



Annual Report  
연례 보고서  
報告書



2008 | Annual Report

Monotype Imaging Holdings Inc. is a leading global provider of text imaging solutions that enable the display and printing of high-quality text. Our software technologies have been widely deployed across and embedded in a range of consumer electronic devices – including laser printers, digital copiers, mobile phones, digital televisions, set-top boxes, navigation devices and digital cameras, as well as in numerous software applications and operating systems. We combine these proprietary technologies with access to more than 10,000 typefaces from a library of some of the most widely used designs in the world. We also license our typefaces to creative and business professionals through custom font design services, direct sales and our e-commerce Web sites [Fonts.com](http://Fonts.com), [ITCFonts.com](http://ITCFonts.com), [Linotype.com](http://Linotype.com) and [Faces.co.uk](http://Faces.co.uk).

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# A letter to our shareholders and customers

—Doug Shaw, CEO

Fellow shareholders,

In 2008, Monotype Imaging delivered solid results. I am pleased to report we achieved strong profitability and cash flow, reflecting the strength of our market position and attractive business model. We also made significant progress on our long-term growth initiatives, which included broadening our product offerings, strengthening our reach into new and existing accounts and device categories, and enhancing our e-commerce font offerings. All this was accomplished in the face of difficult economic conditions.

WE ENDED 2008 with revenue of \$110.9 million, compared to \$105.2 million in 2007. Net income for 2008 increased 70 percent to \$15.4 million, from \$9.1 million in the prior year. We strengthened our balance sheet and generated significant cash flow from operations of \$30.5 million, an increase of 12 percent year-over-year, allowing us to pay down \$18.6 million in debt while increasing our cash balances to \$31.9 million. Also in 2008, we identified areas of efficiency in our business that will enable us to continue investing in our long-term growth initiatives while reducing our cost base.

Overall, we are proud of our accomplishments.

## 2008 highlights

In 2008, we enhanced key technologies to target an increasingly diverse mix of consumer electronics devices able to benefit from scalable type. We also focused on extending further into existing accounts. For example, on the mobile side of our business, design wins have traditionally involved high-end smartphones. However, thanks to the flexibility of our solution, OEMs are able to integrate scalable fonts and font technologies across their full range of products, from the high end to the low end.

2008 was a year that underscored our commitment to bring innovation to the mobile space. We unveiled our FlipFont™ application, a downloadable font solution that turns the concept of personalizing mobile phones with fonts into reality. Launched with Vodafone UK on select handsets, FlipFont represents a new opportunity that will help us to reach additional network operators and mobile device manufacturers.

We also launched Edge™ Technology, designed to enable typographic style within a small memory footprint. Edge Technology allows mobile device manufacturers to tackle the difficult, technical challenges associated with the large character sets required to support East Asian fonts, while also ensuring style, scalability and legibility on low-resolution displays – even when text is displayed at small sizes.

We announced important consumer electronics agreements in 2008, including Verizon Wireless, for mobile user interface fonts, and Sharp Corporation of Japan, for fonts and font technologies in handsets sold in China and Taiwan. We also signed HTC of Taiwan, which licensed our Helvetica® typeface.

THANKS TO THE FLEXIBILITY OF OUR SOLUTION, OEMS ARE ABLE TO INTEGRATE  
SCALABLE FONTS AND FONT TECHNOLOGIES ACROSS THEIR FULL RANGE  
OF PRODUCTS, FROM THE HIGH END TO THE LOW END

AS WE FURTHER PROGRESS ON OUR GROWTH INITIATIVES, WE INTEND TO  
CONTINUE BALANCING INVESTMENT WITH EXPENSE MANAGEMENT,  
WHILE ALSO STAYING FOCUSED ON GENERATING FREE CASH FLOW

Outside of the mobile space, we announced technology agreements with Garmin, for a range of automotive navigational devices, and OpenTV, for television set-top boxes. Each of these new customers highlights the universal, important role fonts play to ensure high-quality user experiences. These relationships also demonstrate our commitment to evolve our solutions to an expanding range of devices and markets worldwide.

On the printer side of our OEM business, we released version 6.0 of our Universal Font Scaling Technology, our mainstay solution for printers. UFST® 6.0 allows printer OEMs to more easily display multilingual text on LCD panels while ensuring high-quality, printed output. We also expanded our selection of printer driver development kits, and we included support for Microsoft's XPS page description language, which is part of the Windows Vista® operating system.

On the Creative Professional side, we added French, Spanish and German versions of Fonts.com to reach an expanding base of international customers, and we added thousands of fonts to our e-commerce Web sites. At the end of 2008, we released a dual lineup of font management products based on our popular FontExplorer® X application. Our new Pro and Server editions address the font management needs of both creative professionals and network administrators. FontExplorer X Pro includes a host of features, such as the ability to turn on only selected fonts within specified applications, and the ability to try new fonts from our online store.

### **Looking ahead**

A key growth opportunity involves advancing our technologies and support for Asian markets. With offices in China and Japan – and now Korea – we believe that our local presence in these regions, combined with our technology solutions and world language fonts, provide us a unique, competitive strength.

As we further progress on our growth initiatives, we intend to continue balancing investment with expense management, while also staying focused on generating free cash flow. We remain confident in Monotype Imaging's long-term prospects as a result of our market leading position, attractive business model and strong balance sheet.

On behalf of our board of directors and our dedicated employees, I'd like to thank our customers, partners and you, our shareholders, for your continued support.

Sincerely,



Douglas J. Shaw  
President and CEO

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

**FORM 10-K**

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

For the fiscal year ended December 31, 2008

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-33612

**MONOTYPE IMAGING HOLDINGS INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State of incorporation)

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

500 Unicorn Park Drive  
Woburn, Massachusetts  
(Address of principal executive offices)

01801  
(Zip Code)

Registrant's telephone number, including area code: (781) 970-6000  
(Former Name, Former Address and Former Fiscal year, if changed since last report)

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

<u>Title of Each Class</u>	<u>Name of Exchange on Which Registered</u>
Common Stock, \$0.001 par value	The NASDAQ Stock Market LLC

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

None

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

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

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

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

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

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

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant, computed by reference to the last reported sale price of the common stock as reported on the NASDAQ Global Select Market on June 30, 2008 was approximately \$179,215,826 (assumes officers, directors, and all shareholders beneficially owning 5% or more of the outstanding common shares are affiliates).

The number of shares outstanding of the registrant's common stock as of March 2, 2009 was approximately 34,534,078.

**DOCUMENTS INCORPORATED BY REFERENCE.**

Portions of the registrant's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2009 Annual Meeting of Stockholders are incorporated herein by reference into Part III of this report.

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**MONOTYPE IMAGING HOLDINGS INC.**  
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As used in this report, the terms “we,” “us,” “our,” “Monotype Imaging” and the “Company” mean Monotype Imaging Holdings Inc. and its subsidiaries, unless the context indicates another meaning.

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

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

## PART I

### Item 1. Business

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

### Overview

Monotype Imaging Holdings Inc. is a leading global provider of text imaging solutions. Our technologies and fonts enable the display and printing of high quality digital text. Our software technologies have been widely deployed across, and embedded in a range of consumer electronics, or CE devices, including laser printers, digital copiers, mobile phones, digital televisions, set-top boxes, navigation devices and digital cameras, as well as in numerous software applications and operating systems. In the laser printer market, we have worked together with industry leaders for over 17 years to provide critical components embedded in printing standards. Our scaling, compression, text layout, printer driver and color technologies solve critical text imaging issues for CE device manufacturers by rendering high quality text on low resolution and memory constrained CE devices. We combine these proprietary technologies with access to more than 10,000 typefaces from a library of some of the most widely used designs in the world, including popular names such as Helvetica and Times New Roman. We also license our typefaces to creative and business professionals through custom font design services, direct and indirect sales and our e-commerce websites *fonts.com*, *itcfonts.com*, *linotype.com*, *faces.co.uk* and *fontexplorerx.com*, which combined attracted more than 25 million visits in 2008 from over 200 countries and territories. Our principal offices are located in Woburn, Massachusetts; with regional offices in Mt. Prospect, Illinois; Redwood City, California; Boulder, Colorado; Japan; Hong Kong (China Type Design Ltd.); Korea; the United Kingdom and Germany (Linotype GmbH).

Until November 5, 2004, Agfa Corporation, or Agfa, operated its font and printer driver business through its wholly-owned subsidiary, Agfa Monotype Corporation, or Agfa Monotype. On November 5, 2004, through a series of transactions, all of the common stock of Agfa Monotype was acquired by a newly formed entity, Monotype Imaging Inc., which was wholly owned by TA Associates, Inc., D.B. Zwirn Special Opportunities Fund, and certain of the former officers and employees of Agfa Monotype through a holding company, Imaging Holdings Corp., or IHC. In August 2005, IHC entered into a recapitalization transaction which resulted in it becoming wholly owned by Monotype Imaging Holdings Inc., the registrant and a Delaware corporation.

In 2006, we completed two acquisitions. On July 28, 2006, the Company acquired 80.01% of the capital stock of China Type Design Ltd., or China Type Design, a Hong Kong corporation, specializing in font design. At the time of the acquisition, we already had a 19.99% ownership interest in China Type Design and, following the acquisition, it became our wholly owned subsidiary. With the China Type Design acquisition, we acquired a library of Asian stroke-based fonts and gained the internal capability to develop and produce these fonts. On August 1, 2006, the Company acquired Linotype GmbH, or Linotype, a German company and a leader in the development, marketing, licensing and servicing of digital fonts and proprietor of a font library comprised of typefaces. We also acquired certain fonts and

other intellectual property assets from the seller of Linotype. With the purchase of Linotype, we acquired access to a large library of fonts, a strong brand with a significant web presence and a more complete offering for the creative professional market.

On July 30, 2007, we completed an initial public offering, issuing 6.5 million shares of our common stock at a price of \$12.00 per share. We received net proceeds from the offering of approximately \$67.2 million and used the proceeds, along with cash on hand, to restructure and pay down a portion of our debt. Further details regarding the events which occurred in connection with our initial public offering may be found in Note 1 of our consolidated financial statements. In June 2008, we completed a secondary offering of our common stock under a contractual agreement with a shareholder. We did not receive any proceeds from the secondary offering, as we did not issue any new shares of common stock in connection with the transaction.

### **Industry Overview and Market Opportunity**

Font technology has evolved with the increase in the functionality of CE devices. The latest generation of digital font technology focuses on scalable fonts rather than bitmaps. Bitmaps require the storage of images for each individual character and size, which limits the ability of a CE manufacturer to quickly deploy across multiple CE devices. Scalable fonts are more flexible, compressed and memory efficient.

CE devices are marketed globally and increasingly require robust multi-media functionality. Consumers are increasingly acquiring rich digital media content from service providers, over the Internet, as packaged media and from other users. CE device manufacturers must display text from these different sources, while being expected to provide a consistent look and feel across CE devices, support worldwide languages and provide enhanced navigation and personalization. Laser printer manufacturers are using text imaging solutions to enhance functionality and add features.

Consumers want to access content anywhere, anytime and on any CE device. As technologies enable a revolution where media moves seamlessly from one CE device to another, scalable text imaging technologies that are optimized for these CE devices become critical. For example, PC-like rich media functionality is moving to the mobile phone platform, driving the adoption of robust scalable text and digital televisions are incorporating scalable text for navigation and connectivity.

The market for laser printers and digital copiers is generally more mature than the rest of the CE device market. As a result, the lower end of the market is becoming more commoditized. Laser printer manufacturers are responding by increasing the functionality of their products with advancements such as a larger number of embedded fonts and color output, scanning and copying capabilities and enhanced control panel capabilities. This increased functionality is in turn driving the advancement of the printer industry, particularly the laser printer industry, which accounts for a significant portion of the printer market. More than 38 million laser printers were sold in 2007, per a March 2008 IDC report, generating \$49 billion in revenues for laser printer manufacturers.

The advancement of capabilities and functionality of multimedia CE devices, together with the increased reliance by laser printer manufacturers on enhancing technologies to drive value, favor comprehensive global text imaging solutions.

Graphic designers, advertisers, printers, publishers and other creative and business professionals also rely on fonts to convey meaning and to differentiate brand identity. For example, creative and business professionals at multinational corporations are increasingly tasked with creating solutions that extend branding and marketing communications into new markets around the world. Creative and business professionals historically acquired fonts primarily from local or regional distributors or dealers. However, we believe online font vendors have become the preferred channel to acquire fonts due to the larger selection, greater ease of use, and the ability to easily access font libraries from anywhere.



Original equipment manufacturers, or OEMs, and creative and business professionals are seeking comprehensive text imaging solutions with flexible technologies that can be rapidly integrated into their products. In the CE device market, advanced text imaging solutions, including scalable and multilingual type that is optimized for CE device memory and display limitations, are critical in supporting text portability. We believe laser printer manufacturers are using text imaging solutions to enhance functionality. In addition, creative and business professionals such as graphic designers and advertising agencies are turning to text imaging solutions more frequently for branding and marketing in today's increasingly global business environment. As a result, OEMs and creative and business professionals are requiring advanced text imaging solutions that are powerful and easy to use, and that continue to develop and evolve to address their text imaging needs.

## **Our Products**

We develop text imaging solutions that enable the display and printing of high quality text in all of the world's major languages and are compatible with most major operating environments as well as those developed directly by CE device manufacturers. Our proprietary technologies address critical text imaging needs for CE device manufacturers by rendering high quality text on low resolution and memory constrained CE devices. Our key text imaging technologies and services include:

- *Font Scaling, Compression and Rasterizing Technologies*
  - Our iType font scaling engine renders high quality display of text in every major language and in any size on memory constrained CE devices, including, but not limited to, mobile phones, video game consoles, set-top boxes and digital cameras, and is fully compatible with industry-standard font formats including TrueType and OpenType as well as our proprietary format for stroke-based Asian fonts.
  - Our primary laser printer imaging products are our font scaling engine, Universal Font Scaling Technology and a patented font compression technology, MicroType. Our font scaling engine and font compression technologies are compatible with virtually all font formats and CE device manufacturers' standards, including PostScript and Printer Command Language, or PCL. We currently license these products to 57 laser printer manufacturers worldwide.
  - Our Asian Compression for TrueType, or ACT, enables the accurate and fast rendering of high-quality Asian typeface images for laser printers, digital copiers, mobile phones, digital televisions, set-top boxes and digital cameras.
  - Our SmartHint Asian fonts use a simple stroke-based format that requires much less memory than regular TrueType fonts. SmartHint fonts are targeted to CE devices with small displays, such as mobile phones.
  - Our Edge technology enables high-quality text rendering on memory-constrained devices for fonts in any language, with additional features that address the clear display of East Asian text at any size, using fonts that are stylistic in design.
- *Text Layout Engines*
  - Our WorldType Layout Engine enables CE devices to accurately display multilingual text, including text composed in complex languages such as Indic, Arabic and Hebrew scripts.
- *Printer Driver and Imaging Tools*
  - Our printer driver kits enable printer manufacturers to create customized laser printer drivers that allow applications to print as intended.
  - Our ColorSet imaging tools give printer manufacturers complete control over high-quality color reproduction while minimizing development time.

- *Font Products and Services*
  - Our library of more than 10,000 typefaces includes fonts owned by us and fonts licensed from third parties.
  - We have strong relationships with a broad network of highly talented font designers.
  - Our e-commerce websites *fonts.com*, *itcfonts.com*, *linotype.com*, *faces.co.uk* and *fontexplorerx.com* offer more than 150,000 high quality font products.
  - We offer custom font design services for corporate branding and identity purposes.
  - Our core sets of fonts consist of the PCL 6 and PostScript 3 font collections. These fonts are designed for compatibility with Hewlett Packard, or HP, and Adobe Systems Incorporated, or Adobe, font specifications.
  - Our FlipFont application enables mobile phone users to personalize and enhance their user experience with mobile-optimized fonts chosen from a selection available from an online resource.
- *Font Management Technologies*
  - Our Fontwise product is a comprehensive font license management solution that allows creative and business professional customers to audit, manage and purchase font licenses.
  - Our FontExplorer X font management software allows the end-user to identify fonts required to view and print a given document as the original author intended and provides an easy way to license those fonts.

## **Competitive Strengths**

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

*Technological and Intellectual Property Leadership.* We are a leading global provider of text imaging solutions for laser printers. We have achieved this leadership position by combining our proprietary technologies with extensive font libraries that include many of the world's most popular typefaces. We are leveraging our intellectual property and experience in this market to secure a leading position in other high volume CE device categories. For example, we currently ship our text imaging solutions on mobile phones manufactured by three of the largest manufacturers of mobile phones by unit-volume. We have also established footholds in emerging CE device categories, such as digital televisions, set-top boxes, personal navigation devices and digital cameras.

*Established Relationships with Market Leaders.* We benefit from established relationships with our OEM customers, many of which date back 17 years or more. We work collaboratively with them and obtain insight into their product roadmaps and future requirements. Because our technologies and fonts are embedded in the hardware of our customers' CE devices, it would be costly and time-consuming to replace them. Our OEM customers include many of the largest and most successful companies in each of the markets that we serve. In the mobile phone and CE device space, we provide technologies to market leaders Nokia, Motorola and Sony Ericsson. In the laser printer market our customers include eight of the top ten laser printer manufacturers based on the volume of units shipped worldwide. Our operating system and application partners include Microsoft, Apple, QUALCOMM and Symbian.

*International Presence and Technologies Designed to Serve the Global Market.* In 2008 and in 2007, 67.5% and 68.7% of our revenue, respectively, was derived from sales by our operating subsidiaries located in Japan, the United Kingdom, Germany and China. Our customers are located in North America, Asia, Europe and other parts of the world. Our technologies and font IP are critical to our OEM customers that

manufacture high volume CE devices that have multimedia functionality and multinational distribution. We support all of the world's major languages. We have specifically designed scalable font rendering technologies for displaying rich content in Asian and other non-Latin languages. We enable OEM customers to engineer a common platform supporting multiple languages, reducing costs and time to market and increasing product flexibility. This is critical to manufacturers of high volume CE devices that have multimedia functionality and multinational distribution. Increasingly, the center of design, manufacturing and consumption of CE devices is in China, Japan and Korea. We have over 17 years of experience partnering with Asian companies such as Ricoh, Toshiba and Kyocera Mita. Additionally, through our acquisition of China Type Design, we have expanded our text imaging solutions portfolio and our international presence. In 2009, we opened a sales office in Seoul, Korea which will further expand our presence in Asia.

*Strong Web Presence and Font Design Services.* We have built an extensive customer base of creative and business professionals to whom we license fonts. Our flagship website with the intuitive domain name, *fonts.com*, along with our other e-commerce websites, including the European site *linotype.com*, provide us with a substantial web presence offering more than 150,000 font products. We have also provided custom font design and branding services to many multinational corporations.

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

*Experienced Leadership and Employee Base.* Our senior management has an average of 18 years of experience in the text imaging and software solutions businesses. Robert M. Givens, our Chairman of the board of directors, and Douglas J. Shaw, our President, Chief Executive Officer and director, have presided over the successful introduction of our text imaging solutions in each of our served markets for over 20 years. Our Chief Financial Officer, Scott E. Landers, has 12 years of public company experience and experience in the software solutions business. John L. Seguin, our Executive Vice President, is a long-time veteran of companies that supply technologies to the CE device industry. Many of the members of our sales, engineering and support staff have been with us since we began serving OEMs and creative and business professionals. As a result, there is significant continuity between our team and our key customers.

## **Our Strategy**

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

*Increase Penetration of our Technologies and Fonts into Emerging CE Device Categories.* We believe our technologies and fonts are increasingly vital to the mass-market success of certain high growth CE device categories such as digital televisions, set-top boxes, personal navigation devices and digital cameras. We have an established base of customers in these CE device categories and we intend to increase our targeted sales activities to add new customers and increase the number of products, models, applications and systems in which our technologies and fonts are embedded. For example, our Edge technology, which enables the clear display of East Asian text using stylistic fonts, addresses the inherent challenges these new CE devices present, such as memory constraints and low resolution screens. Edge-enhanced fonts provide a new level of memory efficiency and display quality at small text sizes. We intend to market our text imaging solutions for inclusion in emerging CE device categories with sophisticated display imaging needs such as high definition DVD players and DVD recorders and in-vehicle entertainment devices. In addition, we intend to extend our reach into new products, customers and models by continuing to partner with leading independent software vendors.

*Extend our Leadership Position with Enhanced Technologies in the Laser Printer Market.* While the laser printer market has been growing at a slower pace than the market for other CE devices, we have historically sustained consistent growth by anticipating and rapidly adapting to changes in this market. For example, we tailored our products to support PCL and PostScript. With the release of Microsoft Windows Vista, we began supporting XPS and the increased font offering that is part of Microsoft Windows Vista. As laser printers evolved from analog and monochrome to digital and color printers and, more recently to multi-function printers, we also enhanced our existing compression technologies and imaging tools to maintain the high quality rendering of printed text in these new CE devices. We also introduced new products such as our printer driver kits and color tools to address the increasing demand for customized driver applications. We intend to leverage our extensive experience in this market and our long-standing relationships with laser printer manufacturers to maintain our leadership position in the laser printer market.

*Leverage our Installed Base of Leading OEM Customers by Providing New Technologies and Fonts.* Our customers include many of the largest manufacturers in the CE device markets as well as independent software vendors, and we continually seek to develop new technologies and fonts to serve these customers. For example, our Edge technology, which enables the clear display of text using stylistic fonts, addresses the challenges our OEM customers face. By providing additional technologies and fonts, we seek to leverage our core relationships to maintain or increase the average selling prices of our text imaging solutions and to further penetrate our existing OEM customer base. Such technologies include worldwide language support products for laser printers and new products and technologies for multi-function and color printers.

*Expand and Deepen our Global Presence, Particularly in Asia.* We intend to drive our revenue growth by leveraging our knowledge of global markets and our global operations. We believe that the expected continued economic growth in Asia will further the demand for Asian text imaging solutions. Through organic expansion and acquisitions, including our acquisition of China Type Design, we are increasing our ability to service CE device manufacturers and consumers throughout the world. We intend to focus on the Chinese, Japanese and Korean language markets for laser printers and digital copiers, which together represent approximately 25% of the total global laser printer market. We believe there are significant growth opportunities in these markets due to our limited penetration to date.

*Continue to Develop our Online Offerings and Services.* We have a strong online presence with our websites *fonts.com*, *itcfonts.com*, *linotype.com*, *faces.co.uk* and *fontexplorerx.com*. Together these websites attracted more than 25 million visits in 2008 from over 200 countries and territories. We believe there are opportunities to increase our revenue per visitor by continuing to offer innovative solutions to this community of users, as well as to benefit from growth in web traffic at these sites. For example, FontExplorer X Pro is available for sale through *fontexplorerx.com* and our Flipfont application and suite of fonts is available online through supported phones. FlipFont enables users to personalize their mobile phone with fonts.

*Selectively Pursue Complementary Acquisitions, Strategic Partnerships and Third-Party Intellectual Property.* We intend to pursue selected acquisitions, strategic partnerships and third-party intellectual property to accelerate our time to market with complementary text imaging solutions, penetrate new geographies and enhance our intellectual property portfolio. We believe that the market for laser printer and other text imaging technologies is still fragmented. We have a demonstrated track record of identifying, acquiring and integrating companies that enhance our intellectual property portfolio.

## **Our Customers**

Our technologies and services are sold to customers in two principal markets: OEM and creative professional. The OEM market consists of both CE device manufacturers and independent software

vendors. Our creative professional customers include purchasers of font end-user licenses, a large proportion of which are large publishing firms, corporations and advertising agencies. In 2008, 2007 and 2006 our revenue in these two markets was as follows (in thousands):

<u>Principal Markets</u>	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	<u>Revenue</u>	<u>Percentage of Total Revenue</u>	<u>Revenue</u>	<u>Percentage of Total Revenue</u>	<u>Revenue</u>	<u>Percentage of Total Revenue</u>
OEM .....	\$ 77,810	70%	\$ 72,612	69%	\$64,268	75%
Creative Professional .....	33,051	30%	32,540	31%	21,936	25%
Total .....	<u>\$110,861</u>	<u>100%</u>	<u>\$105,152</u>	<u>100%</u>	<u>\$86,204</u>	<u>100%</u>

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

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

- mobile phone makers Nokia, Motorola, Sony Ericsson;
- eight of the top ten laser printer manufacturers based on the volume of units shipped worldwide and our technology and products ship in one of the two remaining manufacturers' devices through our relationship with their printer device manufacturers;
- digital television and set-top box manufacturers TTE Technology, Toshiba, JVC; and
- other multinational corporations and automotive and financial corporations such as Agilent, British Airways and Barclays.

In 2008, 2007 and 2006, our top ten licensees by revenue accounted for approximately 46.3%, 46.6% and 53.0% of our total revenue, respectively. In 2008, 2007 and 2006, no one customer accounted for more than 10% of our total revenue.

## Sales and Marketing

Our OEM sales efforts are focused on large CE device manufacturers and independent software vendors with whom we seek to establish long-term relationships. Our creative and business professional sales representatives directly target prospective corporate clients and specialty dealers to whom we may provide our fonts and custom font design services.

Our marketing organization works to deliver a consistent message detailing our capabilities and to develop new avenues for presenting our text imaging solutions. Our marketing efforts are principally focused on promoting our websites *fonts.com*, *itcfonts.com*, *linotype.com*, *faces.co.uk* and *fontexplorerx.com* through affiliate programs, search engine optimization and email marketing which drive traffic to our websites. Once at our websites, creative and business professionals can find recent typographic news, read typeface designer profiles and access a wealth of educational content, in addition to a selection of more than 150,000 font products.

We promote our text imaging solutions through a combination of newsletters, web content, brochures, print advertising and attendance at conferences and tradeshow. Our email marketing communications, directed to a registered user base that has opted to receive our emails, include

font-related articles, company news and news articles and product offerings. We also maintain our corporate website at *monotypeimaging.com*, which focuses on promoting our corporate identity and our offerings for our OEM customers.

## **Research and Development**

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

In 2008, 2007 and 2006, we incurred research and development expenses of \$14.9 million, or 13.4% of sales, \$18.8 million, or 17.9% of sales, and \$13.8 million, or 16.0% of sales, respectively. Further information on research and development expenses may be found in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

## **Intellectual Property**

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

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

Some of our fonts are owned by third parties and are licensed to us under exclusive and non-exclusive licenses. We have also collaborated with third parties in the production and development of fonts.

## **Competition**

Our text imaging solutions compete with those offered by a variety of companies, including vendors of laser printer and display imaging technologies and printer drivers and providers of fonts. We compete principally on the basis of our technical innovation, engineering and customer support expertise, the breadth of our font offerings and the overall performance of our text imaging solutions, including reliability and timely delivery. Competition with our solutions principally comes from Adobe and Bitstream, Inc., or Bitstream, but we also compete with local providers of text imaging solutions that offer solutions specific to a particular country's language requirements. We also compete with FreeType, an open source collaborative organization that provides its Linux font rendering code for free, with printer driver provider Software Imaging and with Extensis with respect to our FontExplorerX product. The competition for our fonts and custom font design services generally comes from companies offering their

own typeface libraries and custom typeface services, including Bitstream, Adobe, font foundry websites, font-related websites and independent professionals. We also compete with in-house resources of our OEM customers in the areas of font technologies.

Some of our current or future competitors may have significantly greater financial, technical, marketing and other resources than we do, may enjoy greater name recognition than we do, or may have more experience or advantages than we have in the markets in which they compete. Further, many of the CE devices that incorporate our solutions also include solutions developed by our competitors. As a result, we must continue to invest significant resources in product development in order to enhance our text imaging solutions and introduce new high-quality solutions to meet the wide variety of such competitive pressures. Our ability to generate revenue from our business will suffer if we fail to do so successfully.

### Employees and Consultants

At December 31, 2008, we employed 238 persons. In addition, we have an exclusive relationship with Creative Calligraphy Center, a consulting firm that provides font design and production services in China. The table below provides our employees by functional area.

	<u>Number of Employees</u>	<u>Percentage</u>
Sales and marketing .....	94	40%
Research and development .....	93	39%
General and administration .....	<u>51</u>	<u>21%</u>
Total .....	<u>238</u>	<u>100%</u>

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

### Segment Information

Information concerning revenue from our two principal markets for the last three years may be found in Note 16 to our consolidated financial statements. We do not allocate expenses and assets to our two principal markets, OEM and creative professional, and operating results are assessed on an aggregate basis to make decisions about the allocation of resources. Further information about our principal markets and segment information, including geographic revenue, may be found in Note 16 to our consolidated financial statements.

