

Financial Engines, Inc.
Form 10-Q
November 06, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2012

OR

.. **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File No. 001-34636

FINANCIAL ENGINES, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

94-3250323
(I.R.S. Employer
Identification No.)

1050 Enterprise Way, 3rd Floor

Sunnyvale, CA 94089

(Address of principal executive offices, Zip Code)

(408) 498-6000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

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

As of October 31, 2012, 47,329,498 shares of Common Stock, par value \$0.0001, were issued and outstanding.

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FINANCIAL ENGINES, INC.

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QUARTERLY REPORT ON FORM 10-Q

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Table of Contents**PART I: FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements (Unaudited)****FINANCIAL ENGINES, INC. AND SUBSIDIARIES**

Condensed Consolidated Balance Sheets

(Unaudited)

	December 31, 2011	September 30, 2012
	(In thousands, except per share data)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 145,002	\$ 166,382
Accounts receivable, net	30,495	41,574
Prepaid expenses	3,008	2,583
Deferred tax assets	13,155	13,155
Other current assets	3,498	4,067
Total current assets	195,158	227,761
Property and equipment, net	3,926	13,404
Internal use software, net	10,723	10,561
Long-term deferred tax assets	31,424	25,954
Direct response advertising, net	8,851	10,410
Other assets	4,361	3,929
Total assets	\$ 254,443	\$ 292,019
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 9,740	\$ 15,574
Accrued compensation	13,262	10,542
Deferred revenue	9,691	8,343
Other current liabilities	124	215
Total current liabilities	32,817	34,674
Long-term deferred revenue	1,533	1,239
Long-term deferred rent	459	6,206
Other liabilities	74	241
Total liabilities	34,883	42,360
Commitments and Contingencies (see note 8)		
Stockholders' equity:		
Preferred stock, \$0.0001 par value - 10,000 authorized as of December 31, 2011 and September 30, 2012; None issued and outstanding as of December 31, 2011 and September 30, 2012		
Common stock, \$0.0001 par value - 500,000 authorized as of December 31, 2011 and September 30, 2012; 45,784 and 47,161 shares issued and outstanding at December 31, 2011 and September 30, 2012, respectively	5	5
Additional paid-in capital	298,196	316,182
Accumulated deficit	(78,641)	(66,528)

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Total stockholders' equity	219,560	249,659
Total liabilities and stockholders' equity	\$ 254,443	\$ 292,019

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents**FINANCIAL ENGINES, INC. AND SUBSIDIARIES**

Condensed Consolidated Statements of Net and Comprehensive Income

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
(In thousands, except per share data)				
Revenue:				
Professional management	\$ 26,305	\$ 39,582	\$ 76,706	\$ 107,639
Platform	8,299	8,253	24,058	24,764
Other	1,054	611	2,447	2,040
Total revenue	35,658	48,446	103,211	134,443
Costs and expenses:				
Cost of revenue (exclusive of amortization of internal use software)	12,924	18,798	36,811	51,423
Research and development	5,098	6,496	15,644	18,716
Sales and marketing	7,436	10,440	22,312	29,160
General and administrative	3,404	3,653	9,855	11,271
Amortization of internal use software	1,508	1,558	4,276	4,560
Total costs and expenses	30,370	40,945	88,898	115,130
Income from operations	5,288	7,501	14,313	19,313
Interest income (expense)	(1)	(5)	2	(1)
Income before income taxes	5,287	7,496	14,315	19,312
Income tax expense	1,933	2,718	4,942	7,199
Net and comprehensive income	\$ 3,354	\$ 4,778	\$ 9,373	\$ 12,113
Net income per share attributable to holders of common stock				
Basic	\$ 0.07	\$ 0.10	\$ 0.21	\$ 0.26
Diluted	\$ 0.07	\$ 0.10	\$ 0.19	\$ 0.24
Shares used to compute net income per share attributable to holders of common stock				
Basic	45,237	46,889	44,508	46,469
Diluted	49,419	50,194	49,356	50,026

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents**FINANCIAL ENGINES, INC. AND SUBSIDIARIES**

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended September 30,	
	2011	2012
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 9,373	\$ 12,113
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,608	2,075
Amortization of internal use software	4,027	4,263
Stock-based compensation	3,922	7,500
Amortization of deferred sales commissions	1,006	1,464
Amortization and impairment of direct response advertising	1,869	3,695
Provision for doubtful accounts	109	209
Loss on fixed asset disposal		4
Excess tax benefit associated with stock-based compensation	(671)	(1,446)
Changes in operating assets and liabilities:		
Accounts receivable	(9,052)	(11,288)
Prepaid expenses	(100)	425
Deferred tax assets	4,063	5,470
Direct response advertising	(5,526)	(5,240)
Other assets	(1,843)	(2,150)
Accounts payable	3,635	6,899
Accrued compensation	(5,627)	(2,720)
Deferred revenue	6,177	(1,642)
Deferred rent	39	5,788
Other liabilities	1	3
Net cash provided by operating activities	13,010	25,422
Cash flows from investing activities:		
Purchase of property and equipment	(2,621)	(10,954)
Capitalization of internal use software	(4,119)	(4,131)
Restricted cash	(32)	550
Net cash used in investing activities	(6,772)	(14,535)
Cash flows from financing activities:		
Payments on capital lease obligations		(8)
Net share settlements for stock-based awards minimum tax withholdings	(1,718)	
Excess tax benefit associated with stock-based compensation	671	1,446
Proceeds from issuance of common stock, net of offering costs	12,188	9,055
Net cash provided by financing activities	11,141	10,493
Net increase in cash and cash equivalents	17,379	21,380
Cash and cash equivalents, beginning of period	114,937	145,002
Cash and cash equivalents, end of period	\$ 132,316	\$ 166,382

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Supplemental cash flows information:

Income taxes paid, net of refunds	\$ 63	\$ 185
Interest paid	\$ 5	\$ 6
Non-cash operating, investing and financing activities:		
Purchase of property and equipment under capital lease	\$	\$ 223
Capitalized stock-based compensation for internal use software	\$ 219	\$ 267
Capitalized stock-based compensation for direct response advertising	\$ 31	\$ 46

See accompanying notes to the unaudited condensed consolidated financial statements.

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FINANCIAL ENGINES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 Organization and Description of the Business

The Company

Financial Engines is a provider of independent, technology-enabled portfolio management services, investment advice and retirement income services to participants in employer-sponsored defined contribution plans, such as 401(k) plans. The Company helps investors plan for retirement by offering personalized plans for saving and investing, as well as by providing assessments of retirement income needs and readiness, regardless of personal wealth or investment account size. The Company uses its proprietary advice technology platform to provide independent, personalized portfolio management, investment advice and retirement income services to millions of retirement plan participants on a cost-efficient basis.

NOTE 2 Basis of Presentation

Interim Financial Statements

The accompanying condensed consolidated financial statements and notes thereto are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, as filed on February 22, 2012 with the SEC (the 2011 Annual Report). The Condensed Consolidated Balance Sheet as of December 31, 2011, included herein, was derived from the audited financial statements as of that date but does not include all disclosures including notes required by GAAP.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments necessary for the fair presentation of the Company's Balance Sheets as of December 31, 2011 and September 30, 2012, the Company's Statements of Net and Comprehensive Income for the three and nine months ended September 30, 2011 and 2012 and the Company's Statements of Cash Flows for the nine months ended September 30, 2011 and 2012. The results for the nine months ended September 30, 2012 are not necessarily indicative of the results to be expected for the year ending December 31, 2012.

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. Comprehensive income is the same as net income for all periods presented.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Significant items subject to such estimates and assumptions include revenue recognition, income taxes, stock-based compensation, direct response advertising, the useful lives of property, equipment and internal use software cost. Actual results could differ from those estimates under different assumptions or conditions.

Fair Value Measurement

Effective January 1, 2012, the Company has adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2011-4, Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the International Accounting Standards Board on fair value measurement. The guidance clarifies how a principal market is determined, addresses the fair value measurement of instruments with offsetting market or counterparty credit risks, addresses the concept of valuation premise and highest and best use, extends the prohibition on blockage

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factors to all three levels of the fair value hierarchy and requires additional disclosures. The adoption of this pronouncement did not have a material impact on our consolidated financial statements.

Comprehensive Income

Effective January 1, 2012, the FASB amended its guidance on the presentation of comprehensive income in financial statements to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items that are recorded in other comprehensive income. The new accounting guidance requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The adoption of this pronouncement did not have a material impact on our consolidated financial statements as the amendment impacted presentation only.

Recent Accounting Pronouncements

The Company does not believe that any recently issued, but not yet effective, accounting standards if currently adopted would have a material effect on the condensed consolidated financial statements.

