FACTSET RESEARCH SYSTEMS INC
Form 10-Q
July 10, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the fiscal quarter ended May 31, 2008

OR

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

Commission File Number: 1-11869

FactSet Research Systems Inc.

(Exact name of registrant as specified in its charter)

Delaware	**13-3362547**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
601 Merritt 7, Norwalk, Connecticut	**06851**
(Address of principal executive office)	**(Zip Code)**

Registrant s telephone number, including area code: (203) 810-1000

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

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

Large accelerated filer x **Accelerated filer** ¨ **Non-accelerated filer** ¨ **Smaller reporting company** ¨

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

The total number of shares of the registrant s common stock, $.01 par value, outstanding on May 31, 2008 was 47,995,377.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FactSet Research Systems Inc.

CONSOLIDATED STATEMENTS OF INCOME Unaudited

(In thousands, except per share data)	Three Months Ended May 31, 2008	Three Months Ended May 31, 2007	Nine Months Ended May 31, 2008	Nine Months Ended May 31, 2007
Revenues	$ 147,399	$ 121,075	$ 421,812	$ 346,269
Operating expenses				
Cost of services	48,134	39,429	140,555	111,100
Selling, general and administrative	51,346	42,429	147,601	122,746
Total operating expenses	99,480	81,858	288,156	233,846
Income from operations	47,919	39,217	133,656	112,423
Other income	852	2,143	4,325	5,427
Income before income taxes	48,771	41,360	137,981	117,850
Provision for income taxes	16,229	12,785	46,548	38,999
Net income	$ 32,542	$ 28,575	$ 91,433	$ 78,851
Basic earnings per common share	$ 0.68	$ 0.58	$ 1.90	$ 1.61
Diluted earnings per common share	$ 0.65	$ 0.56	$ 1.82	$ 1.54
Weighted average common shares (Basic)	47,934	48,911	48,127	48,942
Weighted average common shares (Diluted)	49,821	51,387	50,218	51,310

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

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FactSet Research Systems Inc.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION Unaudited

(In thousands, except share data)	**May 31, 2008**	**August 31, 2007**
CURRENT ASSETS		
Cash and cash equivalents	$ 166,829	$ 168,834
Investments	24,845	17,388
Accounts receivable, net of reserves	69,369	59,579
Deferred taxes	3,121	2,808
Prepaid taxes	3,385	
Other current assets	5,674	3,723
Total current assets	273,223	252,332
LONG-TERM ASSETS		
Property, equipment and leasehold improvements, at cost	150,074	135,419
Less accumulated depreciation and amortization	(61,949)	(56,474)
Property, equipment and leasehold improvements, net	88,125	78,945
Goodwill	160,211	146,187
Intangible assets, net	36,239	36,789
Deferred taxes	9,249	7,211
Other assets	2,747	2,286
TOTAL ASSETS	$ 569,794	$ 523,750
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 27,116	$ 23,461
Accrued compensation	25,322	30,105
Deferred fees	23,409	25,730
Dividends payable	8,639	5,802
Taxes payable		5,552
Total current liabilities	84,486	90,650
NON-CURRENT LIABILITIES		
Deferred taxes	5,785	6,450
Taxes payable	3,688	
Deferred rent and other non-current liabilities	20,112	17,339
TOTAL LIABILITIES	$ 114,071	$ 114,439
Commitments and contingencies (See Note 8)		
STOCKHOLDERS EQUITY		
Preferred stock, $.01 par value, 10,000,000 shares authorized, none issued	$	$
Common stock, $.01 par value, 100,000,000 shares authorized, 56,943,734 and 56,160,500 shares issued; 47,995,377 and 48,348,703 shares outstanding at May 31, 2008 and August 31, 2007, respectively	569	562
Capital in excess of par value	197,816	162,561
Treasury stock, at cost: 8,948,357 and 7,811,797 shares at May 31, 2008 and August 31, 2007, respectively	(299,105)	(233,372)
Retained earnings	542,431	469,880
Accumulated other comprehensive income	14,012	9,680

TOTAL STOCKHOLDERS EQUITY	455,723	409,311
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 569,794	$ 523,750

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

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FactSet Research Systems Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS Unaudited

