

Financial Engines, Inc.  
Form 10-Q  
November 05, 2013  
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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, 2013**

**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** **94-3250323**  
**(State or other jurisdiction of** **(I.R.S. Employer**  
**incorporation or organization)** **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, 2013, 50,408,883 shares of Common Stock, par value \$0.0001, were issued and outstanding.

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**FINANCIAL ENGINES, INC.**

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## Condensed Consolidated Balance Sheets

(Unaudited)

	December 31, 2012	September 30, 2013
	(In thousands, except per share data)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 181,231	\$ 141,949
Short-term investments		90,027
Accounts receivable, net	44,627	55,289
Prepaid expenses	3,093	3,742
Deferred tax assets	15,293	20,282
Other current assets	3,647	3,011
Total current assets	247,891	314,300
Property and equipment, net	13,366	13,419
Internal use software, net	10,339	8,892
Long-term deferred tax assets	20,639	7,295
Direct response advertising, net	10,236	9,974
Other assets	4,362	3,524
Total assets	\$ 306,833	\$ 357,404
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 15,008	\$ 18,274
Accrued compensation	12,279	11,546
Deferred revenue	7,831	7,765
Dividend payable		2,511
Other current liabilities	260	1,006
Total current liabilities	35,378	41,102
Long-term deferred revenue	1,166	789
Long-term deferred rent	6,653	5,943
Other liabilities	250	229
Total liabilities	43,447	48,063

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Contingencies (see note 9)

Stockholders' equity:

Preferred stock, \$0.0001 par value - 10,000 authorized as of December 31, 2012 and September 30, 2013; None issued and outstanding as of December 31, 2012 and September 30, 2013

Common stock, \$0.0001 par value - 500,000 authorized as of December 31, 2012 and September 30, 2013; 47,915 and 50,290 shares issued and outstanding at December 31, 2012 and September 30, 2013, respectively

	5	5
Additional paid-in capital	323,448	356,144
Accumulated deficit	(60,067)	(46,808)
 Total stockholders' equity	 263,386	 309,341
 Total liabilities and stockholders' equity	 \$ 306,833	 \$ 357,404

See accompanying notes to the unaudited condensed consolidated financial statements.

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

## Condensed Consolidated Statements of Income

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2013	September 30, 2012	September 30, 2013
(In thousands, except per share data)				
Revenue:				
Professional management	\$ 39,582	\$ 52,498	\$ 107,639	\$ 146,453
Platform	8,253	8,484	24,764	24,987
Other	611	1,103	2,040	2,290
<b>Total revenue</b>	<b>48,446</b>	<b>62,085</b>	<b>134,443</b>	<b>173,730</b>
Costs and expenses:				
Cost of revenue (exclusive of amortization of internal use software)	18,798	24,643	51,423	67,117
Research and development	6,496	7,260	18,716	22,527
Sales and marketing	10,440	10,429	29,160	31,692
General and administrative	3,653	5,402	11,271	15,367
Amortization of internal use software	1,558	1,633	4,560	4,993
<b>Total costs and expenses</b>	<b>40,945</b>	<b>49,367</b>	<b>115,130</b>	<b>141,696</b>
Income from operations	7,501	12,718	19,313	32,034
Interest income (expense)	(5)	19	(1)	29
Other expense, net		(10)		(10)
Income before income taxes	7,496	12,727	19,312	32,053
Income tax expense	2,718	4,581	7,199	11,372
<b>Net and comprehensive income</b>	<b>\$ 4,778</b>	<b>\$ 8,146</b>	<b>\$ 12,113</b>	<b>\$ 20,681</b>
Dividends declared per share of common stock	\$	\$ 0.05	\$	\$ 0.15
Net income per share attributable to holders of common stock				
Basic	\$ 0.10	\$ 0.16	\$ 0.26	\$ 0.42
Diluted	\$ 0.10	\$ 0.15	\$ 0.24	\$ 0.40
Shares used to compute net income per share attributable to holders of common stock				
Basic	46,889	49,934	46,469	49,145
Diluted	50,194	52,677	50,026	52,074

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See accompanying notes to the unaudited condensed consolidated financial statements.