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Cash and cash equivalents consist of the following:

	December 31, 2011	September 30, 2012
	(In thousands)	
Cash	\$ 4,331	\$ 1,209
Money market fund	140,671	165,173
Total cash and cash equivalents	\$ 145,002	\$ 166,382

NOTE 4 Concentration of Credit Risk and Fair Value of Financial Instruments

The Company measures and reports its investments in money market funds at fair value on a recurring basis. There have been no changes in the Company's valuation techniques during the three and nine months ended September 30, 2012. The fair value of the Company's investments in certain money market funds approximates their carrying value. Such instruments are classified as Level 1 and are included in cash and cash equivalents, except as noted below.

The following table summarizes the Company's financial assets measured at fair value on a recurring basis:

	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1) ⁽¹⁾	Significant Other Observable Inputs (Level 2) ⁽²⁾	Significant Other Unobservable Inputs (Level 3) ⁽³⁾
	(In thousands)			
Assets:				
Money Market Funds				
December 31, 2011 ⁽⁴⁾	\$ 141,980	\$ 141,980	\$	\$
September 30, 2012 ⁽⁴⁾	\$ 165,932	\$ 165,932	\$	\$

- (1) Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- (2) Level 2: Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- (3) Level 3: Unobservable inputs reflecting the Company's own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.
- (4) Included in the December 31, 2011 and September 30, 2012 balances is \$1.3 million and \$0.8 million, respectively, of restricted cash, classified in other assets in the accompanying Condensed Consolidated Balance Sheet, being held in a money market account pledged as collateral for letters of credit issued in connection with certain operating lease contracts. Long term restricted cash of \$0.8 million is included in other assets in the accompanying Condensed Consolidated Balance Sheet as of September 30, 2012.

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Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. The Company deposits its cash and cash equivalents primarily with a major bank, in which deposits may exceed federal deposit insurance limits.

The Company's customers are concentrated in the United States of America. The Company performs ongoing credit evaluations of its customers and does not require collateral. The Company reviews the need for allowances for potential credit losses and such losses have been insignificant to date.

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Significant customer information is as follows:

	December 31, 2011	September 30, 2012
Percentage of accounts receivable:		
JPMorgan	18%	16%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Percentage of revenue:				
JPMorgan	16%	13%	17%	13%

NOTE 5 Stock-based Compensation

The following table summarizes the stock-based compensation, as included in the condensed consolidated statements of net and comprehensive income, by functional area:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
	(In thousands)			
Stock-based compensation:				
Cost of revenue	\$ 100	\$ 330	\$ 330	\$ 896
Research and development	262	542	865	1,624
Sales and marketing	318	657	983	1,941
General and administrative	586	887	1,495	2,742
Amortization of internal use software	89	102	249	297
Total stock-based compensation	\$ 1,355	\$ 2,518	\$ 3,922	\$ 7,500

Table of Contents**FINANCIAL ENGINES, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****NOTE 6 Net Income Per Common Share**

Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period less the weighted average number of unvested restricted common shares subject to the right of repurchase. Diluted net income per common share is computed by giving effect to all potential dilutive common shares, including options, awards and restricted stock units, unvested restricted common stock subject to repurchase and convertible preferred stock.

The following table sets forth the computation of basic and diluted net income per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
	(In thousands, except per share data)			
Numerator (basic and diluted):				
Net income	\$ 3,354	\$ 4,778	\$ 9,373	\$ 12,113
Denominator (basic):				
Weighted average common shares outstanding	45,237	46,889	44,558	46,469
Less: Weighted average unvested restricted common shares subject to repurchase			(50)	
Net weighted average common shares outstanding	45,237	46,889	44,508	46,469
Denominator (diluted):				
Net weighted average common shares outstanding	45,237	46,889	44,508	46,469
Dilutive stock options outstanding	4,182	3,188	4,798	3,477
Unvested restricted stock units		117		80
Weighted average unvested restricted common shares subject to repurchase			50	
Net weighted average common shares outstanding	49,419	50,194	49,356	50,026
Net income per share:				
Basic	\$ 0.07	\$ 0.10	\$ 0.21	\$ 0.26
Diluted	\$ 0.07	\$ 0.10	\$ 0.19	\$ 0.24

Diluted net income per share does not include the effect of the following anti-dilutive common equivalent shares:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
	(In thousands)			
Stock options and awards outstanding	390	1,231	228	1,112

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FINANCIAL ENGINES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 7 Income Taxes

The Company recorded an income tax provision of \$1.9 million and \$2.7 million for the three months ended September 30, 2011 and 2012, respectively, and an income tax provision of \$4.9 million and \$7.2 million for the nine months ended September 30, 2011 and 2012, respectively. The Company's effective tax rate was 35% and 37% for the nine months ended September 30, 2011 and 2012, respectively. The increase in the Company's effective tax rate was due primarily to the expiration of the federal research and development credit which has not currently been extended for 2012.

As of September 30, 2012, the Company continues to believe that sufficient positive evidence exists from historical operations and future projections to conclude that it is more likely than not to fully realize its federal deferred tax assets and to partially realize its State of California deferred tax assets in future periods. The Company continuously evaluates additional facts representing positive and negative evidence in the determination of the realizability of the deferred tax assets. The Company continues to apply a valuation allowance on certain deferred tax assets in the amount of \$2.0 million as of September 30, 2012 relating to net operating losses for the State of California as it is not more likely than not that the Company will be able to realize these assets prior to their expiration.

The Company is subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions. All tax years since inception are open due to loss carryforwards and may be subject to examination in one or more jurisdictions. The Company has undergone a federal tax examination for fiscal years 2006 and 2007 and the results did not have a material impact on its financial condition and results of operations.

At September 30, 2012, the Company had net operating loss carryforwards for federal purposes of approximately \$134.9 million that expire at varying dates from 2020 to 2031. Of the \$134.9 million, approximately \$61.4 million relates to excess tax benefits related to stock options and awards. When realized as a reduction of income taxes payable, the excess tax benefits will be credited to additional paid-in capital.

As of December 31, 2011 and September 30, 2012, the Company had gross unrecognized tax benefits for income taxes associated with uncertain tax positions of \$6.6 million and \$6.7 million, respectively. The balance of the gross unrecognized tax benefits is not expected to materially change in the next twelve months.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense. During the nine months ended September 30, 2011 and 2012, the accrued interest and penalties were immaterial.

NOTE 8 Commitments and Contingencies

Contingencies

The Company includes service level commitments to its customers warranting certain levels of reliability and performance. To date, the Company has not incurred any material costs as a result of such commitments and has not accrued any liabilities related to such obligations.

Other Receivable and Deferred Rent

As discussed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, the Company entered into an operating lease contract for a new headquarters facilities space in October 2011. The operating lease contract includes a tenant improvement allowance of \$5.3 million. As of September 30, 2012, there was a receivable balance of \$1.1 million related to the tenant improvement allowance included in other current assets on the Condensed Consolidated Balance Sheets. As of December 31, 2011, there was no receivable balance related to the tenant improvement allowance.

The Company recognizes rent expense on a straight-line basis over the lease period commencing on the date that the premise is available from the landlord. The lease includes the period required to make the leased space suitable for the Company. For purposes of calculating straight-line

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rent expense, the commencement date of the lease term reflects the date the Company took possession of the building.

The Company classifies tenant improvement allowances in its Condensed Consolidated Balance Sheets under deferred rent and amortizes them on a straight-line basis over the related lease period. Tenant improvement allowance activity is presented as part of cash flows from operating activities in the accompanying Condensed Consolidated Statements of Cash Flows.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Report contains forward-looking statements that involve risks and uncertainties. In some cases, you can identify forward-looking statements by terms such as may, might, will, objective, intend, should, could, can, would, expect, believe, design, estimate, plan, or the negative of these terms, and similar expressions intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Forward-looking statements include, but are not limited to, statements about anticipated trends and challenges in our business and the markets in which we operate; the capabilities, benefits and effectiveness of our services; our plans for future services, enhancements of existing services and our growth; our expectations regarding our expenses and revenue, including our deferred tax assets and sources of revenue; our anticipated cash needs, financing activities and our estimates regarding our capital requirements and our needs for additional financing; our ability to retain and attract customers; our regulatory environment; our ability to recruit and retain professionals; volatility of our stock; payment of dividends; impact of our accounting policies; benefit of non-GAAP financial measures; our disclosure controls and procedures; our legal proceedings; intellectual property; and our expectations regarding competition. These statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, the risks set forth throughout this Report, including under Item 1A, Risk Factors. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Our investment advisory and management services are provided through our subsidiary, Financial Engines Advisors L.L.C., a federally registered investment adviser. References in this Report to Financial Engines, our company, we, us and our refer to Financial Engines, Inc. and its consolidated subsidiaries during the periods presented unless the context requires otherwise.