### Corporate and Investor Information

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

further information about the public reference room. You may also inspect our SEC reports and other information at the offices of the Financial Industry Regulatory Authority, 1735 K Street, N.W., Washington, D.C. 20006.

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

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

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

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

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

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

We derive a substantial majority of our revenue from the licensing of our text imaging solutions to OEMs. For the years ended December 31, 2008, 2007 and 2006, our top ten licensees by revenue accounted for approximately 46.3%, 46.6% and 53.0% of our total revenue, respectively. Accordingly, if we are unable to maintain these relationships or establish relationships with new customers, our licensing revenue will be adversely affected. In addition, our license agreements are generally for a limited period of time and, upon expiration of their license agreements, OEMs may not renew their agreements or may elect not to enter into new agreements with us on terms as favorable as our current agreements.

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

The CE device markets are highly competitive and CE device manufacturers are continually looking for ways to reduce the costs of components included in their products in order to maintain or broaden consumer acceptance of those products. Because our technologies are a component incorporated into CE



devices, when negotiating renewals of customer contracts, we face pressure from our customers to lower our license fees. We have in the past, and may in the future, need to lower our license fees to preserve customer relationships or extend use of our technology to a broader range of products. To the extent we lower our license fees in the future, we cannot be certain that we will be able to achieve related increases in the use of our technologies or other benefits to fully offset the effects of these adjustments.

***A continued decline in the value of our common stock could result in an impairment charge that if material, could result in a default of our debt covenants.***

As a result of our acquisitions, we have significant goodwill and indefinite-lived intangible assets on our balance sheet. We test our goodwill and our indefinite-lived assets for impairment annually and test our goodwill and our indefinite-lived intangible assets for impairment on an interim basis when events or changes in circumstances indicate that the carrying value may not be recoverable. The deteriorating macro-economic environment and the decline in our stock price, may necessitate the performance of an interim goodwill or an indefinite-lived intangible impairment analysis or both. This testing may determine that our goodwill or indefinite-lived intangible assets are impaired in whole, in part, or not at all. Any impairment will require us to record a non-cash charge, which could be material. If we record a material impairment charge on our goodwill or indefinite-lived intangible assets, it could result in non-compliance with our Amended and Restated Credit Agreement.

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

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

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

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

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

We expect that our future success will depend, in part, upon our ability to successfully penetrate existing markets for CE devices, including laser printers, digital copiers, mobile phones, digital televisions,

set-top boxes, navigation devices and digital cameras. To date, we have penetrated only some of these markets. Our ability to grow our revenue depends upon our ability to further penetrate these markets and to successfully penetrate those markets in which we currently have no presence. Demand for our text imaging solutions in any of these developing markets may not develop or grow, and a sufficiently broad base of OEMs may not adopt or continue to use products that employ our text imaging solutions. Because of our limited experience in some of these markets, we may not be able to adequately adapt our business and our solutions to the needs of these customers. In addition, traditionally we have licensed our technologies and fonts to OEMs that embed our technology on their platforms.

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

New licensing and business models are evolving in the software industry. For example, a company may provide software applications, data and related services over the Internet, using primarily advertising or subscription-based revenue models. Recent advances in computing and communications technologies have made this model viable. As software licensing models evolve, we may not be successful in adapting to these new business models and our business prospects could suffer.

***The rate of growth of the market for CE devices is uncertain.***

Our success depends in large part upon the ability of CE device manufacturers who license our text imaging solutions to successfully market and sell their products. Continued growth in the adoption of CE devices like mobile phones and technological improvements in wireless devices, such as increases in functional memory, are critical to our future growth. If CE device manufacturers do not continue to successfully develop and market new products and services incorporating our text imaging solutions, or the products that our customers develop and market do not meet market acceptance, our revenue and operating results will be adversely affected.

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

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

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

To be successful we must design our text imaging solutions to interoperate effectively with a variety of CE devices. We depend on the cooperation of CE device manufacturers with respect to the components integrated into their devices, such as page description languages, or PDLs, as well as software developers that create the operating systems and applications, to incorporate our solutions into their product offerings. If manufacturers of CE devices elect not to incorporate our solutions into their product offerings, our revenue potential would be adversely affected.

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

Maintaining and strengthening the Monotype and Linotype brands, the *fonts.com*, *itcfonts.com*, *linotype.com* and *faces.co.uk* brands, the FontExplorerX brand, as well as the brands of our fonts, such as

Helvetica and ITC Avant Garde, is critical to maintaining and expanding our business, as well as to our ability to enter into new markets for our text imaging solutions. If we fail to promote and maintain these brands successfully, our ability to sustain and expand our business and enter into new markets will suffer. Maintaining and strengthening our brands will depend heavily on our ability to continue to develop and provide innovative and high-quality solutions for our customers, as well as to continue to maintain our strong online presence. If we fail to maintain high-quality standards, if we fail to meet industry standards, or if we introduce text imaging solutions that our customers or potential customers reject, the strength of our brands could be adversely affected. Further, unauthorized third parties may use our brands in ways that may dilute or undermine their strength.

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

Our future success will depend on market demand for text imaging solutions that enable CE devices to render high quality text. This market is characterized by rapidly changing technology, evolving industry standards and needs, and frequent new product introductions. If the need for laser printers and other CE devices utilizing our technology were to decrease or if current models of these products were replaced by new or existing products for which we do not have a competitive solution or if our solutions are replaced by others that become the industry standard, our customers may not purchase our solutions and our revenue would be adversely affected. For example, if graphical device interface, or GDI, printers became the industry standard replacing PDL printers, our revenue would be adversely affected.

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

Growth in our revenue over the past several years has been the result, in part, of the growth in sales of laser printers incorporating our text imaging solutions and a significant portion of our revenue in 2008, 2007 and 2006 has been derived from laser printer manufacturers. However, as the market for these laser printers matures, we expect that it will grow at a slower rate than other markets in which we operate. If sales of printers incorporating our text imaging solutions level off or decline, then our licensing revenue may be adversely affected.

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

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

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

- sales and marketing advantages;
- advantages in the recruitment and retention of skilled personnel;
- advantages in the establishment and negotiation of profitable strategic, distribution and customer relationships;

- advantages in the development and acquisition of innovative software technology and the acquisition of software companies;
- greater ability to pursue larger scale product development and distribution initiatives on a global basis;
- substantially larger patent portfolios; and
- operational advantages.

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

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

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

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

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

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

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

We hold patents related to certain of our rasterizer and compression technologies and trademarks on many of our fonts. Our patents may be challenged or invalidated, patents may not issue from any of our

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

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

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

We have offices in five foreign countries and we are dedicating a significant portion of our sales efforts in countries outside North America. We are dependent on international sales for a substantial amount of our total revenue. In 2008 and 2007, approximately 67.5% and 68.7%, respectively, of our total revenue was derived from operations outside the U.S and we expect that international sales will continue to represent a substantial portion of our revenue for the foreseeable future. This future international revenue will depend on the continued use and expansion of our text imaging solutions, including the licensing of our technologies and fonts worldwide.

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

- our ability to enforce our contractual and intellectual property rights, especially in those foreign countries that do not respect and protect intellectual property rights to the same extent that the United States does, which increases the risk of unauthorized and uncompensated use of our text imaging solutions;
- United States and foreign government trade restrictions, including those that may impose restrictions on importation of programming, technology or components to or from the United States;
- foreign government taxes, regulations and permit requirements, including foreign taxes that we may not be able to offset against taxes imposed upon us in the United States, and foreign tax and other laws limiting our ability to repatriate funds to the United States;
- foreign labor laws, regulations and restrictions;
- changes in diplomatic and trade relationships;
- difficulty in staffing and managing foreign operations;

- political instability, natural disasters, war and/or events of terrorism; and
- the strength of international economies.

***We are an international company and, as a result, we face significant foreign currency exchange rate risk***

We face risks related to fluctuations in foreign currency exchange rates, in particular fluctuations in the exchange rate of the Japanese yen, the European Union's euro, and the United Kingdom's pound sterling, including risks related to hedging activities we may undertake. For example, prior to instituting foreign currency hedging, we recorded losses on foreign currency exchange of \$1.4 million in 2005 primarily due to fluctuation in the value of the Japanese yen relative to the United States dollar. Although we attempt to mitigate a portion of these risks through foreign currency hedging, these activities may not effectively offset the adverse financial effect resulting from unfavorable movements in currency exchange rates.

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

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

***The Microsoft Windows Vista operating system could have an adverse impact on our future licensing revenue.***

Among the changes incorporated into the Microsoft Windows Vista operating system are fundamental changes to the printing and networking subsystems within the operating system. Microsoft Windows Vista includes fonts and a new Extensible Markup Language referred to as XML Paper Specification language, or XPS. Should we fail to be compatible with these technologies, or if the laser printer market shifts away from PCL and PostScript to Microsoft Windows Vista's language, our licensing revenue could be adversely affected.

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

Disputes and litigation regarding the ownership of technologies and fonts and rights associated with text imaging solutions, such as ours, are common, and sometimes involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own patents may therefore provide little or no deterrence. Third parties have from time to time claimed, and in the future may claim, that our products and services infringe or violate their intellectual property rights. Any such claims could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages and prevent us from selling our products. We may be forced to litigate to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of other parties' proprietary rights. Even if we were to prevail, any litigation regarding intellectual property could be costly and time-consuming and divert the attention of our management and key personnel from our business operations. We may also be obligated to indemnify our customers or business partners pursuant to any such litigation, which could further exhaust our resources.

Furthermore, as a result of an intellectual property challenge, we may be required to enter into royalty, license or other agreements, and we may not be able to obtain such agreements at all or on terms acceptable to us. We have been in the past involved in litigation with third parties, including Adobe, to defend our intellectual property rights and have not always prevailed.

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

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

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

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

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

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

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

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

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

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

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

***We are incurring increased costs and demands upon management as a result of complying with the laws and regulations affecting public companies, which could affect our operating results.***

As a public company we are incurring significant legal, accounting and other expenses that we did not incur as a private company, including costs associated with public company reporting requirements. We also have incurred and will incur costs associated with recently adopted corporate governance requirements, including requirements under the Sarbanes-Oxley Act, as well as rules implemented by the SEC, and the NASDAQ Global Select Market. The expenses incurred by public companies for reporting and corporate governance purposes have been increasing. We expect that the rules and regulations applicable to us could cause our legal and financial compliance costs to increase and could make some activities more time-consuming and costly. In addition, in the current public company environment



officers and directors are subject to increased scrutiny and may be subject to increased potential liability. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as our executive officers. In addition, our management team will also have to adapt to the requirements of being a public company, as most of our senior executive officers have limited experience in the public company environment. This could negatively impact our future success.

***If we fail to maintain proper and effective internal controls in the future, our ability to produce accurate financial statements could be impaired, which could adversely affect our ability to operate our business and our stock price.***

Implementing adequate internal financial and accounting controls and procedures to ensure that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. Section 404 of the Sarbanes-Oxley Act requires annual management assessments of the effectiveness of our internal controls over financial reporting and that our independent auditors separately report on the effectiveness of our internal control over financial reporting. Both we and our independent auditors will be testing our internal controls in connection with the Section 404 requirements and could, as part of that documentation and testing, identify material weaknesses, significant deficiencies or other areas for further attention or improvement in the future. Our networks may be vulnerable to security risks and hacker attacks, which may affect our ability to maintain effective internal controls as contemplated by Section 404. Implementing any appropriate changes to our internal controls in the future may require specific compliance training for our directors, officers and employees, entail substantial costs to modify our existing accounting systems, and take a significant period of time to complete. Such changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In addition, future disclosure regarding our internal controls or investors' perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements may adversely affect our stock price.

***Because of their significant stock ownership, some of our existing stockholders are able to exert substantial control over us and our significant corporate decisions.***

As of December 31, 2008, our executive officers, directors and their affiliates, in the aggregate, beneficially owned approximately 39.8% of our outstanding common stock. As a result, these persons, acting together, have the ability to control the outcome of all matters submitted to our stockholders for approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets. In addition, these persons, acting together, have the ability to substantially control the management and affairs of our company. This concentration of ownership may harm the market price of our common stock by, among other things:

- delaying, deferring or preventing a change in control of our Company;
- causing us to enter into transactions or agreements that are not in the best interests of all stockholders; or
- discouraging potential acquirers from making offers to purchase our Company.

***Our quarterly results and stock price may fluctuate significantly.***

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

- general economic conditions;
- demand for CE devices that include our text imaging solutions;
- demand for our fonts and custom font design services;

- delays in product shipment by our customers;
- industry consolidation;
- introduction, enhancement and market acceptance of text imaging solutions by us and our competitors;
- price reductions by us or our competitors or changes in how text imaging solutions are priced;
- the mix of text imaging solutions offered by us and our competitors;
- the mix of international and U.S. revenue generated by our solutions;
- financial implications of acquisitions, in particular foreign acquisitions involving different accounting standards, foreign currency issues, international tax planning requirements and the like;
- timing of billings to customers on royalty reports received by us under our licensing agreements; and
- our ability to hire and retain qualified personnel.

For example, as a result of the schedule of royalty reporting from laser printer and other CE device manufacturers, our OEM revenue in the third quarter of 2008 was lower than the revenue in the prior quarter. In the third quarter of 2008 our OEM revenue declined by approximately \$0.4 million, compared to the prior quarter due to the timing of product delivery and billings to a significant customer. Also, as a result of variances on the timing of transactions through our e-commerce websites, our revenue varies from quarter to quarter. In addition, a substantial portion of our quarterly revenue is based on actual shipments by our customers of products incorporating our text imaging solutions in the preceding quarter, and not on contractually agreed upon minimum revenue commitments. Because the shipping of products by our customers is outside our control and difficult to predict, our ability to accurately forecast quarterly revenue is limited. Additionally, under a fixed fee license agreement we have, we have agreed to certain reductions in the fee payable over a period of years. Quarterly fluctuations in our operating results may, in turn, cause the price of our stock to fluctuate substantially. We believe that quarterly comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indication of our future performance.

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

Our future success depends in large part upon the continued services of key members of our senior management team. All of our executive officers and key employees are at-will employees. Douglas J. Shaw, who was appointed Chief Executive Officer on January 1, 2007, has been with the Company in various senior management roles for more than 20 years. Mr. Shaw has been critical to the overall management of the Company, as well as the development of our solutions, our culture and our strategic direction. The loss of his services or of the services of other key members of our senior management could seriously harm our ability to execute our business strategy. We also may have to incur significant costs in identifying, hiring, training and retaining replacements for key employees.

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

Our performance is largely dependent on the talents and efforts of highly skilled individuals, including font designers who are recognized as leaders in the industry and experienced software engineers. These individuals have acquired specialized knowledge and skills with respect to us and our operations. These individuals can be terminated or can leave our employ at any time. Some of these

individuals are consultants. If any of these individuals or a group of individuals were to terminate their employment unexpectedly or end their consulting relationship sooner than anticipated, we could face substantial difficulty in hiring qualified successors, could incur significant costs in connection with their termination and could experience a loss in productivity while any such successor obtains the necessary training and experience.

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

***We may expand through acquisitions of other companies, which may divert our management's attention or result in additional dilution to stockholders or use of resources that are necessary to operate other parts of our business.***

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

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

In addition, a significant portion of the purchase price of companies we acquire may be allocated to acquired goodwill and other intangible assets, which must be assessed for impairment at least annually. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our earnings based on this impairment assessment process, which could harm our results of operations. Acquisitions could also result in potentially dilutive issuances of equity securities or in the incurrence of debt, which could adversely affect our operating results. In addition, if an acquired business fails to meet our expectations, our operating results may suffer.

***Our past growth through acquisitions may not be representative of future growth.***

Our revenue for 2007 was 22.0% higher than our revenue for 2006. Revenue grew approximately 14.2% due to the inclusion of the results of operations of Linotype and China Type Design for a full year in 2007, compared to only five months in 2006. We do not expect to sustain similar growth in future periods. For example, our revenue in 2008 was 5.4% higher than our revenue in 2007, with no acquisitions in either period.

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

### ***Our substantial indebtedness could affect our financing options and liquidity.***

We have \$113.6 million of debt outstanding and an undrawn \$20.0 million revolving credit facility. Availability under the line-of-credit was reduced by approximately \$4.0 million at December 31, 2008, as a result of our outstanding derivative instruments with our lender. Our indebtedness is secured by substantially all of our assets and could have important consequences to our business or the holders of our common stock, including:

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

### ***We are subject to restrictive debt covenants that impose operating and financial restrictions on us and could limit our ability to grow our business.***

Covenants in our credit facility impose significant operating and financial restrictions on us. These restrictions prohibit or limit, among other things, our incurrence of additional indebtedness, dividends and distributions, asset sales, transactions with affiliates and acquisitions and creation of certain types of liens. These restrictions could limit our ability to take advantage of business opportunities. Furthermore, our indebtedness requires us to maintain a maximum leverage ratio. Our ability to comply with this ratio may be affected by events beyond our control, including prevailing economic, financial and industry conditions. If we are unable to comply with the covenants and leverage ratio in our current credit facility in the future, we may be unable to obtain waivers of non-compliance from the lenders, which would put us in default under the facility, or we may be required to pay substantial fees or penalties to the lenders. If we are in default under the facility, the rate of interest we are charged on the facility will increase, which we may be unable to pay on a continual basis. These developments could have a material adverse effect on our business.

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

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

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

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

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

***Shares of our common stock are relatively illiquid.***

There has only been a public market for our common stock since the completion of our initial public offering in July 2007. For the quarterly period ended December 31, 2008, the average daily trading volume of our common stock on the NASDAQ Global Select Market was less than 85,000 shares. As a result of our relatively small public float, our common stock may be less liquid than the stock of companies with broader public ownership. Among other things, trading of a relatively small volume of our common stock may have a greater impact on the trading price for our shares than would be the case if our public float were larger.

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

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

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

We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and the repayment of indebtedness and do not anticipate declaring or paying any cash dividends for the foreseeable future. Moreover, our credit agreement relating to our senior credit facility arranged by Wells Fargo Foothill, Inc., or First Lien Credit Facility, imposes restrictions on our ability to declare and pay dividends.

***Future sales of our common stock may cause our stock price to decline.***

Our stockholders that held our stock prior to our initial public offering now hold a significant percentage of our outstanding shares of common stock. Any sale (or any distributions by partnership stockholders to their limited partners followed by a sale) by us or our current stockholders of our common stock in the public market, or the perception that sales could occur, could adversely affect the prevailing market price for our common stock.

Certain of the holders of our common stock prior to our initial public offering have rights, subject to some limited conditions, to demand that we file a registration statement on their behalf to register their shares or that we include their shares in a registration statement that we file on our behalf or on behalf of other stockholders. If such demand rights are exercised pursuant to the terms and conditions of the registration rights agreement, we will incur significant expenses in connection with the filing of such registration statement. Additionally, the filing of a registration statement at the request of the stockholders may divert the attention of our senior management from our business operations.

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

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

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

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

<u>Location</u>	<u>Principal Use</u>	<u>Approximate Square Feet</u>	<u>Lease term</u>
<b>Facilities Used in Current Operations</b>			
Bad Homburg, Germany . . . . .	R&D, Marketing, Sales and Administrative	21,000	Leased; expires in 2012 with two 5-year renewal options
Salfords, United Kingdom . . . . .	R&D, Marketing, Sales and Administrative	6,000	Leased; expires in 2013
Woburn, Massachusetts, USA . .	R&D, Marketing, Sales, Administrative and Corporate	38,000	Leased; expires in February 2011

We also maintain six additional leased facilities in Mount Prospect, Illinois, Redwood City, California, Boulder, Colorado, Berkshire, United Kingdom, Tokyo, Japan, Korea and Hong Kong. These additional offices occupy approximately 40,000 square feet in the aggregate. We do not consider any specific leased facility to be material to our operations. We believe equally suited facilities are available in several other areas throughout the United States and abroad.

**Item 3. Legal Proceedings**

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

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

No matters were submitted to a vote of security holders during the quarter ended December 31, 2008.

## PART II

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

#### Market Information and Related Stockholder Matters

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

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

	<u>High</u>	<u>Low</u>
<b>Period 2008:</b>		
First Quarter .....	\$15.70	\$12.63
Second Quarter .....	16.01	11.89
Third Quarter .....	13.22	10.69
Fourth Quarter .....	10.90	3.90
<b>Period 2007:</b>		
Third Quarter (commencing on July 25, 2007) .....	\$14.00	\$11.40
Fourth Quarter .....	17.49	13.04

The closing price of our common stock, as reported by the NASDAQ Global Select Market, was \$2.13 on March 2, 2009.

#### Holders

As of March 2, 2009, there were approximately 107 holders of record of our common stock.

#### Dividends

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

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

The following table sets forth information regarding securities authorized for issuance under the Company’s equity compensation plans as of December 31, 2008. To date, the Company has not granted any warrants or rights.

<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options</u>	<u>Weighted-average exercise price of outstanding options</u>	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column) (3)</u>
Equity compensation plans approved by security holders (1) .....	3,077,231	\$7.95	3,470,408
Equity compensation plans not approved by security holders (2) .....	—	—	—
<b>Total</b> .....	<b>3,077,231</b>	<b>\$7.95</b>	<b>3,470,408</b>

- (1) Includes our 2004 Stock Option and Grant Plan, or 2004 Award Plan, and our 2007 Stock Option and Incentive Plan, or 2007 Award Plan.
- (2) There are no equity compensation plans in place not approved by security holders.
- (3) Total shares allocated to the plans less the total number of awards granted through December 31, 2008.

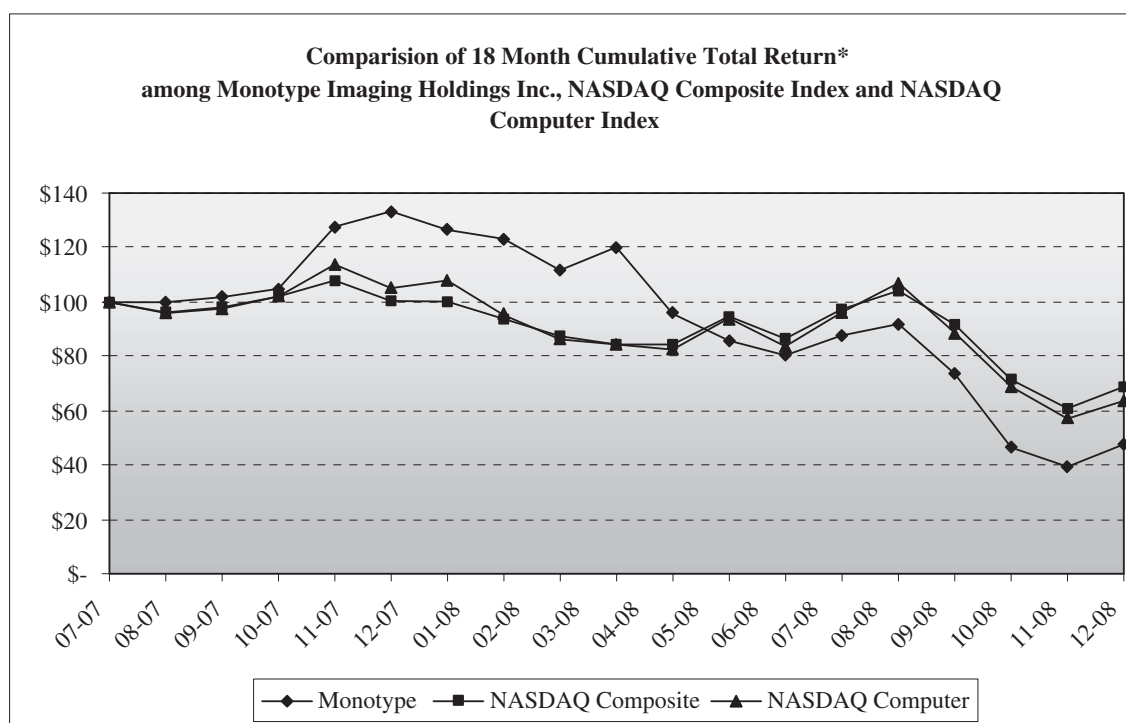
## Listing Requirements

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

## Performance Graph

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

The following graph shows a comparison from July 25, 2007, the date our common stock commenced trading on the NASDAQ Global Select Market, through December 31, 2008 of the cumulative total return for our common stock, The NASDAQ Composite Index and The NASDAQ Computer Index. Such returns are based on historical results and are not intended to suggest future performance. Data for The NASDAQ Composite Index and The NASDAQ Computer Index assumes that dividends, if any, were reinvested.



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

## Unregistered Sales of Equity Securities

None.

## Issuer Purchases of Securities

Pursuant to the terms of our 2004 Award Plan, we have the right to repurchase unvested restricted shares from employees upon their termination, and it is generally our policy to do so. Pursuant to the terms of our 2007 Award Plan, we automatically reacquire any unvested restricted shares at their original price from the grantee upon termination of employment. We did not repurchase any shares of our common stock during the quarterly period ended December 31, 2008.



## Item 6. Selected Financial Data

The following selected consolidated financial data should be read in conjunction with, and is qualified by reference to, our consolidated financial statements and related notes and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” appearing elsewhere in this report. The data presented for the years ended December 31, 2008, 2007 and 2006, and as of December 31, 2008 and 2007, are derived from our audited consolidated financial statements included elsewhere in this report. The data for the twelve months ended December 31, 2006 includes the operating results of Linotype, following our acquisition of Linotype on August 1, 2006, and the results of operations of China Type Design, following our acquisition of China Type Design on July 28, 2006. The data presented for the year ended December 31, 2005 reflects our operations after we were acquired from Agfa Corporation and is derived from our audited consolidated financial statements not included in this report. The data presented for the predecessor period from January 1, 2004 through November 4, 2004 and the post-acquisition period November 5, 2004 through December 31, 2004, and as of December 31, 2005 and 2004, are derived from our consolidated financial statements not included in this report.

	(In thousands except share and per share data)					
	Years Ended December 31,				November 5,	January 1,
	2008	2007	2006	2005	2004 to December 31, 2004	2004 to November 4, 2004
		(Successor)				(Predecessor)
<b>Condensed Consolidated Statement of Operations Data:</b>						
Revenue .....	\$ 110,861	\$ 105,152	\$ 86,204	\$ 73,776	\$ 13,037	\$ 52,010
Cost of revenue .....	9,101	8,705	8,305	9,513	1,224	8,577
Cost of revenue-amortization of acquired technology .....	3,392	3,376	3,021	2,408	401	728
Marketing and selling .....	22,911	19,206	14,931	11,730	1,853	9,299
Research and development .....	14,867	18,837	13,813	10,668	1,835	8,290
General and administrative .....	19,882	15,605	10,112	5,639	1,081	7,948
Transaction bonus .....	—	—	—	—	—	25,207
Amortization of other intangibles ..	6,924	7,162	6,687	6,459	1,073	607
Total costs and expenses .....	77,077	72,891	56,869	46,417	7,467	60,656
Income (loss) from operations .....	33,784	32,261	29,335	27,359	5,570	(8,646)
Other (income) expense:						
Interest (income) expense, net .....	8,077	17,554	19,516	14,735	2,034	(335)
Loss on extinguishment of debt .....	—	2,958	—	—	—	—
Other (income) expense, net .....	556	(2,147)	(3,164)	819	284	109
Total other expense (income) .....	8,633	18,365	16,352	15,554	2,318	(226)
Income (loss) before provision for income taxes .....	25,151	13,896	12,983	11,805	3,252	(8,420)
Provision (benefit) for income taxes .....	9,770	4,832	5,921	4,684	1,338	(2,817)
Net income (loss) .....	\$ 15,381	\$ 9,064	\$ 7,062	\$ 7,121	\$ 1,914	\$ (5,603)
Net (loss) income available to common stockholders .....	\$ 15,381	\$ (25,022)	\$ (17,325)	\$ 92	\$ 106	\$ (5,603)
Net (loss) income per common share:						
Basic .....	\$ 0.45	\$ (1.55)	\$ (7.37)	\$ 0.07	\$ 0.08	\$ (5,603.00)
Diluted .....	\$ 0.44	\$ (1.55)	\$ (7.37)	\$ 0.05	\$ 0.07	\$ (5,603.00)
Weighted average number of common shares outstanding:						
Basic .....	33,818,508	16,174,165	2,351,356	1,417,484	1,371,016	1,000
Weighted average number of common shares outstanding:						
Diluted .....	35,304,794	16,174,165	2,351,356	27,421,316	26,000,656	1,000

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
<b>Consolidated Summary Balance Sheet Data:</b>					
Cash and cash equivalents .....	\$ 31,941	\$ 19,584	\$ 8,540	\$ 10,784	\$ 9,237
Total current assets .....	41,191	28,096	16,362	16,199	16,146
Total assets .....	277,421	276,346	270,273	203,879	211,761
Total current liabilities .....	38,227	40,882	35,337	30,552	23,893
Total debt .....	113,596	131,400	202,898	157,809	131,598
Convertible redeemable preferred stock .....	—	—	40,170	15,793	58,268
Additional paid-in capital .....	142,676	138,219	687	226	—
Total stockholders' equity (deficit) .....	120,836	102,007	(12,580)	3,703	1,899

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

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

### **Overview**

We are a leading global provider of text imaging solutions. Our technologies and fonts enable the display and printing of high quality digital text. Our software technologies have been widely deployed across, and embedded in, a range of CE devices, including laser printers, digital copiers, mobile phones, digital televisions, set-top boxes, navigation devices and digital cameras, as well as in numerous software applications and operating systems. In the laser printer market, we have worked together with industry leaders for over 17 years to provide critical components embedded in printing standards. Our scaling, compression, text layout, printer driver and color technologies solve critical text imaging issues for CE device manufacturers by rendering high quality text on low resolution and memory constrained CE devices. We combine these proprietary technologies with access to more than 10,000 typefaces from a library of some of the most widely used designs in the world, including popular names such as Helvetica and Times New Roman. We also license our typefaces to creative and business professionals through custom font design services, direct sales and our e-commerce websites *fonts.com*, *itcfonts.com*, *linotype.com*, *faces.co.uk* and *fontexplorerx.com*, which attracted more than 25 million visits in 2008 from over 200 countries and territories.