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## Condensed Consolidated Statements of Cash Flows

(Unaudited)

	<b>Nine Months Ended</b>	
	<b>September 30, 2012</b>	<b>2013</b>
	<b>(In thousands)</b>	
<b>Cash flows from operating activities:</b>		
Net income	\$ 12,113	\$ 20,681
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	2,075	2,888
Amortization of internal use software	4,263	4,679
Stock-based compensation	7,500	10,442
Amortization of deferred sales commissions	1,464	1,432
Amortization and impairment of direct response advertising	3,695	4,491
Amortization of discount on short-term investments		1
Provision for doubtful accounts	209	298
Loss on fixed asset disposal	4	
Excess tax benefit associated with stock-based compensation	(1,446)	(2,822)
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	(11,288)	(10,959)
Prepaid expenses	425	(649)
Deferred tax assets	5,470	8,354
Direct response advertising	(5,240)	(4,215)
Other assets	(2,150)	(718)
Accounts payable	6,899	6,247
Accrued compensation	(2,720)	(733)
Deferred revenue	(1,642)	(443)
Deferred rent	5,788	26
Other liabilities	3	3
<b>Net cash provided by operating activities</b>	<b>25,422</b>	<b>39,003</b>
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(10,954)	(3,065)
Capitalization of internal use software	(4,131)	(3,345)
Release of restricted cash	550	759
Purchases of short-term investments		(90,028)
<b>Net cash used in investing activities</b>	<b>(14,535)</b>	<b>(95,679)</b>
<b>Cash flows from financing activities:</b>		



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Payments on capital lease obligations	(8)	(48)
Excess tax benefit associated with stock-based compensation	1,446	2,822
Proceeds from issuance of common stock, net of offering costs	9,055	19,531
Cash dividend payments		(4,911)
Net cash provided by financing activities	10,493	17,394
Net increase (decrease) in cash and cash equivalents	21,380	(39,282)
Cash and cash equivalents, beginning of period	145,002	181,231
Cash and cash equivalents, end of period	\$ 166,382	\$ 141,949
Supplemental cash flows information:		
Income taxes paid, net of refunds	\$ 185	\$ 506
Interest paid	\$ 6	\$ 7
Non-cash operating, investing and financing activities:		
Purchase of property and equipment under capital lease	\$ 223	\$ 34
Unpaid purchases of property and equipment	\$ 631	\$ 477
Capitalized stock-based compensation for internal use software	\$ 267	\$ 202
Capitalized stock-based compensation for direct response advertising	\$ 46	\$ 54

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, Inc. (the Company or Financial Engines) was incorporated on May 13, 1996 under the laws of the State of California and is headquartered in Sunnyvale, California. In February 2010, the Company was reincorporated under the laws of the State of Delaware.

Financial Engines is a provider of independent, technology-enabled portfolio management services, investment advice and retirement income services primarily 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, 2012, as filed on February 22, 2013 with the SEC (the 2012 Annual Report). The Condensed Consolidated Balance Sheet as of December 31, 2012, 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, 2012 and September 30, 2013, the Company's Statements of Income for the three and nine months ended September 30, 2012 and 2013 and the Company's Statements of Cash Flows for the nine months ended September 30, 2012 and 2013. The results for the nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the year ending December 31, 2013.

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.