Overview

We are a leading provider of independent, technology-enabled portfolio management, investment advice and retirement income services to participants in employer-sponsored defined contribution retirement plans, such as 401(k) plans. We use our proprietary advice technology platform to provide our services to millions of retirement plan participants on a cost-efficient basis. Our business model is based on workplace delivery of our services. We target three key constituencies in the retirement plan market: plan participants, plan sponsors and plan providers.

Revenue

We generate revenue primarily from management fees on Assets Under Management, or AUM, as well as from platform fees, by providing portfolio management services, investment advice and retirement income services to plan participants of employer-sponsored retirement plans. We maintain two types of relationships with retirement plan providers. In direct advisory relationships, we are the primary advisor and a plan fiduciary. In subadvisory relationships, the plan provider is the primary advisor and plan fiduciary, and we act in a subadvisory capacity.

Professional Management

We derive professional management revenue from member fees paid by or on behalf of plan participants who are enrolled in our Professional Management service for the management of their account assets. Our Professional Management service is a discretionary investment management service that includes retirement income services, a Retirement Plan analyzing investments, contribution rate and projected retirement income, a Retirement Checkup designed to help plan participants develop a strategy for closing the gap, if any, between the participant's retirement goal and current retirement income forecast and retirement income services. Income+ is a feature of our Professional Management service that provides retirement income for 401(k) participants by providing discretionary portfolio management with an income objective and steady monthly payments from their 401(k) accounts during retirement. The services are generally made available to plan participants in a 401(k) plan by written agreements with the plan provider, plan sponsor and the plan participant.

Our arrangements with customers generally provide for member fees based on the value of assets we manage for plan participants and are generally payable quarterly in arrears. The majority of our member fees across both advisory and subadvisory relationships are calculated on a monthly basis, as the product of member fee rates and the value of AUM at or near the end of each month for members. In general, we expect this methodology to reduce the impact of financial market volatility on our professional management revenue, although this methodology may result in lower member fees if the financial markets are down when member fees are calculated, even if the market had performed well earlier in the month or the quarter.

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Pursuant to the contracts with our members, we calculate our member fees based on the asset amounts in these files as received directly from the plan providers, with no judgments or estimates on our part. None of our member fees are based on investment performance or other incentive arrangements. Our fees generally are based on AUM, which is influenced by market performance. Our fees are not based on a share of the capital gains or appreciation in a member's account. In some cases, our member fees may adjust downward based on overall participant or AUM enrollment performance milestones over time. Our member fees are determined by the value of the assets in the member's account at the specified dates and are recognized as the services are performed.

Prior to fiscal year 2012, we saw an increase in professional management revenue in the fourth quarter due to the fee structure with one of our subadvisory plan providers, under which we recognized the difference between earned revenue and annual minimum contractual revenue in the fourth quarter. Effective January 2012, we no longer expect to see this fourth quarter trend as the fee structure for this particular plan provider has been renegotiated to provide an earned revenue fee structure that eliminates the annual minimum contractual revenue provision. As a result, the earned revenue from this plan provider could vary substantially with market performance and net enrollment, as is the case with professional management revenue from our other plan providers. Exclusive of these factors, we expect the revised contract will result in comparable annual economics to the prior arrangement without the seasonality effect.

Historically, we have seen a general preference from plan sponsors to commence campaigns in the second and third quarters of the year and we expect this trend to continue. In order to encourage enrollment into our Professional Management service, we use a variety of promotional techniques, some of which can potentially impact the amount of revenue recognized, the timing of revenue recognition or both. We would generally expect our professional management revenue to continue to increase as a percentage of overall revenue, which will cause our revenue to become increasingly more sensitive to market performance.

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Enrollment Metrics

We measure enrollment in our Professional Management service by members as a percentage of eligible plan participants and by AUM as a percentage of Assets Under Contract, or AUC, in each case across all plans where the Professional Management service is available for enrollment, including plans where enrollment campaigns are not yet concluded or have not commenced.

AUM is defined as the amount of retirement plan assets that we manage as part of our Professional Management service. Our AUM is the value of assets under management as reported by plan providers at or near the end of each month or quarter. Our members are the plan participants who are enrolled in our Professional Management service as reported by plan providers at or near the end of each month or quarter.

AUC is defined as the amount of assets in retirement plans under contract for which the Professional Management service has been made available to eligible participants. Our AUC and eligible participants do not include assets or participants in plans where we have signed contracts but for which we have not yet made the Professional Management service available. Eligible participants and assets under contract are reported by plan providers with varying frequency and at different points in time, and is not always updated or marked to market. If markets have declined since the reporting date, or if assets have left the plan, our AUC may be overstated. If markets have risen since the reporting date, or if assets have been added to the plan, our AUC may be understated. Some plan participants may not be eligible for our services due to plan sponsor limitations on employees treated as insiders for purposes of securities laws or other characteristics of the plan participant. Certain securities within a plan participant's account may be ineligible for management by us, such as employer stock subject to trading restrictions, and we do not manage or charge a fee for that portion of the account. In both of these circumstances, assets of the relevant participants may be included in AUC but cannot be converted to AUM. We believe that AUC can be a useful indicator of the additional plan assets available for enrollment efforts that, if successful, would result in these assets becoming AUM. We believe that total eligible participants provides a useful approximation of the number of participants available for enrollment into the Professional Management service.

As of September 30, 2012, we had approximately \$560 billion of AUC and 6.3 million eligible plan participants in plans for which the Professional Management service is available, which includes approximately \$27 billion of AUC and 340,000 eligible plan participants in plans for which Income+ has been made available to participants.

In addition to measuring enrollment in all plans where the Professional Management service is available, we measure enrollment in plans where the Professional Management service has been available for at least 14 months and in plans where it has been available for at least 26 months.

	Members as a Percentage of Eligible Participants	AUM as a Percentage of AUC⁽¹⁾
All plans as of September 30, 2012		
Professional Management available	10.2%	11.0%
Professional Management available 14 months or more	11.3%	12.0%
Professional Management available 26 months or more	12.2%	12.7%

- (1) We receive AUM data from plan providers at or near the end of each quarter and AUC data from plan providers at various points in time, neither of which is marked to market as of quarter end. In quarters with significant volatility, especially near the end of the quarter, the AUC data we receive from plan providers can be significantly different than market values as of quarter end. As of September 30, 2012, we performed a calculation to estimate the marked-to-market asset enrollment rate as of September 30, 2012, which we believe was approximately 10.9% where Professional Management is available, approximately 11.9% where Professional Management has been available for 14 months or more and approximately 12.6% where Professional Management has been available for 26 months or more.

As of September 30, 2012, the approximate aggregate style exposure of the portfolios we managed was as follows:

Cash	5%
Bonds	25%

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Domestic Equity	47%
International Equity	23%
Total	100%

We estimate the aggregate percentage of equity exposures have ranged from a low of approximately 56% to a high of approximately 78% since we began managing assets on a discretionary basis in September 2004. These percentages can be affected by the asset exposures of the overall market portfolio, the demographics of our member population including the adoption of Income+, the number of members who have told us that they want to assume greater or lesser investment risk, and, to a lesser extent given the amount of assets we have under management, the proportion of our members for whom we have completed the transition from their initial portfolio.

Table of Contents**Changes in AUM**

The following table illustrates estimated changes in our AUM over the last four quarters:

	Q4 11	Q1 12	Q2 12	Q3 12
	(In billions)			
AUM, beginning of period	\$ 42.0	\$ 47.5	\$ 53.7	\$ 54.2
New Enrollment ⁽¹⁾	4.6	3.0	3.7	4.9
Voluntary Cancellations ⁽²⁾	(1.3)	(1.2)	(1.0)	(1.2)
Involuntary Cancellations ⁽³⁾	(1.1)	(0.8)	(1.0)	(0.9)
Contributions ⁽⁴⁾	0.9	1.0	1.0	1.1
Market Movement and Other ⁽⁵⁾	2.4	4.2	(2.2)	3.4
AUM, end of period	\$ 47.5	\$ 53.7	\$ 54.2	\$ 61.5

