to three years.

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended September 30, 2007, 2006 and 2005 (Continued)**

We assess potential impairment of capitalized internal-use software whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted net cash flows that are expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. We capitalized \$0.2 million, \$0.8 million and \$1.1 million in fiscal 2007, 2006 and 2005, respectively. Amortization expense related to internal-use software was \$2.0 million, \$2.5 million and \$3.0 million in fiscal 2007, 2006 and 2005, respectively.

***Capitalized Software Development Costs***

All costs incurred prior to the resolution of unproven functionality and features, including new technologies, are expensed as research and development. After the uncertainties have been tested and the development issues have been resolved and technological feasibility is achieved, subsequent direct costs such as coding, debugging and testing are capitalized. Capitalized software development costs are amortized using the greater of the amount computed using (a) the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product or (b) the straight-line method over the remaining estimated economic life of the product. Capitalized software development costs were \$0, net of accumulated amortization of \$3.4 million as of September 30, 2007 and 2006, and are included in other long-term assets in the accompanying consolidated balance sheets. Amortization expense related to capitalized software development costs totaled \$0, \$0 and \$1.3 million during fiscal 2007, 2006 and 2005, respectively.

At each balance sheet date, we compare a product's unamortized capitalized cost to the product's estimated net realizable value. To the extent unamortized capitalized costs exceed net realizable value based on the product's estimated future gross revenues, reduced by the estimated future costs of completing and disposing of the product, the excess is written off. This analysis requires us to estimate future gross revenues associated with certain products, and the future costs of completing and disposing of certain products. If these estimates change, reductions or write-offs of capitalized software development costs could result. No write-offs were recorded during fiscal 2007, 2006 or 2005.

***Goodwill and Intangible Assets***

Goodwill and intangible assets with indefinite lives are tested for impairment at least annually or more frequently if impairment indicators arise. Goodwill represents the excess of the purchase price over the fair value of net assets acquired, including identified intangible assets, in connection with our business combinations accounted for by the purchase method of accounting (see Note 2).

We amortize our intangible assets, which result from our acquisitions accounted for under the purchase method of accounting, using the straight-line method or based on the forecasted cash flows associated with the assets over the following estimated useful lives:

**Estimated Useful Life**

Completed technology	5 to 6 years
Customer contracts and relationships	2 to 15 years
Trade names	5 years
Other	3 years

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

***Revenue Recognition***

Software license fee revenue is recognized when persuasive evidence of an arrangement exists, delivery of the product has occurred at our customer's location, the fee is fixed or determinable and collection is probable. We use the residual method to recognize revenue when an arrangement includes one or more elements to be delivered at a future date and vendor-specific objective evidence (VSOE) of the fair value of all undelivered elements exists. VSOE of fair value is based on the normal pricing practices for those products and services when sold separately by us and customer renewal rates for post-contract customer support services. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. If evidence of the fair value of one or more undelivered elements does not exist, the revenue is deferred and recognized when delivery of those elements occurs or when fair value can be established. The determination of whether fees are fixed or determinable and collection is probable involves the use of assumptions. We evaluate contract terms and customer information to ensure that these criteria are met prior to our recognition of license fee revenue.

When software licenses are sold together with implementation or consulting services, license fees are recognized upon delivery provided that the above criteria are met, payment of the license fees is not dependent upon the performance of the services, and the services do not provide significant customization or modification of the software products and are not essential to the functionality of the software that was delivered. For arrangements with services that are essential to the functionality of the software, the license and related service revenues are recognized using contract accounting as described below.

If at the outset of an arrangement we determine that the arrangement fee is not fixed or determinable, revenue is deferred until the arrangement fee becomes due assuming all other revenue recognition criteria have been met. If at the outset of an arrangement we determine that collectibility is not probable, revenue is deferred until the earlier of when collectibility becomes probable or the receipt of payment. If there is uncertainty to the customer's acceptance of our deliverables, revenue is not recognized until the earlier of receipt of customer acceptance, expiration of the acceptance period, or where we can demonstrate we meet the acceptance criteria.

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

Revenues recognized from our credit scoring, data processing, data management and internet delivery services are recognized as these services are performed, provided persuasive evidence of an arrangement exists, fees are fixed or determinable, and collection is reasonably assured. The determination of certain of our credit scoring and data processing revenues requires the use of estimates, principally related to transaction volumes in instances where these volumes are reported to us by our clients on a monthly or quarterly basis in arrears. In these instances, we estimate transaction volumes based on preliminary customer transaction information, if available, or based on average actual reported volumes for an immediate trailing period. Differences between our estimates and actual final volumes reported are recorded in the period in which actual volumes are reported.



Transactional or unit-based license fees under software license arrangements, network service and internally-hosted software agreements are recognized as revenue based on system usage or when fees based on system usage exceed monthly minimum license fees, provided persuasive evidence of an arrangement exists, fees are fixed or determinable and collection is probable. The determination of certain of our transactional or unit-based license fee revenues requires the use of estimates, principally related to transaction usage or active account volumes in instances where this information is reported to us by our clients on a monthly or quarterly basis in arrears. In these instances, we estimate transaction volumes based on preliminary customer transaction information, if available, or based on average actual reported volumes for an immediate trailing period. Differences between our estimates and actual final volumes reported are recorded in the period in which actual volumes are reported.

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

We provide consulting, training, model development and software integration services under both hourly-based time and materials and fixed-priced contracts. Revenues from these services are generally recognized as the services are performed. For fixed-price service contracts, we apply the percentage-of-completion method of contract accounting to determine progress towards completion, which requires the use of estimates. In such instances, management is required to estimate the input measures, generally based on hours incurred to date compared to total estimated hours of the project, with consideration also given to output measures, such as contract milestones, when applicable. Adjustments to estimates are made in the period in which the facts requiring such revisions become known and, accordingly, recognized revenues and profits are subject to revisions as the contract progresses to completion. Estimated losses, if any, are recorded in the period in which current estimates of total contract revenue and contract costs indicate a loss. If substantive uncertainty related to customer acceptance of services exists, we apply the completed contract method of accounting and defer the associated revenue until the contract is completed.

Revenue recognized under the percentage-of-completion method in excess of contract billings is recorded as an unbilled receivable. Such amounts are generally billable upon reaching certain performance milestones as defined by individual contracts. Billings collected in advance of performance and recognition of revenue under contracts are recorded as deferred revenue.

In certain of our non-software arrangements, we enter into contracts that include the delivery of a combination of two or more of our service offerings. Typically, such multiple element arrangements incorporate the design and development of data management tools or systems and an ongoing obligation to manage, host or otherwise run solutions for our customer. Such arrangements are divided into separate units of accounting provided that the delivered item has stand-alone value and there is objective and reliable evidence of the fair value of the undelivered items. The total arrangement fee is allocated to the undelivered elements based on their fair values and to the initial delivered elements using the residual method. Revenue is recognized separately, and in accordance with our revenue recognition policy, for each element.

As described above, sometimes our customer arrangements have multiple deliverables, including service elements. Generally, our multiple element arrangements fall within the scope of specific accounting standards that provide guidance regarding the separation of elements in multiple-deliverable arrangements and the allocation of consideration among those elements (e.g., American Institute of Certified Public Accountants Statement of Position ( SOP ) No. 97-2, *Software Revenue Recognition*, as amended). If not, we apply the separation provisions of Emerging Issues Task Force ( EITF ) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. The provisions of EITF Issue No. 00-21 require us to unbundle multiple element arrangements into separate units of accounting when the delivered element(s) has stand-alone value and fair value of the undelivered element(s) exists. When we are able to unbundle the arrangement into separate units of accounting, we apply one of the accounting policies described above to each unit. If we are unable to unbundle the arrangement into separate units of accounting, we apply one of the accounting policies described above to the entire arrangement. Sometimes this results in recognizing the entire arrangement fee when delivery of the last element in a multiple element arrangement occurs. For example, if the last undelivered element is a service, we recognize revenue for the entire arrangement fee as the service is performed, or if no pattern of performance is discernable, we recognize revenue on a straight-line basis over the term of the arrangement.

We record revenue on a net basis for those sales in which we have in substance acted as an agent or broker in the transaction.

*Allowance for Doubtful Accounts*

We make estimates regarding the collectibility of our accounts receivable. When we evaluate the adequacy of our allowance for doubtful accounts, we analyze specific accounts receivable balances, historical bad debts, customer creditworthiness, current economic trends and changes in our customer payment cycles. Material

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended September 30, 2007, 2006 and 2005 (Continued)**

differences may result in the amount and timing of expense for any period if we were to make different judgments or utilize different estimates. If the financial condition of our customers deteriorates resulting in an impairment of their ability to make payments, additional allowances might be required.

***Income Taxes***

Income taxes are recognized during the year in which transactions enter into the determination of financial statement income, with deferred taxes being provided for temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. A deferred income tax asset or liability is computed for the expected future impact of differences between the financial reporting and tax bases of assets and liabilities as well as the expected future tax benefit to be derived from tax loss and tax credit carryforwards. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount more likely than not to be realized in future tax returns. Tax rate changes are reflected in income during the period the changes are enacted.

***Earnings per Share***

Diluted earnings per share are based on the weighted-average number of common shares outstanding and potential common shares. Potential common shares result from the assumed exercise of outstanding stock options or other potentially dilutive equity instruments, including our outstanding senior convertible notes, when they are dilutive under the treasury stock method or the if-converted method. Basic earnings per share are computed on the basis of the weighted-average number of common shares outstanding.

***Comprehensive Income***

Comprehensive income is the change in our equity (net assets) during each period from transactions and other events and circumstances from non-owner sources. It includes net income, foreign currency translation adjustments and unrealized gains and losses, net of tax, on our investments in marketable securities.

***Foreign Currency***

We have determined that the functional currency of each foreign operation is the local currency. Assets and liabilities denominated in their local foreign currencies are translated into U.S. dollars at the exchange rate on the balance sheet date. Revenues and expenses are translated at average rates of exchange prevailing during the period. Translation adjustments are accumulated as a separate component of stockholders' equity.

From time to time, we utilize forward contract instruments to manage market risks associated with fluctuations in certain foreign currency exchange rates as they relate to specific balances of accounts receivable and cash denominated in foreign currencies. It is our policy to use derivative financial instruments to protect against market risks arising in the normal course of business. Our policies prohibit the use of derivative instruments for the sole purpose of trading for profit on price fluctuations or to enter into contracts that intentionally increase our underlying exposure. All of our forward foreign currency contracts have maturity periods of less than three months.

At the end of the reporting period, foreign currency denominated receivable and cash balances are remeasured into the functional currency of the reporting entities at current market rates. The change in value from this remeasurement is reported as a foreign exchange gain or loss for that period in other income (expense) in the accompanying consolidated statements of income. The resulting gains or losses from the forward foreign currency contracts described above, which are also included in other income (expense), mitigate the exchange rate risk of the associated assets.

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

***Share-Based Compensation***

Prior to October 1, 2005, we accounted for our share-based employee compensation plans under the measurement and recognition provisions of Accounting Principles Board Opinion ( APB ) No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by Financial Accounting Standards Board Statement of Financial Accounting Standards ( SFAS ) No. 123, *Accounting for Stock-Based Compensation*. We generally recorded no employee compensation expense for options granted prior to October 1, 2005 as options granted generally had exercise prices equal to the fair market value of our common stock on the date of grant. We also recorded no compensation expense in connection with our 1999 Employee Stock Purchase Plan ( Purchase Plan ) as the purchase price of the stock was not less than 85% of the lower of the fair market value of our common stock at the beginning of each offering period or at the end of each offering period. In accordance with SFAS No. 123, we disclosed our net income and earnings per share as if we had applied the fair value-based method in measuring compensation expense for our share-based incentive awards.

Effective October 1, 2005, we adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, using the modified prospective transition method. Under that transition method, compensation expense that we recognize beginning on that date includes expense associated with the fair value of all awards granted on and after October 1, 2005, and expense for the unvested portion of previously granted awards outstanding on October 1, 2005. Results for prior periods have not been restated. See Note 16 for further discussion of the impact of the adoption of SFAS No. 123(R).

***Impairment of Long-lived Assets***

We assess potential impairment to long-lived assets and certain identifiable intangible assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted net cash flows that are expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. We determined that our long-lived intangible assets were not impaired at September 30, 2007, 2006 or 2005. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

***Advertising and Promotion Costs***

Advertising and promotion costs are expensed as incurred. Advertising and promotion costs totaled \$1.2 million, \$4.3 million and \$5.3 million in fiscal 2007, 2006 and 2005, respectively, and are included in selling, general and administrative expenses in the accompanying consolidated statements of income.

***New Accounting Pronouncements Not Yet Adopted***

In July 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*, which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions.