(In thousands)	Nine Months Ended May 31, 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 91,433	$ 78,851
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	22,498	21,223
Stock-based compensation expense	10,630	6,827
Deferred income taxes	(3,043)	(5,428)
Gain on sale of assets	(65)	(62)
Tax benefits from share-based payment arrangements	(8,040)	(5,365)
Changes in assets and liabilities, net of effects of acquisition		
Accounts receivable, net of reserves	(9,314)	4,265
Accounts payable and accrued expenses	3,266	(1,809)
Accrued compensation	(4,894)	(1,589)
Deferred fees	(2,674)	178
Taxes payable, net of prepaid taxes	3,043	66
Landlord contributions	674	432
Other working capital accounts, net	(98)	1,473
Net cash provided by operating activities	103,416	99,062
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of business, net of cash acquired	(13,891)	
Proceeds from sales of investments	31,353	12,984
Purchases of investments	(38,781)	(13,490)
Purchases of property, equipment and leasehold improvements	(25,841)	(25,407)
Net cash used in investing activities	(47,160)	(25,913)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividend payments	(17,251)	(8,792)
Repurchase of common stock	(65,737)	(33,737)
Repayment of note		(2,258)
Proceeds from employee stock plans	16,431	11,436
Tax benefits from share-based payment arrangements	8,040	5,365
Net cash used in financing activities	(58,517)	(27,986)
Effect of exchange rate changes on cash and cash equivalents	256	333
Net (decrease) increase in cash and cash equivalents	(2,005)	45,496
Cash and cash equivalents at beginning of period	168,834	126,549
Cash and cash equivalents at end of period	$ 166,829	$ 172,045

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FactSet Research Systems Inc.

May 31, 2008

(Unaudited)

1. DESCRIPTION OF BUSINESS

FactSet Research Systems Inc. (the Company or FactSet) is a leading provider of global financial and economic information, including fundamental financial data on tens of thousands of companies worldwide. FactSet offers access to financial data and analytics to thousands of investment professionals around the world. Combining hundreds of databases into its own dedicated online service, FactSet provides the tools to download, combine, and manipulate financial data for investment analysis. FactSet applications support and make more efficient workflows for buy and sell-side professionals. These professionals include portfolio managers, research and performance analysts, risk managers, marketing professionals, sell-side equity research professionals, investment bankers and fixed income professionals. FactSet applications provide users access to company analysis, multicompany comparisons, industry analysis, company screening, portfolio analysis, predictive risk measurements, alphatesting, portfolio optimization and simulation, real-time news and quotes and tools to value and analyze fixed income securities and portfolios. FactSet is also available via wireless, handled devices and is fully integrated with Microsoft Office applications such as Excel, Word and PowerPoint that allows for the creation of extensive custom reports.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial data as of May 31, 2008 and for the three and nine months ended May 31, 2008 and 2007 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. The August 31, 2007 Consolidated Statement of Financial Condition was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and notes to them included in the Company s Annual Report on Form 10-K for the fiscal year ended August 31, 2007.

In the opinion of management, the accompanying statements of financial condition and related interim statements of income and cash flows include all normal adjustments in order to present fairly the results of the Company s operations for the periods presented in conformity with accounting principles generally accepted in the United States. Certain prior year amounts have been reclassified to conform to current year presentation.

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany activity and balances have been eliminated from the consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates have been made in areas that include receivable reserves, valuation of goodwill, useful lives and valuation of fixed and intangible assets, accrued compensation, asset retirement obligations, income and other taxes, stock-based compensation and allocation of purchase price to assets and liabilities acquired. Actual results could differ from those estimates.

Revenue Recognition

FactSet revenues are derived from month-to-month subscriptions to services such as workstations (also referred to as users), content and applications. At the option of investment management clients, FactSet services may be paid either in commissions from securities transactions or in cash. To facilitate the payment for services in commissions, the Company s wholly owned subsidiary, FactSet Data Systems, Inc. (FDS), is a member of the Financial Industry Regulatory Authority, Inc. (FINRA) and is a registered broker-dealer under Section 15 of the Securities and Exchange Act of 1934. Services paid in commissions are derived from securities transactions introduced and cleared on a fully disclosed basis through a

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designated clearing broker. That is, a client paying subscription charges on a commission basis directs the clearing broker to credit the commission on the transaction to FDS at the time the client executes a securities transaction. Clients may also direct commissions to unrelated third party brokers and request payment be transmitted to FactSet to pay for its services.