***Short-term Investments***

Short-term investments consist of U.S. Treasury securities. The Company classifies its short-term investments as held-to-maturity as the Company has the positive intent and ability to hold to maturity and such investments are carried at amortized cost. The Company evaluates the investments periodically for possible other-than-temporary impairment. In order to determine whether a decline in value is other-than-temporary, the Company evaluates, among other factors: the duration and extent to which the fair value has been less than the carrying value, and its intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

***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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The Company considers all highly liquid investments purchased with an original remaining maturity of three months or less at the date of purchase to be cash equivalents. Cash and cash equivalents consist of the following:

	<b>December 31, 2012</b>	<b>September 30, 2013</b>
	<b>(In thousands)</b>	
Cash	\$ 2,558	\$ 8,303
Money market fund	178,673	133,646
<b>Total cash and cash equivalents</b>	<b>\$ 181,231</b>	<b>\$ 141,949</b>

As of September 30, 2013, the Company's bank removed the collateral requirements associated with the letters of credit related to the Company's operating facilities, resulting in \$0.8 million reclassified from restricted cash to cash equivalents.

**NOTE 4 Short-Term Investments**

The Company considers all investments purchased with an original remaining maturity of between three and twelve months at the date of purchase to be short-term investments. The U.S. Treasury securities are classified as held-to-maturity. A reconciliation between amortized cost and fair value of short-term investments is as follows:

	<b>September 30, 2013</b>
	<b>(In thousands)</b>
<b>U.S. Treasury Securities:</b>	
Amortized cost	\$ 90,027
Gross unrecognized gains	23
Gross unrecognized losses	
<b>Fair Value</b>	<b>\$ 90,050</b>

**NOTE 5 Concentration of Credit Risk and Fair Value of Financial Instruments**

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The Company measures and reports its investments in money market funds at fair value, which approximates their carrying value due to the short period of time to maturity, and reports its investments in U.S. Treasury securities at amortized cost at each reporting period. There have been no changes in the Company's valuation techniques during the nine months ended September 30, 2013. The Company began purchasing six-month and twelve-month U.S. Treasury securities in May 2013. The U.S. Treasury securities have maturity dates through May 2014. Both the money market funds and U.S. Treasury securities are classified as Level 1.

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## FINANCIAL ENGINES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

	As of December 31, 2012				As of September 30, 2013				
	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1) <sup>(1)</sup>			Significant Other Observable Inputs (Level 2) <sup>(2)</sup>			Significant Other Unobservable Inputs (Level 3) <sup>(3)</sup>	
					Total Fair Value				(In thousands)
Assets:									
Money Market Funds <sup>(4)</sup>	\$ 179,433	\$ 179,433	\$	\$	\$ 133,646	\$ 133,646	\$	\$	
US Treasury Securities	\$	\$	\$	\$	\$ 90,050	\$ 90,050	\$	\$	

- (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, 2012 money market fund balance is \$0.8 million of long-term restricted cash, which is classified in other assets in the accompanying Condensed Consolidated Balance Sheet, and was being held in a money market account pledged as collateral for letters of credit issued in connection with certain operating lease contracts. As of September 30, 2013, the Company's bank removed the collateral requirements associated with letters of credit related to the Company's operating facilities.

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents, short-term investments and trade accounts receivable. The Company deposits its cash and cash equivalents primarily with a major bank, where 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.

Significant customer information is as follows:

	<b>December 31, 2012</b>	<b>September 30, 2013</b>		
<b>Percentage of accounts receivable:</b>				
JPMorgan	15%	16%		
	<b>Three Months Ended September 30, 2012</b>		<b>Nine Months Ended September 30, 2012</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	
<b>Percentage of revenue:</b>				
JPMorgan	13%	12%	13%	12%

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The following table summarizes the stock-based compensation, as included in the Condensed Consolidated Statements of Income, by functional area:

	<b>Three Months Ended</b>		<b>Nine Months</b>	
	<b>September 30,</b>		<b>Ended</b>	
	<b>2012</b>	<b>2013</b>	<b>September 30,</b>	<b>2013</b>
	<b>(In thousands)</b>			
<b>Stock-based compensation:</b>				
Cost of revenue	\$ 330	\$ 445	\$ 896	\$ 1,081
Research and development	542	977	1,624	2,381
Sales and marketing	657	1,039	1,941	2,563
General and administrative	887	1,672	2,742	4,103
Amortization of internal use software	102	99	297	314
<b>Total stock-based compensation</b>	<b>\$ 2,518</b>	<b>\$ 4,232</b>	<b>\$ 7,500</b>	<b>\$ 10,442</b>

For the three months ended September 30, 2013, the Company included a dividend yield of 0.3% in their Black-Scholes option pricing model to reflect the anticipated dividends to be paid over the expected term of the awards.