- (1) The aggregate amount of assets under management, at the time of enrollment, of new members who enrolled in our Professional Management service within the period. We receive 401(k) account balances for each member at least weekly, including 401(k) account balances for new members. Accordingly, we are able to capture the 401(k) account balances within a week of enrollment for any given new member.
- (2) The aggregate amount of assets, at the time of cancellation, for voluntary cancellations from the Professional Management service within the period. Members may cancel at any time without any requirement to provide advance notice. Our quarter end AUM excludes the assets of any account cancelled by a member prior to the end of the last day of the quarter. We can quantify this amount for any period by retrieving the account value from the last file received during the week prior to cancellation.
- (3) The aggregate amount of assets, as of the last available positive account balance, for involuntary cancellations occurring when the member's 401(k) plan account balance has been reduced to zero or when the cancellation of a plan sponsor contract for the Professional Management service has become effective within the period. Plan sponsors may cancel their contract for the provision of Professional Management services to the plan participants upon specified notice or without notice for fiduciary reasons or breach of contract. If a plan sponsor has provided advance notice of cancellation of the plan sponsor contract, however, the AUM for members of that plan sponsor is included in our AUM until the effective date of the cancellation, after which it is no longer part of our AUM. If a member's account value falls to zero, either upon the effective date of a sponsor cancellation or the member transferring the entire account balance, we treat the account as an involuntary cancellation and quantify the amount for any period by retrieving the account value from the last file received with a positive balance. Involuntary member cancellations due to the effective date of a plan sponsor cancellation occurring between October 1, 2012 and October 31, 2012 would cause the AUM that was reported as of September 30, 2012 to be reduced by less than 0.1%.
- (4) Employer and employee contributions are estimated each quarter from annual contribution rates based on data received from plan providers or plan sponsors. Typically, we receive data from plan providers or plan sponsors via weekly member files, allowing us to estimate contributions for those members for whom we have received this data. For the last four quarters, the weekly member files contained annual contribution rates, employer matching and salary levels for a subset of our total members, representing approximately 84-91% of our overall AUM. The average contribution rate is calculated using this data and extrapolated to approximate 100% of employee and employer contributions for our overall AUM. The data presented in the table above differs from data provided in filings prior to September 30, 2012, as the prior contributions data reported represented only that subset of members for whom we received salary data.
- (5) Other factors affecting assets under management include estimated market movement, plan administrative fees, participant loans and hardship withdrawals, and timing differences. We cannot separately quantify the impact of the other factors contained in this line item as the information we receive from the plan providers does not separately identify these transactions or the changes in balances due to market movement. We would expect that market movement would typically represent the most substantial portion of this line item in a given quarter.

Our AUM increases or decreases based on several factors. AUM can increase due to market performance, by the addition of new assets as participants enroll into our Professional Management service, both at existing sponsors as well as at new sponsors where the services have been made available, and by the addition of new assets from employee and employer contributions into their 401(k) accounts. AUM can decrease due to market performance and by the reduction of assets as a result of members terminating their membership, members rolling their assets out of the retirement plan, and sponsors canceling the Professional Management service. Historically, member cancellation rates have typically increased during periods where there has been a significant decline in stock market performance. In addition, member cancellation rates are typically the highest in the three and six months immediately following the completion of a given promotional campaign, and certain types of

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promotional techniques may result in higher than average cancellation rates at the end of the promotional period.

A substantial portion of the assets we manage is invested in equity securities, the market prices of which can vary substantially based on changes in economic conditions. An additional portion is invested in fixed income securities, which will generally have lower volatility than the equity market. Therefore, while any changes in equity market performance would significantly affect the value of our AUM, particularly for the AUM invested in equity securities, such changes would typically result in lower volatility for our AUM than the volatility of the equity market as a whole. Because a substantial portion of our revenue is derived from the value of our AUM, changes in fixed income or equity market performance could significantly affect the amount of revenue in a given period. If any of these factors reduces our AUM, the amount of member fees we would earn for managing those assets would decline, which in turn could negatively impact our revenue.

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Platform. We derive platform revenue from recurring, subscription-based platform fees for access to either our full suite of services, including Professional Management, Online Advice service, and Retirement Evaluation, or to our Online Advice service only, and to a lesser extent, from setup fees. Online Advice is a nondiscretionary Internet-based investment advisory service, which includes features such as: recommendations among the investment alternatives available in the employer sponsored retirement plan; a summary of the current value of the plan account; a forecast of how much the plan account investments might be worth at retirement; whether a change is recommended to the contribution rate, risk and diversification and/or unrestricted employer stock holdings; and a projection of how much the participant may spend at retirement. Plan participants may use the service as frequently as they choose to monitor progress toward their financial goals, receive forecasts and investment recommendations and access educational content at our website. The arrangements generally provide for our fees to be paid by the plan sponsor, plan provider or the retirement plan itself, depending on the plan structure. Platform revenue is generally paid annually in advance and recognized ratably over the term of the subscription period beginning after the completion of customer setup and data connectivity. Setup fees are recognized ratably over the estimated average life of sponsor relationships, which is estimated for accounting purposes to be five years.

Other Revenue. Other revenue includes reimbursement for a portion of marketing and member materials from certain subadvisory relationships and reimbursement for providing personal statements to participants from a limited number of plan sponsors. The costs associated with these reimbursed print fulfillment materials are expensed to cost of revenue as incurred.

Costs and Expenses

Employee compensation and related expenses represent our largest expense and includes wages expense, cash incentive compensation expense, benefits expenses, employer payroll tax expense and non-cash stock-based compensation expense. Our cash incentive compensation plan is based, in part, on achieving pre-determined annual corporate financial objectives and may result in an increased current period expense while the anticipated revenue benefits associated with the achievement of such corporate financial objectives may be realized in future periods. We allocate compensation and other related expenses including non-cash stock-based compensation to our cost of revenue, research and development, sales and marketing, general and administrative as well as amortization of internal use software expense categories. While we expect our headcount to increase over time, we believe that the economies of scale in our business model can allow us to grow our compensation and related expenses at a lower rate than revenue. We anticipate granting equity awards to board members and certain of our employees each year, with the most significant event typically occurring in the middle of the fourth quarter that may result in significant non-cash stock-based compensation expense. We anticipate providing annual compensation increases to certain of our employees each year, typically in the second quarter that may result in an increase primarily to wages expense.

Other costs and expenses include the costs of fees paid to plan providers related to the exchange of plan and plan participant data as well as implementing our transaction instructions for member accounts, marketing and member materials and postage, and amortization and depreciation for hardware and software purchases and support. The following summarizes our cost of revenue and certain significant operating expenses:

Cost of Revenue. Cost of revenue includes fees paid to plan providers for connectivity to plan and plan participant data, printed materials fulfillment costs for certain subadvisory relationships for which a portion are reimbursed, printed member materials, and employee-related costs for technical operations, implementations, operations, advisor call center operations and portfolio management. Costs in this area are related primarily to payments to third parties, employee compensation and related expenses, and purchased materials. Costs for connectivity to plan and plan participant data are expected to increase proportionally with our professional management revenue, as well as by contractual increases in plan provider fees as a result of achieving certain milestones. The expenses included in cost of revenue are shared across the different revenue categories, and we are not able to meaningfully allocate such costs between separate categories of revenue. Consequently, all costs and expenses applicable to our revenue are included in the category cost of revenue in our statements of income. Amortization of internal use software, a portion of which relates to our cost of revenue, is not included in cost of revenue but is reflected as a separate line item in our statement of income.

Research and Development. Research and development expense includes costs associated with defining and specifying new features and ongoing enhancement to our Advice Engines and other aspects of our service offerings, financial research, quality assurance, related administration and other costs that do not qualify for capitalization. Costs in this area are related primarily to employee compensation for our investment research, product development and engineering personnel and associated expenses and, to a lesser extent, external consulting expenses, which relate primarily to support and maintenance of our existing services.

Sales and Marketing. Sales and marketing expense includes costs associated with plan provider and plan sponsor relationship management, plan provider and plan sponsor marketing, direct sales, product marketing, public relations and printing of and postage for marketing materials for direct advisory relationships including amortization of direct response advertising. Costs in this area are related primarily to employee compensation for sales and marketing personnel and related expenses, and also include commissions, printed materials and general marketing programs.

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General and Administrative. General and administrative expense includes costs for finance, accounting, legal, compliance and administration. Costs in this area include employee compensation and related expenses and fees for consulting and professional services. We have incurred and we expect that we will continue to incur expenses as a result of becoming a public company for, among other things, SEC reporting and compliance, including compliance with the Sarbanes-Oxley Act of 2002, director fees, insurance, and other similar expenses.

Amortization of Internal Use Software. Amortization of internal use software expense includes engineering costs associated with (1) enhancing our advisory service platform and (2) developing internal systems for tracking member data, including AUM, member cancellations and other related member statistics. Associated direct development costs are capitalized and amortized using the straight-line method over the estimated lives, typically three to five years, of the underlying technology. Costs in this area include employee compensation and related expenses, and fees for external consulting services.

Table of Contents**Critical Accounting Estimates**

There have been no changes in the methodologies used to make critical accounting estimates in the preparation of our condensed consolidated financial statements during the three and nine months ended September 30, 2012, as compared to those disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations for the fiscal year ended December 31, 2011 included in our 2011 Annual Report. We have, however, expanded the information provided with respect to judgments, estimates and assumptions related to income taxes in the disclosure below

Income Taxes. We are subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions.