FactSet applies Staff Accounting Bulletin No. 104 (SAB 104), *Revenue Recognition*, to its business arrangements for revenue recognition. Primarily all clients are invoiced monthly to reflect the actual services provided. Remaining clients are invoiced quarterly or annually in advance. Subscription revenue is earned each month as the service is rendered to clients on a monthly basis. A receivable reserve is estimated for uncollectible amounts previously billed. This provision is accounted for as a reduction of revenue, with a corresponding reduction to accounts receivable. FactSet recognizes revenue when all the following criteria are met:

- the client subscribes to FactSet services,
- the FactSet service has been rendered and earned during the month,
- the amount of the subscription is fixed and determinable based on established rates for each product offering, quoted on an annualized basis, and
- collectibility is reasonably assured.

Under the guidance in SAB 104, the Company s subscriptions represent a single earnings process. Collection of subscription revenues through FDS s external clearing broker does not represent a separate service or earnings process since FDS is not the principal party to the settlement of the securities transactions for which the clearing broker charges clearing fees. Clearing fees are recorded as a reduction to revenues in the period incurred, at the time that a client executes securities transactions through the designated clearing broker. The Company earns the right to recover the clearing fee from its clients at the time the securities transactions are executed, which is the period in which the clearing fees are incurred.

Amounts that have been earned but not yet paid are reflected on the Consolidated Statements of Financial Condition as accounts receivable, net of reserves. Amounts invoiced in advance or client payments that are in excess of earned subscription revenues are reflected on the Consolidated Statements of Financial Condition as deferred fees. As of May 31, 2008, the amount of accounts receivable, net of reserves that was unbilled totaled $1.1 million, which was billed at the beginning of June 2008.

The Company calculates its receivable reserve through analyzing aged client receivables and reviewing the recent history of client receivable write-offs. As of May 31, 2008 and August 31, 2007, the receivable reserve was $1.5 million and $1.4 million, respectively.

Property, Equipment and Leasehold Improvements

Computers and related equipment are depreciated on a straight-line basis over estimated useful lives of three years or less. The Company completed its upgrade from Hewlett Packard (HP) Alpha mainframe machines to HP Integrity mainframe machines during the second quarter of fiscal 2008. All HP Integrity machines purchased during fiscal 2008 are depreciated over a useful life of three years.

Effective as of the beginning of the fourth quarter of fiscal 2007, the Company elected to change its method of depreciation for furniture and fixtures to straight-line from the double declining balance method. Furniture and fixtures are depreciated over their estimated useful lives between five and seven years. This change did not have a material impact to the Company s consolidated financial statements. Leasehold improvements are amortized on a straight-line basis over the terms of the related leases or estimated useful lives of the improvements, whichever period is shorter.

The Company performs a test for impairment whenever events or changes in circumstances indicate that the carrying amount of an individual asset or asset group may not be recoverable. Should projected undiscounted future cash flows be less than the carrying amount of the asset or asset group, an impairment charge reducing the carrying amount to fair value is required. Fair value is determined based on the most appropriate valuation technique, including discounted cash flows.

Income Taxes

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*, which supplements SFAS 109, *Accounting for Income Taxes*, by defining the confidence level that a tax position must meet in order to be recognized in the financial statements. FIN 48 requires the tax effect of a position to be recognized only if it is more-likely-than-not to be sustained based solely on its technical merits as of the reporting date. If a tax position is not considered more-likely-than-not to be sustained based solely on its technical merits, no benefits of the position are recognized. This method constitutes a different standard for recognition than was previously required. The more-likely-than-not threshold must continue to be met in each reporting period to support continued recognition of a benefit. At adoption, companies must adjust their financial statements to reflect only those tax positions that are more-likely-than-not to be sustained as of the adoption date. Any necessary adjustment is recorded directly to opening retained earnings in the period of adoption and reported as a change in accounting principle. FIN 48 is effective for fiscal years beginning after December 15, 2006 and as a result was effective for the Company on September 1, 2007. See Note 12 for information relating to the implementation of this interpretation and other required disclosures pertaining to uncertain tax positions.