During November 2008, we announced a restructuring plan. The plan was to reduce headcount in certain areas and redeploy certain other employees within the Company in order to focus on key initiatives across the business. The small headcount reduction will be offset by the hiring of a few key additional employees whose technical expertise is better aligned with our key initiatives.

### **Sources of Revenue**

We derive revenue from two principal sources: licensing our text imaging solutions to CE device manufacturers and independent software vendors, which we refer to as our OEM revenue, and licensing our fonts to creative and business professionals, which we refer to as our creative professional revenue. We derive our OEM revenue primarily from CE device manufacturers. We derive our creative professional revenue primarily from multinational corporations, graphic designers, advertisers, printers and publishers. Historically, we have experienced, and we expect to continue to have, lower revenue in the first quarter of the year due to the timing of some contractual payments of licensing fees from our OEM customers. In prior years we have experienced, and we may in the future have, seasonal slowness in the third quarter of the year from our creative professional customers.

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

	2008		2007		2006	
	Sales	% of Total	Sales	% of Total	Sales	% of Total
	(In thousands of dollars, except %)					
United States .....	\$ 35,975	32.5%	\$ 32,873	31.3%	\$37,050	43.0%
Asia .....	42,658	38.5	40,823	38.8	33,732	39.1
United Kingdom ....	12,905	11.6	12,171	11.6	8,653	10.0
Germany .....	19,323	17.4	19,285	18.3	6,769	7.9
Total .....	<u>\$110,861</u>	<u>100.0%</u>	<u>\$105,152</u>	<u>100.0%</u>	<u>\$86,204</u>	<u>100.0%</u>

For the years ended December 31, 2008, 2007 and 2006, sales by our subsidiaries located outside North America comprised 67.5%, 68.7% and 57.0%, respectively, of our total revenue. We expect that sales by our international subsidiaries will continue to represent a substantial portion of our revenue for the foreseeable future. Future international revenue will depend on the continued use and expansion of our text imaging solutions worldwide.

We derive a majority of our revenue from a limited number of customers, in particular manufacturers of laser printers and mobile phones. For the years ended December 31, 2008, 2007 and 2006, our top ten licensees by revenue accounted for approximately 46.3%, 46.6% and 53.0% of our total revenue, respectively. No one customer accounted for more than 10% of our total revenue in 2008, 2007 and 2006.

### **OEM Revenue**

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

### **Creative Professional Revenue**

Our creative professional revenue is derived from font licenses and from custom font design services. We license fonts directly to end-users through our e-commerce websites, via telephone, email and indirectly through third-party resellers. We also license fonts and provide custom font design services to graphic designers, advertising agencies and corporations.

Revenue from font licenses to our e-commerce customers is recognized upon payment by the customer and electronic shipment of the software embodying the font. Revenue from font licenses to other customers is recognized upon shipment of the software embodying the font. Revenue from resellers is recognized upon notification from the reseller that our font product has been licensed. We generally recognize custom font design services revenue upon delivery.

### **Cost of Revenue**

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

Cost of revenue also includes amortization of acquired technology, which we amortize over 12 to 15 years. For purposes of amortizing acquired technology we estimate the remaining useful life of the technology based upon various considerations, including our knowledge of the technology and the way our customers use it. We use the straight-line method to amortize our acquired technology. There is no reliable evidence to suggest that we should expect any other pattern of amortization than an even pattern, and we believe this best reflects the expected pattern of economic usage.

### **Marketing and Selling**

Our marketing and selling expense consists of salaries, bonuses, commissions and benefits related to our marketing and selling personnel, business travel expenses, advertising and trade show expenses, web-related expenses, allocated facilities costs and other overhead expenses. Sales commission expense varies as a function of revenue and goal achievement from period-to-period. During 2008, there was a shift in headcount from development related activities to primarily focus on presale customer support and commercial web site development. Together with annual salary increases and increased share based compensation expense, this resulted in increased personnel costs in 2008, as compared to 2007. We anticipate that our marketing and selling expense will increase in 2009 as a result of a full year of expenses associated with this headcount shift.

### **Research and Development**

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

Our research and development is primarily focused on enhancing the functionality of our text imaging solutions and developing new products. From time to time we license third-party font technology in connection with new technology development projects that are part of our research and development efforts. Our research and development costs are expensed as incurred. During 2008, there was a shift in headcount from development related activities to primarily focus on presale customer support and commercial web site development, resulting in a decrease in research and development expenses as compared to 2007; however, increased annual salaries and increases in other personnel related expenses

offset the majority of the decrease. A significant portion of the research and development share based compensation expense is associated with a consultant, who was granted restricted stock in connection with the acquisition of China Type Design. The restricted stock for this consultant is subject to variable accounting.

### **General and Administrative**

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

In 2008, our general and administrative expenses were significantly higher than in 2007, primarily a result of expenses relating to a secondary offering of our common stock in June 2008 and increased Sarbanes Oxley expenses.

### **Restructuring**

On November 10, 2008, the Company announced a restructuring plan. Under the restructuring plan, the Company reduced headcount in certain areas and redeployed certain other employees within the Company in order to focus on key initiatives across the business. The small headcount reduction will be offset by the hiring of a few key additional employees whose technical expertise is better aligned with our key initiatives. We do not anticipate an overall change in headcount. As of December 31, 2008, we recorded \$0.7 million of restructuring costs for severance and termination benefits, which is included in our operating expenses. The restructuring plan was completed at December 31, 2008, other than making deferred cash payments to certain terminated employees. Future cash expenditures related to this plan are expected to be approximately \$0.4 million, net of tax savings.

### **Amortization of Intangible Assets**

We amortize intangible assets acquired as follows:

- Customer relationships—10 to 15 years; and
- Non-compete agreements—4 to 6 years.

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

### **Acquisitions**

On August 1, 2006, we completed the acquisition of the capital stock of Linotype. We also acquired certain fonts and other intellectual property assets from the seller of the Linotype capital stock. The total purchase price for Linotype and the related intellectual property was approximately \$59.7 million in cash, which included the related acquisition costs of approximately \$0.7 million. The purchase price was financed with proceeds from the term loans under our credit facilities. Linotype's results of operations have been included in our consolidated financial statements since the date of acquisition and all inter-company balances have been eliminated.

On July 28, 2006, we acquired 80.01% of the capital stock of China Type Design for approximately \$4.1 million in cash and three promissory notes in the aggregate amount of \$0.6 million that converted into a total of 415,903 shares of our common stock in connection with our initial public offering. Prior to

their conversion, the notes accrued interest at 3.9% per annum and the principal and accrued interest converted into our common stock at a price of \$1.50 per share. At the time of this acquisition, we already had a 19.99% ownership interest in China Type Design, and following the acquisition, it became our wholly-owned subsidiary. The results of operations of China Type Design have been included in our consolidated financial statements since the date of acquisition and all inter-company balances have been eliminated. Prior to the acquisition, we did not have the ability to exercise significant influence over operating and financial policies of China Type Design, and accordingly, the results of its operations were accounted for using the cost method of accounting.

We accounted for the acquisitions of Linotype and China Type Design using the purchase method of accounting in accordance with Statements of Financial Accounting Standards (“SFAS”) No. 141, *Business Combinations*.

### **Critical Accounting Policies**

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

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

#### **Revenue Recognition**

We recognize revenue in accordance with Statement of Position, *Software Revenue Recognition*, or SOP 97-2, as modified by SOP 98-9, *Modifications of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions*. Revenue is recognized when persuasive evidence of an agreement exists, the product has been delivered or services have been provided, the fee is fixed or determinable, and collection of the fee is probable.

#### **Sales Taxes**

We record revenue net of sales taxes. Sales taxes are collected and remitted to tax authorities as required, typically on a monthly or quarterly basis. Prior to 2008, Japanese consumption taxes were remitted on an annual basis. As a result, accrued sales tax in years prior to 2008 consisted principally of Japanese consumption tax. Further information can be found in Note 6 to our consolidated financial statements included in this report under Item 8.

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

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

In light of the deteriorating macro-economic environment, declines in the stock market and the decline of the Company's market capitalization, we may be required to perform interim goodwill impairment analyses in the future. Our stock price has continued to decline subsequent to December 31, 2008 and has reached a level at which, if sustained, or if it deteriorates further, may require us to perform goodwill impairment analysis. This analysis may determine that our goodwill is impaired in whole, in part, or not at all. In the event that the Company determines that its goodwill is impaired in whole, or in part, the Company will record a non-cash charge, which could be material. At this time, the Company cannot determine if an impairment charge is probable and cannot reasonably estimate the amount, if any, of potential impairment charges. If an impairment of goodwill is recognized, an analysis of impairment of our other long-lived assets would be required pursuant to SFAS 144. In the event that the Company determines that these assets are impaired, the Company will record a non-cash charge, which could be material. If we record a material impairment charge on our goodwill, indefinite-lived intangibles or our long-lived assets, it could result in non-compliance with our Amended and Restated Credit Agreement.

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

Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), *Share Based Payment*, or SFAS 123R, using the prospective method. SFAS 123R requires that all share based payments to employees, including grants of stock options and restricted stock, be recognized in the statements of operations based on their fair values at the grant dates. We use the Black-Scholes option pricing model to determine the fair value of stock options granted to employees. In accordance with SFAS 123R, we recognized the fair value of employees share based awards granted or modified on or after January 1, 2006 using the straight line method over the vesting period of the award.

Prior to our initial public offering, or IPO, on July 25, 2007 there was no public market for our common stock, and, in connection with our issuance of stock options, our board of directors, with the assistance of management, had the ultimate responsibility for determining the value of our common stock. In the absence of a public market for our common stock, the board of directors considered objective and subjective factors in determining the fair value of our common stock, including the liquidation preferences, redemption rights and conversion rights of our then-outstanding convertible preferred stock and the likelihood and timing of achieving a liquidity event such as an initial public offering or sale of the Company.

Prior to March 31, 2006, we granted our employees options to purchase common stock at exercise prices equal to the fair market value of the underlying stock at the time of each grant, as determined by our compensation committee.

In valuing the common stock our compensation committee considered a number of factors, including:

- the illiquidity of our capital stock as a private company;
- the business risks we faced;
- the liquidation preferences, redemption rights and other rights, preferences and privileges of our outstanding preferred stock;
- the outstanding balances on our credit facilities; and
- our actual financial condition and results of operations relative to our formal operating plan during the relevant period.

Effective March 31, 2006, the compensation committee determined to follow the procedures recommended in the American Institute of Certified Public Accountants Technical Practice Aid, *Valuation of Privately-Held Company Equity Securities Issued as Compensation*, or the Practice Aid. This approach requires an assessment of future prospects, based on the value of the business using a series of potential outcomes and weighing the probability of each of those outcomes. Management prepared three scenarios,

a base case, an optimistic case and a pessimistic case. The possibility of an initial public offering was also considered. The compensation committee reviewed a market comparison of our business with a number of publicly traded firms to test the reasonableness of the overall analysis. The compensation committee reviewed the methodology, the resulting valuation and changed the probabilities of the outcomes that were initially applied as well as the weight given to those probabilities to more accurately reflect the changes in the business.

At the date of each option grant, our board of directors determined that the exercise price for each option was equivalent to the then-existing fair value of our common stock. Our board of directors believes it properly valued our common stock in all periods.

Since our IPO, we have valued awards granted based on the grant date closing price of our common stock as traded on the NASDAQ Global Market or the NASDAQ Global Select Market, as applicable. Refer to Note 2 of our consolidated financial statements, for a discussion on our Black-Scholes valuation assumptions under SFAS 123R. During the year ended December 31, 2008, we recorded total share based compensation expense of \$3.6 million, which includes a credit of approximately \$0.1 million associated with the China Type Design restricted shares. During the year ended December 31, 2007, we recorded total share based compensation expense of \$4.3 million, of which \$2.6 million is associated with the China Type Design restricted shares. During the year ended December 31, 2006, we recorded total share based compensation expense of \$0.4 million. In connection with our initial public offering, three promissory notes issued in connection with the acquisition of China Type Design were converted into 415,903 shares of restricted common stock. These shares vest over a four year period that commenced upon the issuance of the notes in July 2006. As of December 31, 2008, the Company had \$10.5 million of unrecognized compensation expense related to employees and directors unvested stock option awards and restricted share awards that are expected to be recognized over a weighted average period of 2.9 years.

### **Pension Plan**

We account for our defined benefit pension plan in accordance with SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plan*. Our unfunded defined benefit pension plan was acquired in connection with our acquisition of Linotype on August 1, 2006. The plan covers substantially all employees of our Linotype subsidiary who joined Linotype prior to April 1, 2006, at which time the pension plan was closed to new participants. Benefits under this plan are based on the employees' years of service and compensation. We fund the plan sufficiently to meet current benefits only. There are no assets associated with the plan. In 2008 and 2007 we paid \$67 thousand and \$55 thousand, respectively, to the plan. At December 31, 2008 and 2007, our unfunded position was \$2.9 million and \$3.2 million, respectively. A significant portion of the pension benefit obligation is determined based on the rate of future compensation increases. Given the fact that the pension plan is unfunded, changes in economic and market conditions may require us to increase cash contributions in future years.

### **Provision for Income Taxes**

We provide for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*, or SFAS 109. Under this method, a deferred tax asset or liability is determined based on the difference between the financial statement and the tax basis of assets and liabilities, as measured by enacted tax rates in effect when these differences are expected to be reversed. This process includes estimating current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and financial accounting purposes. These differences result in deferred tax assets and liabilities. We also assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe recovery to be unlikely, we have established a valuation allowance. Significant judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any



valuation allowance against our deferred tax assets. Our financial position and results of operations may be materially affected if actual results significantly differ from these estimates or the estimates are adjusted in future periods.

For the year ended December 31, 2008, our effective tax rate was 38.8%. Our 2008 effective tax rate was higher than our 2007 effective tax rate of 34.8%, primarily due to the fact that the 2007 rate was decreased by 10.3% as a result of a change in German tax laws enacted in the third quarter of 2007, reducing our tax rate on German taxable income and related German deferred tax liabilities from 40% to 30%. This increase was offset by a decrease in the impact of non-deductible share based compensation on the 2008 rate by approximately 7.1% compared to 2007, due to a decrease in the amount of non-deductible share based compensation coupled with an increase in the Company's pretax income. In addition, the 2008 effective tax rate has been increased by 1.6% due to non-deductible stock registration costs incurred during 2008 in connection with our secondary offering. In 2008 our effective tax rate also benefitted from a reduction in our state deferred tax rate of 2.1%.

In connection with the preparation of its quarterly financial statements for the three months ended September 30, 2008, the Company discovered that it had been erroneously providing for state income taxes based on an incorrect apportionment methodology since 2005. The methodology applied resulted in the overstatement of deferred tax liabilities and a corresponding overstatement of its provision for income taxes. In accordance with SEC Staff Accounting Bulletin (SAB) No. 99, *Materiality* and SAB No. 108 ("SAB 108"), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, the Company assessed the materiality of this error on its financial statements for the year ended December 31, 2007, using both the roll-over method and iron-curtain method as defined in SAB 108. The Company concluded the effect of this error was not material to its financial statements for any prior period and, as such, those financial statements are not materially misstated. The Company also concluded that providing for the correction of the error in 2008 will not have a material effect on its financial statements for the year ending December 31, 2008. Accordingly, the Company recorded a reduction to its provision for income taxes of \$527 thousand and a corresponding reduction to its deferred income tax liabilities in 2008 to correct this error.

The 2007 effective tax rate was lower than the 2006 rate, primarily as a result of the impact of the German tax rate reduction on deferred tax liabilities in Germany. Our actual payments for taxes are significantly lower than our book tax expenses because we amortize goodwill and indefinite-lived intangible assets for tax purposes. The difference between the amortization for tax purposes and accounting for financial statements in accordance with GAAP gives rise to a deferred tax liability for GAAP. The balance of this GAAP deferred tax liability at December 31, 2008 was \$14.1 million. This balance is included within the net intangible and goodwill deferred tax liabilities disclosed in the footnotes to our consolidated financial statements, and is expected to increase each year over the 15 year period that goodwill and indefinite-lived intangible assets are amortized for tax purposes, unless goodwill and indefinite-lived intangibles are determined to be impaired for GAAP purposes. In the event of an impairment, a charge would be recognized in our financial statements, and the GAAP deferred tax liability would be reversed. This charge and reversal of the deferred tax liability would not give rise to a payment of taxes. Absent an impairment, the change in these deferred tax liabilities from period to period generally approximates the additional deduction for amortization we receive for tax purposes, but not for book tax expense.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB 109*, or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting for interim periods,

disclosure and transition. We adopted FIN 48 effective January 1, 2007 and the adoption did not have a material impact on our consolidated results of operations or financial condition. As of December 31, 2008, the total amount of unrecognized tax benefits was \$1.6 million. At December 31, 2007 and at the date of adoption, we had \$1.7 million of unrecognized tax benefits. In accordance with FIN 48, paragraph 19, we have decided to classify potential interest and penalties as a component of tax expense. As of December 31, 2008 and 2007 we had \$0.4 million and \$0.3 million of accrued interest and penalties, respectively.

### **Derivative Financial Instruments**

We account for our derivative instruments in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, or SFAS 133, which requires that all derivative instruments be reported on the balance sheet as either assets or liabilities measured at fair value. All changes in the fair value of derivatives are recognized as current period income or expense unless specific hedge criteria are met, which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting at the inception of each instrument. We recorded our derivatives at fair value, which is determined based on the provisions of SFAS 157, *Fair Value Measurements*, using either quoted market prices or prices for similar instruments. The determination of fair value of our derivatives considers our non-performance risk and that of our counterparties.

### **Results of Operations**

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

	<u>Year Ended December 31,</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
<b>Revenue:</b>			
OEM .....	70.2%	69.1%	74.6%
Creative professional .....	29.8	30.9	25.4
Total revenue .....	100.0	100.0	100.0
Cost of revenue .....	8.2	8.3	9.6
Cost of revenue—amortization of acquired technology .....	3.1	3.2	3.5
Marketing and selling .....	20.7	18.3	17.3
Research and development .....	13.4	17.9	16.0
General and administrative .....	17.9	14.8	11.7
Amortization of other intangible assets .....	6.2	6.8	7.8
Total costs and expenses .....	69.5	69.3	65.9
Income from operations .....	30.5	30.7	34.1
Interest expense, net .....	7.3	16.7	22.6
Loss (gain) on foreign exchange .....	0.9	(2.0)	(0.6)
Gain on derivatives .....	(0.5)	—	(0.6)
Loss on extinguishment of debt .....	—	2.8	—
Other expense (income), net .....	0.1	—	(2.4)
Total other expenses .....	7.8	17.5	19.0
Income before provision for income taxes .....	22.7	13.2	15.1
Provision for income taxes .....	8.8	4.6	6.9
Net income .....	<u>13.9%</u>	<u>8.6%</u>	<u>8.2%</u>

## Year Ended December 31, 2008 as Compared to Year Ended December 31, 2007

*Sales by Segment.* We view our operations and manage our business as one segment; the development, marketing and licensing of technologies and fonts. Factors used to identify our single segment include the financial information available for evaluation by our chief operating decision maker, our president and chief executive officer, in determining how to allocate resources and assess performance. While our technologies and services are sold to customers in two principal markets (CE device manufacturers and independent software vendors, together OEM, and creative professional), expenses and assets are not formally allocated to these market segments, and operating results are assessed on an aggregate basis to make decisions about the allocation of resources. The following table presents revenue for these two principal markets (in thousands):

<u>All dollars</u>	<u>2008</u>	<u>2007</u>	<u>Increase</u>
OEM .....	\$ 77,810	\$ 72,612	\$5,198
Creative Professional .....	33,051	32,540	511
Total revenue .....	<u>\$110,861</u>	<u>\$105,152</u>	<u>\$5,709</u>

### Revenue

Revenue was \$110.9 million and \$105.2 million for the years ended December 31, 2008 and 2007, respectively, an increase of \$5.7 million, or 5.4%, mainly due to increased OEM revenue. OEM revenue increased \$5.2 million, or 7.2%, to \$77.8 million for the year ended December 31, 2008 from \$72.6 million for the year ended December 31, 2007. Approximately \$4.9 million, or 94.7%, of the increase was the result of increased royalty and license revenue in 2008. Royalty revenue increased in our display imaging, driver and printer imaging during 2008, as compared to 2007. The license revenue increase was mainly the result of an increase in display imaging. More than half of the increase in OEM in 2008 as compared to 2007 related to display imaging.

Creative professional revenue was \$33.1 million and \$32.5 million for the years ended December 31, 2008 and 2007, respectively, an increase of \$0.5 million, or 1.6%, the result of increased direct and indirect revenue. Web sales increased 10% year over year, which was offset by decreased custom revenue in the same period. A portion of the increase in web revenue was due to price increases on our web products instituted on April 1, 2008. By contrast, we saw a 43% decline in custom font orders from our corporate customers during the year ended December 31, 2008, as compared to the same period in 2007, which we believe is mainly the result of the recent economic downturn.

### Cost of Revenue

Cost of revenue, excluding amortization of acquired technology, was \$9.1 million and \$8.7 million for the year ended December 31, 2008 and 2007, respectively, an increase of \$0.4 million, or 4.6%. Part of the increase was due to the increase in revenue and the rest was due to product mix over the prior period. Cost of revenue as a percentage of total revenue was 8.2% and 8.3% for the years ended December 31, 2008 and 2007, respectively, which reflects a more favorable product mix in 2008 as compared to 2007. We performed less custom work in 2008 as compared to 2007 which typically has a higher associated cost.

Amortization of acquired technology was \$3.4 million in both years ended December 31, 2008 and 2007.

### Operating Expenses

*Marketing and Selling.* Marketing and selling expense was \$22.9 million and \$19.2 million in 2008 and 2007, respectively, an increase of \$3.7 million, or 19.3% primarily the result of increased personnel

related expenses. Personnel expenses increased \$2.8 million in 2008 as compared to 2007, which included an increase in share based compensation expense of \$0.7 million and severance costs of \$0.3 million, related to our restructuring. Marketing and selling headcount increased 22.1% in 2008, as compared to 2007, mainly the result of shifting the primary focus of several employees from development related activities to presale customer support and commercial web site development. Increased web-based advertising spending in 2008, as compared to 2007, contributed \$0.3 million to the increase.

*Research and Development.* Research and development expense was \$14.9 million and \$18.8 million, in 2008 and 2007, respectively, a decrease of \$3.9 million, or 21.1%. The decrease was primarily the result of a decrease in personnel costs. Share based compensation expense decreased \$2.2 million in 2008 as compared to 2007, primarily due to the conversion of China Type Design promissory notes into shares of restricted stock in connection with our initial public offering in 2007. In 2007, we recorded \$2.6 million of share based compensation expense on these awards, of which \$2.1 million relates to the conversion, and in 2008 we recorded a credit of \$0.1 million. A significant portion of the China Type Design share based compensation is accounted for in accordance with the rules for non-employee stock awards and as a result, fluctuates with changes in our stock price. This was partially offset by an increase in share based compensation expense on employee awards of \$0.5 million in 2008, as compared to 2007. Other personnel related expenses decreased \$1.4 million. During 2008, there was a shift in the primary focus of several employees from development related activities toward presale customer support and commercial web site development. This shift resulted in a 17% reduction in research and development headcount; however, increased salaries and increases in other personnel related expenses offset the majority of the decrease in expenses from this reduction in headcount.

*General and Administrative.* General and administrative expense was \$19.9 million and \$15.6 million in 2008 and 2007, respectively, an increase of \$4.3 million, or 27.4%. Increased personnel costs contributed \$1.7 million to the overall increase, which included increased share based compensation expense of \$0.9 million, the result of severance costs of \$0.3 million, associated with our restructuring, and increased headcount for most of the year along with annual compensation increases in 2008, as compared to 2007. Increased spending on Sarbanes-Oxley Act compliance of \$0.7 million in 2008, as compared to 2007, also contributed to the overall increase. Our first year of compliance with all provisions of the Sarbanes-Oxley Act was 2008. In the second quarter of 2008, we filed a registration statement with respect to a secondary offering of our common stock under a contractual agreement with a shareholder, which contributed \$1.2 million to the overall increase in general and administrative expenses in 2008, compared to \$0.3 million in expense in the same period of 2007 related to our initial public offering. The cost of filing the registration statement was recorded as an expense because the Company did not receive proceeds from the offering. Legal expenses, other than those associated with the registration statement, increased \$0.5 million primarily the result of the ongoing protection of our intellectual property. Going forward, we expect to have lower Sarbanes-Oxley related expenses as the Company moves past the initial compliance hurdle.

*Amortization of Other Intangible Assets.* Amortization of other intangible assets was \$6.9 million and \$7.2 million for the years ended December 31, 2008 and 2007, respectively, a decrease of \$0.2 million, or 3.3%, primarily due to non-compete agreements that became fully amortized during the fourth quarter of 2008. In 2009, we expect amortization to decrease by approximately \$2.1 million, which represents the remaining yearly decrease in amortization of this asset.

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

Interest expense, net of interest income was \$8.1 million in 2008, as compared to \$17.6 million in 2007, a decrease of \$9.5 million, or 54.0%. The decrease is the result of lower total debt outstanding in 2008 as compared to 2007, as well as a decreased rate of interest on the outstanding debt. Total debt outstanding, net of unamortized financing and debt discounts, at December 31, 2008 was \$113.6 million as compared to \$131.4 million at December 31, 2007. In April 2008, we paid approximately \$6.8 million

on the principal of our First Lien Credit Facility in accordance with the agreement. At December 31, 2008, the blended rate of interest on our First Lien Credit Facility was 3.2% as compared to a blended rate of interest of 7.8% at December 31, 2007. We anticipate a further reduction in our interest expense going forward as we continue to have less total debt outstanding.

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

Loss (gain) on foreign exchange was a loss of \$1.0 million and a gain of \$2.1 million in 2008 and 2007, respectively, a decrease of \$3.1 million, primarily due to a loss on our intercompany note. We recorded a \$1.1 million loss on our Euro denominated intercompany note in 2008, as compared to a gain of \$2.1 million on this note in 2007.

#### ***Gain on Derivatives***

Gain on derivatives was \$0.6 million and \$14 thousand in 2008 and 2007, respectively, an increase of \$0.6 million, primarily due to an increase in our use of derivatives to manage risks. During 2008, we entered into a long term currency swap contract to mitigate exposure on our Euro denominated intercompany note. In 2008, the gain on this derivative was \$1.9 million. This was partially offset by a loss on our interest rate swap of \$1.3 million in 2008. We entered into a long term interest rate swap contract in November 2008 to mitigate our exposure to interest rate fluctuations on our debt obligations. There were no currency swap contracts or interest rate swap contracts outstanding in 2007. In 2007 the gain of \$14 thousand related to our interest rate caps.

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

In 2007, we recorded a loss of approximately \$3.0 million on the extinguishment of our Second Lien Credit Facility. On July 30, 2007, we paid in full the \$70 million balance on our Second Lien Credit Facility using the proceeds from our initial public offering, the refinancing of our First Lien Credit Facility and cash on hand. We incurred a prepayment penalty of \$1.4 million as a result of the transaction and wrote off approximately \$1.6 million in unamortized deferred financing costs. There were no similar charges during the same period in 2008.