We use the asset and liability method to account for income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We record a valuation allowance to reduce deferred tax assets to an amount whose realization is more likely than not. We recognize accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense.

During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. As a result, we recognize tax liabilities based on estimates of whether additional taxes and interest will be due. These tax liabilities are recognized when, despite the belief that our tax return positions are supportable, we believe that certain positions may not be fully sustained upon review by tax authorities. We believe that our accruals for tax liabilities are adequate for all open audit years based on our assessment of many factors including past experience and interpretations of tax law. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact income tax expense in the period in which such determination is made.

Prior to September 30, 2010, we maintained a full valuation allowance for our net deferred tax assets, since the likelihood of the realization of those assets had not become more likely than not. We continually evaluate additional facts representing both positive and negative evidence in the determination of the realizability of the deferred tax assets, including scheduling of deferred tax liabilities and projected income from operating activities. The underlying assumptions we use in forecasting future taxable income require significant judgment and take into account all available evidence, including past operating results and our recent performance. In forecasting future taxable income we did not assume any gains as a result of market performance on our AUM or from the addition of new markets and services we may be considering. Nor did we incorporate any marked improvement in our historical enrollment rates, voluntary cancellation rates or involuntary cancellation rates. Historical differences between forecast and actual taxable profits have not resulted in material adjustments to the recognition of our deferred tax assets. We are not relying on tax planning strategies to support the realization of our deferred tax assets. Rather, we are relying primarily on future taxable income to support the realizability of our deferred tax assets and to a much lesser degree through the reversal of existing deductible temporary differences. Furthermore, our deferred tax liabilities are of the same character and jurisdiction as the temporary differences giving rise to our deferred tax assets and will reverse in similar periods as the temporary differences giving rise to our deferred tax assets.

Effective September 30, 2010, we believed that sufficient positive evidence existed from historical operations and future income projections to conclude that it was more likely than not to fully realize our federal deferred tax assets and to partially realize our state of California deferred tax assets. Therefore, we released valuation allowances of \$55.4 million during the year ended December 31, 2010. We continue to apply a valuation allowance on certain deferred tax assets in the amount of \$2.0 million relating to the state of California as it is not more likely than not that we will be able to realize these assets prior to their expiration. As of December 31, 2011, the amount of pre-tax income we need to generate in future years in order to realize our deferred tax assets is approximately \$120 million and \$312 million with respect to approximately \$42 million of federal related deferred tax assets and \$3 million of state related net deferred tax assets, respectively.

As of September 30, 2012, we had net operating loss carryforwards for federal and state income tax purposes of approximately \$134.9 million and \$87.5 million, respectively, available to reduce future income subject to income taxes. The federal and state net operating loss carryforwards expire through 2031.

As of September 30, 2012, approximately \$61.4 million of the net operating losses will benefit additional paid in capital when realized. As of September 30, 2012, we also had research credit carryforwards for federal and state of California income tax purposes of approximately \$5.0 million and \$7.0 million, respectively, available to reduce future income taxes, which are based on estimates of future realizability. The federal research credit carryforwards expire through 2031. The state of California research credit carries forward indefinitely.

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All tax years since inception are open and may be subject to examination in one or more jurisdictions.

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The following tables set forth our results of operations. The period to period comparison of financial results is not necessarily indicative of future results.

Comparison of Three Months Ended September 30, 2011 and 2012

	Three Months Ended September 30, 2011		Three Months Ended September 30, 2012		Increase (Decrease)	
	(As a percentage of revenue)		(In thousands, except percentages)		Amount	%
Revenue:						
Professional management	74%	82%	\$ 26,305	\$ 39,582	\$ 13,277	50%
Platform	23	17	8,299	8,253	(46)	(1)
Other	3	1	1,054	611	(443)	(42)
Total revenue	100	100	35,658	48,446	12,788	36
Costs and expenses:						
Cost of revenue (exclusive of amortization of internal use software)	36	39	12,924	18,798	5,874	45
Research and development	14	13	5,098	6,496	1,398	27
Sales and marketing	21	22	7,436	10,440	3,004	40
General and administrative	10	8	3,404	3,653	249	7
Amortization of internal use software	4	3	1,508	1,558	50	3
Total costs and expenses	85	85	30,370	40,945	10,575	35
Income from operations	15	15	5,288	7,501	2,213	42
Interest income (expense)			(1)	(5)	(4)	400
Income before income tax expense	15	15	5,287	7,496	2,209	42
Income tax expense	6	5	1,933	2,718	785	41
Net income	9%	10%	\$ 3,354	\$ 4,778	\$ 1,424	42%

Revenue

Total revenue increased \$12.8 million, or 36%, from \$35.7 million for the three months ended September 30, 2011 to \$48.4 million for the three months ended September 30, 2012. The increase was due primarily to growth in professional management revenue of \$13.3 million for the three months ended September 30, 2012 compared to the three months ended September 30, 2011. Professional management revenue and platform revenue comprised 82% and 17%, respectively, of total revenue for the three months ended September 30, 2012.

Professional Management Revenue

Professional management revenue increased \$13.3 million, or 50%, from \$26.3 million for the three months ended September 30, 2011 to \$39.6 million for the three months ended September 30, 2012. The increase in professional management revenue for the three months ended September 30, 2012 was due primarily to an increase in the average AUM used to calculate fees from approximately \$42.6 billion for the three months ended September 30, 2011 to approximately \$59.2 billion for the three months ended September 30, 2012. This increase in average AUM was driven primarily by increased net enrollment resulting from marketing campaigns and other ongoing member acquisitions, as well as market appreciation and contributions.

Effective January 2012, due to a revised agreement with one of our subadvisory plan providers, an annual minimum contractual revenue provision has been eliminated, which historically resulted in an increase in professional management revenue in the fourth quarter. We expect the revised contract will result in comparable annual economics to the prior arrangement without the seasonality effect in the fourth quarter.

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Platform Revenue

Platform revenue was \$8.3 million for both the three months ended September 30, 2011 and September 30, 2012.

Other Revenue

Other revenue decreased \$0.4 million, or 42%, from \$1.1 million for the three months ended September 30, 2011 to \$0.6 million for the three months ended September 30, 2012. The decrease in other revenue for the three months ended September 30, 2012 was due primarily to a decrease in reimbursable printed fulfillment materials from certain subadvisory relationships.

Table of Contents*Costs and Expenses*

Costs and expenses increased \$10.6 million, or 35%, from \$30.4 million for the three months ended September 30, 2011 to \$40.9 million for the three months ended September 30, 2012. This increase was due to a \$5.9 million increase in cost of revenue, exclusive of amortization of internal use software, a \$1.4 million increase in research and development expense, a \$3.0 million increase in sales and marketing expense, a \$0.2 million increase in general and administrative expense and a \$0.1 million increase in amortization of internal use software for the three months ended September 30, 2012 compared to the three months ended September 30, 2011.

Across functional areas, non-cash stock-based compensation expense increased for the three months ended September 30, 2012 compared to the three months ended September 30, 2011 primarily due to the equity awards granted in mid-November 2011 under the graded-vesting attribution method over a four-year vesting period, resulting in greater amounts of non-cash stock-based compensation expense recognized in earlier periods of the grants with declining amounts recognized in later periods. In addition, wages and cash incentive compensation expenses also increased due primarily to headcount growth and annual compensation increases effective April 1, 2012. Rent expense, which is included in allocated overhead expenses, increased for the three months ended September 30, 2012 compared to the three months ended September 30, 2011 due primarily to the commencement of our lease contract for the new headquarters facilities, which has been expensed in addition to the rent expense on our prior headquarters facility lease, which terminated in August 31, 2012.

We currently anticipate issuing equity grants with an aggregate estimated value between \$12 million and \$13 million to certain of our existing employees in mid-November 2012 and we will account for these equity grants over a four year vesting period utilizing an accelerated graded vesting method. We estimate these November 2012 equity grants will incur non-cash stock-based compensation expense of approximately \$5.8 million for the year ended December 31, 2013.