***Cash Dividends***

Prior to fiscal 2013, the Company did not declare or pay any cash dividends on its common stock. In February 2013, May 2013, July 2013 and October 2013, the Board of Directors declared quarterly cash dividends in the amount of \$0.05 per share of common stock outstanding. While the Company currently expects to pay comparable cash dividends on a quarterly basis in the future, any future determination with respect to the declaration and payment of dividends will be at the discretion of the Board of Directors. As of September 30, 2013, the Company had a dividend payable balance of \$2.5 million, which was paid to stockholders in October 2013.

***2009 Stock Incentive Plan***

In February 2013, the Board of Directors amended and restated the Amended and Restated 2009 Stock Incentive Plan (the Updated Stock Incentive Plan) and approved the 2013-2017 Long-Term Incentive Program (the LTIP)



thereunder. The Updated Stock Incentive Plan was subsequently approved by stockholders in May 2013. Under the LTIP, the Company may grant performance stock unit (PSU) awards based on objective performance criteria pre-established by the Compensation Committee of the Board of Directors. In March 2013, the Compensation Committee granted PSUs under the LTIP to certain executives, which had a fair value of \$43.59 per share in May 2013. Assuming 100% achievement against the objective performance criteria and no cancellations, the Company would issue 414,300 PSUs over the term of this LTIP. Further details on the Updated Stock Incentive Plan and the LTIP are presented in the Proxy Statement filed on April 1, 2013. The Company recognizes non-cash stock-based compensation expense under the graded-vesting attribution method. Each PSU award consists of two vesting cliffs, with sixty percent eligible to vest on December 31, 2015 and forty percent eligible to vest on December 31, 2017. The expense associated with each vesting cliff will be straight-lined over its respective period beginning in May 2013, which will result in greater amounts of non-cash stock-based compensation expense recognized in earlier periods of the grants with declining amounts recognized in later periods. Depending on performance against the target metrics, vesting will be between 0% and 140% of target value for each of the vesting cliffs and the expense will be reviewed and adjusted based on forecasts at the end of each balance sheet period. Assuming 100% achievement against the objective performance criteria, the total expense value of these PSUs would be approximately \$13.2 million as of the grant date, net of estimated forfeitures.

Upon vesting, PSUs are settled in common stock on a one-for-one basis. The Company intends to withhold shares upon vesting that would otherwise be distributed to the employee having a fair market value equal to the amount necessary to satisfy minimum tax withholding obligations, which the Company will remit from operational cash.

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

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2013</b>	<b>2012</b>	<b>2013</b>
	<b>(In thousands, except per share data)</b>			
<b>Numerator (basic and diluted):</b>				
Net income	\$ 4,778	\$ 8,146	\$ 12,113	\$ 20,681
<b>Denominator (basic):</b>				
Weighted average common shares outstanding	46,889	49,934	46,469	49,145
<b>Denominator (diluted):</b>				
Net weighted average common shares outstanding	46,889	49,934	46,469	49,145
Dilutive stock options outstanding	3,188	2,470	3,477	2,705
Dilutive unvested restricted stock units	117	273	80	224
<b>Net weighted average common shares outstanding</b>	<b>50,194</b>	<b>52,677</b>	<b>50,026</b>	<b>52,074</b>
<b>Net income per share:</b>				
Basic	\$ 0.10	\$ 0.16	\$ 0.26	\$ 0.42
Diluted	\$ 0.10	\$ 0.15	\$ 0.24	\$ 0.40