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

For the year ended December 31, 2008, our effective tax rate was 38.8%. The 2008 effective rate was higher than the 2007 effective tax rate of 34.8%, primarily due to a decrease in the 2007 rate by 10.3% as a result of a change in German tax laws enacted in the third quarter of 2007, reducing our tax rate on German taxable income and related German deferred tax liabilities from 40% to 30%. As a result, deferred taxes related to our German operations have been adjusted to reflect the rates expected to be in effect when those deferred taxes are expected to reverse. In 2008, our effective tax rate was reduced by 2.1% resulting from a reduction in state income tax rates, and the corresponding adjustment to deferred state income taxes. This was partially offset by a decrease in non-deductible share based compensation in 2008 to 1.7%, from 8.8%, the result of a reduction in the amount of non-deductible share based compensation expense coupled with an increase in the Company's pre-tax income. In addition, the 2008 effective tax rate increased by 1.6% due to non-deductible stock registration costs incurred during 2008.

We recorded a tax provision of \$9.8 million during the 2008 fiscal year. The effective tax rate for 2008 was 38.8% of income before taxes, compared to an effective tax rate of 34.8% of income before taxes for 2007. Our tax rate in 2008 differs from the statutory rates primarily due to the effects of stock compensation charges of \$1.2 million that will not result in a tax deduction in the future. This had the effect of increasing the tax provision by \$0.4 million and the overall effective tax rate by 1.7%. In addition, the current year tax rate is increased as a result of the effect of non-deductible stock registration costs of \$1.2 million that had the effect of increasing the provision by \$0.4 million, and the overall effective tax

rate by 1.6%. We have recorded a valuation allowance against certain deferred tax assets, including foreign tax credits, where we have determined that their future use is uncertain. SFAS No. 109 requires a valuation allowance be established when it is “more likely than not” that all or a portion of deferred tax assets will not be realized. A review of all available positive and negative evidence is considered, including a company’s performance, the market environment in which the company operates, length of carry-back and carry-forward periods, existing sales backlog, future taxable income projections and tax planning strategies. We have historically provided valuation allowances on certain tax assets, due to the uncertainty of generating taxable income in the appropriate jurisdiction and of the appropriate character to realize such assets. In these instances, the Company has made the determination that it is “more likely than not” that all or a portion of the deferred tax will not be realized. The Company will continue to review its deferred tax position on a periodic basis and will reflect any change in judgment as a discrete item in the related period.

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

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax expense together with assessing the future impact of temporary differences resulting from differing treatment of items for tax and accounting purposes. The tax effect of these temporary differences is shown on our December 31, 2008 consolidated balance sheet (see Note 11 to our consolidated financial statements) and denotes these differences as a net deferred tax liability of \$15.1 million. This consists of total deferred tax liabilities of \$18.3 million and net deferred tax assets of \$3.2 million after providing a valuation allowance of \$3.0 million.

### **Year Ended December 31, 2007 as Compared to Year Ended December 31, 2006**

The following discussion compares the year ended December 31, 2007 with the year ended December 31, 2006. Revenue and operating expenses in 2007 as compared to 2006 increased substantially as a result of the acquisition of Linotype. Revenue and operating expenses from China Type Design have been included in the period since its acquisition but have not had a material effect on our financial statements.

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

<u>All dollars</u>	<u>2007</u>	<u>2006</u>	<u>Increase</u>
OEM .....	\$ 72,612	\$64,268	\$ 8,344
Creative Professional .....	32,540	21,936	10,604
Total revenue .....	<u>\$105,152</u>	<u>\$86,204</u>	<u>\$18,948</u>

### **Revenue**

Revenue was \$105.2 million and \$86.2 million for the years ended December 31, 2007 and 2006, respectively, an increase of \$18.9 million, or 22.0%. We experienced growth in both OEM and creative professional revenue year over year. OEM revenue was \$72.6 million and \$64.3 million for the year ended December 31, 2007 and 2006, respectively, an increase of \$8.3 million, or 13.0%. Approximately

\$5.4 million of this increase was the result of a full year of Linotype revenue in 2007 as compared with five months of Linotype revenue in 2006, and a \$2.2 million increase in royalty revenue. Creative professional revenue increased \$10.6 million, or 48.3%, from \$21.9 million for the year ended December 31, 2006 to \$32.5 million for the year ended December 31, 2007. Approximately \$7.1 million of this increase was the result of a full year of revenue from Linotype. In addition, web sales increased by \$1.7 million and direct sales increased by \$1.4 million.

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

Cost of revenue, excluding amortization of acquired technology, was \$8.7 million and \$8.3 million for the year ended December 31, 2007 and 2006, respectively, an increase of \$0.4 million, or 4.8%. This increase was primarily due to the increase in revenue over the prior period. Cost of revenue as a percentage of total revenue was 8.3% and 9.6% for the years ended December 31, 2007 and 2006, respectively. The decrease, as a percent of revenue, was primarily a result of a reduction of third-party royalties following our acquisition of Linotype and lower custom revenue.

Amortization of acquired technology increased \$0.4 million, or 11.8%, to \$3.4 million for the year ended December 31, 2007 as compared to \$3.0 million in the same period in 2006. The increase was primarily due to our acquisition of Linotype during the third quarter of 2006.

### ***Operating Expenses***

*Marketing and Selling.* Marketing and selling expense was \$19.2 million and \$14.9 million, in 2007 and 2006, respectively, an increase of \$4.3 million, or 28.6%. This increase was primarily the result of our acquisition of Linotype and employee-related expenses. A full year of Linotype expenses in 2007 contributed \$2.4 million of the increase. Employee-related expenses increased by \$1.1 million, including share based compensation expense, due to increased headcount from 2006. Increased spending on web-based advertising contributed \$0.2 million to the increase.

*Research and Development.* Research and development expense was \$18.8 million and \$13.8 million, in 2007 and 2006, respectively, an increase of \$5.0 million, or 36.4%. This increase was primarily the result of \$2.9 million in share based compensation expense, \$2.6 million of which is associated with our acquisition of China Type Design, and an additional \$1.6 million of expenses related to a full year of Linotype expenses in 2007 as compared to five months of expenses in 2006.

*General and Administrative.* General and administrative expense was \$15.6 million and \$10.1 million, in 2007 and 2006, respectively, an increase of \$5.5 million, or 54.3%. Expenses increased in several areas within general and administrative in 2007 mainly as a result of two items: a full year of Linotype expenses in the current period and share based compensation expense. We acquired Linotype in August 2006 and a full year of Linotype expenses in 2007, as compared to five months of Linotype expenses in 2006, contributed \$2.5 million to the increase. Increased costs associated with our efforts to comply with the Sarbanes-Oxley Act, additional costs incurred in preparation for becoming a public company and increased legal expenses together contributed \$0.8 million. Employee-related expenses, including an increase in share based compensation expense of \$0.7 million, contributed \$1.7 million to the increase. In addition, headcount increased in 2007 as compared to the same period in 2006, primarily as a result of increased headcount and infrastructure to operate as a public company. The increase in legal expenses of \$0.2 million was primarily related to trademark and patent work associated in part with our acquisition of Linotype in 2006.

*Amortization of Other Intangible Assets.* Amortization of other intangible assets was \$7.2 million and \$6.7 million for the year ended December 31, 2007 and 2006, respectively, an increase of \$0.5 million, or 7.1%. The increase related primarily to amortization on the acquired intangible assets of Linotype.

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

Interest expense, net of interest income was \$17.6 million in 2007 as compared to \$19.5 million in 2006, a decrease of \$1.9 million, or 10.1%. In July 2007, we reduced our total debt outstanding by \$70.0 million with the repayment of our Second Lien Credit Facility and renegotiated the borrowing rates of our First Lien Credit Facility. In July 2006, we had increased our borrowings to finance the Linotype and China Type acquisitions. As a result, in the first seven months of 2007, our interest expense was higher than the same period of 2006. For the remaining months of 2007 as compared to the same period in 2006, we had significantly less interest expense as our total borrowings were less and our borrowing rates were lower. Going forward, we anticipate a reduction in our interest expense as we have less total debt outstanding and we expect to continue to reduce debt using cash flow from operations.

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

Loss (gain) on foreign exchange was a gain of \$2.2 million and a gain of \$0.6 million in 2007 and 2006, respectively, an increase of \$1.5 million or 257.6%. The increase primarily relates to our Euro denominated intercompany note.

### ***Gain on derivatives***

Gain on derivatives was \$14 thousand and \$0.5 million in 2007 and 2006, respectively, a decrease of approximately \$0.5 million. The gains in both periods related to our interest rate cap contracts.

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

In 2007, we recorded a loss of approximately \$3.0 million on the extinguishment of our Second Lien Credit Facility. On July 30, 2007, we paid in full the \$70 million balance on our Second Lien Credit Facility using the proceeds from our initial public offering, the refinancing of our First Lien Credit Facility and cash on hand. We incurred a prepayment penalty of \$1.4 million as a result of the transaction and wrote off approximately \$1.6 million in unamortized deferred financing costs. There were no similar charges during the same period in 2006.

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

Other income, net of other expense was \$16 thousand and \$1.6 million in 2007 and 2006, respectively, a decrease of \$1.6 million, or 99.0%. In the year ended December 31, 2006, we recognized a \$1.7 million gain for a one-time tax exemption from foreign sales tax. There was no similar gain in 2007.

### ***Dividend income***

In 2006, we recorded dividend income of \$0.5 million pertaining to our 20% investment in China Type Design. China Type Design became our wholly-owned subsidiary in July 2006. There were no investments in 2007.

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

For the year ended December 31, 2007, our effective tax rate was 34.8%. The 2007 rate decreased from 2006, primarily as a result of a change in German tax laws enacted in the third quarter of 2007, reducing the tax rate on our taxable income in Germany from 40% to 30%. As a result, deferred taxes related to our German operations have been adjusted to reflect the rates expected to be in effect when those deferred taxes are expected to reverse.

We recorded a tax provision of \$4.8 million during the 2007 fiscal year. The effective tax rate for 2007 was 34.8% of income before taxes, compared to an effective tax rate of 45.6% of income before taxes



for 2006. Our tax rate in 2007 differs from the statutory rates due to the recognition of a \$1.4 million tax benefit related to the above-mentioned change in German tax rates which resulted in a 10.3% decrease in the overall effective tax rate. Other significant differences in the effective tax rate are due to the effects of stock compensation charges of \$3.5 million that will not result in a tax deduction in the future. This had the effect of increasing the tax provision by \$1.2 million and the overall effective tax rate by 8.8%. Our tax rate in 2006 reflects the tax effect of certain foreign dividends, not offset by foreign tax credits. We have recorded a valuation allowance against certain deferred tax assets, including foreign tax credits, where we have determined that their future use is uncertain. SFAS No. 109 requires a valuation allowance be established when it is “more likely than not” that all or a portion of deferred tax assets will not be realized. A review of all available positive and negative evidence is considered, including a company’s performance, the market environment in which the company operates, length of carry-back and carry-forward periods, existing sales backlog, future taxable income projections and tax planning strategies. We have historically provided valuation allowances on certain tax assets, due to the uncertainty of generating taxable income in the appropriate jurisdiction and of the appropriate character to realize such assets. In these instances, the Company has made the determination that it is “more likely than not” that all or a portion of the deferred tax will not be realized. The Company will continue to review its deferred tax position on a periodic basis and will reflect any change in judgment as a discrete item in the related period.

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

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax expense together with assessing the future impact of temporary differences resulting from differing treatment of items for tax and accounting purposes. The tax effect of these temporary differences is shown on our December 31, 2007 consolidated balance sheet (see Note 11 to our consolidated financial statements) and denotes these differences as a net deferred tax liability of \$12.5 million. This consists of total deferred tax liabilities of \$15.6 million and net deferred tax assets of \$3.1 million after providing a valuation allowance of \$3.2 million.

## **Recently Issued Accounting Pronouncements**

### *Derivative Instruments and Hedging Activities*

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133*, or SFAS 161. SFAS 161 requires enhanced disclosures about an entity’s derivative and hedging activities. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company does not expect that this new pronouncement will have a material impact on the Company’s financial statements in future periods.

### *Business Combinations*

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*, or SFAS 141R. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008 and applies to all business combinations. SFAS 141R provides that, upon initially obtaining control, an acquirer shall recognize 100 percent of the fair values of acquired assets, including goodwill, and assumed liabilities, with only limited exceptions, even if the acquirer has not acquired 100 percent of its target. As a

consequence, the current step acquisition model will be eliminated. Additionally, SFAS 141R changes current practice, in part, as follows: (1) contingent consideration arrangements will be fair valued at the acquisition date and included on that basis in the purchase price consideration; (2) transaction costs will be expensed as incurred, rather than capitalized as part of the purchase price; (3) pre-acquisition contingencies, such as legal issues, will generally have to be accounted for in purchase accounting at fair value; and (4) in order to accrue for a restructuring plan in purchase accounting, the requirements in FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities, would have to be met at the acquisition date. While there is no expected impact to our consolidated financial statements on the accounting for acquisitions completed prior to December 31, 2008, the adoption of SFAS 141R on January 1, 2009 could materially change the accounting for business combinations consummated subsequent to that date.

#### *Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, or SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. SFAS 157 also expands financial statement disclosures about fair value measurements. On February 6, 2008, the FASB issued FASB Staff Position (FSP) 157-2 which delays the effective date of SFAS 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS 157 and FSP 157-2 are effective for financial statements issued for fiscal years beginning after November 15, 2007. We have elected a partial deferral of SFAS 157 in accordance with the provisions of FSP 157-2 related to the measurement of fair value when evaluating goodwill, other intangible assets and other long-lived assets for impairment. The impact of partially adopting SFAS 157 effective January 1, 2008 was not material to our consolidated financial statements. We do not expect the adoption of FSP 157-2 to be material to our consolidated financial statements.

#### **Liquidity and Capital Resources**

##### ***Initial Public Offering***

On July 30, 2007, we completed our initial public offering, issuing 6.5 million shares of our common stock at a price of \$12.00 per share. Concurrent with the offering, all of our outstanding convertible redeemable preferred shares were converted into an aggregate of 23,361,416 shares of our common stock and 5,840,354 shares of redeemable preferred stock which were redeemed in connection with the offering. After underwriter's commissions and other costs and expenses, we received net proceeds of approximately \$67.2 million and paid the redemption cost of the redeemable preferred stock which totaled approximately \$9.7 million. We used the net proceeds from the offering, net proceeds of \$10.8 million from the amendment to our First Lien Credit Facility and \$1.6 million of cash on hand, to pay in full the outstanding borrowings under our Second Lien Credit Facility of approximately \$70.0 million, plus a \$1.4 million prepayment penalty. The changes to our outstanding debt are described in Credit Facilities, below.

##### ***Cash Flows for the Years Ended December 31, 2008, 2007 and 2006***

Since our inception, we have financed our operations primarily through cash from operations, private and public stock sales and long-term debt arrangements, as described below. We believe our existing cash and cash equivalents, our cash flow from operating activities and available bank borrowings will be sufficient to meet our anticipated cash needs for at least the next twelve months. At December 31, 2008, our principal sources of liquidity were cash and cash equivalents totaling \$31.9 million and a \$20.0 million revolving line-of-credit which was undrawn at December 31, 2008, 2007 and 2006. Availability under the line-of-credit, however, was reduced by approximately \$4.0 million at December 31, 2008 as a

result of our outstanding derivative instruments with our lender. Our future working capital requirements will depend on many factors, including the operations of our existing business, our potential strategic expansion, and future acquisitions we might undertake. To the extent that our cash and cash equivalents, our current debt arrangements and our cash flow from operating activities are insufficient to fund our future activities, we may need to raise additional funds through bank credit arrangements or public or private equity or debt financings. In the event additional funding is required, we may not be able to obtain bank credit arrangements or effect an equity or debt financing on terms acceptable to us or at all especially in light of the economic downturn and the inability or unwillingness of lenders to extend credit.

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

	Year Ended December 31,		
	2008	2007	2006
Net cash provided by operating activities . . . . .	\$ 30,533	\$ 27,278	\$ 19,444
Net cash used in investing activities . . . . .	(1,125)	(1,311)	(65,560)
Net cash (used in) provided by financing activities . . . . .	(17,957)	(15,873)	43,256
Effect of exchange rates on cash and cash equivalents . . . . .	906	950	616
Total increase (decrease) in cash and cash equivalents . . . . .	<u>\$ 12,357</u>	<u>\$ 11,044</u>	<u>\$ (2,244)</u>

### **Operating Activities**

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

We generated \$30.5 million in cash from operations during 2008. Net income, after adjusting for depreciation and amortization, amortization of deferred financing costs, loss on retirement of fixed assets, share based compensation, deferred income taxes, provision for doubtful accounts, unrealized currency loss on foreign denominated intercompany transactions and unrealized gains on derivatives generated \$34.3 million in cash. Prepaid expense and other assets, income tax refunds receivable and deferred revenue provided cash of \$3.1 million. These were offset by increases in accounts receivable and decreases in accounts payable, accrued income taxes, accrued expenses and other liabilities, together which used \$6.9 million in cash. Accounts payable decreased mainly due to certain large vendor payments outstanding at December 31, 2007 for which there were no similar payments outstanding at December 31, 2008. Accrued expense decreased primarily due to larger accrued bonus and sales tax balances at December 31, 2007 than at December 31, 2008 as well as decreased accrued interest due to the timing of payments.

Net cash provided by operations for 2007 was \$27.3 million as compared to \$19.4 million in 2006. Net income, after adjusting for depreciation and amortization, amortization of deferred financing costs, loss on extinguishment of debt, share based compensation, deferred taxes, provision for doubtful accounts, unrealized currency gains and unrealized loss on interest rate caps generated \$24.9 million in cash. Accounts receivable, accounts payable and accrued expenses and other liabilities generated \$4.5 million in cash during the year, which was partially offset by a reduction in our prepaid expenses and other assets and deferred revenue of \$2.5 million. The increase in accrued expenses was mainly due to an increase in foreign sales tax in the current year. We had a one-time tax exemption in 2006 from foreign sales tax in a particular jurisdiction. Net cash provided by accrued income taxes of \$1.8 million was partially offset by a use of cash from income tax refund receivable of \$1.4 million mainly the result of a lower German effective tax rate and an increase in the amount of our tax deduction for goodwill.

In 2006, net income after adjusting for depreciation and amortization, amortization of deferred financing costs and debt discount, share based compensation, deferred income taxes, unrealized currency gains and unrealized loss on interest rate caps generated cash of \$20.7 million. Accrued transaction bonus, deferred compensation and deferred revenue used cash of \$5.2 million, which was partially offset by cash generated from accounts receivable, prepaid expenses and other assets, accounts payable and accrued expenses and other liabilities of \$4.0 million. The decrease in deferred revenue was primarily due to a single customer with a prepaid balance at December 31, 2005 of \$4.5 million that did not make any corresponding prepayments in 2006 and therefore our deferred revenue balance for this customer at the end of 2006 was zero. The accrued transaction bonus was a one time item and is not expected to repeat. Deferred compensation payments made in 2006 relate to a plan that was discontinued in 2004.

### ***Investing Activities***

During 2008, cash used in investing activities was \$1.1 million, consisting of purchases of property and equipment. During 2007, cash used in investing activities was \$1.3 million which consisted primarily of purchases of property and equipment of \$1.2 million.

During 2006, we used \$65.6 million in cash for investing activities, which included \$53.0 million for the acquisitions of Linotype and China Type Design, \$12.0 million for the purchase of exclusive licenses including the intellectual property license associated with the Linotype acquisition and \$0.5 million in capital expenditures. We amended our First and Second Credit Lien Facilities in July 2006 to complete the purchase of Linotype and the intellectual property license that was included in the purchase agreement and the acquisition of China Type Design.

### ***Financing Activities***

During 2008, we used \$18.0 million of cash in financing activities, primarily related to debt payments. Payments on our long-term debt obligations used \$18.6 million in cash. We received \$0.6 million in cash from stock option exercises.

During 2007, we used \$15.9 million of cash in financing activities. We received \$67.4 million in cash from the issuance of common stock associated with our initial public offering, net of underwriter's commissions and other costs and expenses. During the year, we received \$10.8 million in net proceeds from an amendment to our First Lien Credit Facility. Payments on long-term debt were \$84.2 million of which \$70.0 million related to our Second Lien Credit Facility and the remainder was related to installment payments on our debt obligations. We paid \$1.4 million in penalties associated with the early repayment of our Second Lien Credit Facility. We also used \$9.7 million for the redemption of our redeemable preferred stock in connection with the initial public offering. In addition, we received a tax benefit on stock options of \$0.9 million.

During 2006, we generated \$43.3 million of cash from financing activities primarily as a result of \$53.9 million of proceeds related to the amendment of our First and Second Credit Lien Facilities in July 2006. This refinancing was to complete the purchases of Linotype and China Type Design. Additionally, we had cash inflows of \$0.1 million from issuance of common stock. These were partially offset from cash used for the principal payments on long-term debt on the First Lien Credit Facility, deferred costs related to our initial public offering, the repurchase of preferred and common stock and the purchase of interest rate caps to hedge the increase in the debt balances from interest rate increases.

### ***Credit Facilities***

On July 30, 2007, in connection with our initial public offering, we amended and restated our First Lien Credit Facility. Upon entering into our Amended and Restated Credit Agreement on July 30, 2007, the principal amount of our term loan was increased to \$140.0 million payable in monthly installments of

approximately \$1.2 million throughout the term of the facility, which expires in July 2012. The Amended and Restated Credit Agreement provides for an additional annual mandatory principal payment based on excess cash flow, as defined by the agreement, which must be paid within five days of the delivery of our audited financial statements. Also on July 30, 2007, in connection with the initial public offering of our common stock, and with the amendment and restatement of our First Lien Credit Facility, we paid in full the balance of \$70.0 million on our Second Lien Credit Facility, plus a prepayment penalty of \$1.4 million. The prepayment penalty has been recognized as a debt extinguishment expense, along with approximately \$1.6 million of previously capitalized debt financing costs that were written off upon the payoff and termination of the Second Lien Credit Facility.

Interest rates on borrowings under the Amended and Restated Credit Agreement bear interest at either (i) the prime rate plus 1.25%, as defined by the credit agreement, or (ii) the London Inter-Bank Offering Rate, or LIBOR, plus a 2.75%, payable monthly. As of December 31, 2008, the blended interest rate on the First Lien Credit Facility was 3.2%. The Amended and Restated Credit Agreement is secured by substantially all of our assets and places limitations on indebtedness, liens, dividends and distributions, asset sales, transactions with affiliates and acquisitions and conduct of business, all as defined in the agreements. In addition, the Amended and Restated Credit Agreement provides that we maintain a maximum leverage ratio. The leverage ratio is defined as the ratio of aggregate outstanding indebtedness to trailing twelve months Adjusted EBITDA. Adjusted EBITDA is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation expense. As of December 31, 2008, the maximum leverage ratio permitted was 3.25:1.00 and our leverage ratio was 2.39:1.00. The maximum leverage ratio decreased by 0.25 each quarter from April 1, 2008 through December 31, 2008, and will decrease by 0.50 for the quarter ending March 31, 2009 to 2.75:1.00. It will remain at 2.75:1.00 for the remainder of the term of the agreement. The Amended and Restated Credit Agreement also contains a no material adverse change clause.

In May 2007, we amended our First Lien and Second Lien Credit Facilities to define Adjusted EBITDA as described above. In July 2007, we terminated our Second Lien Credit Facility and recognized approximately \$3.0 million of debt extinguishment expense. We also amended our First Lien Credit Facility to provide additional borrowings, reduce our interest rate and modify covenants; however, the Adjusted EBITDA definition was not changed. On April 17, 2008, we amended our First Lien Credit Facility to increase the beneficial ownership threshold in the change of control definition.

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

	Year Ended December 31,		
	2008	2007	2006
Net income .....	\$15,381	\$ 9,064	\$ 7,062
Provision for income taxes .....	9,770	4,832	5,921
Interest expense, net .....	8,077	17,554	19,516
Depreciation and amortization .....	11,441	11,567	10,345
EBITDA .....	\$44,669	\$43,017	\$42,844
Share based compensation .....	3,634	4,257	440
Adjusted EBITDA (1) .....	<u>\$48,303</u>	<u>\$47,274</u>	<u>\$43,284</u>

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

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

The Amended and Restated Credit Agreement also contains provisions for an increased interest rate during periods of default. We do not believe that these covenants will affect our ability to operate our business, and we were in compliance with the covenants under our Amended and Restated Credit Agreement as of December 31, 2008. Our stock price has continued to decline and has reached a level at which, if sustained, or if it deteriorates further, may require us to perform goodwill impairment analysis. This analysis may determine that our goodwill is impaired in whole, in part, or not at all. In the event that the Company determines that its goodwill is impaired, the Company will record a non-cash charge, which could be material. If an impairment of goodwill is recognized, an analysis of impairment of our other long-lived assets would be required pursuant to SFAS 144. In the event that the Company determines that these assets are impaired, the Company will record a non-cash charge, which could be material. If we record a material impairment charge on our goodwill, indefinite-lived intangibles or our long-lived assets, it could result in non-compliance with our Amended and Restated Credit Agreement.

## Other Liquidity Matters

### *Contractual Obligations*

The following summarizes our contractual obligations at December 31, 2008 and the effect of such obligations on liquidity and cash flow in future years (in thousands).

<u>Contractual Obligations</u>	<u>Total</u>	<u>2009</u>	<u>2010-2011</u>	<u>2012-2014</u>	<u>Thereafter</u>
Long-term debt (1) .....	\$115,623	\$17,769	\$27,078	\$70,776	\$—
Operating leases (2) .....	5,396	1,863	2,774	759	—
License fees (2) .....	1,100	900	200	—	—
Total .....	<u>\$122,119</u>	<u>\$20,532</u>	<u>\$30,052</u>	<u>\$71,535</u>	<u>\$—</u>

- (1) See Note 7 to the audited consolidated financial statements included in this report under Item 8.
- (2) See Note 17 to the audited consolidated financial statements regarding contractual obligations included in this report under Item 8.

In addition to the above, we have contractual obligations under our interest rate swap and currency swap instruments at December 31, 2008. The interest rate swap contract has a notional amount of \$80.0 million, decreasing to \$50.0 million effective November 30, 2009 and matures on November 28, 2010.

Under the terms of the agreement, we pay a fixed rate of interest on the notional amount of 2.2% and receive interest on the notional amount at the floating one-month LIBOR rate, which at December 31, 2008 was 0.47125%. Net settlements are due monthly. Under the currency swap contract, we pay 1.0 million Euros and we receive payments of \$1.5 million quarterly. The currency swap contract terminates on December 2012.

We may be required to make cash outlays related to our unrecognized tax benefits. However, due to the uncertainty of the timing of future cash flows associated with our unrecognized tax benefits, we are unable to make reasonably reliable estimates of the period of cash settlement, if any, with the respective taxing authorities. Accordingly, unrecognized tax benefits of \$1.6 million as of December 31, 2008 have been excluded from the contractual obligations table above. For further information on unrecognized tax benefits, see Note 11 to our consolidated financial statements included in this report under Item 8.

#### *Legal proceedings and disputes*

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

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

As of December 31, 2008 and 2007, we did not have any relationships with unconsolidated entities, often referred to as special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Other than our operating leases for office space and computer equipment, and derivative financial instruments discussed in "Quantitative and Qualitative Disclosures about Market Risk," we do not engage in off-balance sheet financing arrangements.

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

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

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

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables. Cash equivalents consist primarily of bank deposits and overnight repurchase agreements. Deposits of cash held outside the United States totaled approximately \$10.8 million and \$11.2 million at December 31, 2008 and 2007, respectively.

We grant credit to customers in the ordinary course of business. Credit evaluations are performed on an ongoing basis to reduce credit risk, and no collateral is required from our customers. An allowance for uncollectible accounts is provided for those accounts receivable considered to be uncollectible based upon historical experience and credit evaluation. As of December 31, 2008 one customer, Nokia accounted for 19% of our gross accounts receivable. As of December 31, 2007, no customer individually accounted for 10% or more of our accounts receivable. Due to the nature of our quarterly revenue streams derived from royalty revenue, it is not unusual for our accounts receivable balances to include a few customers with large balances. Historically, we have not recorded material losses due to customers' nonpayment.

For the years ended December 31, 2008, 2007 and 2006, no customer accounted for more than 10% of our revenue.