Derivative Instruments

The Company conducts business globally in several currencies including the British Pound Sterling, Euro Dollar and Japanese Yen. As such, it is exposed to movements in foreign currency exchange rates compared to the U.S. dollar. To limit the financial exposure related to the effects of foreign exchange rate fluctuations, the Company may utilize derivative instruments (foreign currency contracts). The Company does not enter into foreign exchange forward contracts for trading or speculative purposes.

FactSet entered into foreign currency forward contracts to reduce the short-term effects of foreign currency fluctuations during fiscal 2008. At May 31, 2008, the aggregated notional amount of all foreign currency forward contracts outstanding was 1.0 million Euros, a decrease from 3.5 million Euros as of the beginning of the fiscal third quarter. These hedging programs are not designed to provide foreign currency protection over longer time horizons. In designing a specific hedging approach, FactSet considered several factors, including offsetting exposures, significance of exposures, forecasting risk and potential effectiveness of the hedge. The gains and losses on foreign currency forward contracts partially offset the variability in operating expenses associated with currency movements. The Company s market risks associated with its foreign currency expenses relate to variances from the Company s forecasted versus actual foreign currency transactions and balances. These transactions are designated and accounted for as cash flow hedges in accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities.* The effective portion of the derivative s gain or loss is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into earnings when the hedged exposure affects earnings. FactSet did not enter into any new foreign currency forward contracts during the third quarter of fiscal 2008. See Note 13 for additional disclosure of the use of foreign currency forward contracts by FactSet.

3. NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. In February 2008, the FASB issued FSP 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* and FSP 157-2, *Effective Date of FASB Statement No. 157*. FSP 157-1 amends SFAS 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008. The provisions of SFAS 157 will be applied prospectively to fair value measurements and disclosures beginning in the first quarter of fiscal 2009 and is not expected to have a material effect on the Company s financial position and results of operations.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115*, which will permit the measurement of many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis (the fair value option). The guidance is applicable for fiscal years beginning after November 15, 2007. The Company will adopt SFAS 159 in the first quarter of fiscal 2009 and does not expect the adoption of this Statement to have a material effect on the Company s financial position and results of operations.

In December 2007, the FASB issued SFAS 141 (revised 2007), *Business Combinations* and SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51.* SFAS 141(R) will significantly change current practices regarding business combinations. Among the more significant changes, SFAS 141(R) expands the definition of a business and a business combination; requires the acquirer to recognize the assets acquired, liabilities assumed and noncontrolling interests (including goodwill), measured at fair value at the acquisition date; requires acquisition-related expenses and restructuring costs to be recognized separately from the business combination; requires assets acquired and liabilities assumed from contractual and non-contractual contingencies to be recognized at their acquisition-date fair values with subsequent changes recognized in earnings; and requires in-process research and development to be capitalized at fair value as an indefinite-lived intangible asset. SFAS 160 will change the accounting and reporting for minority interests, reporting them as equity separate from the parent entity s equity, as well as requiring expanded disclosures. The Company will adopt SFAS 141(R) and SFAS 160 in the first quarter of fiscal 2010 and does not expect the adoption of these standards to have a material effect on the Company s financial position and results of operations.

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In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities*, an amendment of SFAS 133. SFAS 161 requires disclosures of how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years beginning after November 15, 2008, with early adoption permitted. The Company will adopt SFAS 161 in the first quarter of fiscal 2010 and does not expect the adoption of this standard to have a material effect on the Company s financial position and results of operations.

In May 2008, the FASB issued SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles.* SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with US generally accepted accounting principles (GAAP). The GAAP hierarchy previously resided in the American Institute of Certified Public Accountants statements on auditing standards, which are directed to the auditor rather than the reporting entity. SFAS 162 moves the GAAP hierarchy to the accounting literature, thereby directing it to reporting entities since it is the entity (not its auditor) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. The Company will adopt SFAS 162 when it becomes effective which is 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles* and does not expect the adoption of this standard to have an effect on the Company s financial position and results of operations.

In May 2008, the FASB issued FASB Staff Position (FSP) SFAS 142-3, *Determination of the Useful Life of Intangible Assets.* The FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, *Goodwill and Other Intangible Assets.* The FSP is intended to improve the consistency between the useful life of an intangible asset determined under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) and other U.S. GAAP. The Company will adopt FSP 142-3 in the first quarter of fiscal 2010 and does