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>	<b>September 30,</b>	<b>September 30,</b>	<b>September 30,</b>
	<b>2012</b>	<b>2013</b>	<b>2012</b>	<b>2013</b>
	<b>(In thousands)</b>			
Stock options outstanding	1,231	175	1,112	325

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Restricted stock units outstanding				11
Performance stock units outstanding		102		47
Total anti-dilutive shares outstanding	1,231	277	1,112	383

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**FINANCIAL ENGINES, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 8 Income Taxes**

The Company recorded an income tax provision of \$2.7 million and \$4.6 million for the three months ended September 30, 2012 and 2013, respectively, and an income tax provision of \$7.2 million and \$11.4 million for the nine months ended September 30, 2012 and 2013, respectively. The Company's effective tax rate was 37% and 35% for the nine months ended September 30, 2012 and 2013, respectively. The decrease in the Company's effective tax rate was due primarily to the reinstatement of the federal research and development credit as well as an increase in disqualifying stock dispositions during the nine months ended September 30, 2013.

As of December 31, 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 \$1.4 million as of December 31, 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. As of September 30, 2013, there are no on-going tax audits in any significant tax jurisdictions.

At December 31, 2012, the Company had net operating loss carryforwards for federal purposes of approximately \$151.8 million that expire at varying dates through 2031. As of December 31, 2012 and September 30, 2013, the Company had gross unrecognized tax benefits for income taxes associated with uncertain tax positions of \$6.7 million and \$6.8 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, 2012 and 2013, the accrued interest and penalties were immaterial.

**NOTE 9 Commitments and Contingencies**

*Commitments*

In August 2013, the Company entered into an operating lease amendment for their Phoenix facility totaling \$3.4 million in future minimum payments through January 2020. The Company has a right of first refusal with respect to any available space located on the 2<sup>nd</sup> floor of the building. The new operating lease contract included a tenant

improvement allowance of approximately \$0.9 million, which had not been drawn upon as of September 30, 2013.

*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.

**Table of Contents****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, we believe, design, estimate, predict, potential, 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 effective tax rate; our anticipated cash needs, 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; our expectations regarding the amounts, timing and frequency of any 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, 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 primarily 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 investors on a cost-efficient basis. Our business model is based primarily on workplace delivery of our services, where we target three key constituencies in the retirement plan market: plan participants, plan sponsors and plan providers. We help investors plan for retirement by offering personalized plans for saving and investing, as well as providing assessments of retirement income needs and readiness, regardless of personal wealth or investment account size.

**Revenue**

We generate revenue primarily from management fees on Assets Under Management (AUM), as well as from platform fees, by providing portfolio management services, investment advice and retirement income services primarily 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 (or its affiliate) 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.

Pursuant to the contracts with our members, we calculate our member fees based on the asset amounts in data 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 or the applicable fee schedule 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.

In order to encourage enrollment into our Professional Management service, we use a variety of promotional and communication campaign techniques, some of which can potentially impact the amount of revenue recognized, the timing of revenue recognition or both. 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. 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.

**Table of Contents***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 (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 AUC are reported by plan providers with varying frequency and at different points in time, and are not always updated or marked to market. If markets have declined or if assets have left the plan since the reporting date, our AUC may be overstated. If markets have risen or if assets have been added to the plan since the reporting date, 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, 2013, we had approximately \$752 billion of AUC and 7.7 million eligible plan participants in plans for which the Professional Management service is available, which includes approximately \$81 billion of AUC and 828,000 eligible plan participants in plans at 45 plan sponsors for which Income+ has been made available to participants.

As of September 30, 2013, we had 104 Income+ plan sponsor contracts, including the aforementioned 45 plan sponsors where Income+ has been made available to participants and 59 plan sponsors for which the service has not yet been made available, representing a total of approximately \$182 billion of retirement assets and 1.9 million 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.