### **Interest Rate Risk**

We use interest rate derivative instruments to hedge our exposure to interest rate volatility resulting from our variable rate debt, as more fully described in Note 8 to our consolidated financial statements included in this report under Item 8. SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, or SFAS 133, requires that all derivative instruments be reported on the balance sheet at fair value and establishes criteria for designation and effectiveness of hedging relationships, including a requirement that all designations must be made at the inception of each instrument. As we did not make such initial designations, SFAS 133 requires changes in the fair value of the derivative instrument to be recognized as current period income or expense.

The fair value of derivative instruments is estimated based on the amount that we would receive or pay to terminate the agreements at the reporting date. Our exposure to market risk associated with changes in interest rates relates primarily to our long term debt. The interest rate on our First Lien Credit Facility fluctuates with either the prime rate or the LIBOR interest rate. At December 31, 2008, the blended rate of interest on our outstanding debt was 3.2%. For each one percent increase in interest rates our interest expense would increase by \$1.2 million; however, this would be mitigated by our interest rate cap and interest rate swap. We purchase interest rate cap instruments to hedge our exposure to fluctuations in interest rates on our debt obligations. At December 31, 2008 we had one interest rate cap contract outstanding totaling \$110.0 million. The contract has a fixed rate of 6.5% and expires on December 31, 2010. At December 31, 2007, we had two interest rate cap contracts outstanding totaling \$110.0 million. Under these contracts, to the extent that LIBOR exceeds a fixed maximum rate, we will receive payments on the notional amount. At December 31, 2008, there was a shortfall of approximately \$4 million of our total debt that was unhedged. The total fair value of these financial instruments at December 31, 2008 and 2007 was approximately \$13 thousand and \$900, respectively. In 2008, 2007 and 2006, we recognized a loss of \$33 thousand, a gain of \$14 thousand and a gain of \$0.5 million, respectively which have been included in gain on derivatives in the accompanying consolidated statements of operations.

We purchase interest rate swap instruments to hedge our exposure to interest rate fluctuations on our debt obligations. On November 28, 2008 we entered into a long term interest rate swap contract to pay a fixed rate of interest of 2.2% in exchange for a floating rate interest payment tied to the one-month LIBOR. The contract has a notional amount of \$80.0 million, decreasing to \$50.0 million effective November 30, 2009 and matures on November 28, 2010. The total fair value of the financial instrument at December 31, 2008, was a liability of approximately \$1.3 million. In 2008, we recognized a loss of \$1.3 million which has been included in gain on derivatives in the accompanying consolidated statement of operations.

### **Foreign Currency Exchange Rate Risk**

In accordance with SFAS No. 52, *Foreign Currency Translation*, or SFAS 52, all assets and liabilities of our foreign subsidiaries whose functional currency is a currency other than U.S. dollars are translated into U.S. dollars at an exchange rate as of the balance sheet date. Revenue and expenses of these subsidiaries are translated at the average monthly exchange rates. The resulting translation adjustments as calculated from the translation of the foreign subsidiaries to U.S. dollars are recorded as a separate component of stockholders' equity.

We also incur foreign currency exchange gains and losses related to certain customers that are invoiced in U.S. dollars, but who have the option to make an equivalent payment in their own functional currencies at a specified exchange rate as of a specified date. In the period from that date until payment in the customer's functional currency is received and converted into U.S. dollars, we can incur realized gains and losses. To mitigate our exposure we utilize forward contracts with maturities of 90 days or less to hedge our exposure to these currency fluctuations. Any increase or decrease in the fair value of the



forward contracts is offset by the change in the value of the hedged assets of our consolidated foreign affiliate. At December 31, 2008 there were no currency contracts outstanding. At December 31, 2007, we had one currency contract outstanding with fair value loss of \$74 thousand.

In addition, we incur foreign currency exchange rate gains and losses on an intercompany note with one of our foreign subsidiaries that is denominated in Euros. At December 31, 2008 the note balance was approximately \$22.2 million. The effect of an immediate 10% strengthening of the U.S. dollar as compared to the Euro would result in a \$2.2 million unrealized transaction loss on this note receivable which would be reported in loss (gain) on foreign exchange within our results of operations; however, this would be mitigated by our currency swap. On May 7, 2008, we entered into a long term currency swap contract to purchase 18.3 million Euros in exchange for \$28.0 million to mitigate our exposure to currency fluctuation risk on this note. The contract payment terms approximate the payment terms of this intercompany note and the notional amount is amortized down over time as payments are made. For the year ended December 31, 2008, we incurred gain of \$1.9 million on the currency swap contract which is included in gain on derivatives in the accompanying consolidated statements of operations. Prior to May 7, 2008, this note was unhedged. Gains and loss on the intercompany note are included in loss (gain) on foreign exchange in the accompanying consolidated statements of operations. For the years ended December 31, 2008, 2007 and 2006 we incurred a net foreign exchange loss of \$1.1 million, a gain of \$2.1 million and a gain of \$0.6 million, respectively.

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

**MONOTYPE IMAGING HOLDINGS INC.  
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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Monotype Imaging Holdings Inc. as of December 31, 2008 and 2007, and the related consolidated statements of operations, convertible redeemable preferred stock, redeemable preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedule. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Monotype Imaging Holdings Inc. at December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2007, Monotype Imaging Holdings Inc. adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Monotype Imaging Holdings Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 10, 2009, expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Boston, Massachusetts  
March 10, 2009

**MONOTYPE IMAGING HOLDINGS INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share data)

	December 31,	
	2008	2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents .....	\$ 31,941	\$ 19,584
Accounts receivable, net of allowance for doubtful accounts of \$236 and \$177 at December 31, 2008 and 2007 .....	6,010	4,459
Income tax refunds receivable .....	-	1,391
Deferred income taxes .....	1,637	1,506
Prepaid expenses and other current assets .....	1,603	1,156
Total current assets .....	41,191	28,096
Property, plant and equipment, net .....	2,093	2,290
Goodwill .....	138,898	141,346
Intangible assets, net .....	91,416	102,446
Other assets .....	3,823	2,168
Total assets .....	\$277,421	\$276,346
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable .....	\$ 646	\$ 1,845
Accrued expenses and other current liabilities .....	12,443	13,116
Accrued income taxes .....	1,700	2,687
Deferred revenue .....	5,669	4,652
Current portion of long-term debt .....	17,769	18,582
Total current liabilities .....	38,227	40,882
Long-term debt, less current portion .....	95,827	112,818
Other long-term liabilities .....	1,064	486
Deferred income taxes .....	17,165	15,567
Reserve for income taxes, net of current portion .....	1,343	1,387
Accrued pension benefits .....	2,959	3,199
Commitments and contingencies (Note 17)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, Authorized shares: 10,000,000 at December 31, 2008 and 2007; Issued and outstanding: none .....	-	-
Common shares, \$0.001 par value; Authorized shares: 250,000,000 at December 31, 2008 and 2007; Issued: 34,512,692 and 34,262,941 at December 31, 2008 and 2007, respectively .....	35	34
Additional paid-in capital .....	142,676	138,219
Treasury stock, at cost, 86,194 and 53,194 shares at December 31, 2008 and 2007, respectively .....	(86)	(41)
Accumulated deficit .....	(23,445)	(38,826)
Accumulated other comprehensive income .....	1,656	2,621
Total stockholders' equity .....	120,836	102,007
Total liabilities and stockholders' equity .....	\$277,421	\$276,346

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

**MONOTYPE IMAGING HOLDINGS INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except share and per share data)

	Year Ended December 31,		
	2008	2007	2006
Revenue .....	\$ 110,861	\$ 105,152	\$ 86,204
Cost of revenue .....	9,101	8,705	8,305
Cost of revenue—amortization of acquired technology .....	3,392	3,376	3,021
Marketing and selling .....	22,911	19,206	14,931
Research and development .....	14,867	18,837	13,813
General and administrative .....	19,882	15,605	10,112
Amortization of other intangible assets .....	6,924	7,162	6,687
Total costs and expenses .....	<u>77,077</u>	<u>72,891</u>	<u>56,869</u>
Income from operations .....	33,784	32,261	29,335
Other expense:			
Interest expense .....	8,197	17,759	19,687
Interest income .....	(120)	(205)	(171)
Loss (gain) on foreign exchange .....	1,016	(2,117)	(592)
Gain on derivatives .....	(591)	(14)	(490)
Loss on extinguishment of debt .....	—	2,958	—
Other expense (income), net .....	131	(16)	(1,621)
Dividend income .....	—	—	(461)
Total other expense .....	<u>8,633</u>	<u>18,365</u>	<u>16,352</u>
Income before provision for income taxes .....	25,151	13,896	12,983
Provision for income taxes .....	9,770	4,832	5,921
Net income .....	<u>\$ 15,381</u>	<u>\$ 9,064</u>	<u>\$ 7,062</u>
Net income (loss) available to common stockholders .....	<u>\$ 15,381</u>	<u>\$ (25,022)</u>	<u>\$ (17,325)</u>
Net income (loss) per common share:			
Basic .....	\$ 0.45	\$ (1.55)	\$ (7.37)
Diluted .....	\$ 0.44	\$ (1.55)	\$ (7.37)
Weighted average number of shares outstanding: Basic .....	33,818,508	16,174,165	2,351,356
Weighted average number of shares outstanding: Diluted ..	35,304,794	16,174,165	2,351,356

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

**MONOTYPE IMAGING HOLDINGS INC.**  
**CONSOLIDATED STATEMENTS OF CONVERTIBLE REDEEMABLE PREFERRED STOCK, REDEEMABLE PREFERRED STOCK**  
**AND STOCKHOLDERS' EQUITY (DEFICIT)**  
(in thousands, except share amounts)

	Convertible Redeemable Preferred Stock		Redeemable Preferred Stock		Common Stock		Treasury Stock		Additional Paid-In Capital		Retained Earnings (Deficit)		Accumulated Other Comprehensive Income (Loss)		Total Stockholders' Equity (Deficit)		Comprehensive Income	
	Shares	Value	Shares	Value	Shares	Amount	Shares	Amount	Shares	Amount	Deficit	Income	Income	Loss	Deficit	Income	Income	Income
<b>Balance, January 1, 2006</b>	5,846,155	\$15,793				\$4				\$226	\$3,521	\$ (48)	\$3,703			\$7,062	\$7,062	
Net income											7,062							
Accretion of convertible redeemable preferred stock redemption value		24,387									(24,387)							
Repurchase of convertible redeemable preferred stock	(5,801)	(10)																
Repurchase of unvested shares of restricted common stock																		
Issuance of capital shares																		
—restricted share grants										13								13
—exercised options										8								8
Share based compensation										440								440
Unrecognized actuarial gain, net of tax													41					41
Cumulative translation adjustment, net of tax													581					581
Comprehensive income																		
<b>Balance, December 31, 2006</b>	5,840,354	\$40,170	—		3,764,088	\$4	40,836	\$(41)		\$687	\$(13,804)	\$574	\$(12,580)					\$7,684

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

**MONOTYPE IMAGING HOLDINGS INC.**  
**CONSOLIDATED STATEMENTS OF CONVERTIBLE REDEEMABLE PREFERRED STOCK, REDEEMABLE PREFERRED STOCK, AND STOCKHOLDERS' EQUITY (DEFICIT)—(Continued)**  
(in thousands, except share and per share data)

	Convertible Redeemable Preferred Stock		Redeemable Preferred Stock	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity (Deficit)	Comprehensive Income
	Shares	Redemption Value		Shares	Amount	Shares	Amount					
<b>Balance, December 31, 2006</b> .....	5,840,354	\$ 40,170	—	\$ 4	40,836	\$(41)	\$ 687	\$(13,804)	\$ 574	\$ (12,580)	9,064	9,064
Net income .....								9,064				
Accretion of convertible redeemable preferred stock redemption value .....		34,086										
Conversion of convertible redeemable preferred stock to redeemable preferred stock and common stock ..	(5,840,354)	(74,256)	5,840,354	23	74,232		74,232				74,255	
Redemption of redeemable preferred stock .....			(5,840,354)				(9,654)				(9,654)	
Conversion of convertible notes payable .....				415,903	—	—	155				155	
Issuance of capital shares —restricted share grants .....				21,559	—	—	—				—	
—exercised options .....				212,333	—	—	266				266	
Repurchase of unvested restricted common shares .....				(12,358)	—	—	92				—	
Vesting of restricted shares .....											—	92
Issuance of common stock upon initial public offering, net of related costs ..				6,500,000	7		67,244				67,251	
Share based compensation .....							4,257				4,257	
Tax benefit associated with options ..							940				940	
Unrecognized actuarial gain, net of tax .....									328		328	
Cumulative translation adjustment, net of tax .....									1,719		1,719	
Comprehensive income .....												\$11,111
<b>Balance, December 31, 2007</b> .....	—	\$ —	—	34,262,941	\$34	53,194	\$(41)	\$138,219	\$(38,826)	\$ 2,621	\$102,007	15,381
Net income .....								15,381			15,381	
Issuance of capital shares —restricted share grants .....				71,617	—	—	—				—	
—exercised options .....				211,134	1		615				616	
Repurchase of unvested restricted common shares .....				(33,000)		33,000	(45)				(45)	
Vesting of restricted shares .....											154	
Share based compensation .....											3,634	
Tax benefit associated with options ..											54	
Unrecognized actuarial gain, net of tax .....										175	175	
Cumulative translation adjustment, net of tax .....									(1,140)		(1,140)	
Comprehensive income .....												\$14,416
<b>Balance, December 31, 2008</b> .....	—	\$ —	—	34,512,692	\$35	86,194	\$(86)	\$142,676	\$(23,445)	\$ 1,656	\$120,836	15,381

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

**MONOTYPE IMAGING HOLDINGS INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Year Ended December 31,		
	2008	2007	2006
<b>Cash flows from operating activities:</b>			
Net income .....	\$15,381	\$ 9,064	\$ 7,062
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization .....	11,441	11,567	10,345
Amortization of deferred financing costs and debt discount .....	778	1,007	1,044
Loss on retirement of fixed assets .....	111	-	-
Loss on extinguishment of debt .....	-	2,958	-
Share based compensation .....	3,634	4,257	440
Deferred income taxes .....	3,237	(1,048)	2,404
Provision for doubtful accounts .....	126	240	-
Unrealized currency loss (gain) on foreign denominated intercompany transactions .....	433	(3,212)	(1,089)
Unrealized (gains) losses on derivatives .....	(803)	36	459
Changes in operating assets and liabilities, net of effect of acquisitions:			
Accounts receivable .....	(2,469)	261	1,349
Income tax refund receivable .....	1,391	(1,391)	-
Prepaid expenses and other assets .....	927	(1,597)	871
Accounts payable .....	(1,155)	144	1,038
Accrued income taxes .....	(974)	1,833	-
Accrued expenses and other liabilities .....	(2,287)	4,072	730
Accrued transaction bonus .....	-	-	(267)
Deferred compensation .....	-	-	(975)
Deferred revenue .....	762	(913)	(3,967)
Net cash provided by operating activities .....	<u>30,533</u>	<u>27,278</u>	<u>19,444</u>
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment .....	(1,125)	(1,236)	(539)
Purchase of technology and trademarks .....	-	-	(12,047)
Acquisition of businesses, net of cash acquired .....	-	(75)	(52,974)
Net cash used in investing activities .....	<u>(1,125)</u>	<u>(1,311)</u>	<u>(65,560)</u>

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



**MONOTYPE IMAGING HOLDINGS INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS—(Continued)**  
(in thousands)

	Year Ended December 31,		
	2008	2007	2006
<b>Cash flows from financing activities:</b>			
Purchase of interest rate caps .....	(45)	—	(33)
Deferred costs related to public offering .....	—	—	(186)
Proceeds from issuance of debt, net of issuance costs .....	—	10,783	53,949
Payments on long-term debt .....	(18,582)	(84,245)	(10,534)
Payment of penalty fee associated with debt extinguishment .....	—	(1,400)	—
Redemption of redeemable preferred stock .....	—	(9,654)	—
Net proceeds from initial public offering .....	—	67,437	—
Excess tax benefit of stock options .....	54	940	—
Proceeds from exercise of common stock options and issuance of restricted stock .....	616	266	111
Repurchase of common and convertible redeemable preferred stock .....	—	—	(51)
Net cash (used in) provided by financing activities .....	(17,957)	(15,873)	43,256
Effect of exchange rates on cash and cash equivalents .....	906	950	616
Increase (decrease) in cash and cash equivalents .....	12,357	11,044	(2,244)
Cash and cash equivalents, beginning of year .....	19,584	8,540	10,784
Cash and cash equivalents, end of year .....	\$ 31,941	\$ 19,584	\$ 8,540
Supplemental disclosures:			
Interest paid .....	\$ 8,347	\$ 14,413	\$ 17,914
Income taxes paid .....	\$ 5,501	\$ 3,701	\$ 210
Non cash transactions:			
Issuance of convertible notes payable in connection with acquisition of China Type Design .....	\$ —	\$ —	\$ 600
Issuance of common stock in connection with the conversion of the convertible notes payable .....	\$ —	\$ 155	\$ —
Unvested restricted stock liability recognized in connection with the conversion of the convertible notes payable .....	\$ —	\$ 468	\$ —

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

**MONOTYPE IMAGING HOLDINGS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2008**

**1. Nature of Business**

Monotype Imaging Holdings Inc. (the "Company") is a leading global provider of text imaging solutions. The Company's technologies and fonts enable the display and printing of high quality digital text. The Company's technologies and fonts have been widely deployed across a range of consumer electronic, or CE devices, including laser printers, digital copiers, mobile phones, digital televisions, set-top boxes and digital cameras, as well as in numerous software applications and operating systems. The Company licenses its text imaging solutions to CE device manufacturers, independent software vendors and creative and business professionals. The Company is headquartered in Woburn, Massachusetts. The Company operates in one business segment: the development, marketing and licensing of technologies and fonts. The Company also maintains various offices worldwide for selling and marketing, research and development and administration. At December 31, 2008, the Company conducts its operations through two domestic operating subsidiaries, Monotype Imaging Inc. ("MTI") and International Typeface Corporation ("ITC"), and four foreign operating subsidiaries, China Type Design Limited ("China Type Design"), Monotype Imaging KK ("Monotype Japan"), Monotype Imaging Ltd. ("Monotype UK") and Linotype GmbH ("Linotype").

*Initial Public Offering*

We completed our initial public offering on July 30, 2007, issuing 6.5 million shares of our common stock at a price of \$12.00 per share. After underwriter's commissions and other costs and expenses, we received net proceeds of approximately \$67.2 million. The following events occurred in connection with the initial public offering:

- 5,840,354 shares of convertible redeemable preferred stock held by certain investors were converted into 23,361,416 shares of common stock and 5,840,354 shares of redeemable preferred stock. The conversion resulted in approximately \$64.6 million being reclassified to the capital accounts of the Company, and approximately \$9.7 million being reclassified to redeemable preferred stock. We used approximately \$9.7 million in proceeds from the initial public offering to redeem all of the shares of redeemable preferred stock at its stated redemption price of \$1.653 per share.
- We amended and restated our First Lien Credit Facility (see Note 7) which increased our borrowings thereunder to \$140.0 million from \$128.4 million and increased the maximum available under our revolving line-of-credit to \$20 million from \$10 million. In connection with this amendment and restatement, we paid a fee of \$0.7 million.
- We used the proceeds from the offering, net proceeds from the amendment to our First Lien Credit Facility and cash on hand, to pay in full the outstanding borrowings under our Second Lien Credit Facility (see Note 7) of \$70.0 million, plus a \$1.4 million prepayment penalty.
- Three convertible promissory notes issued in connection with our acquisition of China Type Design in July 2006 with an aggregate face amount of \$0.6 million were converted into 415,903 shares of restricted common stock of the Company.

Each of the aforementioned events is discussed in detail in the accompanying notes.

**2. Significant Accounting Policies**

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

### ***Basis of Presentation and Consolidation***

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

In November 2004, Imaging Acquisition Corporation, our wholly-owned subsidiary, acquired all of the common stock of Agfa Monotype Corporation (“Agfa Monotype”), a wholly-owned subsidiary of Agfa Corporation (“Agfa”). On November 5, 2004, Agfa Monotype was spun off into a new entity, MTI, which was owned by TA Associates, D.B. Zwirn and certain of the former officers and employees of Agfa Monotype through Imaging Holdings Corp. (“IHC”). IHC became the parent of MTI. In December 2004, we formed Monotype Japan, our wholly-owned Japanese subsidiary. In August 2005, IHC entered into a recapitalization transaction and debt refinancing which resulted in the Company becoming the parent of IHC.

In July 2006, we acquired 80.01% of the capital stock of China Type Design, a Hong Kong corporation. At the time of this acquisition, we already had a 19.99% ownership interest in China Type Design, and following the acquisition, it became our wholly-owned subsidiary. In August 2006, we completed the acquisition of the capital stock of Linotype, a German corporation, through our newly formed wholly-owned subsidiary, Monotype Imaging GmbH.

The accompanying consolidated financial statements present the Company as of and for the years ended December 31, 2008, 2007 and 2006, including the accounts of ITC, China Type Design, Monotype Japan, Monotype UK and Linotype. All intercompany accounts and transactions have been eliminated.

### ***Comparative Amounts***

Certain prior year amounts have been reclassified to conform to the current year presentation in the financial statements for the year ended December 31, 2008. These reclassifications had no effect on previously reported results of operations or financial position. Investment in interest rate caps and prepaid royalties at December 31, 2007 have been included in the caption of other assets in our long term asset section of our consolidated balance sheet. Deferred revenue, net of current portion has been included in the caption of other long-term liabilities in our consolidated balance sheet.

### ***Use of Estimates***

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

### ***Fair Value of Financial Instruments***

Our financial instruments consist of cash and cash equivalents, accounts receivable, derivative instruments and debt. On January 1, 2008, we adopted SFAS 157, which clarifies the definition of fair value, prescribes methods for measuring fair value, establishes a fair value hierarchy based on inputs used

to measure fair value and expands disclosures about the use of fair value measurements. On February 6, 2008, the FASB issued FASB Staff Position 157-2 (“FSP 157-2”), which delays the effective date of SFAS 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS 157 and FSP 157-2 are effective for financial statements issued for fiscal years beginning after November 15, 2007. We have elected a partial deferral of SFAS 157 in accordance with the provisions of FSP 157-2 related to the measurement of fair value when evaluating goodwill, other intangible assets and other long-lived assets for impairment. The impact of partially adopting SFAS 157 was not material to our consolidated financial statements. We do not expect the adoption of FSP 157-2 to be material to our consolidated financial statements.

**Cash and Cash Equivalents**

Cash and cash equivalents consist of bank deposits and overnight repurchase agreements. We consider all highly liquid investments with original maturities of three months or less at the time of acquisition to be cash equivalents and are stated at fair value. The Company does not believe it is exposed to any significant credit risk on its cash equivalents.

**Concentration of Credit Risks**

Financial instruments that potentially subject us to concentration of credit risk consist principally of cash and cash equivalents and trade receivables. Cash equivalents consist primarily of bank deposits and overnight repurchase agreements. Deposits of cash held outside the U.S. totaled approximately \$10.8 million and \$11.2 million, at December 31, 2008 and 2007, respectively.

We grant credit to customers in the ordinary course of business. Credit evaluations are performed on an ongoing basis to reduce credit risk, and no collateral is required from our customers. An allowance for uncollectible accounts is provided for those accounts receivable considered to be uncollectible based upon historical experience and credit evaluation. As of December 31, 2008 one customer accounted for 19% of our gross accounts receivable. As of December 31, 2007, no customers individually accounted for 10% or more of our accounts receivable. For the years ended December 31, 2008, 2007 and 2006 no one customer accounted for 10% or more of our total revenue. Historically, we have not recorded material losses due to customers’ nonpayment.

**Property and Equipment**

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

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

**Goodwill and Indefinite-lived Intangible Assets**

Goodwill represents the excess of the cost of acquired businesses over the fair value of identifiable net assets assumed in a business combination. We account for goodwill and indefinite-lived intangible assets in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 142, *Goodwill and Other Intangible Assets* (“SFAS 142”) which requires that goodwill not be amortized, but instead be tested at least annually in accordance with the provisions of SFAS 142.

The provisions of SFAS 142 require that a two-step impairment test be performed on goodwill. In the first step, the Company must compare the fair value of each reporting unit to its carrying value. The Company determines the fair value of our reporting units based on the present value of estimated future cash flows and market approach. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and further testing is not required. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then an impairment loss equal to the difference will need to be recorded.

Impairment testing for goodwill is done at a reporting unit level. Reporting units are one level below the business segment level, but can be combined when reporting units within the same segment have similar economic characteristics. We operate within a single business segment and conducted our impairment analysis on the Company as a whole by calculating the fair value of our Company as compared to our carrying value. We estimated the fair value by using forecasts of discounted cash flows and market approach. The Company performs its annual goodwill impairment test as of December 31<sup>st</sup>. The fair value was greater than the carrying value of the goodwill, and therefore, no write down of goodwill was recorded.

We perform similar procedures on our indefinite-lived intangible assets. We apply the relief from royalty method, a variation of discounted cash flows, to determine the fair value of these assets. We perform our annual indefinite-lived intangible asset impairment test as of December 31<sup>st</sup>. The fair value was greater than the carrying value of the indefinite-lived intangible assets, and therefore, no write down of such assets was recorded.

In light of the deteriorating macro-economic environment, declines in the stock market and the decline of the Company's market capitalization, we may be required to perform interim goodwill impairment analyses. Our stock price continued to decline subsequent to December 31, 2008 and has reached a level at which, if sustained, or if it deteriorates further, may require us to perform goodwill impairment analysis, as detailed above. This analysis may determine that our goodwill is impaired in whole, in part, or not at all. In the event that the Company determines that its goodwill is impaired in whole, or in part, the Company will record a non-cash charge, which could be material. At this time, the Company cannot determine if an impairment charge is probable and cannot reasonably estimate the amount, if any, of potential impairment charges. If an impairment of goodwill is recognized, an analysis of impairment of our other long-lived assets would be required pursuant to SFAS 144. In the event that the Company determines that these assets are impaired, the Company will record a non-cash charge, which could be material. If we record a material impairment charge on our goodwill or our indefinite-lived intangibles, it could result in non-compliance with our Amended and Restated Credit Agreement.

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

We account for long-lived assets including property and equipment and long-lived amortizable intangible assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). SFAS 144 requires companies to assess whether indicators of impairment are present on a periodic basis. If such indicators are present, SFAS 144 prescribes a two step impairment test (i) if the carrying amount of a long-lived asset is not recoverable based on its undiscounted future cash flows, and (ii) measure an impairment loss as the difference between the carrying amount and the fair value of the asset. We have had no impairments or indicators of impairment of our long-lived assets during the years presented. Our stock price continued to decline subsequent to December 31, 2008 and has reached a level at which, if sustained, or if it deteriorates further, may require performance of impairment testing on our long-lived assets in accordance with SFAS 144. This analysis may determine that our long-lived

assets are impaired in whole, in part, or not at all. In the event that the Company determines that its long-lived assets are impaired in whole, or in part, the Company will record a non-cash charge, which could be material. At this time, the Company cannot determine if an impairment charge is probable and cannot reasonably estimate the amount, if any, of potential impairment charges.

### **Revenue Recognition**

We recognize revenue in accordance with Statement of Position (“SOP”) 97-2, *Software Revenue Recognition* (“SOP 97-2”), as modified by SOP 98-9, *Modifications of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions*. Revenue is recognized when persuasive evidence of an agreement exists, the product has been delivered or services have been provided, the fee is fixed or determinable and collection of the fee is probable.

#### *OEM Revenue*

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

#### *Creative Professional Revenue*

We derive our creative professional revenue primarily from font licenses to end-users and custom font design services. We license fonts directly to end-users through our e-commerce websites and via telephone and email, and indirectly through third-party resellers. We also license fonts and provide custom font design services to graphic designers, advertising agencies and corporations.

Revenue from font licenses to our e-commerce customers is recognized upon payment by the customer and electronic shipment of the software embodying the font. Revenue from font licenses to other customers is recognized upon shipment of the software embodying the font. Revenue from resellers is recognized upon notification from the reseller that our font product has been licensed. We generally recognize custom font design services revenue upon delivery of the font.

### **Sales Taxes**

We record revenue net of sales taxes. Sales taxes are collected and remitted to tax authorities as required, typically on a monthly or quarterly basis, except for Japanese consumption tax, which is remitted on a monthly basis. As a result, accrued sales tax consists principally of Japanese consumption tax.

### **Cost of Revenue**

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

### **Deferred Revenue**

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

### **Research and Development Expenses**

Our research and development expense consists principally of salaries, bonuses and benefits of our research and development, engineering and font design personnel who are primarily focused on enhancing the functionality of our text imaging solutions and developing new products. In accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to Be Sold or Otherwise Marketed*, such costs are required to be expensed until the point that technological feasibility of the software is established. Technological feasibility is determined after a working model has been completed. As our research and development costs primarily relate to software development during the period prior to technological feasibility, all research and development costs are charged to operations as incurred.