The accounting provisions of FIN 48 will be effective for the Company beginning October 1, 2007. We are in the process of determining what effect, if any, the adoption of FIN 48 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

in the process of determining what effect, if any, the adoption of SFAS No. 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets & Financial Liabilities Including an Amendment of SFAS No. 115* ( SFAS 159 ). SFAS 159 permits companies to choose to measure certain financial instruments and other items at fair value. The standard requires that unrealized gains and losses are reported in earnings for items measured using the fair value option. SFAS 159 will become effective for fiscal years beginning after November 15, 2007. We are in the process of determining what effect, if any, the adoption of SFAS 159 will have on our consolidated financial statements.

In August 2007, the FASB proposed FASB Staff Position ( FSP ) APB 14-a, *Accounting for Convertible Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. The proposed FSP would require the proceeds from the issuance of such convertible debt instruments to be allocated between debt (at a discount) and an equity component. The debt discount would be amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense. The proposed change in accounting treatment would be effective for fiscal years beginning after December 15, 2007, and applied retrospectively to prior periods. If adopted as proposed, this FSP would change the accounting treatment for our Senior Notes, which were issued in August 2003. The new accounting treatment would require us to retrospectively record a significant amount of non-cash interest as the discount on the debt is amortized. We are in the process of determining the effect the adoption of the proposed FSP will have on our consolidated financial statements.

**2. Acquisitions**

***RulesPower, Inc.***

On September 23, 2005, we acquired certain assets of RulesPower, Inc. ( RulesPower ), a leading provider of analytics and decision management technology, in exchange for cash consideration of \$6.5 million. The purpose of this acquisition was to acquire RulesPower's high-performance business rules management systems. These systems utilize proprietary execution engines that help users manage large amounts of data by executing rules faster and more efficiently. We intend to integrate this technology into Blaze Advisor system's existing performance optimization capabilities, rules repository, developer tools, templates for business user rules management and other Fair Isaac products in which the Blaze Advisor system is embedded. We accounted for this transaction using the purchase method of accounting. Our allocation of the purchase price included \$5.3 million for goodwill and \$1.2 million for intangible assets, consisting of core technology. The acquired intangible assets have an estimated useful life of five years and are being amortized over this period using the straight-line method. The goodwill was allocated entirely to our Analytical Software Tools operating segment and will be deductible for tax purposes.

***Braun Consulting, Inc.***

On November 10, 2004, we acquired all of the issued and outstanding stock of Braun Consulting, Inc. ( Braun ), a marketing strategy and technology consulting firm, in exchange for cash consideration of \$37.1 million and contingent cash consideration of \$3.3 million payable to a former Braun shareholder if certain revenue parameters are achieved during either the fiscal year ended September 30, 2005, the two fiscal years ended September 30, 2006, or the three



fiscal years ended September 30, 2007. These revenue parameters were not achieved and, accordingly, no contingent cash consideration was paid. The acquisition of Braun was consummated principally to complement our marketing solutions and services related to marketing strategy and customer management technologies, as well as to expand our capabilities in markets targeted for growth, including healthcare, retail and pharmaceuticals. Braun is included in the Professional Services operating segment. The results of operations of Braun have been included in our results prospectively from November 10, 2004.

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

The total purchase price, excluding contingent consideration, is summarized as follows (in thousands):

Total cash consideration	\$ 37,093
Acquisition-related costs	615
Fair value of options to purchase Fair Isaac common stock, less \$0.4 million representing the portion of the intrinsic value of unvested options allocated to unearned compensation	2,023
Total purchase price	\$ 39,731

In connection with the acquisition, we issued 182,000 options to purchase Fair Isaac common stock in exchange for outstanding Braun options. The table above reflects the total fair value of these options based on application of the Black-Scholes option pricing model, less the portion of the intrinsic value related to unvested options, which was allocated to unearned compensation.

Our allocation of the purchase price was as follows (in thousands):

**Assets:**

Cash, cash equivalents and marketable securities available for sale	\$ 9,643
Receivables, net	7,196
Prepaid expenses and other current assets	645
Deferred income taxes, current portion	1,907
Property and equipment	3,405
Goodwill	9,374
Intangible assets:	
Customer contracts and relationships	3,580
Deferred income taxes, less current portion	15,326
Other assets	56
Total assets	51,132

**Liabilities:**

Current liabilities	7,781
Non-current liabilities	3,620
Total liabilities	11,401
<b>Net assets</b>	<b>\$ 39,731</b>

The acquired customer contracts and relationships, which include backlog, have a weighted average useful life of approximately 4.5 years and are being amortized over their estimated useful lives using the straight-line method. The goodwill was allocated to our Professional Services operating segment, and will not be deductible for tax purposes.

### **3. Sales of Product Line Assets**

In March 2007, we sold the assets and products associated with our mortgage banking solutions product line for \$15.8 million in cash. The assets sold include accounts receivable, certain identifiable intangible assets and goodwill. We recognized a \$1.5 million pre-tax gain, but a \$0.4 million after-tax loss on the sale due to goodwill associated with the mortgage banking solutions product line that was not deductible for income tax purposes. We acquired the mortgage banking solutions through our May 2004 acquisition of London Bridge Software Holdings

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

plc ( London Bridge ). The product line sold includes software and e-commerce services used in the origination processing, underwriting, pricing, product definition, closing, secondary marketing, servicing, and default management of mortgage and construction loans, and BridgeLink™ e-Services for the mortgage industry. Revenues attributable to the mortgage banking solutions product line for the years ended September 30, 2007, 2006 and 2005 were \$7.7 million, \$19.9 million and \$20.5 million, respectively.

In November 2004, we sold all of the issued and outstanding stock of London Bridge Phoenix Software, Inc. ( Phoenix ) to Harland Financial Solutions, Inc. ( Harland ). In connection with this disposition, we sold all of the Phoenix related assets, including all Phoenix bank processing solutions, the associated customer base, intellectual property rights and other related assets to Harland in exchange for cash consideration of \$22.7 million and the assumption of substantially all Phoenix liabilities by Harland. Phoenix was an indirectly wholly-owned subsidiary that we acquired in connection with our acquisition of London Bridge in May 2004. As this disposition occurred shortly after the London Bridge acquisition and the fair value of Phoenix did not change significantly from the date of the London Bridge acquisition, no gain or loss was recorded in connection with this transaction. The excess of the consideration received over the book value of the net assets sold in this disposition, amounting to \$15.1 million, was recorded as a decrease to goodwill in the Strategy Machines Solutions segment.

**4. Cash, Cash Equivalents and Marketable Securities Available for Sale**

The following is a summary of cash, cash equivalents and marketable securities available for sale at September 30, 2007 and 2006:

	2007				2006			
	Amortized Cost	Gross Gains	Gross Losses	Fair Value	Amortized Cost	Gross Gains	Gross Losses	Fair Value
<b>Cash and Cash Equivalents:</b>								
Cash	\$ 50,260	\$	\$	\$ 50,260	\$ 33,944	\$	\$	\$ 33,944
Money market funds	40,029			40,029	17,045			17,045
Commercial paper	4,997		(2)	4,995	24,189		(24)	24,165
	\$ 95,286	\$	\$ (2)	\$ 95,284	\$ 75,178	\$	\$ (24)	\$ 75,154
<b>Short-term Marketable Securities:</b>								
U.S. government obligations	\$ 93,054	\$ 32	\$ (5)	\$ 93,081	\$ 105,512	\$ 6	\$ (211)	\$ 105,307

Edgar Filing: FAIR ISAAC CORP - Form 10-K

Corporate debt	32,239	15	(8)	32,246	32,684		(100)	32,584
Other debt securities					14,250			14,250
	\$ 125,293	\$ 47	\$ (13)	\$ 125,327	\$ 152,446	\$ 6	\$ (311)	\$ 152,141

**Long-term  
Marketable  
Securities:**

U.S. government obligations	\$ 5,999	\$ 13	\$	\$ 6,012	\$ 25,490	\$ 23	\$ (49)	\$ 25,464
Corporate debt	1,517			1,517	7,817	6	(32)	7,791
Marketable equity securities	5,581	666		6,247	4,894	169		5,063
	\$ 13,097	\$ 679	\$	\$ 13,776	\$ 38,201	\$ 198	\$ (81)	\$ 38,318

Table of Contents

## FAIR ISAAC CORPORATION

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended September 30, 2007, 2006 and 2005 (Continued)**

Short-term marketable securities mature at various dates over the course of the next twelve months. Our long-term U.S. government obligations and corporate debt investments mature at various dates over the next one to three years. During fiscal 2007, 2006 and 2005, we recognized no realized gains or losses on investments.

The long-term marketable equity securities represent securities held under a supplemental retirement and savings plan for certain officers and senior management employees, which are distributed upon termination or retirement of the employees.

The following table shows the gross unrealized losses and fair value of our investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2007 and 2006:

Description of Securities	Less Than 12 Months		2007 12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Commercial paper	\$ 4,995	\$ (2)	\$	\$	\$ 4,995	\$ (2)
U.S. government obligations			5,494	(5)	5,494	(5)
Corporate debt	1,982	(3)	3,488	(5)	5,470	(8)
	\$ 6,977	\$ (5)	\$ 8,982	\$ (10)	\$ 15,959	\$ (15)

Description of Securities	Less Than 12 Months		2006 12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Commercial paper	\$ 24,165	\$ (24)	\$	\$	\$ 24,165	\$ (24)
U.S. government obligations	49,678	(45)	34,678	(215)	84,356	(260)
Corporate debt	20,944	(32)	15,625	(100)	36,569	(132)
	\$ 94,787	\$ (101)	\$ 50,303	\$ (315)	\$ 145,090	\$ (416)

**5. Receivables**

Receivables at September 30, 2007 and 2006 consisted of the following:

	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
Billed	\$ 127,965	\$ 118,144
Unbilled	57,506	53,668
	185,471	171,812
Less allowance for doubtful accounts	(8,069)	(6,006)
Receivables, net	\$ 177,402	\$ 165,806

Unbilled receivables represent revenue recorded in excess of amounts billable pursuant to contract provisions and generally become billable at contractually specified dates or upon the attainment of milestones. Unbilled amounts are expected to be realized within one year. During fiscal 2007, 2006 and 2005, we increased our allowance

Table of Contents**FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

for the provision for doubtful accounts by \$5.0 million, \$2.2 million and \$3.7 million, respectively, recorded an allowance for doubtful accounts on acquired receivables of \$0, \$0 and \$0.5 million, respectively, and wrote off receivables (net of recoveries) of \$2.9 million, \$3.4 million and \$5.7 million, respectively. In addition, we recorded a \$5.9 million decrease in the allowance in fiscal 2005 from the completion of the purchase price allocation for the London Bridge acquisition, the disposition of Phoenix and currency translation.

**6. Other Investments**

In May 2007, we made a \$10 million investment in convertible preferred stock in a private company. The company is developing a range of products focused on revenue cycle activities for hospitals and other healthcare providers. Our interest is accounted for using the cost-method.

**7. Goodwill and Intangible Assets**

Goodwill and intangible assets with indefinite lives are tested for impairment at least annually or more frequently if impairment indicators arise. Our other intangible assets have definite lives and are being amortized using the straight-line method or based on the forecasted cash flows associated with the assets over their estimated useful lives.

As prescribed by SFAS No. 142, *Goodwill and Other Intangible Assets*, we have determined that our reporting units are the same as our reportable segments (see Note 17). We selected the fourth quarter to perform our annual goodwill impairment test, and determined that goodwill was not impaired as of July 1, 2007 and 2006.

Intangible assets that are subject to amortization consisted of the following at September 30, 2007 and 2006:

	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
Completed technology	\$ 74,720	\$ 79,980
Customer contracts and relationships	80,194	85,346
Trade names	8,600	8,600
Foreign currency translation adjustments	4,023	1,458
	167,537	175,384
Less accumulated amortization	(104,614)	(84,484)
	\$ 62,923	\$ 90,900

Amortization expense associated with our intangible assets, which has been reflected as a separate operating expense caption within the accompanying consolidated statements of income, consisted of the following during fiscal 2007, 2006 and 2005:



	<b>2007</b>	<b>2006</b>	<b>2005</b>
		<b>(In thousands)</b>	
Cost of revenues	\$ 13,388	\$ 14,928	\$ 14,815
Selling, general and administrative expenses	9,838	10,263	11,085
	\$ 23,226	\$ 25,191	\$ 25,900

In the table above, cost of revenues reflects our amortization of completed technology, and selling, general and administrative expenses reflect our amortization of other intangible assets.