Cost of Revenue

Cost of revenue, exclusive of amortization of internal use software, increased \$5.9 million, or 45%, from \$12.9 million for the three months ended September 30, 2011 to \$18.8 million for the three months ended September 30, 2012. This increase was due primarily to an increase of \$4.5 million in fees paid to plan providers for connectivity to plan and plan participant data for the three months ended September 30, 2012 compared to the three months ended September 30, 2011, resulting from an increase in professional management revenue, as well as contractual increases in plan provider fees as a result of achieving certain AUM milestones. In addition, there was an increase in printed marketing materials expense for subadvisory relationships and printed member materials of \$0.8 million due primarily to an increase in print costs as a result of a revised agreement with one of our subadvisory plan providers, as well as an increase in the volume of subadvisory participants receiving our printed campaign and member materials this quarter. There was also an increase of \$0.2 million in wages expense and an increase of \$0.2 million in non-cash stock-based compensation expense, which were partially offset by a decrease in cash incentive compensation expense of \$0.1 million. Allocated overhead expenses, including rent expense, increased \$0.3 million. As a percentage of revenue, cost of revenue increased from 36% for the three months ended September 30, 2011 to 39% for the three months ended September 30, 2012 due primarily to an increase in data connectivity fees resulting from the achievement of certain contractual AUM based milestones in 2012 and to a lesser extent, an increase in print costs as a result of a revised agreement with one of our subadvisory plan providers. We do not currently expect any additional AUM based milestones to significantly affect data connectivity fees in future periods.

Research and Development

Research and development expense increased \$1.4 million, or 27%, from \$5.1 million for the three months ended September 30, 2011 to \$6.5 million for the three months ended September 30, 2012. There was a \$0.7 million increase in allocated overhead expenses, including rent expense, for the three months ended September 30, 2012 compared to the three months ended September 30, 2011. In addition, there was an increase in non-cash stock-based compensation expense of \$0.3 million, an increase in wages, benefits and payroll tax expenses of \$0.3 million and an increase in cash incentive compensation expense of \$0.1 million. As a percentage of revenue, research and development expense decreased from 14% for the three months ended September 30, 2011 to 13% for the three months ended September 30, 2012. The decrease as a percentage of revenue was primarily due to a slower increase in employee-related expenses relative to the increase in revenue during the same period.

Sales and Marketing

Sales and marketing expense increased \$3.0 million, or 40%, from \$7.4 million for the three months ended September 30, 2011 to \$10.4 million for the three months ended September 30, 2012. There was a \$0.7 million increase in wages, benefits and payroll tax expenses, a \$0.3 million increase in non-cash stock-based compensation expense, a \$0.2 million increase in cash incentive compensation expense, and \$0.1 million increase in commission expense for the three months ended September 30, 2012 compared to the three months ended September 30, 2011.

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Additionally, there was a \$0.6 million increase in advisory printed enrollment materials expense as amortization of direct response advertising increased, as well as a \$0.5 million increase in allocated overhead expenses, including rent. There was also a net increase in consulting and general marketing program expenses of \$0.5 million as well as a \$0.1 million increase in recruiting expenses. As a percentage of revenue, sales and marketing expense increased from 21% for the three months ended September 30, 2011 to 22% for the three months ended September 30, 2012. The increase as a percentage of revenue was primarily due to consulting expenses related to a customer experience design project for the three months ended September 30, 2012.

General and Administrative

General and administrative expense increased \$0.2 million, or 7%, from \$3.4 million for the three months ended September 30, 2011 to \$3.7 million for the three months ended September 30, 2012. There was a \$0.3 million increase in non-cash stock-based compensation expense for the three months ended September 30, 2012 compared to the three months ended September 30, 2011. In addition, wages expense increased \$0.2 million and cash incentive compensation expense increased by \$0.1 million. There was also an increase of \$0.1 million in other expenses. These increases were offset by a decrease in expenses related to supporting operations as a public company of \$0.3 million and a decrease in allocated overhead expenses of \$0.2 million. As a percentage of revenue, general and administrative expense decreased from 10% for the three months ended September 30, 2011 to 8% for the three months ended September 30, 2012. The decrease as a percentage of revenue was primarily due to a slower increase in allocated overhead expenses, as general and administrative headcount grew at a slower rate than other areas, relative to the increase in revenue during the same period.

Income Taxes

Income tax expense increased from \$1.9 million for the three months ended September 30, 2011 to \$2.7 million for the three months ended September 30, 2012 due to an increase in taxable income. Our effective tax rates were 37% and 36% for the three months ended September 30, 2011 and 2012, respectively. We expect to see an effective tax rate of approximately 38%, excluding the effect of research and development credits, any changes in valuation allowances, and discrete items such as disqualifying stock dispositions in future periods.

As of September 30, 2012, we continue to believe that sufficient positive evidence exists from historical operations and future projections to conclude that it is more likely than not to fully realize our federal deferred tax assets and to partially realize our State of California deferred tax assets in future periods. We continuously evaluate additional facts representing positive and negative evidence in the determination of the realizability of the deferred tax assets. We continue to apply a valuation allowance on certain deferred tax assets in the amount of \$2.0 million as of September 30, 2012 relating to net operating losses for the State of California as it is not more likely than not that we will be able to realize these assets prior to their expiration.

Table of Contents*Comparison of Nine Months Ended September 30, 2011 and 2012*

	Nine Months Ended September 30, 2011 2012 (As a percentage of revenue)		Nine Months Ended September 30, 2011 2012 (In thousands, except percentages)		Increase (Decrease) Amount %	
Revenue:						
Professional management	74%	80%	\$ 76,706	\$ 107,639	\$ 30,933	40%
Platform	23	18	24,058	24,764	706	3
Other	3	2	2,447	2,040	(407)	(17)
Total revenue	100	100	103,211	134,443	31,232	30
Costs and expenses:						
Cost of revenue (exclusive of amortization of internal use software)	36	38	36,811	51,423	14,612	40
Research and development	15	14	15,644	18,716	3,072	20
Sales and marketing	22	22	22,312	29,160	6,848	31
General and administrative	10	8	9,855	11,271	1,416	14
Amortization of internal use software	3	4	4,276	4,560	284	7
Total costs and expenses	86	86	88,898	115,130	26,232	30
Income from operations	14	14	14,313	19,313	5,000	35
Interest income (expense)			2	(1)	(3)	n/a
Income before income tax expense	14	14	14,315	19,312	4,997	35
Income tax expense	5	5	4,942	7,199	2,257	46
Net income	9%	9%	\$ 9,373	\$ 12,113	\$ 2,740	29%

Revenue

Total revenue increased \$31.2 million, or 30%, from \$103.2 million for the nine months ended September 30, 2011 to \$134.4 million for the nine months ended September 30, 2012. The increase was due primarily to growth in professional management revenue of \$30.9 million for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011. Professional management revenue and platform revenue comprised 80% and 18%, respectively, of total revenue for the nine months ended September 30, 2012.

Professional Management Revenue

Professional management revenue increased \$30.9 million, or 40%, from \$76.7 million for the nine months ended September 30, 2011 to \$107.6 million for the nine months ended September 30, 2012. The increase in professional management revenue for the nine months ended September 30, 2012 was due primarily to an increase in the average AUM used to calculate fees from approximately \$42.1 billion for the nine months ended September 30, 2011 to approximately \$55.1 billion for the nine months ended September 30, 2012. This increase in AUM was driven primarily by increased net enrollment resulting from marketing campaigns and other ongoing member acquisitions, as well as contributions and market appreciation.

Platform Revenue

Platform revenue increased \$0.7 million, or 3%, from \$24.1 million for the nine months ended September 30, 2011 to \$24.8 million for the nine months ended September 30, 2012. The increase in platform revenue for the nine months ended September 30, 2012 was due primarily to increased platform fee revenue resulting from service availability at new sponsors.

Costs and Expenses

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Costs and expenses increased \$26.2 million, or 30%, from \$88.9 million for the nine months ended September 30, 2011 to \$115.1 million for the nine months ended September 30, 2012. This increase was due to a \$14.6 million increase in cost of revenue, exclusive of amortization of internal use software, a \$3.1 million increase in research and development expense, a \$6.8 million increase in sales and marketing expense, a \$1.4 million increase in general and administrative expense and a \$0.3 million increase in amortization of internal use software for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011.

Across functional areas, non-cash stock-based compensation expense increased for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011 primarily due to the equity awards granted in mid-November 2011 under the graded-vesting attribution method over a four-year vesting period, resulting in greater amounts of non-cash stock-based compensation expense recognized in earlier periods of the grants with declining amounts recognized in later periods. In addition, wages and cash incentive compensation expenses also increased due to headcount growth and annual compensation increases effective April 1, 2012. Rent expense increased for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011 due to the commencement of our lease contract for the new headquarters facilities, which was expensed in addition to our prior headquarters facilities lease for the period April 1, 2012 through August 31, 2012.