### **Advertising Costs**

We expense advertising costs as incurred. Advertising expenses were \$3.5 million, \$3.6 million and \$2.0 million for the years ended December 31, 2008, 2007 and 2006, respectively.

### **Stock-Based Compensation**

We adopted SFAS No. 123 (revised 2004), *Share Based Payment*, (“SFAS 123R”), on January 1, 2006 which is a revision of Statement No. 123 (“SFAS 123”) *Accounting for Stock Based Compensation*. SFAS 123R supersedes Accounting Principles Board (“APB”) No. 25, *Accounting for Stock Issued to Employees* (“APB 25”), and amends Financial Accounting Standards Board (“FASB”) Statement No. 95 *Statement of Cash Flows*. SFAS 123R requires all share based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

Prior to 2006, we accounted for employee stock-based compensation in accordance with the provisions of APB 25 and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation—an Interpretation of APB No. 25*, and we complied with the disclosure provisions of SFAS 123, and related SFAS No. 148, *Accounting for Stock-Based Compensation—Transaction and Disclosure*. Under APB 25, compensation expense is based on the difference, if any, on the date of the grant, between the fair value of our stock and the exercise price of the option. We amortize such stock-based compensation, if any, using the straight-line method over the vesting period.

The Company accounts for transactions in which services are received from nonemployees in exchange for equity instruments based on the fair value of such services received or of the equity instruments issued, whichever is more reliably measured, in accordance with SFAS 123 and EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. During the year ended December 31, 2007, the Company granted 197,554 shares of restricted stock to a consultant, in connection with the acquisition of China Type Design. This award vests over four years and resulted in a credit to share based compensation expense of \$0.3 million in 2008, and expense of \$1.8 million in 2007. The Company did not issue any awards to nonemployees in 2008 or 2006.

SFAS 123R requires nonpublic companies that used the minimum value method in SFAS 123 for either recognition or pro forma disclosures to apply SFAS 123R using the prospective-transition method. As such, the Company will continue to apply APB 25 in future periods to equity awards outstanding at the date of SFAS 123R’s adoption that were measured using the minimum value method.

Effective with the adoption of SFAS 123R, the Company elected to use the Black-Scholes option pricing model to determine the weighted-average fair value of options granted. In accordance with SFAS 123R, the Company recognizes the compensation cost of share based awards on a straight-line basis over the vesting period of the award.

The determination of the fair value of share based payment awards utilizing the Black-Scholes model is affected by our stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. We do not have a long history of market prices of our common stock and as such we estimate volatility in accordance with Staff Accounting Bulletin No. 107 (“SAB 107”) using historical volatilities of similar public entities. The expected life of the awards is estimated based on the simplified method, as defined in SAB 107. The risk-free interest rate assumption is based on a treasury instrument whose term is consistent with the expected life of our awards. The expected dividend yield assumption is based on our history and expectation of paying no dividends.

Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Share based compensation expense recognized in our financial statements beginning in 2006 and thereafter is based on awards that are ultimately expected to vest. We evaluate the assumptions used to value our awards on a quarterly basis and if factors change and we employ different assumptions, stock-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. Future stock-based compensation expense and unearned stock-based compensation will increase to the extent that we grant additional equity awards to employees or we assume unvested equity awards in connection with acquisitions.

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

	Year Ended December 31,		
	2008	2007	2006
Risk-free interest rate . . . . .	2.8%	4.4%	4.8%
Expected dividend yield . . . . .	—	—	—
Expected volatility . . . . .	66.0%	68.8%	76.4%
Expected term . . . . .	6.1 years	6.0 years	6.0 years
Weighted average fair value per share . . . . .	\$8.75	\$8.50	\$4.68

Prior to March 31, 2006, we granted our employees options to purchase common stock at exercise prices equal to the fair market value of the underlying stock at the time of each grant, as determined by our compensation committee.

In valuing the common stock our compensation committee considered a number of factors, including:

- the illiquidity of our capital stock as a private company;
- the business risks we faced;
- the liquidation preferences, redemption rights and other rights, preferences and privileges of our outstanding preferred stock;
- the outstanding balances on our credit facilities; and
- our actual financial condition and results of operations relative to our formal operating plan during the relevant period.



Effective March 31, 2006, the compensation committee determined to follow the procedures recommended in the American Institute of Certified Public Accountants Practice Aid. This approach requires an assessment of future prospects, based on the value of the business using a series of potential outcomes and weighing the probability of each of those outcomes. Management prepared three scenarios, a base case, an optimistic case and a pessimistic case. The possibility of an initial public offering was also considered. The compensation committee reviewed a market comparison of our business with a number of publicly traded firms to test the reasonableness of the overall analysis. The compensation committee reviewed the methodology, the resulting valuation and changed the probabilities of the outcomes that were initially applied as well as the weight given to those probabilities to more accurately reflect the changes in the business.

At the date of each option grant, our board of directors determined that the exercise price for each option was equivalent to the then-existing fair value of our common stock. Our board of directors believes it properly valued our common stock in all periods. After our IPO, we value awards granted based on the grant date closing price of our common stock as traded on either the NASDAQ Global Market or NASDAQ Global Select Market.

See Note 14 for a summary of the stock option activity under our stock-based employee compensation plans for the year ended December 31, 2008.

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

We use interest rate and foreign currency derivative instruments to hedge our exposure to interest rate volatility resulting from our variable rate debt and fluctuations in foreign currencies on our intercompany note (Note 8) and other foreign currency transactions. SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, (SFAS 133), requires that all derivative instruments be reported on the balance sheet at fair value and establishes criteria for designation and effectiveness of hedging relationships, including a requirement that all designations must be made at the inception of each instrument. As we did not make such initial designations, SFAS 133 requires changes in the fair value of the derivative instrument to be recognized as current period income or expense.

### ***Foreign Currency Translation***

In accordance with SFAS No. 52, *Foreign Currency Translation*, all assets and liabilities of our foreign subsidiaries whose functional currency is a currency other than US dollars are translated into US dollars at an exchange rate as of the balance sheet date. Revenue and expenses of these subsidiaries are translated at the average monthly exchange rates in effect for the periods in which the transactions occur. The gains and losses arising from these transactions are reported as a component of loss (gain) on foreign exchange in our consolidated statements of operations. The unrealized gains and losses are reported in "accumulated other comprehensive income (loss)" in our consolidated statements of stockholders' equity.

### ***Accumulated Other Comprehensive Income***

SFAS No. 130, *Reporting Comprehensive Income*, requires disclosure of all components of comprehensive income on an annual and interim basis. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Accumulated other comprehensive income (loss) consists of foreign currency translation adjustments and adjustments to record changes in the funded status of our defined benefit pension plan in accordance with SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132 (R)* ("SFAS No. 158").

### ***Income Taxes***

We account for income taxes in accordance with SFAS 109. Under this method, a deferred tax asset or liability is determined based on the difference between the financial statement and the tax basis of

assets and liabilities, as measured by enacted tax rates in effect when these differences are expected to be reversed. This process includes estimating current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and financial accounting purposes. These differences result in deferred tax assets and liabilities. We also assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized, we have established a valuation allowance. Significant judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance against our deferred tax assets.

We monitor the undistributed earnings of our foreign subsidiaries and, as necessary, provide for income taxes on those earnings that are not deemed permanently invested. As of December 31, 2008, the Company had approximately \$3.0 million in undistributed earnings in our foreign subsidiaries; for which deferred taxes have been provided.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB 109*, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting for interim periods, disclosure and transition. The Company adopted FIN 48 effective January 1, 2007. As a result of adopting the new standard, the Company reclassified certain deferred tax liabilities to reserve for income taxes and accrued liabilities. There was no net effect on the Company's financial position as a result of adopting the new standard. The total amount of uncertain tax positions, at December 31, 2008 and 2007 was \$1.6 million and \$1.7 million, respectively. In accordance with FIN 48, paragraph 19, the Company decided to classify interest and penalties as a component of tax expense. The total amount of recorded interest and penalties expense at December 31, 2008 and 2007 was \$0.4 million and \$0.3 million, respectively.

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

The Company calculates net income (loss) per share in accordance with SFAS No. 128, *Earnings Per Share*, or SFAS 128, as clarified by EITF Issue No. 03-6, *Participating Securities and the Two-class Method Under FASB Statement No. 128, Earnings Per Share*. EITF Issue No. 03-6 clarifies the use of the "two-class" method of calculating earnings per share as originally prescribed in SFAS 128. Effective for periods beginning after March 31, 2004, EITF Issue No. 03-6 provides guidance on how to determine whether a security should be considered a "participating security" for purposes of computing earnings per share and how earnings should be allocated to a participating security when using the two-class method for computing basic earnings per share. The Company has determined that its previously outstanding convertible redeemable preferred stock represented a participating security and therefore adopted the provisions of EITF Issue No. 03-6 for all periods that convertible preferred stock was outstanding.

Under the two-class method, basic net income (loss) per share is computed by dividing the net income (loss) applicable to common stockholders by the weighted-average number of common shares outstanding for the fiscal period. Diluted net income (loss) per share is computed using the more dilutive of (a) the two-class method or (b) the if-converted method. Prior to the conversion of convertible preferred stock, the Company allocated net income first to preferred stockholders based on dividend rights under the Company's certificate of incorporation and then to common stockholders based on ownership interests. Net losses were not allocated to preferred stockholders. Subsequent to the conversion of convertible preferred stock, all income is allocated to common stockholders. Diluted net income (loss) per share gives effect to all potentially dilutive securities, including stock options and restricted stock, using the treasury stock method.

## **Recently Issued Accounting Pronouncements**

### *Derivative Instruments and Hedging Activities*

In March 2008, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* (“SFAS 161”). SFAS 161 requires enhanced disclosures about an entity’s derivative and hedging activities. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company does not expect that this new pronouncement will have a material impact on the Company’s financial statements in future periods.

### *Business Combinations*

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (“SFAS 141R”). SFAS 141R is effective for fiscal years beginning on or after December 15, 2008 and applies to all business combinations. SFAS141R provides that, upon initially obtaining control, an acquirer shall recognize 100 percent of the fair values of acquired assets, including goodwill, and assumed liabilities, with only limited exceptions, even if the acquirer has not acquired 100 percent of its target. As a consequence, the current step acquisition model will be eliminated. Additionally, SFAS141R changes current practice, in part, as follows: (1) contingent consideration arrangements will be fair valued at the acquisition date and included on that basis in the purchase price consideration; (2) transaction costs will be expensed as incurred, rather than capitalized as part of the purchase price; (3) pre-acquisition contingencies, such as legal issues, will generally have to be accounted for in purchase accounting at fair value; and (4) in order to accrue for a restructuring plan in purchase accounting, the requirements in FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, would have to be met at the acquisition date. While there is no expected impact to our consolidated financial statements on the accounting for acquisitions completed prior to December 31, 2008, the adoption of Statement 141(R) on January 1, 2009 could materially change the accounting for business combinations consummated subsequent to that date.

### *Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, or SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. SFAS 157 also expands financial statement disclosures about fair value measurements. On February 6, 2008, the FASB issued FASB Staff Position (FSP) 157-2 which delays the effective date of SFAS 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS 157 and FSP 157-2 are effective for financial statements issued for fiscal years beginning after November 15, 2007. We have elected a partial deferral of SFAS 157 in accordance with the provisions of FSP 157-2 related to the measurement of fair value when evaluating goodwill, other intangible assets and other long-lived assets for impairment. The impact of partially adopting SFAS 157 effective January 1, 2008 was not material to our consolidated financial statements. We do not expect the adoption of FSP 157-2 for non-financial assets to be material to our consolidated financial statements.

## **3. Business Acquisitions**

In accordance with SFAS No. 141, *Business Combinations* (“SFAS 141”), we record acquisitions under the purchase method of accounting. Accordingly, the purchase price is allocated to the tangible assets and liabilities and intangible assets acquired, based on their estimated fair values. The excess purchase price over the fair value of indentified assets is recorded as goodwill. Under SFAS 142, goodwill and purchased

intangibles with indefinite lives are not amortized but are reviewed for impairment annually, or more frequent, if impairment indicators arise. Purchased intangibles with definite lives are amortized over their respective useful lives.

### ***Acquisition of Linotype***

On August 1, 2006, we completed the acquisition of Linotype, a German company and a leader in the development, marketing, licensing and servicing of digital fonts and proprietor of a font library comprised of typefaces. We also acquired certain fonts and other intellectual property assets from the seller of Linotype. With the purchase of Linotype, we acquired access to a large library of fonts, a strong brand with a significant web presence and a more complete offering for the creative professional market. We have also reduced our cost of revenue by the amount paid to Linotype to license their fonts prior to the acquisition. We restructured our debt agreements to fund the acquisition (see Note 7). Linotype's results of operations have been included in our consolidated financial statements since the date of acquisition and all inter-company balances have been eliminated. The total purchase price for Linotype and the related intellectual property, which was purchased separately, was approximately \$59.7 million in cash, which included the related acquisition costs of approximately \$0.7 million, and was allocated as follows:

	<u>Fair Value at Acquisition Date (in thousands)</u>
Assets:	
Current assets .....	\$ 5,192
Non-current assets .....	59
Fixed assets .....	691
Customer relationships .....	5,800
Technology .....	9,600
Trademarks .....	5,600
Non-compete agreements .....	1,300
Goodwill .....	<u>43,085</u>
Total assets acquired .....	71,327
Current liabilities assumed .....	(6,090)
Deferred income taxes .....	<u>(5,547)</u>
Net assets acquired .....	<u>\$59,690</u>

The acquired intangible assets that are subject to amortization have a weighted average useful life of approximately 14 years. Customer relationships and technology have an estimated 15 year life and non-compete agreements have an estimated five year life. These assets will be amortized over their respective useful lives using the straight-line method. Trademarks have an indefinite life and are subject to annual review to determine if an impairment exists. The fair value of the assets acquired and liabilities assumed was less than the purchase price, resulting in goodwill of \$43.1 million.

We made an election under Section 338(g) of the U.S. Internal Revenue Code, or IRC to treat the acquisition of the stock of Linotype as an asset acquisition for U.S. tax purposes. In addition, we have filed an election to treat Linotype as a disregarded entity for U.S. tax purposes. As a result, all of the goodwill is expected to be deductible for U.S. income tax purposes.

### ***Pro Forma Financial Information***

The following unaudited pro forma financial information (in thousands, except per share data) presents the combined results of operations of the Monotype Imaging and Linotype as if the acquisition

had occurred as of the beginning of the period presented, after giving effect to certain adjustments, including amortization of intangibles. The unaudited pro forma financial information does not necessarily reflect the results of operations that would have occurred had the combined companies constituted a single entity during such periods, and is not necessarily indicative of the results which may be obtained in the future.

	<u>Year Ended December 31, 2006</u>
Pro forma revenues .....	\$ 96,689
Pro forma net income .....	\$ 8,194
Net loss available to common stockholders .....	\$(16,193)
Pro forma basic and diluted loss per share .....	\$ (6.89)

### ***Acquisition of China Type Design***

On July 28, 2006, we acquired 80.01% of the capital stock of China Type Design, a Hong Kong corporation specializing in font design, for approximately \$4.1 million in cash and three promissory notes in the aggregate face amount of \$0.6 million that were convertible into a total of 400,000 shares of our restricted common stock at the option of the holder or automatically if a drag along right is exercised or upon an initial public offering (see Note 7). With the China Type Design acquisition, we acquired a library of Asian stroke-based fonts and gained the capability to develop and produce these fonts. At the time of this acquisition, we already had a 19.99% ownership interest in China Type Design, and following the acquisition, it became our wholly-owned subsidiary. The results of operations of China Type Design have been included in our consolidated financial statements since the date of acquisition and all intercompany balances have been eliminated. Prior to the acquisition, we did not have the ability to exercise significant influence over operating and financial policies of China Type Design and, accordingly, the results of its operations were accounted for using the cost method of accounting.

The total purchase price of \$4.8 million, including related acquisition costs of approximately \$0.1 million has been allocated as follows:

	<u>Fair Value at Acquisition Date (in thousands)</u>
Assets:	
Current assets .....	\$1,507
Fixed assets .....	61
Customer relationships .....	400
Technology .....	200
Trademarks .....	100
Non-compete agreements .....	300
Goodwill .....	<u>2,726</u>
Total assets acquired .....	5,294
Current liabilities assumed .....	(363)
Deferred income taxes .....	<u>(180)</u>
Net assets acquired .....	<u>\$4,751</u>

The acquired intangible assets that are subject to amortization have a weighted average useful life of approximately 12 years. Customer relationships and technology have an estimated 15 year life and non-compete agreements have an estimated six year life. These assets will be amortized over their respective estimated useful lives using the straight-line method. Trademarks have an indefinite life and are subject to annual review to determine if an impairment exists. The fair value of the assets acquired and liabilities assumed was less than the purchase price, resulting in goodwill of \$2.7 million.

The results of operations of China Type Design were not material to our results; accordingly no pro forma financial information has been presented.

#### 4. Property and Equipment

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

	December 31,	
	2008	2007
Computer equipment .....	\$ 3,689	\$ 3,368
Furniture and fixtures .....	676	1,276
Leasehold improvements .....	180	141
Total cost .....	4,545	4,785
Less accumulated depreciation and amortization .....	(2,452)	(2,495)
Property and equipment, net .....	<u>\$ 2,093</u>	<u>\$ 2,290</u>

Depreciation and amortization expense for the years ended December 31, 2008, 2007 and 2006, was \$1.1 million, \$1.0 million and \$0.6 million, respectively.

#### 5. Goodwill and Intangible Assets

##### Goodwill

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

Balance at December 31, 2006 .....	\$138,452
Foreign currency exchange rate changes .....	4,804
Deferred tax adjustment (Note 11) .....	(1,910)
Balance at December 31, 2007 .....	\$141,346
Foreign currency exchange rate changes .....	(2,348)
Deferred tax adjustment (Note 11) .....	(100)
Balance at December 31, 2008 .....	<u>\$138,898</u>

The utilization of pre-acquisition net operating loss carryforwards subject to a full valuation allowance, and the application of certain provisions of SFAS No. 109, *Accounting for Income Taxes* ("SFAS 109") resulted in the recognition of a decrease in goodwill by approximately \$1.8 million for the year ended December 31, 2007. Goodwill also decreased by an additional \$0.1 million in the year ended December 31, 2007 due to the tax effect of excess tax basis goodwill amortization. As a result of our adoption of SFAS 141R on January 1, 2009, future reversals of our valuation allowance will result in a benefit to our income tax expense and will no longer result in a reduction to goodwill.

## Intangible Assets

Intangible assets are stated at cost and are amortized over the expected life of the asset. Intangible assets as of December 31, 2008 and 2007 are as follows (dollar amounts in thousands):

	Life (Years)	December 31, 2008			December 31, 2007		
		Gross Carrying Amount	Accumulated Amortization	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer relationships . . . . .	10-15	\$ 46,331	\$(17,585)	\$28,746	\$ 46,657	\$(13,206)	\$ 33,451
Acquired technology . . . . .	12-15	43,513	(12,568)	30,945	43,634	(9,197)	34,437
Non-compete agreements . . . . .	4-6	11,620	(10,707)	913	11,691	(8,261)	3,430
Trademarks . . . . .		26,412	—	26,412	26,728	—	26,728
Domain names . . . . .		4,400	—	4,400	4,400	—	4,400
Total . . . . .		<u>\$132,276</u>	<u>\$(40,860)</u>	<u>\$91,416</u>	<u>\$133,110</u>	<u>\$(30,664)</u>	<u>\$102,446</u>

Amortization expense is calculated using the straight-line method.

Estimated future intangible amortization expense based on balances at December 31, 2008 is as follow (in thousands):

	Acquired Technology	Other Intangible Assets
2009 . . . . .	\$ 3,383	\$ 4,743
2010 . . . . .	3,383	4,743
2011 . . . . .	3,383	4,624
2012 . . . . .	3,383	4,438
2013 . . . . .	3,383	4,409
Thereafter . . . . .	14,030	6,702
Total amortization expense . . . . .	<u>\$30,945</u>	<u>\$29,659</u>

## 6. Accrued Expenses and Other Current Liabilities

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

	December 31,	
	2008	2007
Payroll and related benefits . . . . .	\$ 4,302	\$ 5,256
Royalties . . . . .	2,343	2,223
Interest . . . . .	49	1,140
Legal and audit fees . . . . .	979	727
Sales taxes . . . . .	542	2,264
Derivative liability . . . . .	1,009	—
Deferred taxes . . . . .	1,091	—
Restructuring . . . . .	635	—
Other . . . . .	1,493	1,506
Total accrued expenses . . . . .	<u>\$12,443</u>	<u>\$13,116</u>

## 7. Debt

Long-term debt consists of the following (in thousands):

	December 31,	
	2008	2007
First Lien Credit Facility—\$114.5 million, interest at London Inter-Bank Offering Rate (LIBOR) plus 2.75% (3.2% at December 31, 2008), and \$1.1 million at Prime plus 1.25% (4.5% at December 31, 2008) due in monthly installments of principal and interest through July 2012 .....	\$115,607	\$134,167
Note payable—Other .....	16	38
	<u>115,623</u>	<u>134,205</u>
Less unamortized financing costs and debt discount .....	(2,027)	(2,805)
Total debt .....	113,596	131,400
Less current portion .....	(17,769)	(18,582)
Long-term debt .....	<u>\$ 95,827</u>	<u>\$112,818</u>

The aggregate annual maturities of long-term debt are as follows (in thousands):

Years ending December 31:	
2009 .....	\$17,769
2010 .....	13,078
2011 .....	14,000
2012 .....	70,776

### *Credit Facilities*

On July 30, 2007, in connection with our initial public offering, we amended and restated our First Lien Credit Facility which increased our borrowing there under to \$140.0 million from \$128.4 million and increased the maximum available under our revolving line-of-credit to \$20 million (“Amended and Restated Credit Agreement”). In connection with this amendment and restatement, we paid a fee of \$0.7 million. Using proceeds from our initial public offering, proceeds from the Amended and Restated Credit Agreement and cash on hand, we paid the entire \$70 million outstanding balance on our Second Lien Credit Facility, together with a prepayment penalty fee of \$1.4 million. The prepayment penalty fee was charged to operations as a debt extinguishment expense, along with approximately \$1.6 million of previously capitalized debt financing costs associated with the Second Lien Credit Facility that were written off upon the payoff and termination of the facility.

Upon entering into our Amended and Restated Credit Agreement, our scheduled monthly principal payments were increased to approximately \$1.2 million throughout the term of the facility, which expires in July 2012. The Amended and Restated Credit Agreement provides for an additional annual mandatory principal payment based on excess cash flow, as defined by the agreement, which must be paid within five days of the delivery of our audited financial statements. The next twelve scheduled monthly payments are reduced ratably by an aggregate of 50% of this additional payment. Accordingly, we have included an additional \$4.6 million in the current portion of long-term debt at both December 31, 2008 and 2007. Borrowings under the Amended and Restated Credit Agreement continue to bear interest at either (i) the prime rate plus a margin, or (ii) LIBOR plus a margin as defined by the Amended and Restated Credit Agreement, payable monthly. However, the margin for prime rate borrowings was reduced from 1.75% to 1.25%, and the margin for LIBOR rate borrowings was reduced from 3.25% to 2.75%. In addition, while the Amended and Restated Credit Agreement continues to be secured by substantially all of our assets and continues to place limitations on indebtedness, liens, dividends and distributions, asset sales, transactions with affiliates and acquisitions and conduct of business, all as defined in the agreements, the



limitation on capital spending and certain other financial covenants were removed. The only remaining financial covenant in our Amended and Restated Credit Agreement is a maximum leverage ratio. The leverage ratio is defined as the ratio of aggregate outstanding indebtedness to trailing twelve months Adjusted EBITDA. Adjusted EBITDA is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation. The Amended and Restated Credit Agreement also contains provisions for an increased interest rate during periods of default. We do not believe that these covenants will affect our ability to operate our business, and we were in compliance with the covenants under our Amended and Restated Credit Agreement as of December 31, 2008.

As of December 31, 2008, the blended interest rate on the Amended and Restated Credit Agreement was 3.2%.

The First and Second Lien Credit Facilities were originally entered into in November 2004, to partially finance our acquisition from Agfa. Our First Lien Credit Facility provided for a \$75.0 million term loan and a \$5.0 million revolving line-of-credit that were to expire on July 28, 2011. Our Second Lien Credit Facility term loan provided a \$40.0 million term loan which was due and payable in full on July 28, 2011.

In August 2005, we amended our First and Second Lien Credit Facilities to increase the borrowings permitted under the Credit Facilities to \$100.0 million and \$65.0 million, respectively. The additional borrowings were used to finance a recapitalization whereby holders of our convertible redeemable preferred stock received cash payments in the aggregate amount of approximately \$48.3 million and certain subordinated notes issued to TA Associates, D.B. Zwirn and certain former officers and employees of Agfa Monotype were retired at their face amount plus accrued and unpaid interest, plus a pre-payment premium equal to 6.0% of the face amount.

In July 2006, we again amended our permitted borrowings under our First and Second Lien Credit Facilities to increase the borrowings permitted under the Credit Facilities to \$140.0 million and \$70.0 million, respectively. We also increased the maximum borrowings under the revolving line-of-credit of our First Lien Credit Facility to \$10.0 million. These amendments were made primarily to fund the acquisition of Linotype.

The principal amount of the First Lien Credit Facility term loan was payable in monthly installments of approximately \$0.8 million in year one, \$1.0 million in year two and \$1.1 million in year three and thereafter through maturity. In addition, based on the annual audited financial statements, if the leverage ratio, as defined in the First Lien Credit Facility agreement, as of the end of the year, exceeded a specified maximum, we would be required to repay 50.0% of Adjusted EBITDA less payments for principal, interest, capital expenditures and taxes for the period. The next twelve scheduled monthly payments would then be reduced ratably by an aggregate of 50% of this additional payment. The additional payment made in April 2007 was \$3.3 million and our next twelve monthly payments thereafter were accordingly reduced by \$136 thousand each. Our Second Lien Credit Facility term loan provided a \$70.0 million term loan which was due and payable in full on July 28, 2011. At our option, borrowings under these facilities bore interest at either (i) the prime rate plus a margin, as defined by the respective credit agreement, or (ii) the London Interbank Offered Rate ("LIBOR") plus a margin as defined by the respective credit agreement, payable monthly. The Credit Facility was secured by substantially all of our assets and was senior to all other debts of the Company. The Credit Facilities required us to maintain certain identical quarterly financial covenants, including minimum Adjusted EBITDA, a minimum fixed charge coverage ratio, a maximum leverage ratio, and a maximum amount of capital spending.

In November 2004, we paid loan origination fees for the term loans totaling \$2.8 million that were recorded as a reduction in the proceeds received by us, and accounted for as debt discounts, which,

accordingly, were amortized into interest expense over the life of the related loans using the effective interest method, until amendment of the Credit Facilities in August 2005. Upon the amendments of the Credit Facilities in August 2005 and July 2006, we incurred additional fees to the lenders totaling approximately \$1.4 million and \$1.9 million, respectively. These fees were also recorded as reductions in the proceeds received by us, and accounted for as debt discounts. Accordingly, they are amortized into interest expense over the life of the related loans using the effective interest method.

There were no outstanding borrowings on the revolving line-of-credit at December 31, 2008 or 2007.

#### *Convertible Notes Payable*

In connection with the acquisition of China Type Design (see Note 3), we issued three convertible notes payable with an aggregate face amount of \$0.6 million to the former shareholders of China Type Design. The convertible notes payable were convertible into restricted common stock of the Company upon certain trigger events. The convertible notes bore interest at a fixed stated rate of 3.90% per annum, and were payable together with all accrued interest, upon maturity in July 2010. As the stated interest rate was below market rates of interest, we recognized a discount on the debt based upon our incremental borrowing rate at the time of issuance. The discount recognized of \$116 thousand was amortized and charged to interest expense over the term of these notes.

On July 30, 2007, upon completion of the Company's initial public offering, these convertible notes were converted into 415,903 shares of restricted common stock of the Company. In the years ended December 31, 2008 and 2007, we incurred a credit of \$57 thousand and an expense of \$2.6 million of share based compensation expense on these restricted shares which was included in research and development expense within our consolidated statements of operations. We expect to record additional share based compensation charges related to these restricted shares as they vest. In connection with the conversion of these notes into common stock, the remaining debt discount balance of \$96 thousand at July 30, 2007 was charged to interest expense within our consolidated statement of operations.