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended September 30, 2007, 2006 and 2005 (Continued)**

Estimated future intangible asset amortization expense associated with intangible assets existing at September 30, 2007, was as follows (in thousands):

**Fiscal Year**

2008	\$ 13,916
2009	12,737
2010	10,431
2011	5,621
2012	5,602
Thereafter	14,616
	<b>\$ 62,923</b>

The following table summarizes changes to goodwill during fiscal 2007 and 2006, both in total and as allocated to our operating segments.

	<b>Strategy Machine Solutions</b>	<b>Scoring Solutions</b>	<b>Professional Services</b>	<b>Analytic Software Tools</b>	<b>Total</b>
	<b>(In thousands)</b>				
<b>Balance at September 30, 2005</b>	\$ 537,116	\$ 88,254	\$ 12,451	\$ 50,862	\$ 688,683
Purchase accounting adjustments	60			20	80
Foreign currency translation adjustments	5,373			1,026	6,399
<b>Balance at September 30, 2006</b>	542,549	88,254	12,451	51,908	695,162
Purchase accounting adjustments	(4,895)	(140)	494	(851)	(5,392)
Disposition of mortgage product line assets	(7,221)				(7,221)
Foreign currency translation adjustments	8,709			1,664	10,373
<b>Balance at September 30, 2007</b>	\$ 539,142	\$ 88,114	\$ 12,945	\$ 52,721	\$ 692,922

During fiscal 2007, we reduced goodwill related to the London Bridge and HNC Software Inc. acquisition due to the realization of certain deferred tax benefits that had valuation allowances recorded on them and other adjustments to deferred income taxes on acquired entities.



Table of Contents

## FAIR ISAAC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**8. Composition of Certain Financial Statement Captions**

	September 30,	
	2007	2006
	(In thousands)	
<b>Property and equipment:</b>		
Data processing equipment and software	\$ 139,906	\$ 123,692
Office furniture, vehicles and equipment	23,672	28,324
Leasehold improvements	31,667	29,330
Less accumulated depreciation and amortization	(143,088)	(124,735)
	\$ 52,157	\$ 56,611
<b>Other accrued liabilities:</b>		
Income taxes payable	\$	\$ 18,498
Other	31,887	23,149
	\$ 31,887	\$ 41,647

**9. Convertible Notes**

In August 2003, we issued \$400.0 million of Senior Notes that mature on August 15, 2023. The Senior Notes become convertible into shares of Fair Isaac common stock, subject to the conditions described below, at an initial conversion price of \$43.9525 per share, subject to adjustments for certain events. The initial conversion price is equivalent to a conversion rate of approximately 22.7518 shares of Fair Isaac common stock per \$1,000 principal amount of the Senior Notes. Holders may surrender their Senior Notes for conversion, if any of the following conditions is satisfied: (i) prior to August 15, 2021, during any fiscal quarter, if the closing price of our common stock for at least 20 trading days in the 30 consecutive trading day period ending on the last day of the immediately preceding fiscal quarter is more than 120% of the conversion price per share of our common stock on the corresponding trading day; (ii) at any time after the closing sale price of our common stock on any date after August 15, 2021 is more than 120% of the then current conversion price; (iii) during the five consecutive business day period following any 10 consecutive trading day period in which the average trading price of a Senior Note was less than 98% of the average sale price of our common stock during such 10 trading day period multiplied by the applicable conversion rate; provided, however, if, on the day before the conversion date, the closing price of our common stock is greater than 100% of the conversion price but less than or equal to 120% of the conversion price, then holders converting their notes may receive, in lieu of our common stock based on the applicable conversion rate, at our option, cash or common stock with a value equal to 100% of the principal amount of the notes on the conversion date; (iv) if we have called the Senior Notes for redemption; or (v) if we make certain distributions to holders of our common stock or we enter into specified corporate transactions. The conversion price of the Senior Notes will be adjusted upon the occurrence of certain dilutive events as described in the indenture, which include but are not limited to: (i) dividends, distributions,

subdivisions, or combinations of our common stock; (ii) issuance of rights or warrants for the purchase of our common stock under certain circumstances; (iii) the distribution to all or substantially all holders of our common stock of shares of our capital stock, evidences of indebtedness, or other non-cash assets, or rights or warrants; (iv) the cash dividend or distribution to all or substantially all holders of our common stock in excess of certain levels; and (v) certain tender offer activities by us or any of our subsidiaries.

The Senior Notes are senior unsecured obligations of Fair Isaac and rank equal in right of payment with all of our unsecured and unsubordinated indebtedness. The Senior Notes are effectively subordinated to all of our existing and future secured indebtedness and existing and future indebtedness and other liabilities of our subsidiaries. The Senior Notes bear regular interest at an annual rate of 1.5%, payable on August 15 and February 15 of each year

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

until August 15, 2008. Beginning August 15, 2008, regular interest will accrue at the rate of 1.5%, and be due and payable upon the earlier to occur of redemption, repurchase, or final maturity. In addition, the Senior Notes bear contingent interest during any six-month period from August 15 to February 14 and from February 15 to August 14, commencing with the six-month period beginning August 15, 2008, if the average trading price of the Senior Notes for the five trading day period immediately preceding the first day of the applicable six-month period equals 120% or more of the sum of the principal amount of, plus accrued and unpaid regular interest on, the Senior Notes. The amount of contingent interest payable on the Senior Notes in respect of any six-month period will equal 0.25% per annum of the average trading price of the Senior Notes for the five trading day period immediately preceding such six-month period.

We may redeem for cash all or part of the Senior Notes on and after August 15, 2008, at a price equal to 100% of the principal amount of the Senior Notes, plus accrued and unpaid interest. Holders may require us to repurchase for cash all or part of the remaining Senior Notes outstanding on August 15, 2008, August 15, 2013 and August 15, 2018, or upon a change in control, at a price equal to 100% of the principal amount of the Senior Notes being repurchased, plus accrued and unpaid interest.

On March 31, 2005, we completed an exchange offer for the Senior Notes, whereby holders of approximately 99.9% of the total principal amount of our Senior Notes exchanged their existing securities for new 1.5% Senior Convertible Notes, Series B ( New Notes ). The terms of the New Notes are similar to the terms of the Senior Notes described above, except that: (i) upon conversion, we will pay holders cash in an amount equal to the lesser of the principal amount of such notes and the conversion value of such notes, and to the extent such conversion value exceeds the principal amount of the notes, the remainder of the conversion obligation in cash or common shares or combination thereof; (ii) in the event of a change of control, we may be required in certain circumstances to pay a make-whole premium on the New Notes converted in connection with the change of control and (iii) if the conversion condition in the first clause (iii) in the third paragraph preceding this paragraph is triggered and the closing price of our common stock is greater than 100% of the conversion price but less than or equal to 120% of the conversion price, the holders converting New Notes shall receive cash with a value equal to 100% of the principal amount of New Notes on the conversion date.

The first date noteholders could require us to repurchase the Senior Notes was August 15, 2007. As a result, certain noteholders exercised their repurchase option and we repurchased \$9.0 million of the Senior Notes. As of September 30, 2007, \$391.0 million of the Senior Notes remain outstanding and are classified as short-term debt in our consolidated balance sheet, because noteholders may require us to repurchase for cash all or part of the Senior Notes on August 15, 2008.

The fair value of the Senior Notes at September 30, 2007 and 2006, as determined based upon quoted market prices, was \$391.5 million and \$407.0 million, respectively.

**10. Credit Agreement**

In October 2006, we entered into a five-year unsecured revolving credit facility with a syndicate of banks. In July 2007, we entered into an amended and restated credit agreement that increased the revolving credit facility from \$300 million to \$600 million. Proceeds from the credit facility can be used for working capital and general corporate

purposes and may also be used for the refinancing of existing debt, acquisitions, and the repurchase of the Company's common stock. Interest on amounts borrowed under the credit facility is based on (i) a base rate, which is the greater of (a) the prime rate and (b) the Federal Funds rate plus 0.50% or (ii) LIBOR plus an applicable margin. The margin on LIBOR borrowings ranges from 0.30% to 0.55% and is determined based on our consolidated leverage ratio. In addition, we must pay utilization fees if borrowings and commitments under the credit facility exceed 50% of the total credit facility commitment, as well as facility fees. The credit facility contains certain restrictive covenants, including maintenance of consolidated leverage and fixed charge coverage ratios. The

Table of Contents**FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

credit facility also contains covenants typical of unsecured facilities. As of September 30, 2007, we had \$170.0 million of borrowings outstanding under the credit facility at an average interest rate of 5.9%.

**11. Restructuring and Acquisition-Related Expenses**

During fiscal 2007, we vacated excess lease space located in California and Maryland and recorded a lease exit accrual of \$1.2 million, representing future cash lease obligations net of estimated sublease income, and a \$0.2 million write off of fixed assets abandoned as a part of this action. We also recorded a \$1.0 million charge for severance costs associated with the elimination of certain management positions. Cash payments for the majority of these severance costs will be paid in fiscal 2008.

During fiscal 2006, we vacated excess lease space primarily located in California and recorded a lease exit accrual of \$13.0 million, representing future cash lease obligations, net of estimated sublease income. In connection with a restructuring initiative, we incurred charges of \$5.1 million for severance costs associated with a reduction of 190 employees primarily in product management, delivery and development functions. Cash payments for the majority of these severance costs were paid in fiscal 2006. We also recorded a \$0.2 million gain in fiscal 2006 due to the adjustment of liabilities established for the exit of certain leased spaces.

During fiscal 2006, we also recorded a \$0.5 million gain from past rent paid that was refunded to us from the landlord and we wrote off deferred acquisition costs totaling \$2.2 million in connection with abandoned acquisitions, consisting principally of third-party legal, accounting and other professional fees. These amounts are recorded in restructuring and acquisition-related expenses in the accompanying consolidated statements of income, but are not included in the tables below as they do not relate to future cash payments.

During fiscal 2005, in connection with our acquisition of Braun, we recorded a \$4.5 million lease exit accrual and we also completed a plan to reduce Braun staff and accordingly recorded a \$1.3 million employee separation accrual. These amounts were recorded to goodwill in connection with our allocation of the Braun purchase price. During fiscal 2005, we incurred an additional \$1.2 million of lease exit costs related to our London Bridge acquisition. These amounts were recorded to goodwill in connection with our allocation of the Braun and London Bridge purchase prices.

The following table summarizes our restructuring and acquisition-related accruals associated with the above actions. The current portion and non-current portion was recorded in other accrued current liabilities and other long-term liabilities within the accompanying consolidated balance sheets.

	<b>Accrual at September 30, 2004</b>	<b>Goodwill Additions</b>	<b>Cash Payments</b>	<b>Accrual at September 30, 2005</b>
	<b>(In thousands)</b>			
Facilities charges	\$ 6,439	\$ 5,734	\$ (5,812)	\$ 6,361
Employee separation	1,171	1,308	(2,479)	



Edgar Filing: FAIR ISAAC CORP - Form 10-K

	7,610	\$	7,042	\$	(8,291)	6,361
Less: current portion	(3,994)					(3,721)
Non-current	\$	3,616			\$	2,640

Table of Contents

## FAIR ISAAC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)

	Accrual at September 30, 2005	Expense Additions	Cash Payments (In thousands)	Expense Reversals	Accrual at September 30, 2006
Facilities charges	\$ 6,361	\$ 13,014	\$ (4,117)	\$ (164)	\$ 15,094
Employee separation		5,138	(5,048)		90
	6,361	\$ 18,152	\$ (9,165)	\$ (164)	15,184
Less: current portion	(3,721)				(6,161)
Non-current	\$ 2,640				\$ 9,023

	Accrual at September 30, 2006	Expense Additions	Cash Payments (In thousands)	Accrual at September 30, 2007
Facilities charges	\$ 15,094	\$ 1,206	\$ (6,006)	\$ 10,294
Employee separation	90	1,012	(90)	1,012
	15,184	\$ 2,218	\$ (6,096)	11,306
Less: current portion	(6,161)			(4,051)
Non-current	\$ 9,023			\$ 7,255

**12. Income Taxes**

The provision for income taxes was as follows during fiscal 2007, 2006 and 2005:

	2007	2006	2005
	(In thousands)		
<b>Current:</b>			
Federal	\$ 32,762	\$ 44,832	\$ 40,213
State	4,183	8,346	5,771

Edgar Filing: FAIR ISAAC CORP - Form 10-K

Foreign	4,267	1,403	277
	41,212	54,581	46,261
<b>Deferred:</b>			
Federal	4,423	2,336	13,396
State	(623)	(1,211)	(117)
	3,800	1,125	13,279
<b>Total provision</b>	\$ 45,012	\$ 55,706	\$ 59,540

The foreign provision was based on foreign pretax earnings (loss) of \$2.7 million, \$3.8 million and \$(9.8) million in fiscal 2007, 2006 and 2005, respectively. Current foreign tax expense related to foreign tax withholding was \$2.3 million, \$4.1 million and \$2.3 million in fiscal year 2007, 2006 and 2005, respectively.