<b>Members as a Percentage of Eligible</b>	<b>AUM as a Percentage of AUC<sup>(1)</sup></b>
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	<b>Participants</b>	
<b>All plans as of September 30, 2013</b>		
Professional Management available	9.7%	10.9%
Professional Management available 14 months or more	11.2%	12.3%
Professional Management available 26 months or more	11.9%	13.0%

- (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, 2013, we performed a calculation to estimate the marked-to-market asset enrollment rate as of September 30, 2013, which we believe was approximately 10.9% where Professional Management is available, approximately 12.2% where Professional Management has been available for 14 months or more and approximately 12.9% where Professional Management has been available for 26 months or more.

As of September 30, 2013, the approximate aggregate style exposure of the portfolios we managed was as follows:

Cash	3%
Bonds	24%
Domestic Equity	47%
International Equity	26%
<b>Total</b>	<b>100%</b>

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 12	Q1 13	Q2 13	Q3 13
	(In billions)			
<b>AUM, beginning of period</b>	\$ 61.5	\$ 63.9	\$ 70.8	\$ 74.3
New Enrollment <sup>(1)</sup>	3.8	3.1	4.7	4.8
Voluntary Cancellations <sup>(2)</sup>	(1.4)	(1.2)	(1.2)	(1.5)
Involuntary Cancellations <sup>(3)</sup>	(1.3)	(0.8)	(1.0)	(1.3)
Contributions <sup>(4)</sup>	1.2	1.3	1.3	1.4
Market Movement and Other <sup>(5)</sup>	0.1	4.5	(0.3)	4.3
<b>AUM, end of period</b>	<b>\$ 63.9</b>	<b>\$ 70.8</b>	<b>\$ 74.3</b>	<b>\$ 82.0</b>

- (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, 2013 and October 31, 2013 would cause the AUM that was reported as of September 30, 2013 to be reduced by 0.01%.
- (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 86-91% 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 previously reported contributions data 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 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 fees for access to either our full suite of services, including Professional Management, Online Advice service, and Retirement Evaluation, or to our legacy 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 or quarterly 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 seven 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. 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 include 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 that may result in significant non-cash stock-based compensation expense. The largest events typically occur in the first and fourth quarters, although significant grants may also occur at other times. 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 and cash incentive compensation expenses.

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, printed marketing and member materials and postage, consulting and professional service expenses, facilities expenses, 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, advisor call center, operations, implementations 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 Consolidated 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 engineering, product development, and investment research 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 provider and sponsor relationship management, provider and sponsor marketing, direct sales, product marketing and customer experience, 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.

**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 compensation, 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 and customer experience 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.

### **Critical Accounting Estimates**

There have been no changes in the matters for which we make critical accounting estimates in the preparation of our condensed consolidated financial statements during the nine months ended September 30, 2013, 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, 2012 included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

**Table of Contents****Results of Operations**

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, 2012 and 2013**

	Three Months Ended September 30,		Three Months Ended September 30,		Increase (Decrease)	
	2012	2013	2012	2013	Amount	%
	(As a percentage of revenue)		(In thousands, except percentages)			
<b>Revenue:</b>						
Professional management	82%	84%	\$ 39,582	\$ 52,498	\$ 12,916	33%
Platform	17	14	8,253	8,484	231	3
Other	1	2	611	1,103	492	81
<b>Total revenue</b>	<b>100</b>	<b>100</b>	<b>48,446</b>	<b>62,085</b>	<b>13,639</b>	<b>28</b>
<b>Costs and expenses:</b>						
Cost of revenue (exclusive of amortization of internal use software)	39	40	18,798	24,643	5,845	31
Research and development	13	12	6,496	7,260	764	12
Sales and marketing	22	17	10,440	10,429	(11)	
General and administrative	8	9	3,653	5,402	1,749	48
Amortization of internal use software	3	2	1,558	1,633	75	5
<b>Total costs and expenses</b>	<b>85</b>	<b>80</b>	<b>40,945</b>	<b>49,367</b>	<b>8,422</b>	<b>21</b>
<b>Income from operations</b>	<b>15</b>	<b>20</b>	<b>7,501</b>	<b>12,718</b>	<b>5,217</b>	<b>70</b>
Interest income (expense)			(5)	19	24	n/a
Other expense, net				(10)	(10)	n/a
<b>Income before income tax expense</b>	<b>15</b>	<b>20</b>	<b>7,496</b>	<b>12,727</b>	<b>5,231</b>	<b>70</b>
<b>Income tax expense</b>	<b>5</b>	<b>7</b>	<b>2,718</b>	<b>4,581</b>	<b>1,863</b>	<b>69</b>
<b>Net income</b>	<b>10%</b>	<b>13%</b>	<b>\$ 4,778</b>	<b>\$ 8,146</b>	<b>\$ 3,368</b>	<b>70%</b>