## **8. Financial Instruments**

### *Derivative Financial Instruments*

On November 28, 2008, we entered into a long term interest rate swap contract to pay a fixed rate of interest of 2.2% in exchange for a floating rate interest payment tied to the one-month LIBOR to mitigate our exposure to interest rate fluctuations on our debt obligations. The contract has a notional amount of \$80.0 million, decreasing to \$50.0 million effective November 30, 2009, and matures on November 28, 2010. The total fair value of this financial instrument at December 31, 2008, was a liability of approximately \$1.3 million, which is included in other liabilities in the accompanying consolidated balance sheet. In 2008 we recognized a loss of \$1.3 million which has been included in gain on derivatives in the accompanying consolidated statement of operations. Prior to November 28, 2008, we did not have any interest rate swap contracts outstanding.

On May 7, 2008, we entered into a long-term currency swap contract to purchase 18.3 million Euros in exchange for \$28.0 million to mitigate foreign currency exchange rate risk on a Euro denominated intercompany note. The currency swap matures on December 14, 2012. The contract payment terms approximate the payment terms of this intercompany note. The currency swap contract reduces the availability under our revolving line-of-credit by \$4.0 million and is accounted for under the provisions of SFAS 133 and SFAS 157. We did not designate the contract as a hedge; as such, associated gains and losses are recorded to gain on derivatives in our consolidated statement of operations. The total fair value of the currency swap at December 31, 2008 was approximately \$2.1 million. The current portion of \$0.4 million of the currency swap is included in prepaid expenses and other current assets and the long-term

portion of \$1.7 million of the swap is included in other assets in our accompanying consolidated balance sheet at December 31, 2008. For the year ended December 31, 2008, we incurred an aggregate fair value gain of \$1.9 million, which is included in gain on derivatives in our accompanying consolidated statements of operations.

At December 31, 2008, we had one interest rate cap contract outstanding with a notional amount totaling \$110.0 million. The contract has a fixed rate of 6.5% and expires December 31, 2010. Under the contract, to the extent that the London Inter-Bank Offering Rate (LIBOR) exceeds a fixed maximum rate, we will receive payments on the notional amount. The total fair value of the financial instrument at December 31, 2008 and December 31, 2007 was approximately \$13 thousand and \$900, respectively. In the year ended December 31, 2008 and 2007, we recognized a loss of \$33 thousand and a gain of \$14 thousand, respectively, which have been included in gain on derivatives in the accompanying consolidated statements of operations.

We also incur foreign currency exchange gains and losses related to certain customers that are invoiced in US dollars, but who have the option to make an equivalent payment in their own functional currencies at a specified exchange rate as of a specified date. In the period from that date until payment in the customer's functional currency is received and converted into US dollars, we can incur unrealized gains and losses. We utilize forward contracts with maturities of 90 days or less to hedge our exposure to these currency fluctuations. Any increase or decrease in the fair value of the forward contracts is offset by the change in the value of the hedged assets of our consolidated foreign affiliate. There was one outstanding currency hedge at December 31, 2007 with a marked to market loss of \$74 thousand recognized in (gain) loss on foreign exchange within our consolidated statement of operations. The fair value of this instrument was included in accrued expenses in our consolidated balance sheet. There were no outstanding currency hedges at December 31, 2008.

### ***Fair Value Measurements***

As defined in SFAS 157, fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, SFAS 157 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

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

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

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

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

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

	Fair Value Measurement at December 31, 2008			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Cash equivalents .....	\$21,146	\$21,146	\$ -	\$-
Derivatives—currency swap, current portion .....	352	-	352	-
Derivatives—interest rate cap, long-term portion .....	13	-	13	-
Derivatives—currency swap, long-term portion .....	1,712	-	1,712	-
Total assets .....	<u>\$23,223</u>	<u>\$21,146</u>	<u>\$2,077</u>	<u>\$-</u>
<b>Liabilities:</b>				
Derivatives—interest rate swap, current portion .....	\$ 1,009	\$ -	\$1,009	\$-
Derivatives—interest rate swap, long-term portion .....	265	-	265	-
Total liabilities .....	<u>\$ 1,274</u>	<u>\$ -</u>	<u>\$1,274</u>	<u>\$-</u>

The following describes the valuation methodologies used to determine fair value and key inputs:

*Cash equivalents.* Our cash equivalents include U.S. government backed securities that are considered to be highly liquid and tradeable. These securities are valued based on quoted market prices for similar instruments and are therefore classified as Level 1 within our fair value hierarchy.

*Derivative instruments.* We enter into derivative transactions to mitigate exposures mainly to interest rate fluctuations and foreign currency translation risk. Our derivative instruments include interest rate caps on long-term debt, currency swaps and interest rate swaps. The fair value of our derivatives is based on quoted market prices from various banking institutions or an independent third party provider for similar instruments. In determining the fair value, we consider our non-performance risk and that of our counterparties.

## 9. Employee Benefit Plans

### Defined Contribution Plans

The Company has defined contribution plans in the United States, the United Kingdom and Japan. The Company has a defined contribution employee savings plan in the United States. In the United States, the provisions of Section 401(k) of the Internal Revenue Code under which its United States employees may make contributions govern the plan. As prescribed by the 401(k) Plan, we make a dollar-for-dollar matching contribution up to the first 6.0% of the participant's compensation. The 401(k) Plan also provides for a discretionary employer profit sharing contribution. Participants are fully vested in the current value of their contributions and all earnings thereon. Participants become vested in the employer contributions and all earnings thereon based on years of service as follows: 25.0% vested after one year; 50.0% vested after two years; 100.0% vested after three years. In the United Kingdom we contribute 5% of each employee's salary into a retirement account provided the employee contributes a minimum of 3% of salary. In Japan, the Company contributes a fixed percent of the employee's salary into an interest bearing

account. Contributions to all of the Company's defined contribution plans were \$1.3 million, \$1.0 million and \$0.9 million for the years ended December 31, 2008, 2007 and 2006, respectively, and have been included in the accompanying consolidated statements of operations.

### **Defined Benefit Pension Plan**

Linotype maintains an unfunded defined benefit pension plan based on the "Versorgungsordnung der Heidelberger Druckmaschinen AG" (the "Linotype Plan") which covers substantially all employees of Linotype who joined before April 1, 2006, at which time the Linotype Plan was closed. Employees are entitled to benefits in the form of retirement, disability and surviving dependent pensions. Benefits generally depend on years of service and the salary of the employees.

The components of net periodic benefit cost included in the accompanying consolidated statement of operations were as follows:

	<u>2008</u>	<u>2007</u>	<u>Period from Acquisition through December 31, 2006</u>
Service cost .....	\$ 99	\$122	\$ 46
Interest cost .....	173	144	55
Recognized losses .....	(17)	—	—
Net periodic benefit cost .....	<u>\$255</u>	<u>\$266</u>	<u>\$101</u>

The assumptions used to determine the net periodic benefit cost were as follows:

	<u>2008</u>	<u>2007</u>	<u>Period from Acquisition through December 31, 2006</u>
Weighted-average Discount Rate .....	5.8%	5.5%	4.5%
Weighted-average Rate of Compensation Increase .....	3.0%	2.0%	2.0%

### **Reconciliation of Funded Status and Accumulated Benefit Obligation**

The Linotype Plan is an unfunded plan and accordingly has no assets. A reconciliation of the beginning and ending balance of the projected benefit obligation for the years ended December 31, 2008 and 2007 is as follow:

	<u>2008</u>	<u>2007</u>
<b>Change in projected benefit obligation:</b>		
Projected benefit obligation at beginning of year .....	\$ 3,170	\$ 3,109
Service cost .....	99	122
Interest cost .....	173	144
Actuarial gains .....	(282)	(468)
Benefits paid .....	(67)	(55)
Foreign currency exchange rate changes .....	(152)	318
Projected benefit obligation at end of year .....	<u>\$ 2,941</u>	<u>\$ 3,170</u>
Accumulated benefit obligation .....	<u>\$ 2,842</u>	<u>\$ 3,056</u>
<b>Funding status at end of year .....</b>	<u>\$(2,941)</u>	<u>\$(3,170)</u>
<b>Net Amounts Recognized in the Financial Statements:</b>		
Current liability .....	\$ 76	\$ 70
Unrecognized actuarial gain reported within accrued pension benefits and accumulated other comprehensive loss .....	<u>\$ 2,865</u>	<u>\$ 3,100</u>
Net accrued pension liability recognized .....	2,941	3,170
Amounts included in other accumulated comprehensive income not yet recognized in periodic pension cost, net of tax .....	544	369
Amounts expected to be amortized from accumulated comprehensive income into net periodic pension costs over the next fiscal year consists of net actuarial gain/loss .....	33	17

Linotype also provides cash awards to its employees based on length of service. At December 31, 2008 and 2007, the balance accrued for such benefits totaled \$94 thousand and \$99 thousand, respectively, and is included in accrued pension benefits in the accompanying consolidated balance sheets.

The assumptions used to determine the accrued pension benefits (obligations) were as follows:

	<u>2008</u>	<u>2007</u>
Weighted-average Discount Rate .....	5.8%	5.5%
Weighted-average Rate of Compensation Increase .....	3.0%	2.0%
Rate of Inflation .....	2.0%	2.0%

The most recent actuarial valuation of the plan was performed as of December 31, 2008. The measurement dates are December 31, 2008 for 2008 and December 31, 2007 for 2007.

The following table reflects the total future expected benefit payments to plan participants. These payments have been estimated based on the same assumptions used to measure the Company's benefit obligation at year end.

<b>Expected Future Benefit Payments:</b>	
2009 .....	\$ 76
2010 .....	82
2011 .....	86
2012 .....	92
2013 .....	106
2014-2018 .....	826

## **10. Related-Party Transactions**

On July 28, 2006, we acquired 80.01% of the capital stock of China Type Design, which is described in more detail in Note 3. At the time of this acquisition, we had a 19.99% ownership interest in China Type Design and did not have the ability to exert significant influence over its operations. Accordingly, prior to the acquisition the results of operations of China Type Design were accounted for using the cost method of accounting. We received dividend income of \$0.5 million from China Type Design during the period January 1, 2006 to July 27, 2006.

We paid consulting fees to China Type Design for font design services, which are included in research and development expense in the accompanying consolidated statements of operations. For the period January 1, 2006 to July 27, 2006, consulting fees to China Type Design totaled approximately \$0.7 million.

We also paid royalties to China Type Design for font sales, which are included in our cost of revenue in the accompanying consolidated statements of operations. In the period January 1, 2006 to July 27, 2006, we incurred approximately \$0.1 million for royalty expenses to China Type Design.

In addition, we received royalty income from China Type Design for font sales, which is included in revenue in the accompanying consolidated statements of operations. In the period January 1, 2006 to July 27, 2006, we recognized royalty income from China Type Design of approximately \$14 thousand.

## 11. Income Taxes

The components of domestic and foreign income before the provision for income taxes are as follows (in thousands):

	<u>2008</u>	<u>2007</u>	<u>2006</u>
U.S. ....	\$15,467	\$ 6,010	\$ 8,558
Foreign .....	9,684	7,886	4,425
Total income before income tax provision .....	<u>\$25,151</u>	<u>\$13,896</u>	<u>\$12,983</u>

The components of the income tax provision are as follows (in thousands):

	<u>December 31,</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current			
State and local .....	\$ 655	\$ 424	\$ 323
U.S. Federal .....	2,504	811	1,417
Foreign jurisdictions .....	3,374	4,645	2,135
	<u>6,533</u>	<u>5,880</u>	<u>3,875</u>
Deferred			
State and local .....	(671)	4	252
U.S. Federal .....	4,170	396	1,752
Foreign jurisdictions .....	(262)	(1,448)	42
	<u>3,237</u>	<u>(1,048)</u>	<u>2,046</u>
Total provision .....	<u>\$9,770</u>	<u>\$ 4,832</u>	<u>\$5,921</u>

During the year, the Company recognized a tax benefit of approximately \$0.1 million related to stock based compensation, and has recorded a credit to additional paid in capital for this amount. In addition, the Company has reduced goodwill by \$0.1 million related to realization of tax benefits related to acquisitions.

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

	<u>December 31,</u>					
	<u>2008</u>		<u>2007</u>		<u>2006</u>	
Provision for income taxes at statutory rate .....	\$8,803	35.0%	\$ 4,864	35.0%	\$4,414	34.0%
State and local income taxes, net of federal income (tax) benefit .....	508	2.0%	278	2.0%	380	2.9%
Non-deductible registration costs .....	415	1.6%	-	-	-	-
Foreign dividends .....	-	-	-	-	1,374	10.6%
Foreign tax credits .....	-	-	-	-	(201)	(1.5)%
Foreign rate differential .....	189	0.7%	(30)	(0.2)%	-	-
Effect of rate changes on deferred taxes .....	(527)	(2.1)%	(1,427)	(10.3)%	-	-
Stock compensation .....	423	1.7%	1,226	8.8%	-	-
Research credits .....	(208)	(0.8)%	(342)	(2.4)%	-	-
Other, net .....	167	0.7%	263	1.9%	(46)	(0.4)%
Reported income tax provision .....	<u>\$9,770</u>	<u>38.8%</u>	<u>\$ 4,832</u>	<u>34.8%</u>	<u>\$5,921</u>	<u>45.6%</u>

For the year ended December 31, 2008, our effective tax rate was 38.8%. The rate is higher than our 2007 effective tax rate, primarily as a result of the impact of the change in tax rates in Germany, from 40% to 30%, in 2007 which had the effect of decreasing the 2007 rate by 10%. This resulted in a decrease in deferred taxes provided in Germany. This has been partially offset by the reduction in the tax effect of stock compensation charges for financial reporting purposes that may not result in deductions for tax purposes. This amount resulted in an increase in the 2008 tax provision of 1.7%, versus an 8.8% increase in 2007. In addition, the 2008 tax rate was increased for non-deductible stock registration costs.

In connection with the preparation of its quarterly financial statements for the three months ended September 30, 2008, the Company discovered that it had been erroneously providing for state income taxes based on an incorrect apportionment methodology since 2005. The methodology applied resulted in the overstatement of deferred tax liabilities and a corresponding overstatement of its provision for income taxes. In accordance with SEC Staff Accounting Bulletin (SAB) No. 99, *Materiality* and SAB No. 108 (“SAB 108”), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, the Company assessed the materiality of this error on its financial statements for the year ended December 31, 2007, using both the roll-over method and iron-curtain method as defined in SAB 108. The Company concluded the effect of this error was not material to its financial statements for any prior period and, as such, those financial statements are not materially misstated. The Company also concluded that providing for the correction of the error in 2008 will not have a material effect on its financial statements for the year ending December 31, 2008. Accordingly, the Company recorded a reduction to its provision for income taxes of \$527 thousand and a corresponding reduction to its deferred income tax liabilities in 2008 to correct this error.

Significant components of the Company’s deferred tax assets and liabilities consisted of the following (in thousands):

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
Deferred tax assets:		
Compensation related deductions .....	\$ 978	\$ 174
Foreign reserves and other .....	330	19
Fixed assets .....	–	115
Tax credit carryforwards .....	4,879	5,958
Accrued expenses .....	20	20
Subtotal deferred tax assets .....	<u>6,207</u>	<u>6,286</u>
Valuation allowance .....	<u>(3,042)</u>	<u>(3,171)</u>
Total deferred income tax assets .....	<u>\$ 3,165</u>	<u>\$ 3,115</u>
Deferred tax liabilities:		
Intangible assets .....	\$ 1,478	\$ 3,098
Goodwill .....	14,052	11,001
Unrealized gains .....	911	5
Unremitted earnings of foreign subsidiary .....	1,068	–
Other .....	747	1,463
Total deferred tax liabilities .....	<u>\$ 18,256</u>	<u>\$ 15,567</u>
Net deferred tax liabilities .....	<u>\$ 15,091</u>	<u>\$ 12,452</u>
Allocated as follows:		
Net deferred income tax assets—short-term .....	1,637	1,506
Net deferred income tax assets—long-term (1) .....	1,528	1,609
Net deferred income tax liabilities—short-term (2) .....	(1,091)	–
Net deferred income tax liabilities—long-term .....	<u>(17,165)</u>	<u>(15,567)</u>
Net deferred income tax liabilities .....	<u>\$ (15,091)</u>	<u>\$ (12,452)</u>

(1) Included in other assets in the accompanying consolidated balance sheet.

(2) Included in accrued expenses and other current liabilities in the accompanying consolidated balance sheet.



In assessing the realizability of the deferred tax assets, the primary evidence we considered included the cumulative pre-tax income for financial reporting purposes over the past three years, and the estimated future taxable income based on historical, as well as subsequent interim period operating results. After giving consideration to these factors, we concluded that it was more likely than not that the domestic deferred tax assets would be fully realized, and as a result, no valuation allowance against the domestic deferred tax assets was deemed necessary at December 31, 2008 and 2007. However, realization of certain other foreign deferred tax assets were not deemed to be more likely than not, and as a result, a valuation allowance against the foreign deferred tax assets was recognized as of December 31, 2008 and 2007.

A valuation allowance has been established for potential foreign tax credits that may be generated by Linotype Germany's deferred tax liability related to temporary differences caused by purchase accounting adjustments. As of December 31, 2007 this valuation allowance against these credits was \$3.2 million. The Company realized \$0.3 million of these credits in 2007 and adjusted goodwill by this amount. In addition, the Company has determined that it is more likely than not that it would realize a benefit of additional credits, or U.S. deductions, equal to a tax benefit of \$1.3 million and recorded an additional reduction of goodwill in 2007. We have elected to treat Linotype as a branch for U.S. tax purposes, and therefore we are eligible to claim a foreign tax credit for taxes paid to Germany. As a result of the complexity of the U.S. foreign tax credit computation, and the uncertainty related to whether we will be entitled to a foreign tax credit when the related taxes are paid or accrued, we have established a valuation allowance against the remaining balance of these credits. Adjustments made to our valuation allowances during 2008 were for currency rate fluctuations only and were deemed not to be material. As a result of adopting SFAS 141R on January 1, 2009, future reversals of this valuation allowance will result in a benefit to our income tax expense and will no longer result in a reduction to goodwill.

As a result of the implementation of FIN 48, the Company has classified approximately \$1.5 million to its reserve for uncertain tax positions at December 31, 2008.

The following is a reconciliation of the Company's gross uncertain tax positions at December 31, 2008 and 2007 (in thousands):

January 1, 2007 .....	\$ 1,663
Increases related to positions taken in prior years .....	604
Increases related to positions taken in the current year .....	—
Decrease related to positions taken in current year .....	<u>(599)</u>
December 31, 2007 .....	\$ 1,668
Increases related to positions taken in prior years .....	124
Decrease related to positions taken in prior years .....	(245)
Increases related to positions taken in the current year .....	<u>84</u>
December 31, 2008 .....	<u><u>\$ 1,631</u></u>

Of this amount of unrecognized tax benefits, approximately \$1.1 million, if recognized, would result in a reduction of the Company's effective tax rate. As of December 31, 2008, the Company has recorded a liability of \$1.3 million related to uncertain tax positions, in long term liabilities and \$0.2 million in current liabilities. The balance of the uncertain tax positions relate to deferred tax assets that have been reduced. The Company recognizes interest and penalties as a component of income tax expense. As of December 31, 2008 the Company has accrued approximately \$0.4 million for tax related interest and penalties. The current year tax provision includes a provision of approximately \$0.1 million for interest or \$82 thousand, net of federal benefit.

The Company monitors the undistributed earnings of foreign subsidiaries and, as necessary, provides for income taxes on those earnings that are not deemed permanently invested. As of December 31, 2008, there was approximately \$3.0 million of undistributed earnings related to the Company's U.K. subsidiary, for which deferred U.S. taxes have been provided.

The Company is currently subject to audit by the Internal Revenue Service and foreign jurisdictions for the years 2005 through 2008. The Company and its subsidiaries state income tax returns are subject to audit for the years 2004 through 2008.

## 12. Stockholders' Equity

We completed our initial public offering on July 30, 2007 issuing 6.5 million shares of our common stock at a price of \$12.00 per share (see Note 1).

### Capital Stock

#### Convertible Redeemable Preferred Stock

At December 31, 2006, we had authorized 5,994,199 shares of convertible redeemable preferred stock, or CRPS, with a par value of \$0.01 per share. CRPS held senior rank in all respects to all other classes or series of capital stock of the Company.

In connection with our initial public offering, on July 30, 2007, all of the outstanding CRPS or 5,840,354 shares, converted into 23,361,416 shares of common stock and 5,840,354 shares of redeemable preferred stock. The conversion resulted in approximately \$64.6 million being reclassified to the capital accounts of the Company, and approximately \$9.7 million being reclassified to redeemable preferred stock. At December 31, 2008 and 2007 we had no authorized CRPS.

#### Redeemable Preferred Stock

At December 31, 2006, we had authorized 5,994,199 shares of redeemable preferred stock, or RPS, with a par value of \$0.01 per share. In connection with our initial public offering, our outstanding CRPS was converted into 5,840,354 shares of RPS. Also in accordance with our initial public offering and in accordance with the redemption features of our RPS, all of those RPS shares were redeemed at \$1.653 per share. We used approximately \$9.7 million in proceeds from the initial public offering to redeem all of the shares of RPS. At December 31, 2008 and 2007, we had no authorized RPS.

### Accumulated other comprehensive income

The following table provides the components of accumulated other comprehensive income (loss):

	<u>Foreign Currency Translation Adjustment</u>	<u>SFAS No. 158 Pension Liability</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>
Balance at December 31, 2006 .....	\$ 533	\$ 41	\$ 574
Current year change, net of tax of \$1,095 and \$140 for foreign currency translation and SFAS No. 158, respectively .....	<u>1,719</u>	<u>328</u>	<u>2,047</u>
Balance at December 31, 2007 .....	2,252	369	2,621
Current year change, net of tax of (\$739) and \$75 for foreign currency translation and SFAS No. 158, respectively .....	<u>(1,140)</u>	<u>175</u>	<u>(965)</u>
Balance at December 31, 2008 .....	<u>\$ 1,112</u>	<u>\$544</u>	<u>\$1,656</u>

### 13. Net income (loss) per share

The following table presents a reconciliation of the numerator and denominator used in the calculation of basic and diluted net income (loss) per share under the “two class” method (in thousands, except per share data):

	Year Ended December 31,		
	2008	2007	2006
Numerator:			
Net income, as reported .....	\$ 15,381	\$ 9,064	\$ 7,062
Less: preferred stock accretion .....	—	(34,086)	(24,387)
Net income (loss) available to common shareholders ..	<u>\$ 15,381</u>	<u>\$ (25,022)</u>	<u>\$ (17,325)</u>
Denominator:			
Basic: .....			
Weighted-average shares of common stock outstanding .....	34,389,086	17,099,950	3,756,636
Less: Weighted-average shares of unvested restricted common stock outstanding .....	(570,578)	(925,785)	(1,405,280)
Weighted-average number of common shares used in computing basic net income (loss) per common share .....	<u>33,818,508</u>	<u>16,174,165</u>	<u>2,351,356</u>
Net income (loss) per share applicable to common shareholders—basic .....	<u>\$ 0.45</u>	<u>\$ (1.55)</u>	<u>\$ (7.37)</u>
Diluted: .....			
Weighted-average shares of common stock outstanding .....	34,389,086	17,099,950	3,756,636
Less: Weighted-average shares of unvested restricted common stock outstanding .....	(570,578)	(925,785)	(1,405,280)
Weighted-average number of common shares issuable upon exercise of outstanding stock options, based on the treasury stock method ...	1,065,759	—	—
Weighted-average number of shares of restricted common stock outstanding .....	420,527	—	—
Weighted-average number of common shares used in computing diluted net income (loss) per common share .....	<u>35,304,794</u>	<u>16,174,165</u>	<u>2,351,356</u>
Net income (loss) per share applicable to common shareholders—diluted .....	<u>\$ 0.44</u>	<u>\$ (1.55)</u>	<u>\$ (7.37)</u>

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

	Year Ended December 31,		
	2008	2007	2006
Convertible redeemable preferred stock .....	—	—	23,370,124
Unvested restricted shares .....	—	925,785	1,405,280
Options .....	1,033,662	1,322,142	940,972
Convertible notes payable .....	—	—	170,960

#### 14. Stock Compensation Plans

In November 2004, the Company's stockholders approved the 2004 Stock Option and Grant Plan (the "2004 Award Plan"). The 2004 Award Plan provides long-term incentives and rewards to full-time and part-time officers, directors, employees, consultants, advisors and other key persons (collectively, "Key Persons") who are responsible for, or contribute to, the management, growth or profitability of the Company. Options and stock grants issued under the 2004 Award Plan generally vest over a four year period and expire ten years from the date of grant. The Company has granted incentive stock options, nonqualified stock options and restricted stock awards under the 2004 Award Plan. As of December 31, 2008, 2,591,204 options and 2,810,403 restricted stock awards have been granted under the 2004 Option Plan. There will be no future grants of awards from the 2004 Award Plan. Pursuant to the terms of our 2004 Award Plan, we have the right to repurchase unvested restricted shares from employees upon their termination, and it is generally our policy to do so. In the years ended December 31, 2008 and 2007 we repurchased 33,000 shares and 12,358 shares, respectively, of unvested restricted stock in accordance with the 2004 Award Plan.

In March 2007, the Company's Board of Directors approved the adoption of the Company's 2007 Stock Option and Incentive Plan ("2007 Award Plan"), and the 2007 Award Plan was subsequently approved by stockholders in May 2007 and became effective on July 24, 2007. The 2007 Award Plan permits the Company to make grants of incentive stock options, non-qualified stock options, stock appreciation rights, deferred stock awards, restricted stock awards, unrestricted stock awards, cash-based awards and dividend equivalent rights to Key Persons. The Company has reserved 4,383,560 shares of common stock for issuance of awards under the 2007 Award Plan, subject to adjustment for any stock split, dividend or other change in the Company's capitalization. In addition, shares that are forfeited or cancelled from awards under the 2004 Award Plan or the 2007 Award Plan will be available for future grants under the 2007 Award Plan. Stock options granted under the 2007 Award Plan have a maximum term of ten years from the date of grant and generally vest over four years. Option awards granted under the 2007 Award Plan must have an exercise price of no less than the fair market value of the common stock on the date of grant. As of December 31, 2008, 1,284,801 options and 85,176 restricted stock awards have been granted under the 2007 Option Plan. Pursuant to the terms of our 2007 Award Plan, we automatically reacquire any unvested restricted shares at their original price from the grantee upon termination of employment. In the years ended December 31, 2008 and 2007, we did not repurchase any shares of our common stock pursuant to the 2007 Award Plan.

#### Share Based Compensation

The following presents the impact of share based compensation expense on our condensed consolidated statements of operations (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Marketing and selling .....	\$1,141	\$ 476	\$128
Research and development .....	717	2,875	78
General and administrative .....	1,776	906	234
Total share based compensation .....	<u>\$3,634</u>	<u>\$4,257</u>	<u>\$440</u>

Included in our share based compensation expense in the year ended December 31, 2007, was \$2.6 million of expense on the shares of restricted common stock that were issued upon the conversion of the China Type Design promissory notes (see Note 7) which is included in research and development in the accompanying consolidated statements of operations.

As of December 31, 2008, the Company had \$10.5 million of unrecognized compensation expense related to employees and directors unvested stock option awards and restricted share awards that are expected to be recognized over a weighted average period of 2.9 years.

### Stock Option Awards

Stock option activity for the year ended December 31, 2008 is presented below:

	Number of Shares	Weighted- Average Exercise Price per Share	Aggregate Intrinsic Value (1) (in thousands)	Weighted- Average Remaining Contractual Life (in Years)
Outstanding at December 31, 2007 .....	2,335,769	\$ 4.57		
Granted .....	1,159,318	\$14.21		
Exercised .....	(211,134)	\$ 2.91		
Cancelled .....	(206,722)	\$10.00		
Outstanding at December 31, 2008 .....	<u>3,077,231</u>	\$ 7.95	\$4,392	7.9
Exercisable at December 31, 2008 .....	<u>1,336,992</u>	\$ 3.57	\$3,751	6.9
Vested and expected to vest at December 31, 2008 (2) .....	<u>2,972,817</u>	\$ 7.83	\$4,354	

- (1) The aggregate intrinsic value is calculated as the positive difference between the exercise price of the underlying options and the quoted price of our shares of common stock on December 31, 2008.
- (2) Represents the number of vested options as of December 31, 2008, plus the number of unvested options expected to vest as of December 31, 2008, based on the unvested options outstanding at December 31, 2008, adjusted for estimated forfeitures.