During fiscal 2007, 2006 and 2005, we realized certain tax benefits related to nonqualified and incentive stock options in the amounts of \$16.7 million, \$10.6 million and \$12.7 million, respectively, that were credited directly to paid-in-capital.

Table of Contents

## FAIR ISAAC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)

Deferred tax assets and liabilities at September 30, 2007 and 2006 were as follows:

	2007	2006
	(In thousands)	
<b>Deferred tax assets:</b>		
Net operating loss carryforwards	\$ 26,000	\$ 34,987
Research credit carryforwards	14,039	15,928
Capital loss carryforward	7,358	11,280
Investments	789	2,483
Accrued compensation	4,161	3,088
Share-based compensation	23,686	14,914
Deferred revenue	1,280	3,896
Accrued lease costs	5,000	5,756
Property and equipment	3,872	
Capitalized research and development	4,133	7,957
Other	10,182	9,871
	100,500	110,160
Less valuation allowance	(23,983)	(26,927)
	76,517	83,233
<b>Deferred tax liabilities:</b>		
Intangible assets	(23,579)	(28,576)
Convertible notes	(23,904)	(18,710)
Property and equipment		(1,920)
Prepaid expense	(4,132)	(10,597)
Other	(13,062)	(7,311)
	(64,677)	(67,114)
Deferred tax assets, net	\$ 11,840	\$ 16,119

Based upon the level of historical taxable income and projections for future taxable income over the periods that the deferred tax assets will reverse, management believes it is more likely than not that we will realize the benefits of the deferred tax asset, net of the existing valuation allowance at September 30, 2007.

For fiscal 2007, the decrease in the valuation allowance was primarily due to a partial utilization of the U.S. Capital Loss carryforward. The remaining valuation allowance is associated with foreign operations and acquired federal and state research and development credits and remaining capital loss carryforwards for which realization also remains

uncertain.

For fiscal 2007, the change in the balance of the NOL carryforward was due to utilization. We acquired NOL and research credit carryforwards in connection with our acquisitions of Braun, London Bridge, and HNC in fiscal 2005, 2004 and 2002, respectively. As of September 30, 2007, we had available U.S. federal, state and foreign NOL carryforwards of approximately \$49.8 million, \$14.4 million and \$32.3 million, respectively. We also have available U.S. federal and state research credit carryforwards of approximately \$8.9 million and \$7.8 million, respectively. The U.S. federal NOL carryforwards will expire at various dates beginning in fiscal 2010 through fiscal 2024, if not utilized. The state NOL carryforwards will begin to expire in fiscal 2008 through fiscal 2024, if not utilized. The U.S. federal research credit carryforwards will begin to expire in fiscal 2008 through 2022, if not

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

utilized. Utilization of the U.S. federal and state NOL and research credit carryforwards are subject to an annual limitation due to the change in ownership provisions of the Internal Revenue Code of 1986 (the Code), as amended, and similar state provisions. In addition, certain limitations apply to our ability to utilize the foreign NOL carryforwards.

We are currently under examination by the IRS for tax returns filed for fiscal 2002 through 2006 and by the California Franchise Tax Board for fiscal 2003 through 2005. Although the final outcome of these examination remains unknown, we have reserved for potential adjustments that may result from the examinations and believe the final resolution will not have a material effect on our results of operations. We assess the adequacy of these reserves in each reporting period based on then-current information. Adjustments to the reserves are recognized in our income tax provision in the period in which such determination is made.

The reconciliation between the U.S. federal statutory income tax rate of 35% and our effective tax rate is shown below for fiscal 2007, 2006 and 2005:

	2007	2006	2005
	(In thousands)		
Income tax provision at U.S. federal statutory rates	\$ 52,381	\$ 55,717	\$ 67,931
State income taxes, net of U.S. federal benefit	2,839	4,638	2,964
Foreign taxes	(1,944)	(1,472)	(2,804)
Extraterritorial income exclusion	(491)	(4,600)	(11,505)
Research credits	(7,454)	(183)	(2,217)
Manufacturing deduction	(944)	(1,058)	
Valuation allowance for foreign losses		138	3,253
Other	625	2,526	1,918
Recorded income tax provision	\$ 45,012	\$ 55,706	\$ 59,540

The decrease in our effective tax rate in fiscal 2007 compared with fiscal 2006 was due to the recognition in fiscal 2007 of \$8.2 million of tax benefits. The tax benefits included favorable settlements of the fiscal 1998 through 2001 U.S. federal examinations and the fiscal 1999 through 2002 California Franchise Tax Board examinations. Our effective tax rate, however, was adversely impacted by the sale of our mortgage banking solutions product line, due to \$3.3 million of goodwill associated with the product line that was not deductible for income tax purposes. These items reduced our effective tax rate in fiscal 2007 by 5.4%. In addition to the tax benefits, our effective tax rate in fiscal 2007 was also affected by the repeal of the Extraterritorial Income Exclusion, which was effective December 31, 2006.

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)****13. Earnings Per Share**

The following reconciles the numerators and denominators of basic and diluted earnings per share ( EPS ) during fiscal 2007, 2006 and 2005:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands, except per share data)</b>		
Numerator for basic earnings per share net income	\$ 104,650	\$ 103,486	\$ 134,548
Interest expense on Senior Notes, net of tax	4	4	2,508
Numerator for diluted earnings per share	\$ 104,654	\$ 103,490	\$ 137,056
Denominator shares:			
Basic weighted-average shares	56,054	63,579	66,556
Effect of dilutive securities	1,494	1,546	7,028
Diluted weighted-average shares	57,548	65,125	73,584
Earnings per share:			
Basic	\$ 1.87	\$ 1.63	\$ 2.02
Diluted	\$ 1.82	\$ 1.59	\$ 1.86

The computation of diluted EPS for fiscal 2007, 2006 and 2005 excludes options to purchase approximately 3,660,000, 3,194,000 and 3,211,000 shares of common stock, respectively, because the options exercise prices exceeded the average market price of our common stock in these fiscal years and their inclusion would be antidilutive. On October 13, 2004, the FASB ratified the consensus reached by the EITF with respect to Issue No. 04-8, *The Effect of Contingently Convertible Instruments on Diluted Earnings Per Share*. This consensus requires us to consider all instruments with contingent conversion features that are based on the market price of our own stock in our diluted earnings per share calculation, regardless of whether the market price conversion triggers are then met. The computation for diluted EPS for fiscal 2005 includes approximately 4,529,000 shares of common stock issuable upon conversion of our Senior Notes. Effective with the completed exchange offer on March 31, 2005, the dilutive effect of the New Notes are calculated using the treasury stock method.

**14. Stockholders Equity*****Common Stock***

From time to time, we repurchase our common stock in the open market pursuant to programs approved by our Board of Directors. During fiscal 2007, 2006 and 2005, we expended \$451.1 million, \$256.5 million and \$328.5 million,

respectively, in connection with our repurchase of common stock under such programs. See Note 21 regarding a new stock repurchase program approved subsequent to September 30, 2007.

We paid quarterly dividends on common stock of two cents per share, or eight cents per year, during each of fiscal 2007, 2006 and 2005.

***Stockholder Rights Plan***

We maintain a stockholder rights plan pursuant to which one right to purchase preferred stock was distributed for each outstanding share of common stock held of record on August 21, 2001. Since this distribution, all newly issued shares of common stock have been accompanied by a preferred stock purchase right. In general, the rights will become exercisable and trade independently from the common stock if a person or group acquires or obtains the right to acquire 15 percent or more of the outstanding shares of common stock or commences a tender or exchange



**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

offer that would result in that person or group acquiring 15 percent or more of the outstanding shares of common stock, either event occurring without the consent of the Board of Directors. Each right represents a right to purchase Series A Participating Preferred Stock in an amount and at an exercise price that are subject to adjustment. The person or group who acquired 15 percent or more of the outstanding shares of common stock would not be entitled to make this purchase. The rights will expire in August 2011, or they may be redeemed by the Company at a price of \$0.001 per right prior to that date.

**15. Employee Benefit Plans**

***Defined Contribution Plans***

We sponsor a Fair Isaac 401(k) plan for eligible employees. Under this plan, eligible employees may contribute up to 25% of compensation, not to exceed statutory limits. We also provide a company matching contribution. Investment in Fair Isaac common stock is not an option under this plan. Our contributions into all 401(k) plans, including former acquired company sponsored plans that have since merged into the Fair Isaac 401(k) plan or have been frozen, totaled \$7.5 million, \$7.4 million and \$6.8 million during fiscal 2007, 2006 and 2005, respectively.

***Employee Incentive Plans***

We maintain various employee incentive plans for the benefit of eligible employees, including officers. The awards generally are based on the achievement of certain financial and performance objectives subject to the discretion of management. Total expenses under our employee incentive plans were \$12.8 million, \$8.6 million and \$6.9 million during fiscal 2007, 2006 and 2005, respectively.

**16. Stock-Based Employee Benefit Plans**

***Description of Stock Option and Share Plans***

We maintain the 1992 Long-term Incentive Plan (the 1992 Plan ) under which we may grant stock options, stock appreciation rights, restricted stock, restricted stock units and common stock to officers, key employees and non-employee directors. Under the 1992 Plan, a number of shares equal to 4% of the number of shares of Fair Isaac common stock outstanding on the last day of the preceding fiscal year is added to the shares available under this plan each fiscal year, provided that the number of shares for grants of incentive stock options for the remaining term of this plan shall not exceed 5,062,500 shares. As of September 30, 2007, 2,665,941 shares remained available for grants under this plan. The 1992 Plan will terminate in February 2012. In November 2003, our Board of Directors approved the adoption of the 2003 Employment Inducement Award Plan (the 2003 Plan ). The 2003 Plan reserves 2,250,000 shares of common stock solely for the granting of inducement stock options and other awards, as defined, that meet the employment inducement award exception to the New York Stock Exchange's listing standards requiring shareholder approval of equity-based inducement incentive plans. Except for the employment inducement award criteria, awards under the 2003 Plan will be generally consistent with those made under our 1992 Plan. As of September 30, 2007, 1,563,116 shares remained available for grants under this plan. The 2003 Plan shall remain in effect until terminated by the Board of Directors. We also maintain individual stock option plans for certain of our executive officers and the chairman of the board. There are no shares available for future grants under these plans.

Stock option awards granted during fiscal 2007 typically had a maximum term of seven years and vested ratably over four years. Stock option awards granted prior to October 1, 2005, typically had a maximum term of ten years and vested ratably over four years.

We assumed all outstanding stock options held by former employees and non-employee directors of HNC, who as of our acquisition date, held unexpired and unexercised stock option grants under the various HNC stock option plans. As of September 30, 2007, 1,324,864 shares remained available for future grant under these option plans.

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

***Description of Employee Stock Purchase Plan***

Under our Purchase Plan, we are authorized to issue up to 5,062,500 shares of common stock to eligible employees. Employees may have up to 10% of their base salary withheld through payroll deductions to purchase Fair Isaac common stock during semi-annual offering periods. The purchase price of the stock is the lower of 85% of (i) the fair market value of the common stock on the enrollment date (the first day of the offering period), or (ii) the fair market value on the exercise date (the last day of each offering period). Offering period means approximately six-month periods commencing (a) on the first trading day on or after January 1 and terminating on the last trading day in the following June, and (b) on the first trading day on or after July 1 and terminating on the last trading day in the following December.

A total of approximately 276,000, 300,000 and 298,000 shares of our common stock with a weighted average purchase price of \$32.33, \$30.88 and \$29.12 per share were issued under the Purchase Plan during fiscal 2007, 2006 and 2005, respectively. At September 30, 2007, 3,283,000 shares remained available for issuance.

***Description of Employee Stock Ownership Plan***

We maintain a Non-U.S. Employee Stock Ownership Plan ( Non-U.S. ESOP ) that covers eligible employees working in the United Kingdom and contributions into the Non-U.S. ESOP are determined annually by our Board of Directors. There were no contributions into this plan during fiscal 2007, 2006 and 2005.

***Impact of SFAS No. 123(R)***

At the beginning of 2006, we adopted SFAS No. 123(R), as described in Note 1. In accordance with SFAS No. 123(R), we recorded \$36.3 million and \$42.1 million of share-based compensation expense for stock options, restricted stock units, non-vested shares and purchases under the Purchase Plan in fiscal 2007 and 2006, respectively. In comparison, we recorded share-based compensation of \$2.9 million during fiscal 2005. The total tax benefit related to this share-based compensation expense was \$13.4 million, \$15.4 million and \$1.1 million in fiscal 2007, 2006 and 2005, respectively. As of September 30, 2007, there was \$57.6 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under all equity compensation plans. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures. We expect to recognize that cost over a weighted average period of 1.5 years.