Table of Contents*Cost of Revenue*

Cost of revenue, exclusive of amortization of internal use software, increased \$14.6 million, or 40%, from \$36.8 million for the nine months ended September 30, 2011 to \$51.4 million for the nine months ended September 30, 2012. This increase was due primarily to an increase of \$10.8 million in fees paid to plan providers for connectivity to plan and plan participant data for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011, resulting from an increase in professional management revenue, as well as contractual increases in plan provider fees as a result of achieving certain AUM milestones. There was also an increase in printed marketing materials expense for subadvisory relationships and printed member materials of \$1.9 million due primarily to an increase in the volume of subadvisory participants receiving our printed campaign and member materials, as well as an increase in print costs as a result of a revised agreement with one of our subadvisory plan providers. In addition, wages, benefits and payroll tax expenses increased \$0.8 million and non-cash stock-based compensation expense increased \$0.6 million. There was also a \$0.7 million increase in allocated overhead expenses, including rent, partially offset by a \$0.2 million decrease in equipment related expenses. As a percentage of revenue, cost of revenue increased from 36% for the nine months ended September 30, 2011 to 38% for the nine months ended September 30, 2012 due primarily to an increase in data connectivity fees resulting from the achievement of certain contractual AUM based milestones and to a lesser extent, an increase in print costs as a result of a revised agreement with one of our subadvisory plan providers.

Research and Development

Research and development expense increased \$3.1 million, or 20%, from \$15.6 million for the nine months ended September 30, 2011 to \$18.7 million for the nine months ended September 30, 2012. There was a \$0.9 million increase in wages, benefits and payroll tax expenses for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011. In addition, there was an increase in non-cash stock-based compensation expense of \$0.8 million. There was also a \$1.2 million increase in allocated overhead expenses, including rent, and a \$0.2 million increase in equipment related and other expenses. As a percentage of revenue, research and development expense decreased from 15% for the nine months ended September 30, 2011 to 14% for the nine months ended September 30, 2012. The decrease as a percentage of revenue was primarily due to a slower increase in employee-related expenses relative to the increase in revenue during the same period.

Sales and Marketing

Sales and marketing expense increased \$6.8 million, or 31%, from \$22.3 million for the nine months ended September 30, 2011 to \$29.2 million for the nine months ended September 30, 2012. There was a \$1.9 million increase in advisory printed enrollment materials expense for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011, as amortization of direct response advertising increased as well as the volume of advisory participants receiving printed campaign materials. Additionally, there was a \$1.5 million increase in wages, benefits and payroll tax expenses, a \$0.9 million increase in non-cash stock-based compensation expense, a \$0.4 million increase in commission expense and a \$0.2 million increase in cash incentive compensation expense. Allocated overhead expenses, including rent, increased \$1.0 million and there was also a net increase in consulting and general marketing programs expenses of \$0.7 million. Lastly, there was a \$0.2 million increase in travel and equipment related expenses. As a percentage of revenue, sales and marketing expense remained flat at 22% for the comparable periods.

General and Administrative

General and administrative expense increased \$1.4 million, or 14%, from \$9.9 million for the nine months ended September 30, 2011 to \$11.3 million for the nine months ended September 30, 2012. There was a \$1.3 million increase in non-cash stock-based compensation expense for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011. In addition, wages, benefits and payroll tax expenses increased \$0.4 million, cash incentive compensation expense increased \$0.1 million and other expenses increased \$0.1 million. These expenses were offset by a decrease in allocated overhead expenses of \$0.3 million and a decrease in expenses related to supporting operations as a public company of \$0.2 million. As a percentage of revenue, general and administrative expense decreased from 10% for the nine months ended September 30, 2011 to 8% for the nine months ended September 30, 2012. The decrease as a percentage of revenue was primarily due to a slower increase in allocated overhead expenses, as general and administrative headcount grew at a slower rate than other areas, relative to the increase in revenue during the same period.

Amortization of Internal Use Software

Amortization of internal use software increased \$0.3 million, or 7%, from \$4.3 million for the nine months ended September 30, 2011 to \$4.6 million for the nine months ended September 30, 2012 due to the amortization of higher capitalized costs caused by an increase in development hours required for recently completed projects compared to projects in prior years.

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Income Taxes

Income tax expense increased from \$4.9 million for the nine months ended September 30, 2011 to \$7.2 million for the nine months ended September 30, 2012. Our effective tax rates were 35% and 37% for the nine months ended September 30, 2011 and 2012, respectively. This increase was due primarily to the expiration of the federal research and development credit, which has not currently been extended for 2012.

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Non-GAAP Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share

Adjusted EBITDA represents net income before net interest expense (income), income tax expense (benefit), depreciation, amortization of internal use software, amortization of direct response advertising, amortization of deferred sales commissions and amortization of non-cash stock-based compensation. Adjusted Net Income represents net income before non-cash stock-based compensation expense, net of tax and certain other items such as the income tax benefit from the release of valuation allowances if applicable for the period. Adjusted Earnings Per Share is defined as Adjusted Net Income divided by the weighted average of dilutive common share equivalents outstanding. For all periods prior to fiscal year 2011, the dilutive common share equivalents outstanding also include on a non-weighted basis the conversion of all preferred stock to common stock, the shares associated with the stock dividend and the shares sold in the initial public offering. This differs from the weighted average diluted shares outstanding used for purposes of calculating GAAP earnings per share.

Our management uses Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share as measures of operating performance, for planning purposes (including the preparation of annual budgets), to allocate resources to enhance the financial performance of our business, to evaluate the effectiveness of our business strategies and in communications with our board of directors concerning our financial performance. Adjusted EBITDA, among other factors, was used for the year ended December 31, 2011 and will be used for the year ended December 31, 2012 when determining cash incentive compensation for employees, including management.

We also present Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share as supplemental performance measures because we believe that these measures provide our board of directors, management and investors with additional information to measure our performance. Adjusted EBITDA provides comparisons from period to period by excluding potential differences caused by variations in the age and book depreciation of fixed assets (affecting relative depreciation expense) and amortization of internal use software, direct response advertising and commissions, and changes in interest expense and interest income that are influenced by capital structure decisions and capital market conditions. Management also believes it is useful to exclude non-cash stock-based compensation expense from Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share because non-cash equity grants made at a certain price and point in time, as well as certain other items such as the income tax benefit from the release of valuation allowances, do not necessarily reflect how our business is performing at any particular time.

Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share are not measurements of our financial performance under GAAP and should not be considered as an alternative to net income, operating income, earnings per share or any other performance measures derived in accordance with GAAP, or as an alternative to cash flows from operating activities as a measure of our profitability or liquidity.

We understand that, although Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share are frequently used by securities analysts, lenders and others in their evaluation of companies, Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share have limitations as an analytical tool, and you should not consider them in isolation, or as a substitute for an analysis of our results as reported under GAAP. In particular you should consider:

Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share do not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;

Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share do not reflect changes in, or cash requirements for, our working capital needs;

Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share do not reflect the non-cash component of employee compensation;

Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized generally will have to be replaced in the future by payment of cash, and Adjusted EBITDA does not reflect any cash requirements for such replacements; and

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Other companies in our industry may calculate Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share differently than we do, limiting their usefulness as a comparative measure.

Given the limitations associated with using Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share, these financial measures should be considered in conjunction with our financial statements presented in accordance with GAAP and the reconciliation of Adjusted EBITDA, Adjusted Net Income and Adjusted Earnings Per Share to the most directly comparable GAAP measure, net income. Further, management also reviews GAAP measures and evaluates individual measures that are not included in Adjusted EBITDA, such as our level of capital expenditures, equity issuance and interest expense, among other measures.

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The table below sets forth a reconciliation of net income to non-GAAP Adjusted EBITDA based on our historical results:

Non-GAAP Adjusted EBITDA	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
	(In thousands)			
Net income	\$ 3,354	\$ 4,778	\$ 9,373	\$ 12,113
Interest expense (income)	1	5	(2)	1
Income tax expense	1,933	2,718	4,942	7,199
Depreciation	570	878	1,608	2,075
Amortization of internal use software	1,419	1,456	4,027	4,263
Amortization and impairment of direct response advertising	721	1,393	1,869	3,695
Amortization of deferred sales commissions	367	565	1,006	1,464
Non-cash stock-based compensation	1,355	2,518	3,922	7,500
Non-GAAP Adjusted EBITDA	\$ 9,720	\$ 14,311	\$ 26,745	\$ 38,310

The table below sets forth a reconciliation of net income to non-GAAP Adjusted Net Income and non-GAAP Adjusted Earnings Per Share based on our historical results:

Non-GAAP Adjusted Net Income and Adjusted EPS	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
	(In thousands, except per share amounts)			
Net income	\$ 3,354	\$ 4,778	\$ 9,373	\$ 12,113
Non-cash stock-based compensation, net of tax ⁽¹⁾	837	1,556	2,423	4,635
Non-GAAP Adjusted Net Income	\$ 4,191	\$ 6,334	\$ 11,796	\$ 16,748
Non-GAAP Adjusted Earnings Per Share	\$ 0.08	\$ 0.13	\$ 0.24	\$ 0.33
Shares of common stock outstanding	45,237	46,889	44,558	46,469
Dilutive restricted stock and stock options	4,182	3,305	4,798	3,557
Non-GAAP adjusted weighted common shares outstanding	49,419	50,194	49,356	50,026

(1) For the calculation of non-GAAP Adjusted Net Income, an estimated statutory tax rate of 38.2% has been applied to non-cash stock-based compensation for all periods presented.