Options granted during the 2007 period prior to our IPO on July 25, 2007, and during the year ended December 31, 2006, were as follows:

Accounting Grant Date	Legal Grant Date (1)	Number of Shares	Exercise Price Per Share (1)	Fair Value of Common Stock (2)	Accounting Grant Date Intrinsic Value of Options (3)
February 16, 2006	February 16, 2006 .....	86,952	\$ 1.70	\$ 1.70	\$ -
October 3, 2006	July 14, 2006 .....	67,356	\$ 4.07	\$ 6.50	\$2.43
October 24, 2006	September 30, 2006 .....	992,600	\$ 6.43	\$ 6.97	\$0.54
January 10, 2007	December 31, 2006 .....	89,000	\$ 8.50	\$ 8.82	\$0.32
May 10, 2007	March 31, 2007 .....	15,556	\$11.35	\$12.19	\$0.84
August 2, 2007	June 30, 2007 .....	50,844	\$13.25	\$12.00	\$ -

- (1) The exercise price was based on a contemporaneous valuation as of each legal grant date. The legal grant date is the date on which the compensation committee of the Board of Directors authorized the option grants with exercise prices equal to the fair market value of our common stock as of that date, to be finalized upon completion of a valuation report in the future.
- (2) For accounting purposes, the grant date for stock options cannot precede the date on which all of the necessary approvals were obtained and the key terms of the grant were known. Accordingly, the Company uses the date on which the compensation committee of our Board of Directors receives and approves the applicable valuation report as the grant date for accounting purposes. The fair value of the common stock at the accounting grant date was determined by straight-line interpolation of the fair value of the common stock per the valuation reports preceding and following the accounting grant date.
- (3) The intrinsic value of the options on the accounting grant date represents the increase in fair value of our common stock during the period of time between the legal and the accounting grant dates.

Both the legal and accounting dates of options granted after our initial public offering on July 25, 2007 were the same as we had a readily available value of our common stock on the particular grant dates as traded on the NASDAQ Global Market.

The aggregate intrinsic value of exercised options in the years ended December 31, 2008, 2007 and 2006 was \$2.0 million, \$2.6 million and \$61 thousand, respectively. The fair value of shares vested during 2008, 2007 and 2006 was \$6.3 million, \$7.5 million and \$2.7 million, respectively.

Cash received from option exercises under all share based payment arrangements for the years ended December 31, 2008, 2007 and 2006 was \$0.6 million, \$0.3 million and \$8 thousand, respectively. Option exercises will result in the issuance of new shares of common stock.

### **Unvested Share Awards**

Unvested share activity for the year ended December 31, 2008 is presented below:

	<u>Shares</u>	<u>Weighted-Average Grant Date Fair Value Per Share</u>
Unvested shares outstanding at December 31, 2007 .....	826,119	\$ 0.43
Granted .....	71,617	\$11.88
Vested .....	(573,436)	\$ 0.23
Forfeited .....	<u>(33,000)</u>	\$ 1.37
Unvested shares outstanding at December 31, 2008 .....	<u>291,300</u>	\$ 3.68

## **15. Restructuring**

On November 10, 2008 we announced a restructuring plan. Under the plan, we reduced headcount in certain areas of the Company and redeployed certain other employees within the Company in order to focus on key initiatives across the business.

The following presents the impact of the restructuring action on our consolidated statements of operations (in thousands):

	<u>2008</u>
Marketing and selling .....	\$297
Research and development .....	124
General and administrative .....	<u>315</u>
Total restructuring .....	<u>\$736</u>

Restructuring charges incurred to date relate to severance and termination benefits. The restructuring plan was completed as of December 31, 2008, other than the payment of deferred termination benefits to certain terminated employees.

The following presents the restructuring provision (in thousands):

	<u>Personnel related</u>
Charges during Q4 .....	\$ 736
Cash payments during Q4 .....	(116)
Foreign currency exchange rate changes .....	<u>15</u>
Provision at December 31, 2008 .....	<u>\$ 635</u>

## 16. Segment Reporting

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

	Year Ended December 31,		
	2008	2007	2006
OEM .....	\$ 77,810	\$ 72,612	\$64,268
Creative Professional .....	33,051	32,540	21,936
Total .....	<u>\$110,861</u>	<u>\$105,152</u>	<u>\$86,204</u>

### Geographic segment information

The Company attributes revenues to geographic areas based on the location of our subsidiary receiving such revenue. For example, licenses may be sold to large international companies which may be headquartered in Asia for instance, but the sales are received and recorded by our subsidiary located in the United States. This revenue is therefore reflected in the United States totals in the table below. We market our products and services through offices in the US and our wholly-owned subsidiaries and affiliates in the United Kingdom, Germany, Hong Kong, and Japan. The following summarizes revenue by location:

	Year Ended December 31,					
	2008		2007		2006	
	Sales	% of Total	Sales	% of Total	Sales	% of Total
	(In thousands, except percentages)					
United States .....	\$ 35,975	32.5%	\$ 32,873	31.3%	\$37,050	43.0%
Asia .....	42,658	38.5	40,823	38.8	33,732	39.1
United Kingdom ....	12,905	11.6	12,171	11.6	8,653	10.0
Germany .....	19,323	17.4	19,285	18.3	6,769	7.9
Total .....	<u>\$110,861</u>	<u>100.0%</u>	<u>\$105,152</u>	<u>100.0%</u>	<u>\$86,204</u>	<u>100.0%</u>

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

	December 31,	
	2008	2007
Long-lived assets:		
United States .....	\$77,242	\$ 86,609
Asia .....	909	1,020
United Kingdom .....	74	62
Germany .....	15,284	17,045
Total .....	<u>\$93,509</u>	<u>\$104,736</u>

## 17. Commitments and Contingencies

### Operating Leases

We conduct operations in facilities under operating leases expiring through 2013. In accordance with the lease terms, we pay real estate taxes and other operating costs. Our German lease contains two five-year renewal options. The Company's future minimum payments under non-cancelable operating leases as of December 31, 2008, are approximately as follows (in thousands):

Years ending December 31:	
2009 .....	\$1,863
2010 .....	1,807
2011 .....	967
2012 .....	736
2013 .....	23
Total .....	<u>\$5,396</u>

Rent expense charged to operations was approximately \$1.7 million, \$1.6 million and \$ 1.2 million for the years ended December 31, 2008, 2007 and 2006, respectively.

### License Agreements

We license fonts and related technology from third parties for development and resale purposes, and certain of our license agreements provide for minimum annual payments. As of December 31, 2008, we had the following minimum commitments under such license agreements (in thousands):

Years ending December 31:	
2009 .....	\$ 900
2010 .....	100
2011 .....	100
2012 .....	—
2013 .....	—
Total .....	<u>\$1,100</u>

### Legal Proceedings

#### *Adobe Systems, Incorporated*

On October 30, 2006 Adobe filed an action in the United States District Court of the Northern District of California against Linotype alleging that Linotype breached its obligations under agreements between Linotype and Adobe by failing to pay all royalties due under those agreements, submitting inaccurate royalty reports, and using the fonts licensed under those agreements improperly and without authorization. Adobe requested unspecified money damages, a declaratory judgment, costs and attorneys' fees. On November 9, 2007, Adobe dismissed the case without prejudice.

### Licensing Warranty

Under our standard license agreement with OEMs, we warrant that the licensed technologies are free of infringement claims of intellectual property rights and will meet the specifications as defined in the licensing agreement for a one-year period. Under the licensing agreements, liability for such indemnity obligations is limited, generally to the total arrangement fee; however, exceptions have been made on a case-by-case basis, increasing the maximum potential liability to agreed upon amounts at the time the



contract is entered into. We have never incurred costs payable to a customer or business partner to defend lawsuits or settle claims related to these warranties, and as a result, management believes the estimated fair value of these warranties is minimal. Accordingly, there are no liabilities recorded for these warranties as of December 31, 2008 and 2007.

## 18. Supplementary Financial Data (Unaudited)

(in thousands, except share amounts)

	Three Months Ended							
	December 31, 2008	September 30, 2008	June 30, 2008	March 31, 2008	December 31, 2007	September 30, 2007	June 30, 2007	March 31, 2007
Revenue .....	\$27,369	\$27,310	\$28,839	\$27,343	\$27,514	\$26,172	\$25,756	\$25,710
Net income .....	\$ 4,078	\$ 4,393	\$ 3,224	\$ 3,686	\$ 3,975	\$ 1,524	\$ 1,985	\$ 1,580
Income (loss) per common share:								
Basic .....	\$ 0.12	\$ 0.13	\$ 0.10	\$ 0.11	\$ 0.12	\$ (0.09)	\$ (4.95)	\$ (4.35)
Diluted .....	\$ 0.12	\$ 0.12	\$ 0.09	\$ 0.10	\$ 0.11	\$ (0.09)	\$ (4.95)	\$ (4.35)

### Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

None.

### Item 9A. Controls and Procedures

We maintain disclosure controls and procedures, which are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer ("CEO") and chief financial officer ("CFO"), as appropriate, to allow timely decisions regarding required disclosure.

Our management, including our CEO and CFO, evaluated the effectiveness of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act, as of the end of the period covered by this Annual Report on Form 10-K. Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective as of December 31, 2008. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

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

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as this term is defined in Exchange Act Rule 13a-15(f) and 15d-15(f) of the Exchange Act. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework set forth in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework set forth in *Internal Control-Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2008.

Our internal control over financial reporting as of December 31, 2008 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report below.

**Changes in Internal Control over Financial Reporting**

An evaluation was also performed under the supervision and with the participation of our management, including the CEO and CFO, of any change in our internal controls over financial reporting that occurred during our last fiscal quarter and that has materially affected, or is reasonably likely to affect, our internal controls over financial reporting. There has been no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited Monotype Imaging Holding Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Monotype Imaging Holding Inc.'s management is responsible 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. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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 its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Monotype Imaging Holdings Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Monotype Imaging Holdings Inc. as of December 31, 2008 and 2007, and the related consolidated statements of operations, convertible redeemable preferred stock, redeemable preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2008 and our report dated March 10, 2009 expressed an unqualified opinion thereon.

ERNST & YOUNG LLP

Boston, Massachusetts  
March 10, 2009

**Item 9B. Other Information**

None.

**PART III**

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

Pursuant to General Instructions G to Form 10-K, the information required for Part III, Item 10 is incorporated herein by reference from our proxy statement in connection with our 2009 Annual Meeting of Stockholders, which proxy statement is expected to be filed with the SEC not later than 120 days after the close of our fiscal year ended December 31, 2008.

**Item 11. Executive Compensation**

Pursuant to General Instructions G to Form 10-K, the information required for Part III, Item 11, including specifically the "Compensation Committee Report," is incorporated herein by reference from our proxy statement in connection with our 2009 Annual Meeting of Stockholders, which proxy statement is expected to be filed with the SEC not later than 120 days after the close of our fiscal year ended December 31, 2008.

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

Pursuant to General Instructions G to Form 10-K, the information required for Part III, Item 12 is incorporated herein by reference from our proxy statement in connection with our 2009 Annual Meeting of Stockholders, which proxy statement is expected to be filed with the SEC not later than 120 days after the close of our fiscal year ended December 31, 2008.

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

Pursuant to General Instructions G to Form 10-K, the information required for Part III, Item 13 is incorporated herein by reference from our proxy statement in connection with our 2009 Annual Meeting of Stockholders, which proxy statement is expected to be filed with the SEC not later than 120 days after the close of our fiscal year ended December 31, 2008.

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

Pursuant to General Instructions G to Form 10-K, the information required for Part III, Item 14 is incorporated herein by reference from our proxy statement in connection with our 2009 Annual Meeting of Stockholders, which proxy statement is expected to be filed with the SEC not later than 120 days after the close of our fiscal year ended December 31, 2008.

## PART IV

### Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this Report:

#### 1. Consolidated Financial Statements

The financial statements required by this item are listed in Item 8, "Financial Statements and Supplementary Data" herein.

#### 2. List of Financial Statement Schedules

See "Schedule II—Valuation and Qualifying Accounts." All other schedules are omitted because they are not applicable, not required or the required information is shown in the consolidated financial statements or notes thereto.

#### 3. List of Exhibits

### EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation of the Registrant (5)
3.2	Amended and Restated By-Laws of the Registrant (4)
3.3	Amendment No. 1 to the Amended and Restated By-Laws (15)
4.1	Specimen Stock Certificate (5)
4.2	Registration Rights Agreement by and among Monotype Imaging Holdings Corp., the Investors and the Management Stockholders named therein, dated as of November 5, 2004 (1)
4.3	Stockholders Agreement by and among Monotype Imaging Holdings Corp., the Management Stockholders and the Investors named therein, dated as of November 5, 2004 (1)
4.4	Amendment No. 1 to Registration Rights Agreement (9)
10.1	2004 Stock Option and Grant Plan (1)
10.2	Form of Non-Qualified Option Agreement under the 2004 Stock Option and Grant Plan (1)
10.3	Form of Incentive Stock Option Agreement under the 2004 Stock Option and Grant Plan (1)
10.4	Form of Restricted Stock Agreement under the 2004 Stock Option and Grant Plan (1)
10.5	2007 Stock Option and Incentive Plan (3)
10.6	Form of Non-Qualified Option Agreement under the 2007 Stock Option and Incentive Plan (3)
10.7	Form of Incentive Stock Option Agreement under the 2007 Stock Option and Incentive Plan (3)
10.8	Form of Restricted Stock Agreement under the 2007 Stock Option and Incentive Plan (3)
10.9	Form of Director Restricted Stock Award Agreement under the 2007 Stock Option and Incentive Plan (12)
10.10	Service agreement by and between the Monotype Imaging Inc. and Frank Wildenberg, dated as of January 24, 2007 (3)

<u>Exhibit Number</u>	<u>Description</u>
10.11	Employment agreement by and between the Monotype Imaging Inc. and Scott E. Landers, dated as of July 14, 2008 (13)
10.12	Employment agreement by and between Douglas J. Shaw and the Monotype Imaging Inc., effective as of December 19, 2008 (16)
10.13	Employment agreement by and between John L. Seguin and the Monotype Imaging Inc., effective as of December 19, 2008 (16)
10.14	Employment agreement by and between David L. McCarthy and the Monotype Imaging Inc., effective as of December 19, 2008 (16)
10.15	Employment agreement by and between Janet M. Dunlap and the Monotype Imaging Inc., effective as of December 19, 2008 (16)
10.16	Employment agreement by and between Alex N. Braverman and the Monotype Imaging Inc., effective as of December 19, 2008 (16)
10.17	Form of Indemnification Agreement between Monotype Imaging Inc. and certain of its Directors and Officers (1)
10.18	Lease, dated as of January 5, 2005, between Acquiport Unicorn, Inc. and Monotype Imaging, Inc., as amended (3)
10.19	Lease, dated as of April 6, 2006, between 6610, LLC and Monotype Imaging, Inc. (1)
10.20	First Amendment to Lease dated as of April 6, 2006, between 6610, LLC and Monotype Imaging, Inc. (8)
10.21	Lease, dated as of February 18, 2008, between 6610, LLC and Monotype Imaging, Inc. (8)
10.22	Lease, dated as of November 14, 2007, between Sachiko Kasai and Monotype Imaging KK (8)
10.23	Lease, dated as of July 10, 2006, between Sun Wah Marine Products (Holdings) Limited and China Type Design Limited (2)
10.24	Lease, dated as of May 24, 2006, between Lake Center Plaza Partners, LLC and Monotype Imaging, Inc. (1)
10.25	Lease, dated as of April 7, 2005, between RAFI (GB) Limited and Monotype Imaging Limited (3)
10.26	Office lease, dated as of December 17, 2006, by and between Sheila L. Ortloff and Monotype Imaging, Inc. (2)
10.27	Third Amendment to Lease by and between Acquiport Unicorn, Inc. and Monotype Imaging, Inc., dated as of March 4, 2008 (8)
10.28	Lease between Tyne Flooring Limited and Agfa Monotype Limited (10)
10.29	Lease dated April 11, 2008 (12)
10.30	Lease between Bytec Group Limited and Monotype Imaging Limited, dated as of June 3, 2008 (14)
10.31	Lease between In Hwa Jung and Monotype Imaging Inc., dated February 5, 2009 *
10.32	Stock Purchase Agreement by and among Agfa Corp., Afga Monotype Corporation and Imaging Acquisition Corporation, dated as of November 5, 2004 (2)
10.33	Security Agreement by and among the Grantors (as defined therein) and Wells Fargo Foothill, Inc., dated as of November 5, 2004 (3)

<u>Exhibit Number</u>	<u>Description</u>
10.34	Supplemental No. 1 to the Security Agreement by and among the Grantors (as defined therein) and Wells Fargo Foothill, Inc., dated as of December 28, 2006 (3)
10.35	Intercompany Subordination Agreement by and among Monotype Acquisition Corporation, Agfa Monotype Corporation, International Typeface Corporation, Monotype Imaging Holdings Corp., and Wells Fargo Foothill, Inc., dated as of November 5, 2004 (3)
10.36	Share Pledge Agreement by and among Monotype Imaging Holdings Corp., Blitz 06-683 GmbH, Wells Fargo Foothill, Inc. and the Lenders (as defined therein), dated as of July 31, 2006 (2)
10.37	Joinder and Consent Agreement to and Consent and Waiver Under Credit Agreement, by and among Linotype Corp., Monotype Imaging Holdings Corp., Monotype Imaging, Inc., International Typeface Corporation, the Required Lenders (as defined therein) and Wells Fargo Foothill, Inc., dated as of December 13, 2006 (2)
10.38	Amended and Restated Credit Agreement by and among Monotype Imaging Holdings Inc., Imaging Holdings Corp., Monotype Imaging Inc., and International typeface Corporation, as Borrowers, the Lenders (as defined therein) and Wells Fargo Foothill, Inc., as the Arranger and Administrative Agent, dated as of July 30, 2007 (6)
10.39	Joinder to Security Agreement, Guaranty and Intercompany Subordination Agreement, by and among Monotype Imaging Holdings Inc., Imaging Holdings Corp., Monotype Imaging Inc., International Typeface Corporation, Linotype Corp., and Wells Fargo Foothill, Inc., as the Arranger and Administrative Agent, dated as of July 30, 2007 (8)
10.40	Supplement No. 2 to the Security Agreement by and among the Grantors (as defined therein) and Wells Fargo Foothill, Inc., dated as of July 30, 2007 (8)
10.41	Copyright Security Agreement by and among the Grantors (as defined therein) and Wells Fargo Foothill, Inc., dated as of July 30, 2007 (8)
10.42	Trademark Security Agreement by and among the Grantors (as defined therein) and Wells Fargo Foothill, Inc., dated as of July 30, 2007 (8)
10.43	Patent Security Agreement by and among the Grantors (as defined therein) and Wells Fargo Foothill, Inc., dated as of July 30, 2007 (8)
10.44	First Amendment to the Amended and Restated Credit Agreement (11)
10.45	Equity Award Grant Policy (3)
10.46	2007 Incentive Compensation Plan, as amended (7)
10.47	2007 (Sales) Incentive Compensation Plan by and between Monotype Imaging Inc. and David L. McCarthy, dated as of March 6, 2007 (3)
10.48	2008 Executive Incentive Compensation Program, as amended (15)
10.49	2009 Executive Incentive Compensation Program, as amended (17)
10.50	Agreement and Plan of Merger by and among the Registrant, MIHC Merger Sub Inc. and Monotype Imaging Holdings Corp., dated as of August 24, 2005 (1)
10.51	Stock Purchase Agreement by and among Monotype Imaging Inc. and certain stockholders of China Type Design Limited, dated as of July 28, 2006 (1)
10.52	Purchase Agreement for the Sale of Shares in Linotype GmbH by and among Heidelberger Druckmaschinen Aktiengesellschaft, Blitz 06-683 GmbH and Monotype Imaging Holdings Corp., dated as of August 1, 2006 (3)

<u>Exhibit Number</u>	<u>Description</u>
14.1	Code of Business Conduct and Ethics (7)
21.1	List of Subsidiaries (1)
23.1	Consent of Independent Registered Public Accounting Firm*
31.1	Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
31.2	Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer and Chief Financial Officer *

- (1) Incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-140232), filed with the SEC on January 26, 2007.
- (2) Incorporated by reference to Amendment No. 1 to the Company's Registration Statement on Form S-1 (File No. 333-140232), filed with the SEC on February 8, 2007.
- (3) Incorporated by reference to Amendment No. 2 to the Company's Registration Statement on Form S-1 (File No. 333-140232), filed with the SEC on April 13, 2007.
- (4) Incorporated by reference to Amendment No. 4 to the Company's Registration Statement on Form S-1 (File No. 333-140232), filed with the SEC on July 5, 2007.
- (5) Incorporated by reference to Amendment No. 5 to the Company's Registration Statement on Form S-1 (File No. 333-140232), filed with the SEC on July 10, 2007.
- (6) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2007, filed on September 7, 2007.
- (7) Incorporated by reference to the Company's Current Report on Form 8-K filed on February 8, 2008.
- (8) Incorporated by reference to the Company's Annual Report on Form 10-K for the period ended December 31, 2007, filed on March 27, 2008.
- (9) Incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-150034), filed with the SEC on April 2, 2008.
- (10) Incorporated by reference to Amendment No. 2 to the Company's Annual Report on Form 10-K for the period ended December 31, 2007, filed on April 22, 2008.
- (11) Incorporated by reference to Amendment No. 1 to the Company's Registration Statement on Form S-1 (File No. 333-150034), filed with the SEC on April 22, 2008.
- (12) Incorporated by reference to Amendment No. 2 to the Company's Registration Statement on Form S-1 (File No. 333-150034), filed with the SEC on May 23, 2008.
- (13) Incorporated by reference to the Company's Current Report on Form 8-K filed on July 17, 2008.
- (14) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2008, filed on August 12, 2008.
- (15) Incorporated by reference to the Company's Current Report on Form 8-K filed on November 7, 2008.
- (16) Incorporated by reference to the Company's Current Report on Form 8-K filed on December 22, 2008.
- (17) Incorporated by reference to the Company's Current Report on Form 8-K filed on March 2, 2009.

\* Filed herewith.



## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on March 13, 2009.

MONOTYPE IMAGING HOLDINGS INC.

By:                   /s/ DOUGLAS J. SHAW                    
**Douglas J. Shaw**  
*President and Chief Executive Officer and Director*

## SIGNATURES AND POWER OF ATTORNEY

KNOWN ALL MEN BY THESE PRESENTS that each individual whose signature appears below constitutes and appoints each of Douglas J. Shaw and Scott E. Landers such person's true and lawful attorney-in-fact and agent with full power of substitution and resubstitution, for such person and in such person's name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and all documents in connection therewith, with the Securities and Exchange Commission, granting unto each said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as such person might or could do in person, hereby ratifying and confirming all that any said attorney-in-fact and agent, or any substitute or substitutes of any of them, may lawfully do or cause to be done by virtue hereof.

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

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/ DOUGLAS J. SHAW <b>Douglas J. Shaw</b>	President, Chief Executive Officer and Director (Duly Authorized Officer and Principal Executive Officer)	March 13, 2009
/s/ SCOTT E. LANDERS <b>Scott E. Landers</b>	Senior Vice President, Chief Financial Officer, Treasurer and Assistant Secretary (Principal Accounting Officer)	March 13, 2009
/s/ ROBERT M. GIVENS <b>Robert M. Givens</b>	Chairman of the Board of Directors	March 13, 2009
/s/ A. BRUCE JOHNSTON <b>A. Bruce Johnston</b>	Director	March 13, 2009
/s/ ROGER J. HEINEN, JR. <b>Roger J. Heinen, Jr.</b>	Director	March 13, 2009
/s/ PAMELA F. LENEHAN <b>Pamela F. Lenehan</b>	Director	March 13, 2009
/s/ PETER J. SIMONE <b>Peter J. Simone</b>	Director	March 13, 2009
/s/ ROBERT L. LENTZ <b>Robert L. Lentz</b>	Director	March 13, 2009

**MONOTYPE IMAGING HOLDINGS INC.**  
**SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS**

<u>Description</u>	<u>Balance at Beginning of Period</u>	<u>Charged (benefit) to Costs and Expenses</u>	<u>Deductions</u>	<u>Balance at End of Period</u>
Year ended December 31, 2008 . . . . .	\$ 177	\$126	\$(67)	\$236
Year ended December 31, 2007 . . . . .	—	240	(63)	177
Year ended December 31, 2006 . . . . .	85	—	(85)	—

**CERTIFICATION**

I, Douglas J. Shaw, certify that:

1. I have reviewed this Annual Report on Form 10-K of Monotype Imaging Holdings Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2009

/s/ DOUGLAS J. SHAW

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Douglas J. Shaw  
Chief Executive Officer

**CERTIFICATION**

I, Scott E. Landers, certify that:

1. I have reviewed this Annual Report on Form 10-K of Monotype Imaging Holdings Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2009

/s/ SCOTT E. LANDERS

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Scott E. Landers  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Monotype Imaging Holdings Inc. (the "Company") on Form 10-K for the year ended December 31, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Douglas J. Shaw, Chief Executive Officer of the Company, and Scott E. Landers, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to our knowledge, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

This certification is being provided pursuant to 18 U.S.C. 1350 and is not to be deemed a part of the Report, nor it is deemed to be "filed" for any purpose whatsoever.

Dated: March 13, 2009

/s/ DOUGLAS J. SHAW

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**Douglas J. Shaw**  
*Chief Executive Officer*

/s/ SCOTT E. LANDERS

---

**Scott E. Landers**  
*Chief Financial Officer*

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form with the electronic version of this written statement required by Section 906, has been provided to Monotype Imaging Holdings Inc. and will be retained by Monotype Imaging Holdings Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

## SHAREHOLDER INFORMATION

### CORPORATE HEADQUARTERS

Monotype Imaging Inc.  
500 Unicorn Park Drive  
Woburn, MA 01801-3345  
[www.monotypeimaging.com](http://www.monotypeimaging.com)

### INVESTOR RELATIONS

Monotype Imaging Inc.  
500 Unicorn Park Drive  
Woburn, MA 01801-3345  
[ir@monotypeimaging.com](mailto:ir@monotypeimaging.com)

### TRANSFER AGENT

American Stock Transfer & Trust Company  
59 Maiden Lane  
New York, NY 10038-4502  
1-800-937-5449  
[info@amstock.com](mailto:info@amstock.com)  
[www.amstock.com](http://www.amstock.com)

### INDEPENDENT AUDITORS

Ernst & Young LLP  
200 Clarendon Street  
Boston, MA 02116-5072

### AGENT BANK

Wells Fargo Foothill, Inc.  
One Boston Place 18<sup>th</sup> Floor  
Boston, MA 02109-4400

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# MONOTYPE IMAGING HOLDINGS INC.

## BOARD OF DIRECTORS AND CORPORATE OFFICERS

### DIRECTORS

**Robert M. Givens**

*Chairman of the Board of Directors*

**Roger J. Heinen, Jr.**

**A. Bruce Johnston**

**Pamela F. Lenehan**

**Robert L. Lentz**

**Douglas J. Shaw**

**Peter J. Simone**

### EXECUTIVE OFFICERS

**Douglas J. Shaw**

*President, Chief Executive Officer and Director*

**John L. Seguin**

*Executive Vice President*

**Scott E. Landers**

*Senior Vice President, Chief Financial Officer,  
Treasurer and Assistant Secretary*

**David R. DeWitt**

*Vice President and General Manager, Creative Professional*

**Janet M. Dunlap**

*General Counsel and Secretary*

**Daniel T. Geron**

*Vice President, Business Development*

**Steven R. Martin**

*Vice President, Engineering and Development*

**David L. McCarthy**

*Vice President and General Manager, OEM Sales*

**Patricia J. Money**

*Vice President, Human Resources*

### OFFICERS

**Mark S. Brown**

*Vice President, OEM Sales*

**Geoffrey W. Greve**

*Vice President, New Type Technology*

**John H. McCallum**

*Managing Director, Monotype Imaging Ltd.*

**Jack P. Murphy**

*Vice President and Chief Technologist*

**Christopher J. Roberts**

*Vice President, Marketing*

**Frank Wildenberg**

*Managing Director, Linotype GmbH*

The front and back cover of this annual report, and its letter to shareholders, was set in a customized version of the Gill Sans® typeface, originally drawn by Eric Gill for the Monotype Corporation in the 1920s. The rest of this annual report was set in fonts from the Mentor™ typeface family designed by Michael Harvey in 2005. It is a 21st century English interpretation of classic roman letterforms and is available from Monotype Imaging.



# 年年度報告

# वार्षिक रिपोर्ट

# Výroční zpráva

# 年次

#### CORPORATE HEADQUARTERS

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fax 852 2591 9232

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