SFAS No. 123(R) also requires companies to calculate an initial pool of excess tax benefits available at the adoption date to absorb any tax deficiencies that may be recognized under SFAS No. 123(R). The pool includes the net excess tax benefits that would have been recognized if we had adopted SFAS No. 123 for recognition purposes on its effective date. We have elected to calculate the pool of excess tax benefits under the alternative transition method described in FASB Staff Position 123(R)-3, *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards*, which also specifies the method we must use to calculate excess tax benefits reported on the statement of cash flows.

Prior to the adoption of SFAS No. 123(R), we presented all tax benefits for deductions resulting from the exercise of stock options as operating cash flows within our consolidated statements of cash flows. SFAS No. 123(R) requires the

cash flows resulting from the tax benefits for tax deductions in excess of the compensation expense recorded for those options (excess tax benefits) to be classified as financing cash flows. Accordingly, the \$12.6 million and \$7.1 million of excess tax benefits that are classified as financing cash inflows in the accompanying consolidated statements of cash flows in fiscal 2007 and 2006, respectively, were classified as operating cash inflows prior to the adoption of SFAS No. 123(R).

Table of Contents**FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)*****Determining Fair Value***

We estimate the fair value of options granted using the Black-Scholes option valuation model. We estimate the volatility of our common stock at the date of grant based on a combination of the implied volatility of publicly traded options on our common stock and our historical volatility rate, consistent with SFAS No. 123(R) and Securities and Exchange Commission Staff Accounting Bulletin No. 107 ( SAB 107 ). Our decision to use implied volatility was based upon the availability of actively traded options on our common stock and our assessment that implied volatility is more representative of future stock price trends than historical volatility. We estimate expected term consistent with the simplified method identified in SAB 107 for share-based awards granted during the fiscal year ended September 30, 2007. We elected to use the simplified method as we changed the contractual life for share-based awards from ten to seven years starting in fiscal 2006. The simplified method calculates the expected term as the average of the vesting and contractual terms of the award. Previously, we estimated expected term based on historical exercise patterns. The dividend yield assumption is based on historical dividend payouts. The risk-free interest rate assumption is based on observed interest rates appropriate for the term of our employee options. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For options granted, we amortize the fair value on a straight-line basis over the vesting period of the options.

We used the following assumptions to estimate the fair value of share-based payment awards during fiscal 2007, 2006 and 2005:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
<b>Stock Options:</b>			
Average expected term (years)	4.79	4.75	4.00
Expected volatility (range)	28 31%	28 30%	39 52%
Weighted average volatility	29%	29%	50%
Risk-free interest rate (range)	3.9 5.0%	4.2 5.2%	3.2 4.0%
Expected dividend yield	0.2%	0.2%	0.2%
	<b>2007</b>	<b>2006</b>	<b>2005</b>
<b>Employee Stock Purchase Plan:</b>			
Average expected term (years)	0.5	0.5	0.5
Expected volatility (range)	21 23%	22 23%	18 46%
Weighted average volatility	23%	23%	31%
Risk-free interest rate (range)	4.9 5.3%	4.4 5.3%	2.5 3.2%
Expected dividend yield	0.2%	0.2%	0.2%

Table of Contents

## FAIR ISAAC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)*Stock-Based Activity*

The following table summarizes option activity during fiscal 2007:

	Shares (In thousands)	Weighted- average Exercise Price	Weighted- average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at October 1, 2006	13,785	\$ 32.25		
Granted	1,469	39.99		
Exercised	(3,137)	23.95		
Forfeited	(1,502)	40.49		
Outstanding at September 30, 2007	10,615	34.61	5.23	\$ 41,156
Options exercisable at September 30, 2007	5,945	31.70	4.67	\$ 35,184

The weighted average fair value of options granted during fiscal 2007, 2006 and 2005 were \$13.23, \$13.79 and \$13.61, respectively. The aggregate intrinsic value of options outstanding at September 30, 2007 was calculated as the difference between the exercise price of the underlying options and the market price of our common stock for the 6.3 million shares that had exercise prices that were lower than the \$36.11 market price of our common stock at September 30, 2007. The total intrinsic value of options exercised during fiscal 2007, 2006 and 2005 was \$49.6 million, \$35.8 million and \$55.8 million, respectively, determined as of the date of exercise.

The following table summarizes non-vested share activity during fiscal 2007:

	Shares (In thousands)	Weighted- average Price
Outstanding at October 1, 2006	122	\$ 35.56
Granted	20	41.37
Released	(28)	35.56
Forfeited	(23)	35.61

Outstanding at September 30, 2007	91	\$	36.84
-----------------------------------	----	----	-------

The following table summarizes restricted stock unit activity during fiscal 2007:

	<b>Shares (In thousands)</b>		<b>Weighted- average Price</b>
Outstanding at October 1, 2006		\$	
Granted	509		40.07
Released			
Forfeited	(41)		41.74
Outstanding at September 30, 2007	468	\$	39.92

We received \$84.1 million in cash from option exercises and issuances of stock under the Purchase Plan in fiscal 2007. The actual tax benefit that we realized for the tax deductions from option exercises of the share-based payment arrangements totaled \$19.8 million for that period.

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

Due primarily to our ongoing program of repurchasing shares on the open market, we had approximately 37.8 million treasury shares at September 30, 2007. We satisfy stock option exercises and Purchase Plan issuances from this pool of treasury shares.

***Comparable Disclosures***

The following table illustrates the effect on our net income and earnings per share for fiscal 2005 as if we had applied the fair value recognition provisions of SFAS No. 123 to share-based compensation using the Black-Scholes valuation model.

		<b>Fiscal 2005 (In thousands, except per share data)</b>
Net income, as reported	\$	134,548
Add: Share-based employee compensation expense included in reported net income, net of tax		1,815
Deduct: Share-based employee compensation expense determined under fair value based method for all awards, net of tax		(28,131)
Proforma net income including share-based compensation	\$	108,232
Earnings per share, as reported:		
Basic	\$	2.02
Diluted	\$	1.86
Proforma earnings per share including share-based compensation:		
Basic	\$	1.63
Diluted	\$	1.51

**17. Segment Information**

We are organized into the following four reportable segments, to align with the internal management of our worldwide business operations based on product and service offerings:

*Strategy Machine™ Solutions.* These are pre-configured EDM applications designed for a specific type of business problem or process, such as marketing, account origination, customer management, fraud and medical bill review. This segment also includes our myFICO solutions for consumers.



*Scoring Solutions.* Our scoring solutions give our clients access to analytics that can be easily integrated into their transaction streams and decision-making processes. Our scoring solutions are distributed through major credit reporting agencies, as well as services through which we provide our scores to lenders directly.

*Professional Services.* Through our professional services, we tailor our EDM products to our clients environments, and we design more effective decisioning environments for our clients. This segment includes revenues from custom engagements, business solution and technical consulting services, systems integration services, and data management services.

*Analytic Software Tools.* This segment is composed of software tools that clients can use to create their own custom EDM applications.

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

Our Chief Executive Officer evaluates segment financial performance based on segment revenues and operating income. Segment operating expenses consist of direct and indirect costs principally related to personnel, facilities, consulting, travel, depreciation and amortization. Indirect costs are allocated to the segments generally based on relative segment revenues, fixed rates established by management based upon estimated expense contribution levels and other assumptions that management considers reasonable. We do not allocate share-based compensation expense, restructuring and acquisition-related expense and certain other income and expense measures to our segments. These income and expense items are not allocated because they are not considered in evaluating the segment's operating performance. Our Chief Executive Officer does not evaluate the financial performance of each segment based on its respective assets or capital expenditures; rather, depreciation and amortization amounts are allocated to the segments from their internal cost centers as described above.

During the fourth quarter of fiscal 2007, we changed responsibility for our medical bill review services, resulting in this service being reflected as a part of our Professional Services segment. These services were previously reflected in our Strategy Machines Solutions segment. Prior period amounts have been restated to reflect this change.

The following tables summarize segment information for fiscal 2007, 2006 and 2005:

	<b>2007</b>				
	<b>Strategy Machine Solutions</b>	<b>Scoring Solutions</b>	<b>Professional Services (In thousands)</b>	<b>Analytic Software Tools</b>	<b>Total</b>
Revenues	\$ 439,273	\$ 180,444	\$ 151,086	\$ 51,433	\$ 822,236
Operating expenses	(377,068)	(65,127)	(144,030)	(50,362)	(636,587)
Segment operating income	\$ 62,205	\$ 115,317	\$ 7,056	\$ 1,071	185,649
Unallocated share-based compensation expense					(36,261)
Unallocated restructuring and acquisition-related expense					(2,455)
Unallocated gain on sale of product line assets					1,541
Operating income					148,474
Unallocated interest income					13,527
Unallocated interest expense					(12,766)
Unallocated other income, net					427
Income before income taxes					\$ 149,662

Depreciation and amortization	\$	31,655	\$	8,301	\$	7,039	\$	3,229	\$	50,224
-------------------------------	----	--------	----	-------	----	-------	----	-------	----	--------

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended September 30, 2007, 2006 and 2005 (Continued)**

	<b>2006</b>				
	<b>Strategy Machine Solutions</b>	<b>Scoring Solutions</b>	<b>Professional Services (In thousands)</b>	<b>Analytic Software Tools</b>	<b>Total</b>
Revenues	\$ 453,232	\$ 177,152	\$ 149,250	\$ 45,731	\$ 825,365
Operating expenses	(367,654)	(64,739)	(135,520)	(42,982)	(610,895)
Segment operating income	\$ 85,578	\$ 112,413	\$ 13,730	\$ 2,749	214,470
Unallocated share-based compensation expense					(42,085)
Unallocated restructuring and acquisition-related expense					(19,662)
Operating income					152,723
Unallocated interest income					15,248
Unallocated interest expense					(8,569)
Unallocated other expense, net					(210)
Income before income taxes					\$ 159,192
Depreciation and amortization	\$ 31,213	\$ 7,887	\$ 6,669	\$ 3,036	\$ 48,805

	<b>2005</b>				
	<b>Strategy Machine Solutions</b>	<b>Scoring Solutions</b>	<b>Professional Services (In thousands)</b>	<b>Analytic Software Tools</b>	<b>Total</b>
Revenues	\$ 449,139	\$ 167,270	\$ 134,231	\$ 48,031	\$ 798,671
Operating expenses	(385,696)	(66,750)	(115,375)	(34,912)	(602,733)
Segment operating income	\$ 63,443	\$ 100,520	\$ 18,856	\$ 13,119	195,938
Unallocated share-based compensation expense					(2,927)
Operating income					193,011

Unallocated interest income						8,402
Unallocated interest expense						(8,347)
Unallocated other income, net						1,022
Income before income taxes						\$ 194,088
Depreciation and amortization	\$ 30,911	\$ 11,213	\$ 6,544	\$ 2,849	\$ 51,517	

Table of Contents**FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended September 30, 2007, 2006 and 2005 (Continued)**

Our revenues and percentage of revenues by reportable market segments were as follows for fiscal 2007, 2006 and 2005, the majority of which were derived from the sale of products and services within the consumer credit, financial services and insurance industries:

	<b>2007</b>		<b>2006</b>		<b>2005</b>	
	<b>(In thousands)</b>					
Strategy Machine Solutions	\$ 439,273	54%	\$ 453,232	55%	\$ 449,139	56%
Scoring Solutions	180,444	22%	177,152	21%	167,270	21%
Professional Services	151,086	18%	149,250	18%	134,231	17%
Analytic Software Tools	51,433	6%	45,731	6%	48,031	6%
	\$ 822,236	100%	\$ 825,365	100%	\$ 798,671	100%

Within our Strategy Machine Solutions segment our customer management solutions accounted for 9% of total revenues in each of fiscal 2007, 2006 and 2005, and our fraud solutions accounted for 15%, 14% and 13% of total revenues in these periods, respectively.

Our revenues and percentage of revenues on a geographical basis are summarized below for fiscal 2007, 2006 and 2005. No individual country outside of the United States accounted for 10% or more of revenue in any of these years.

	<b>2007</b>		<b>2006</b>		<b>2005</b>	
	<b>(In thousands)</b>					
United States	\$ 581,725	71%	\$ 595,202	72%	\$ 597,159	75%
International	240,511	29%	230,163	28%	201,512	25%
	\$ 822,236	100%	\$ 825,365	100%	\$ 798,671	100%

During fiscal 2007, 2006 and 2005, no individual customer contributed to 10% or more of our total revenues, however, we derive a substantial portion of our revenues from our contracts with the three major credit reporting agencies, TransUnion, Equifax and Experian. Revenues collectively generated by agreements with these customers accounted for 19% of our total revenues in fiscal 2007. At September 30, 2007 and 2006, no individual customer contributed to 10% or more of total consolidated receivables.