For the non-GAAP metrics above, the variances in the comparable periods are consistent with the GAAP variances discussed in the Comparison of Three and Nine Months Ended September 30, 2011 and 2012 as presented above in our Management's Discussion and Analysis of Financial Condition and Results of Operations.

Table of Contents**Liquidity and Capital Resources***Sources of Liquidity*

Over the next 12 months, and in the longer term, we expect that our cash and liquidity needs will be met by existing resources, consisting of cash and cash equivalents on hand and cash generated from ongoing operations.

Historically, our operations have been financed through the sale of equity securities, including net cash proceeds in connection with our initial public offering of common stock completed on March 16, 2010 of approximately \$79.0 million, after deducting underwriting discounts and offering costs, and more recently from cash flows from operations. As of September 30, 2012, we had total cash and cash equivalents of \$166.4 million, compared to \$145.0 million as of December 31, 2011.

Consolidated Cash Flow Data

	Nine Months Ended September 30,	
	2011	2012
	(In thousands)	
Net cash provided by operating activities	\$ 13,010	\$ 25,422
Net cash used in investing activities	(6,772)	(14,535)
Net cash provided by financing activities	11,141	10,493
Net increase in cash and cash equivalents	\$ 17,379	\$ 21,380
Cash and cash equivalents, end of period	\$ 132,316	\$ 166,382

Operating Activities

Net cash provided by operating activities for the nine months ended September 30, 2012 increased \$12.4 million compared to net cash provided by operating activities for the nine months ended September 30, 2011. Operating activities for the nine months ended September 30, 2012 resulted in cash provided of \$25.4 million, as net income of \$12.1 million and adjustments for non-cash expenses of \$17.8 million, primarily related to amortization of non-cash stock-based compensation, amortization of internal use software and amortization and impairment of direct response advertising, offset by a decrease in cash related to changes in operating assets and liabilities of \$4.5 million. The decrease in cash related to operating assets and liabilities was primarily due to an increase in accounts receivable due to an increase in revenue, an increase in the capitalization of direct response advertising and a decrease in accrued compensation related to 2011 cash incentive program payments, offset by an increase in deferred rent related to the new headquarters facilities lease. Operating activities for the nine months ended September 30, 2011 resulted in cash provided of \$13.0 million, as net income of \$9.4 million and adjustments for non-cash expenses of \$11.9 million, primarily related to amortization of internal use software and amortization of non-cash stock-based compensation, were offset by a net decrease in cash related to changes in operating assets and liabilities of \$8.2 million. The decrease in cash related to operating assets and liabilities was primarily due to an increase in accounts receivable driven by an increase in revenue, as well as an increase in the capitalization of direct response advertising and a decrease in accrued compensation related to 2010 cash incentive program payments as well as, offset by an increase in deferred revenue.

Investing Activities

Net cash used in investing activities was \$14.5 million for the nine months ended September 30, 2012 compared to \$6.8 million for the nine months ended September 30, 2011. For the nine months ended September 30, 2012, net cash used for the purchase of property and equipment increased \$8.3 million, as we spent \$11.0 million driven primarily by leasehold improvements, furniture and equipment expenditures related to the new headquarters facility during the nine months ended September 30, 2012 compared to general capital expenditures of \$2.6 million for the nine months ended September 30, 2011. For both the nine months ended September 30, 2011 and 2012, we capitalized \$4.1 million of internal use software costs. For the nine months ended September 30, 2012, there was \$0.6 million of cash that became unrestricted upon the release of the security deposit related to the prior headquarters facility.

Financing Activities

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Net cash provided by financing activities was \$10.5 million for the nine months ended September 30, 2012 compared to net cash provided by financing activities of \$11.1 million for the nine months ended September 30, 2011. For the nine months ended September 30, 2012, we received \$9.1 million of proceeds from the issuance of common stock due to the exercise of stock options compared to \$12.2 million during the nine months ended September 30, 2011. We incurred cash payments of \$1.7 million associated with net share settlements for non-cash stock-based awards minimum tax withholdings for the nine months ended September 30, 2011.

We expect to incur cash payments in an amount necessary to satisfy the minimum tax withholding obligations for restricted stock units granted to employees that vest in mid-November 2012, which will be determined based on the fair value of our common stock and applicable tax rates on the vesting date. Based on the fair value of our common stock on September 28, 2012 of \$23.82 and assuming a 40% tax rate, the estimated minimum tax withholdings obligations would be approximately \$0.7 million.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

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Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

Market Risk

Our exposure to market risk is directly related to our role as an investment manager for investor accounts for which we provide portfolio management services. For the nine months ended September 30, 2012, 80% of our revenue was derived from fees based on the market value of AUM compared to 69% for the year ended December 31, 2011. This percentage increased due to a revised agreement with one of our subadvisory plan providers, which increased the amount of fees based on the market value of AUM. In general, we expect the percentage of revenue that is derived from fees based on the market value of AUM to increase over time.

A substantial portion of the assets we manage is invested in equity securities, the market prices of which can vary substantially based on changes in economic conditions.

An additional portion is invested in fixed income securities, which will generally have lower volatility than the equity market. Therefore, while any changes in equity market performance would significantly affect the value of our AUM, particularly for the AUM invested in equity securities, such changes would typically result in lower volatility for our AUM than the volatility of the equity market as a whole. Because a substantial portion of our revenue is derived from the value of our AUM, any changes in fixed income or equity market performance would significantly affect the amount of revenue in a given period. If any of these factors reduces our AUM, the amount of member fees we would earn for managing those assets would decline, which in turn could negatively impact our revenue.

Item 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (or the Exchange Act)) as of the end of the period covered by this report. Based on their evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures as of the end of the period covered by this report were designed and were functioning effectively at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****Item 1A. Risk Factors**

You should carefully review and consider the information regarding certain factors that could materially affect our business, financial condition or future results set forth under Part I Item 1A (Risk Factors) in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. There have been no material changes from the risk factors disclosed in our 2011 Annual Report on Form 10-K.

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

For the three months ended September 30, 2012, we issued 511,471 shares of unregistered common stock for an aggregate purchase price of \$3.3 million upon the exercise of previously granted options which was paid in cash. These transactions were effected under Rule 701 of the Securities Act of 1933, applicable to our 1998 Stock Option Plan. All recipients either received adequate information about us or had access, through employment or other relationships, to such information. There were no underwriters employed in connection with these transactions.

Item 6. *Exhibits***Exhibit**

Number	Description
31.1	Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
31.2	Certificate of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
32.1(1)	Certificate of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
32.2(1)	Certificate of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
101.INS(2)	XBRL Instance Document
101.SCH(2)	XBRL Schema Document
101.CAL(2)	XBRL Calculation Linkbase Document
101.DEF(2)	XBRL Definition Linkbase Document
101.LAB(2)	XBRL Label Linkbase Document
101.PRE(2)	XBRL Presentation Linkbase Document

- (1) The material contained in Exhibit 32.1 and Exhibit 32.2 is not deemed filed with the SEC and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 (the Securities Act) or the Securities Exchange Act of 1934 (the Exchange Act), whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing, except to the extent that the registrant specifically incorporates it by reference.
- (2) In accordance with Rule 406T of Regulation S-T, the information furnished in these exhibits will not be deemed filed for purpose of Section 18 of the Exchange Act. Such exhibits will not be deemed to be incorporated by reference into any filing under the Securities Act or Exchange Act.

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SIGNATURES

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

Date: November 6, 2012

FINANCIAL ENGINES, INC.

/s/ Jeffrey N. Maggioncalda
Jeffrey N. Maggioncalda
President and Chief Executive Officer

(Duly authorized officer and principal executive officer)

/s/ Raymond J. Sims
Raymond J. Sims
Executive Vice President and Chief Financial Officer

(Duly authorized officer and principal financial officer)

/s/ Jeffrey C. Grace
Jeffrey C. Grace
VP, Controller and Principal Accounting Officer

(Duly authorized officer and principal accounting officer)

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Exhibit Index

Exhibit

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- (2) In accordance with Rule 406T of Regulation S-T, the information furnished in these exhibits will not be deemed filed for purpose of Section 18 of the Exchange Act. Such exhibits will not be deemed to be incorporated by reference into any filing under the Securities Act or Exchange Act.