Our property and equipment, net, on a geographical basis are summarized below at September 30, 2007 and 2006. At September 30, 2007 and 2006, no individual country outside of the United States accounted for 10% or more of total consolidated net property and equipment.

	2007		2006	
	(In thousands)			
United States	\$ 46,992	90%	\$ 50,996	90%
International	5,165	10%	5,615	10%
	\$ 52,157	100%	\$ 56,611	100%

**Table of Contents****FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)****18. Commitments**

Minimum future commitments under non-cancelable operating leases were as follows at September 30, 2007:

<b>Fiscal Year</b>	<b>Future Minimum Lease Payments (In thousands)</b>
2008	\$ 23,601
2009	22,671
2010	20,852
2011	15,469
2012	11,923
Thereafter	29,143
	\$ 123,659

The above amounts have not been reduced by contractual sublease commitments totaling \$2.0 million, \$1.2 million, \$1.2 million, \$1.3 million and \$0.5 million in fiscal 2008 through 2012, respectively. We occupy the majority of our facilities under non-cancelable operating leases with lease terms in excess of one year. Such facility leases generally provide for annual increases based upon the Consumer Price Index or fixed increments. Rent expense under operating leases, including month-to-month leases, totaled \$25.6 million, \$28.2 million and \$28.4 million during fiscal 2007, 2006 and 2005, respectively.

We are also a party to a management agreement with 33 of our executives providing for certain payments and other benefits in the event of a qualified change in control of Fair Isaac, coupled with a termination of the officer during the following year.

**19. Contingencies**

We are in disputes with certain customers regarding amounts owed in connection with the sale of certain of our products and services. We also have had claims asserted by former employees relating to compensation and other employment matters. We are also involved in various other claims and legal actions arising in the ordinary course of business. We believe that none of these aforementioned claims or actions will result in a material adverse impact to our consolidated results of operations, liquidity or financial condition. However, the amount or range of any potential liabilities associated with these claims and actions, if any, cannot be determined with certainty. Set forth below are additional details concerning certain ongoing litigation.

***Customer Claims***



We were a party to a lawsuit involving a customer who asserted that our performance under a professional services contract caused them to incur damages. The lawsuit was filed as a counterclaim to a collection lawsuit that we commenced in the United States District Court for the Southern District of Texas. This customer claimed damages in excess of \$10 million. On November 21, 2007, the parties finalized a settlement agreement that includes a release of all claims, and the parties will be filing shortly a joint motion to dismiss the litigation with prejudice. We incurred a \$3.8 million after-tax charge in fiscal 2007 as a result of this settlement agreement.

***Braun Consulting, Inc.***

Braun (which we acquired in November 2004) was a defendant in a lawsuit filed on November 26, 2001, in the United States District Court for the Southern District of New York (Case No. 01 CV 10629) that alleges violations of federal securities laws in connection with Braun's initial public offering in August 1999. This lawsuit is among approximately 300 coordinated putative class actions against certain issuers, their officers and directors, and

**Table of Contents**

**FAIR ISAAC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

underwriters with respect to such issuers' initial public offerings. As successor-in-interest to Braun, we have entered into a Stipulation and Agreement of Settlement, pursuant to a Memorandum of Understanding, along with most of the other defendant issuers in this coordinated litigation, whereby such issuers and their officers and directors would be dismissed with prejudice, subject to the satisfaction of certain conditions, including, among others, approval of the Court. Under the terms of this Agreement, we would not pay any amount of the settlement.

However, since December 2006, certain procedural matters concerning the class status have been decided in the district and appellate courts of the Second Circuit, with the courts ultimately determining that no class status exists for the plaintiffs. Since there is no class status, there can be no agreement, thus the District Court entered an order formally denying the motion for final approval of the settlement agreement. We cannot predict whether the issuers and their insurers will be able to renegotiate a settlement that would comply with the appellate court's ruling. Plaintiffs plan to replead their complaints and move for class certification again.

We intend to continue to defend vigorously against these claims. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation.

***Putative Consumer Class Action Lawsuits***

We were a defendant in a lawsuit captioned as Robbie Hillis v. Equifax Consumer Services, Inc. and Fair Isaac, Inc., filed in the U.S. District Court for the Northern District of Georgia. The plaintiff claimed that the defendants jointly sold the Score Power® credit score product in violation of certain procedural requirements under the Credit Repair Organizations Act (CROA), and in violation of the antifraud provisions of that statute. On June 13, 2007, the Court granted final approval of a settlement agreed to by the parties and directed that final judgment be entered. An appeal was filed on July 11, 2007. The appeal was dismissed, and the settlement agreement is final.

We were a defendant in a lawsuit captioned as Christy Slack v. Fair Isaac Corporation and MyFICO Consumer Services, Inc., which was filed in the United States District Court for the Northern District of California. As in the Hillis matter, the plaintiff is claiming that the defendants violated certain procedural requirements of CROA, and violated the antifraud provisions of CROA, with respect to the sale of credit score products on our myfico.com website. This matter was covered by the settlement agreement in the Robbie Hillis lawsuit, as described above.

**20. Guarantees**

In the ordinary course of business, we are not subject to potential obligations under guarantees that fall within the scope of FASB Interpretation (FIN) No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, except for standard indemnification and warranty provisions that are contained within many of our customer license and service agreements and certain supplier agreements, including underwriter agreements, as well as standard indemnification agreements that we have executed with certain of our officers and directors, and give rise only to the disclosure requirements prescribed by FIN No. 45. In addition, under previously existing accounting principles generally accepted in the United States of America, we continue to monitor the conditions that are subject to the guarantees and indemnifications to identify whether it is probable that a loss has occurred, and would recognize any such losses under the guarantees and indemnifications when those losses are estimable.

Indemnification and warranty provisions contained within our customer license and service agreements and certain supplier agreements are generally consistent with those prevalent in our industry. The duration of our product warranties generally does not exceed 90 days following delivery of our products. We have not incurred significant obligations under customer indemnification or warranty provisions historically and do not expect to incur significant obligations in the future. Accordingly, we do not maintain accruals for potential customer indemnification or warranty-related obligations. The indemnification agreements that we have executed with certain of our officers and directors would require us to indemnify such officers and directors in certain instances.

Table of Contents**FAIR ISAAC CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended September 30, 2007, 2006 and 2005 (Continued)**

We have not incurred obligations under these indemnification agreements historically and do not expect to incur significant obligations in the future. Accordingly, we do not maintain accruals for potential officer or director indemnification obligations. The maximum potential amount of future payments that we could be required to make under the indemnification provisions in our customer license and service agreements, and officer and director agreements is unlimited.

**21. Subsequent Events**

In November 2007, our Board of Directors approved a new common stock repurchase program that replaces our previous program and allows us to purchase shares of our common stock up to an aggregate cost of \$250.0 million in the open market or through negotiated transactions.

**22. Supplementary Financial Data (Unaudited)**

The following table presents selected unaudited consolidated financial results for each of the eight quarters in the two-year period ended September 30, 2007. In the opinion of management, this unaudited information has been prepared on the same basis as the audited information and includes all adjustments (consisting of only normal recurring adjustments, except as noted below) necessary for a fair statement of the consolidated financial information for the period presented.

	<b>Dec. 31, 2006</b>	<b>Mar. 31, 2007</b>	<b>Jun. 30, 2007</b>	<b>Sept. 30, 2007(2)</b>
	<b>(In thousands, except per share data)</b>			
Revenues	\$ 208,227	\$ 201,000	\$ 205,782	\$ 207,227
Cost of revenues	70,569	74,172	73,731	75,010
Gross profit	\$ 137,658	\$ 126,828	\$ 132,051	\$ 132,217
Net income	\$ 31,225	\$ 21,438	\$ 23,768	\$ 28,219
Earnings per share(1):				
Basic	\$ 0.54	\$ 0.38	\$ 0.43	\$ 0.53
Diluted	\$ 0.52	\$ 0.37	\$ 0.42	\$ 0.52
Shares used in computing earnings per share:				
Basic	58,057	56,940	55,776	53,459
Diluted	59,985	58,659	56,896	54,669



Table of Contents

## FAIR ISAAC CORPORATION

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended September 30, 2007, 2006 and 2005 (Continued)**

	<b>Dec. 31, 2005</b>	<b>Mar. 31, 2006</b>	<b>Jun. 30, 2006</b>	<b>Sept. 30, 2006</b>
	<b>(In thousands, except per share data)</b>			
Revenues	\$ 202,790	\$ 208,157	\$ 207,129	\$ 207,289
Cost of revenues	67,045	73,144	71,497	70,291
Gross profit	\$ 135,745	\$ 135,013	\$ 135,632	\$ 136,998
Net income(3)	\$ 28,457	\$ 26,973	\$ 26,003	\$ 22,053
Earnings per share(1):				
Basic	\$ 0.44	\$ 0.41	\$ 0.41	\$ 0.36
Diluted	\$ 0.43	\$ 0.40	\$ 0.40	\$ 0.35
Shares used in computing earnings per share:				
Basic	64,211	65,052	63,664	61,423
Diluted	66,219	66,834	64,973	62,506

- (1) Earnings per share is computed independently for each of the quarters presented. Therefore, the sum of the quarterly per share amounts may not equal the totals for the respective years.
- (2) The results for the quarter ended September 30, 2007 included \$7.3 million of tax benefits, a \$5.9 million charge associated with the resolution of a customer lawsuit and a \$2.5 million charge for restructuring and acquisition-related expenses.
- (3) Restructuring and acquisition-related expenses for the quarters ended December 31, 2005, March 31, 2006, June 30, 2006 and September 30, 2006 were \$(0.7) million, \$2.2 million, \$5.3 million and \$12.9 million, respectively.

**Table of Contents**

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable.

**Item 9A. *Controls and Procedures***

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

No change in Fair Isaac's internal control over financial reporting was identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act that occurred during the quarter ended September 30, 2007, that has materially affected, or is reasonably likely to materially affect, Fair Isaac's internal control over financial reporting.

**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal controls over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). Based on this evaluation management has concluded that our internal control over financial reporting was effective as of September 30, 2007.

Deloitte & Touche LLP, the independent registered public accounting firm that audited the consolidated financial statements included in this Annual Report on Form 10-K, has also audited our internal control over financial reporting as of September 30, 2007, as stated in their attestation report included in Part II, Item 8 of this Annual Report on Form 10-K.

Our management, including our CEO and CFO, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

**Item 9B. *Other Information***

Not applicable.

**Table of Contents**

**PART III**

**Item 10. *Directors, Executive Officers and Corporate Governance***

The required information regarding our Directors is incorporated by reference from the information under the caption *Director Nominees* in our definitive proxy statement for the Annual Meeting of Stockholders to be held on February 4, 2008.

The required information regarding our Executive Officers is contained in Part I of this Annual Report on Form 10-K.

The required information regarding compliance with Section 16(a) of the Securities Exchange Act is incorporated by reference from the information under the caption *Section 16(a) Beneficial Ownership Reporting Compliance* in our definitive proxy statement for the Annual Meeting of Stockholders to be held on February 4, 2008.

Fair Isaac has adopted a Code of Ethics for Senior Financial Management that applies to the Company's Chief Executive Officer, Chief Financial Officer, Controller and other employees performing similar functions who have been identified by the Chief Executive Officer. We have posted the Code of Ethics on our web site located at [www.fairisaac.com](http://www.fairisaac.com). Fair Isaac intends to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or a waiver from, this Code of Ethics by posting such information on its web site. Fair Isaac also has a Code of Conduct and Business Ethics applicable to all directors, officers and employees, which is also available at the web site cited above. The required information regarding the Company's corporate governance guidelines and committee charters is incorporated by reference from the information under the caption *Board Meetings, Committees and Attendance* in our definitive proxy statement for the Annual Meeting of Shareholders to be held on February 4, 2007.

**Item 11. *Executive Compensation***

The information required by this Item is incorporated by reference from the information under the captions *Director Compensation*, *Executive Compensation*, and *Compensation Committee Interlocks and Insider Participation* in our definitive proxy statement for the Annual Meeting of Stockholders to be held on February 4, 2008.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this Item is incorporated by reference from the information under the caption *Security Ownership Of Certain Beneficial Owners and Management and Executive Compensation* in our definitive proxy statement for the Annual Meeting of Stockholders to be held on February 4, 2008.

**Item 13. *Certain Relationships, Related Transactions, and Director Independence***

The information required by this Item is incorporated by reference from the information under the captions *Certain Relationships and Related Transactions* and *Director Independence* in our definitive proxy statement for the Annual Meeting of Stockholders to be held on February 4, 2008.

**Item 14. *Principal Accountant Fees and Services***

The information required by this Item is incorporated by reference from the information under the caption *Audit and Non-Audit Fees* in our definitive proxy statement for the Annual Meeting of Stockholders to be held on February 4, 2008.





**Table of Contents****PART IV****Item 15. Exhibits and Financial Statement Schedules****1. Consolidated Financial Statements:**

	<b>Reference Page Form 10-K</b>
Reports of independent registered public accounting firm	48
Consolidated balance sheets as of September 30, 2007 and 2006	49
Consolidated statements of income for the years ended September 30, 2007, 2006, and 2005	50
Consolidated statements of stockholders' equity and comprehensive income for the years ended September 30, 2007, 2006, and 2005	51
Consolidated statements of cash flows for the years ended September 30, 2007, 2006, and 2005	52
Notes to consolidated financial statements	53

**2. Financial Statement Schedules**

All financial statement schedules are omitted as the required information is not applicable or as the information required is included in the consolidated financial statements and related notes.

**3. Exhibits:**

<b>Exhibit Number</b>	<b>Description</b>
3.1	By-laws of the Company. (Incorporated by reference to Exhibit 4.2 to the Company's Form S-8 Registration Statement, File No. 333-114364, filed April 9, 2004, and Exhibit 3.2 to the Company's Form 8-K filed on November 7, 2006.)
3.2	Composite Certificate of Incorporation of Fair Isaac Corporation. (Incorporated by reference to Exhibit 4.1 to the Company's Form S-8 Registration Statement, File No. 333-114364, filed April 9, 2004.)
4.1	Rights Agreement dated as of August 8, 2001, between Fair, Isaac and Company, Incorporated and Mellon Investor Services LLC, which includes as Exhibit B the form of Rights Certificate and as Exhibit C the Summary of Rights. (Incorporated by reference to Exhibit 4.1 of the Company's Registration Statement on Form 8-A relating to the Series A Participating Preferred Stock Purchase Rights filed August 10, 2001.)
4.2	Form of Rights Certificate. (Included in Exhibit 4.1.)
4.3	Indenture, dated as of August 6, 2003, between the Company and Wells Fargo Bank Minnesota, N.A., as Trustee. (Incorporated by reference to Exhibit 4.6 to the Company's report on Form 10-K for the fiscal year ended September 30, 2003.)
4.4	Form of 1.5% Senior Convertible Note due August 15, 2023. (Included in Exhibit 4.3.)
4.5	Indenture, dated as of March 31, 2005, between Fair Isaac and Wells Fargo Bank, National Association. (Incorporated by reference to Exhibit 10.1 to Fair Isaac's Form 8-K filed on April 5, 2005.)
10.1	HNC's 2001 Equity Incentive Plan and related form of Stock Option Agreement. (Incorporated by reference to Exhibit 4.01 to HNC's Form S-8 Registration Statement, File No. 333-62492, filed June 7,

- 2001.)(1)
- 10.2 HNC's 1995 Directors Stock Option Plan, as amended through April 30, 2000. (Incorporated by reference to Exhibit 4.05 to HNC's Form S-8 Registration Statement, File No. 333-40344, filed June 28, 2000.)(1)
- 10.3 HNC's Form of 1995 Directors Stock Option Plan Option Agreement and Stock Option Exercise Agreement. (Incorporated by reference to Exhibit 10.01 to HNC's Form 10-Q for the quarter ended June 30, 1999.)(1)
- 10.4 HNC's 1998 Stock Option Plan, as amended through September 1, 2000, and related form of option agreement. (Incorporated by reference to Exhibit 4.05 to HNC's Form S-8 Registration Statement, File No. 333-45442, filed September 8, 2000.)(1)

**Table of Contents**

<b>Exhibit Number</b>	<b>Description</b>
10.5	Aptex Software Inc. 1996 Equity Incentive Plan assumed by HNC. (Incorporated by reference to Exhibit 4.03 to HNC's Form S-8 Registration Statement, File No. 333-71923, filed February 5, 1999.)(1)
10.6	Form of Aptex Software Inc. 1996 Equity Incentive Plan Stock Option Agreement and Stock Option Exercise Agreement. (Incorporated by reference to Exhibit 4.04 to HNC's Form S-8 Registration Statement, File No. 333-71923, filed February 5, 1999.)(1)
10.7	Form of Advanced Information Management Solutions, Inc. Stock Option Agreement. (Incorporated by reference to Exhibit 4.02 to HNC's Form S-8 Registration Statement, File No. 333-33952, filed April 4, 2000.)(1)
10.8	ONYX Technologies, Inc. 1999 Stock Plan assumed by HNC. (Incorporated by reference to Exhibit 4.03 to HNC's Form S-8 Registration Statement, File No. 333-33952, filed April 4, 2000.)(1)
10.9	Form of ONYX Technologies, Inc. Stock Option Agreement. (Incorporated by reference to Exhibit 4.04 to HNC's Form S-8 Registration Statement, File No. 333-33952, filed April 4, 2000.)(1)
10.10	Fair, Isaac Supplemental Retirement and Savings Plan and Trust Agreement effective November 1, 1994. (Incorporated by reference to Exhibit 10.20 to the Company's report on Form 10-K for the fiscal year ended September 30, 2001.)(1)
10.11	The Center for Adaptive Systems Applications, Inc. 1995 Stock Option Plan assumed by HNC. (Incorporated by reference to Exhibit 4.05 to HNC's Form S-8 Registration Statement, File No. 333-33952, filed April 4, 2000.)(1)
10.12	Forms of The Center for Adaptive Systems Applications, Inc. Stock Option Agreements. (Incorporated by reference to Exhibit 4.06 to HNC's Form S-8 Registration Statement, File No. 333-33952, filed April 4, 2000.)(1)
10.13	eHNC Inc. 1999 Equity Incentive Plan, as amended, assumed by HNC. (Incorporated by reference to Exhibit 4.01 to HNC's Form S-8 Registration Statement, File No. 333-41388, filed July 13, 2000.)(1)
10.14	Forms of eHNC Inc. Stock Option Agreements and Stock Option Exercise Agreements under the eHNC Inc. 1999 Equity Incentive Plan. (Incorporated by reference to Exhibit 4.02 to HNC's Form S-8 Registration Statement, File No. 333-41388, filed July 13, 2000.)(1)
10.15	eHNC Inc. 1999 Executive Equity Incentive Plan assumed by HNC. (Incorporated by reference to Exhibit 4.03 to HNC's Form S-8 Registration Statement, File No. 333-41388, filed July 13, 2000.)(1)
10.16	Forms of eHNC Inc. Stock Option Agreements and Stock Option Exercise Agreements under the eHNC Inc. 1999 Executive Equity Incentive Plan. (Incorporated by reference to Exhibit 4.04 to HNC's Form S-8 Registration Statement, File No. 333-41388, filed July 13, 2000.)(1)
10.17	Systems/Link Corporation 1999 Stock Option Plan assumed by HNC and related forms of agreements. (Incorporated by reference to Exhibit 4.04 to HNC's Form S-8 Registration Statement, File No. 333-45442, filed September 8, 2000.)(1)
10.18*	Form of Management Agreement entered into with each of the Company's executive officers (except Mark Greene).(1)
10.19	Strategic Partnership Agreement dated as of October 23, 2000, between HNC and GeoTrust, Inc., as amended by Amendment No. 1 dated March 6, 2001. (Incorporated by reference to Exhibit 10.35 to HNC's Form 10-K, as amended, for the year ended December 31, 2000.)
10.20	Form of Indemnity Agreement entered into by the Company with the Company's directors and executive officers. (Incorporated by reference to Exhibit 10.49 to the Company's report on Form 10-K for the fiscal year ended September 30, 2002.)
10.21	Thomas G. Grudnowski Stock Option Plan. (Incorporated by reference to the Company's Form S-8 Registration Statement, File No. 333-32396, filed March 14, 2000.)(1)
10.22	

Edgar Filing: FAIR ISAAC CORP - Form 10-K

Thomas G. Grudnowski Stock Option Plan. (Incorporated by reference to the Company's Form S-8 Registration Statement, File No. 333-66332, filed July 31, 2001.)(1)

10.23 2002 Stock Bonus Plan of the Company. (Incorporated by reference to Exhibit 99.1 of the Company's Form S-8 Registration Statement, File No. 333-97695, filed August 6, 2002.)(1)

93

---

**Table of Contents**

<b>Exhibit Number</b>	<b>Description</b>
10.24	Stock Option Agreement with A. George Battle entered into as of February 5, 2002. (Incorporated by reference to Exhibit 10.58 to the Company's report on Form 10-K for the fiscal year ended September 30, 2002.)(1)
10.25	Nonstatutory Stock Option Agreement with Thomas G. Grudnowski entered into as of November 16, 2001. (Incorporated by reference to Exhibit 10.59 to the Company's report on Form 10-K for the fiscal year ended September 30, 2002.)(1)
10.26	Employment Agreement entered into effective January 30, 2004, by and between Fair Isaac Corporation and Thomas G. Grudnowski. (Incorporated by reference to Exhibit 10.2 to the Company's Form 10-Q for the fiscal quarter ended December 31, 2003.)(1)
10.27	Agreement and Plan of Merger, dated as of September 20, 2004, among Braun Consulting, Inc., Fair Isaac Corporation and HSR Acquisition, Inc. (Incorporated by reference to Exhibit 2.1 to the Company's Form 8-K filed September 24, 2004.)
10.28	Braun's Amended and Restated 1995 Director Stock Option Plan. (Incorporated by reference to Exhibit 10.6 to Braun's Form S-1 Registration Statement, File No. 333-31824, filed March 6, 2000.)(1)
10.29	Braun's 1998 Employee Long-Term Stock Investment Plan. (Incorporated by reference to Exhibit 10.7 to Braun's Form S-1 Registration Statement, File No. 333-79251, filed May 25, 1999.)(1)
10.30	Braun's 1998 Executive Long-Term Stock Investment Plan. (Incorporated by reference to Exhibit 10.8 to Braun's Form S-1 Registration Statement, File No. 333-79251, filed May 25, 1999.)(1)
10.31	Braun's 1999 Independent Director Stock Option Plan. (Incorporated by reference to Exhibit 10 to Braun's Form 10-Q for the fiscal quarter ended September 30, 1999.)(1)
10.32	Braun's Non Qualified Stock Option Plan of Emerging Technologies Consultants, Inc. (Incorporated by reference to Exhibit 99.5 to Braun's Form S-8 Registration Statement, File No. 333-30788, filed February 18, 2000.)(1)
10.33	Braun's 2002 Employee Long-Term Stock Investment Plan, as amended. (Incorporated by reference to Exhibit 99.1 to Braun's Form S-8 Registration Statement, File No. 333-110448, filed November 11, 2003.)(1)
10.34	Fair Isaac Supplemental Retirement and Savings Plan (As Amended And Restated Effective December 1, 2004). (Incorporated by reference to Exhibit 99.1 to Fair Isaac's Form 8-K filed on December 30, 2004.)
10.35	Perleberg Expatriate Agreement. (Incorporated by reference to Exhibit 99.1 to Fair Isaac's Form 8-K filed on March 14, 2005.)
10.36	Letter providing terms of offer of employment by the Company to Michael H. Campbell dated April 15, 2005. (Incorporated by reference to Exhibit 10.01 to Fair Isaac's Form 8-K filed on April 21, 2005.)
10.37	2001 Equity Incentive Plan as adopted April 10, 2001, and amended May 15, 2005. (Incorporated by reference to Exhibit 10.1 to Fair Isaac's Form 10-Q for the fiscal quarter ended June 30, 2005.)
10.38	2003 Employment Inducement Award Plan as amended effective May 15, 2005. (Incorporated by reference to Exhibit 10.2 to Fair Isaac's Form 10-Q for the fiscal quarter ended June 30, 2005.)
10.39*	1992 Long-Term Incentive Plan as amended effective December 3, 2006.
10.40	Description of Outside Director compensation program. (Incorporated by reference to Item 1.01 of Fair Isaac's Form 8-K filed on September 1, 2005.)
10.41	Pautsch Retention Agreement. (Incorporated by reference to Exhibit 10.46 to Fair Isaac's Form 10-K for the fiscal year ended September 30, 2005.)
10.42	Form of Non-Qualified Stock Option Agreement under 1992 Long-Term Incentive Plan (Incorporated by reference to Exhibit 10.42 to the Company's Annual Report of Form 10-K for the period ended September 30, 2006.)(1)

Edgar Filing: FAIR ISAAC CORP - Form 10-K

- 10.43 Form of Restricted Stock Agreement under 1992 Long-Term Incentive Plan. (Incorporated by reference to Exhibit 10.43 to the Company's Annual Report of Form 10-K for the period ended September 30, 2006.)(1)
- 10.44 Transition Agreement dated November 1, 2006, by and between Fair Isaac Corporation and Thomas G. Grudnowski. (Incorporated by reference to Exhibit 10 to Fair Isaac's Form 8-K filed on November 7, 2006.)(1)

**Table of Contents**

<b>Exhibit Number</b>	<b>Description</b>
10.45	Credit Agreement among Fair Isaac, Wells Fargo Bank, National Association, U.S. Bank National Association, Bank of America, N.A., and JPMorgan Chase Bank, N.A., dated October 20, 2006. (Incorporated by reference to Exhibit 10.1 to Fair Isaac's Form 8-K filed on October 23, 2006.)
10.46	Management Incentive Plan, Fiscal 2006.(1)
10.47	Management Incentive Plan, Fiscal 2007. (Incorporated by reference to Exhibit 10.47 to the Company's Annual Report of Form 10-K for the period ended September 30, 2006.)(1)
10.48	Transition Agreement dated December 8, 2006, by and between Fair Isaac and Gresham T. Brebach, Jr. (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended December 31, 2006.)(1)
10.49	Form of Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended December 31, 2006.)(1)
10.50	Employment Agreement dated February 13, 2007, by and between Fair Isaac and Dr. Mark Greene (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 14, 2007.)(1)
10.51	Management Agreement dated February 14, 2007, by and between Fair Isaac and Dr. Mark Greene (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on February 14, 2007.)(1)
10.52	Amended and Restated Credit Agreement among Fair Isaac, Wells Fargo Bank, N.A., U.S. Bank N.A., Bank of America, N.A., JPMorgan Chase Bank, N.A. and Deutsche Bank AG, NY Branch, dated July 23, 2007 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on July 25, 2007).
10.53	Letter Agreement entered into on October 18, 2007 by and between Fair Isaac Corporation and Michael H. Campbell (incorporated by reference to Exhibit 10 to the Company's Form 8-K filed with the SEC on October 22, 2007.)(1)
10.54*	Management Incentive Plan, Fiscal 2008(1)
12.1*	Computations of ratios of earnings to fixed charges.
21.1*	List of Company's subsidiaries.
23.1*	Consent of Deloitte & Touche LLP, independent registered public accounting firm.
31.1*	Rule 13a-14(a)/15d-14(a) Certifications of CEO.
31.2*	Rule 13a-14(a)/15d-14(a) Certifications of CFO.
32.1*	Section 1350 Certification of CEO.
32.2*	Section 1350 Certification of CFO.

(1) Management contract or compensatory plan or arrangement.

\* Filed herewith.



**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**FAIR ISAAC CORPORATION**

By */s/ Charles M. Osborne*  
Charles M. Osborne  
*Executive Vice President*  
*and Chief Financial Officer*

DATE: November 28, 2007

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints CHARLES M. OSBORNE his attorney-in-fact, with full power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<i>/s/ DR. MARK N. GREENE</i>	Chief Executive Officer (Principal Executive Officer) and Director	November 28, 2007
Dr. Mark N. Greene		
<i>/s/ CHARLES M. OSBORNE</i>	Executive Vice President. Chief Financial Officer (Principal Financial Officer)	November 28, 2007
Charles M. Osborne		
<i>/s/ MICHAEL J. PUNG</i>	Vice President, Finance (Principal Accounting Officer)	November 28, 2007
Michael J. Pung		
<i>/s/ A. GEORGE BATTLE</i>	Director	November 28, 2007
A. George Battle		
<i>/s/ TONY J. CHRISTIANSON</i>	Director	November 28, 2007

Tony J. Christianson

/s/ ALEX W. HART

Director

November 28, 2007

Alex W. Hart

/s/ GUY R. HENSHAW

Director

November 28, 2007

Guy R. Henshaw

/s/ JAMES KIRSNER

Director

November 28, 2007

James Kirsner

**Table of Contents**

/s/ WILLIAM J. LANSING

Director

November 28, 2007

William J. Lansing

/s/ MARGARET L. TAYLOR

Director

November 28, 2007

Margaret L. Taylor

**Table of Contents****EXHIBIT INDEX**

**To Fair Isaac Corporation  
Report On Form 10-K For The Fiscal Year Ended September 30, 2007**

<b>Exhibit Number</b>	<b>Description</b>	
3.1	By-laws of the Company.	Incorporated by Reference
3.2	Composite Certificate of Incorporation of Fair Isaac Corporation.	Incorporated by Reference
4.1	Rights Agreement dated as of August 8, 2001, between Fair, Isaac and Company, Incorporated and Mellon Investor Services LLC, which includes as Exhibit B the form of Rights Certificate and as Exhibit C the Summary of Rights.	Incorporated by Reference
4.2	Form of Rights Certificate. (Included in Exhibit 4.1.)	Incorporated by Reference
4.3	Indenture, dated as of August 6, 2003, between the Company and Wells Fargo Bank Minnesota, N.A., as Trustee.	Incorporated by Reference
4.4	Form of 1.5% Senior Convertible Note due August 15, 2023. (Included in Exhibit 4.3.)	Incorporated by Reference
4.5	Indenture, dated as of March 31, 2005, between Fair Isaac and Wells Fargo Bank, National Association.	Incorporated by Reference
10.1	HNC s 2001 Equity Incentive Plan and related form of Stock Option Agreement.	Incorporated by Reference
10.2	HNC s 1995 Directors Stock Option Plan, as amended through April 30, 2000.	Incorporated by Reference
10.3	HNC s Form of 1995 Directors Stock Option Plan Option Agreement and Stock Option Exercise Agreement.	Incorporated by Reference
10.4	HNC s 1998 Stock Option Plan, as amended through September 1, 2000, and related form of option agreement.	Incorporated by Reference
10.5	Aptex Software Inc. 1996 Equity Incentive Plan assumed by HNC.	Incorporated by Reference
10.6	Form of Aptex Software Inc. 1996 Equity Incentive Plan Stock Option Agreement and Stock Option Exercise Agreement.	Incorporated by Reference
10.7	Form of Advanced Information Management Solutions, Inc. Stock Option Agreement.	Incorporated by Reference
10.8	ONYX Technologies, Inc. 1999 Stock Plan assumed by HNC.	Incorporated by Reference
10.9	Form of ONYX Technologies, Inc. Stock Option Agreement.	Incorporated by Reference
10.10	Fair, Isaac Supplemental Retirement and Savings Plan and Trust Agreement effective November 1, 1994.	Incorporated by Reference
10.11	The Center for Adaptive Systems Applications, Inc. 1995 Stock Option Plan assumed by HNC.	Incorporated by Reference
10.12	Forms of The Center for Adaptive Systems Applications, Inc. Stock Option Agreements.	Incorporated by Reference
10.13	eHNC Inc. 1999 Equity Incentive Plan, as amended, assumed by HNC.	Incorporated by Reference
10.14	Forms of eHNC Inc. Stock Option Agreements and Stock Option Exercise Agreements under the eHNC Inc. 1999 Equity Incentive Plan.	Incorporated by Reference
10.15	eHNC Inc. 1999 Executive Equity Incentive Plan assumed by HNC.	Incorporated by Reference
10.16	Forms of eHNC Inc. Stock Option Agreements and Stock Option Exercise Agreements under the eHNC Inc. 1999 Executive Equity Incentive Plan.	Incorporated by Reference

Edgar Filing: FAIR ISAAC CORP - Form 10-K

- 10.17 Systems/Link Corporation 1999 Stock Option Plan assumed by HNC and related forms of agreements. Incorporated by Reference
- 10.18 Form of Management Agreement entered into with each of the Company s executive officers (except Mark Greene). Filed Electronically

**Table of Contents**

<b>Exhibit Number</b>	<b>Description</b>	
10.19	Strategic Partnership Agreement dated as of October 23, 2000, between HNC and GeoTrust, Inc., as amended by Amendment No. 1 dated March 6, 2001.	Incorporated by Reference
10.20	Form of Indemnity Agreement entered into by the Company with the Company's directors and executive officers.	Incorporated by Reference
10.21	Thomas G. Grudnowski Stock Option Plan.	Incorporated by Reference
10.22	Thomas G. Grudnowski Stock Option Plan.	Incorporated by Reference
10.23	2002 Stock Bonus Plan of the Company.	Incorporated by Reference
10.24	Stock Option Agreement with A. George Battle entered into as of February 5, 2002.	Incorporated by Reference
10.25	Nonstatutory Stock Option Agreement with Thomas G. Grudnowski entered into as of November 16, 2001.	Incorporated by Reference
10.26	Employment Agreement entered into effective January 30, 2004, by and between Fair Isaac Corporation and Thomas G. Grudnowski.	Incorporate by Reference
10.27	Agreement and Plan of Merger, dated as of September 20, 2004, among Braun Consulting, Inc., Fair Isaac Corporation and HSR Acquisition, Inc.	Incorporated by Reference
10.28	Braun's Amended and Restated 1995 Director Stock Option Plan	Incorporated by Reference
10.29	Braun's 1998 Employee Long-Term Stock Investment Plan.	Incorporated by Reference
10.30	Braun's 1998 Executive Long-Term Stock Investment Plan.	Incorporated by Reference
10.31	Braun's 1999 Independent Director Stock Option Plan.	Incorporated by Reference
10.32	Braun's Non Qualified Stock Option Plan of Emerging. Technologies Consultants, Inc.	Incorporated by Reference
10.33	Braun's 2002 Employee Long-Term Stock Investment Plan, as amended.	Incorporated by Reference
10.34	Fair Isaac Supplemental Retirement and Savings Plan (As Amended And Restated Effective December 1, 2004).	Incorporated by Reference
10.35	Perleberg Expatriate Agreement.	Incorporated by Reference
10.36	Letter providing terms of offer of employment by the Company to Michael H. Campbell dated April 15, 2005.	Incorporated by Reference
10.37	2001 Equity Incentive Plan as adopted April 10, 2001, and amended May 15, 2005.	Incorporated by Reference
10.38	2003 Employment Inducement Award Plan as amended effective May 15, 2005.	Incorporated by Reference
10.39	1992 Long-Term Incentive Plan as amended effective December 3, 2006	Filed Electronically
10.40	Description of Outside Director compensation program	Incorporated by Reference
10.41	Pautsch Retention Agreement.	Incorporated by Reference
10.42	Form of Non-Qualified Stock Option Agreement under 1992 Long-Term Incentive Plan.(1)	Incorporated by Reference
10.43	Form of Restricted Stock Agreement under 1992 Long-Term Incentive Plan.(1)	Incorporated by Reference
10.44	Transition Agreement dated November 1, 2006, by and between Fair Isaac Corporation and Thomas G. Grudnowski.	Incorporated by Reference
10.45	Credit Agreement among Fair Isaac, Wells Fargo Bank, National Association, U.S. Bank National Association, Bank of America, N.A., and JPMorgan Chase Bank, N.A., dated October 20, 2006.	Incorporated by Reference
10.46		Incorporated by Reference

Management Incentive Plan, Fiscal 2006. Incorporated by reference to Exhibit 10 to Fair Isaac's Form 8-K filed on March 3, 2006.(1)

10.47 Management Incentive Plan, Fiscal 2007.(1)

Incorporated by Reference

**Table of Contents**

<b>Exhibit Number</b>	<b>Description</b>	
10.48	Transition Agreement dated December 8, 2006, by and between Fair Isaac and Gresham T. Brebach, Jr.	Incorporated by Reference.
10.49	Form of Restricted Stock Unit Agreement.	Incorporated by Reference.
10.50	Employment Agreement dated February 13, 2007, by and between Fair Isaac and Dr. Mark Greene.	Incorporated by Reference.
10.51	Management Agreement dated February 14, 2007, by and between Fair Isaac and Dr. Mark Greene.	Incorporated by Reference.
10.52	Amended and Restated Credit Agreement among Fair Isaac, Wells Fargo Bank, N.A., U.S. Bank N.A., Bank of America, N.A., JPMorgan Chase Bank, N.A. and Deutsche Bank AG, NY Branch, dated July 23, 2007.	Incorporated by Reference.
10.53	Letter Agreement entered into on October 18, 2007 by and between Fair Isaac Corporation and Michael H. Campbell	Incorporated by Reference
10.54	Management Incentive Plan, Fiscal 2008	Filed Electronically
12.1	Computations of ratios of earnings to fixed charges	Filed Electronically
21.1	List of Company s subsidiaries.	Filed Electronically
23.1	Consent of Deloitte & Touche LLP, independent registered public accounting firm.	Filed Electronically
31.1	Rule 13a-14(a)/15d-14(a) Certification of CEO.	Filed Electronically
31.2	Rule 13a-14(a)/15d-14(a) Certification of CFO.	Filed Electronically
32.1	Section 1350 Certifications of CEO.	Filed Electronically
32.2	Section 1350 Certifications of CFO.	Filed Electronically