**Revenue**

Total revenue increased \$13.6 million, or 28%, from \$48.4 million for the three months ended September 30, 2012 to \$62.1 million for the three months ended September 30, 2013. The increase was due primarily to growth in professional management revenue of \$12.9 million for the three months ended September 30, 2013 compared to the three months ended September 30, 2012, as well as a \$0.2 million increase in platform revenue and a \$0.5 million increase in other revenue. Professional management revenue and platform revenue comprised 84% and 14%, respectively, of total revenue for the three months ended September 30, 2013.

*Professional Management Revenue*

Professional management revenue increased \$12.9 million, or 33%, from \$39.6 million for the three months ended September 30, 2012 to \$52.5 million for the three months ended September 30, 2013. This increase was due primarily to an increase in the average AUM used to calculate fees from approximately \$59.2 billion for the three months ended September 30, 2012 to approximately \$79.6 billion for the three months ended September 30, 2013. 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.

*Platform Revenue*

Platform revenue increased \$0.2 million, or 3%, from \$8.3 million for the three months ended September 30, 2012 to \$8.5 million for the three months ended September 30, 2013. This increase was due primarily to service availability at new sponsors.

*Other Revenue*

Other revenue increased \$0.5 million, or 81%, from \$0.6 million for the three months ended September 30, 2012 to \$1.1 million for the three months ended September 30, 2013. This increase was due primarily to an increase in reimbursable printed fulfillment materials from certain subadvisory relationships.

*Costs and Expenses*

Costs and expenses increased \$8.4 million, or 21%, from \$40.9 million for the three months ended September 30, 2012 to \$49.4 million for the three months ended September 30, 2013. This increase was due to a \$5.8 million increase in cost of revenue, exclusive of amortization of internal use software, a \$0.8 million increase in research and development expense, a \$1.7 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, 2013 compared to the three months ended September 30, 2012.

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Across functional areas, wages, benefits and employer payroll tax expenses increased for the three months ended September 30, 2013 compared to the three months ended September 30, 2012 due primarily to headcount growth and annual compensation increases effective April 1, 2013. Non-cash stock-based compensation expense increased due primarily to equity awards granted in November 2012 included in stock-based compensation expense for the three months ended September 30, 2013, as well as incurring a full quarter of expense associated with the 2013-2017 Long Term Incentive Program (LTIP) in the three months ended September 30, 2013, which we began expensing in May 2013.

Effective January 1, 2013, employee-related expenses for a senior executive are included in general and administrative and no longer included in sales and marketing due to changes both in his responsibilities and compensation structure. This caused a significant portion of the increase in employee-related expenses in the second quarter of 2013 within general and administrative, and a corresponding offset to the increase in employee-related expense within sales and marketing.

In February 2013, the Board of Directors amended and restated the 2009 Stock Incentive Plan (the Updated Stock Incentive Plan) and approved the LTIP thereunder. The Updated Stock Incentive Plan was subsequently approved by stockholders in May 2013. Under the LTIP, we may grant performance stock unit (PSU) awards based on objective performance criteria pre-established by the Compensation Committee of the Board of Directors. In March 2013, the Compensation Committee granted PSUs under the LTIP to certain executives, which had a fair value of \$43.59 per share in May 2013. Further details on the Updated Stock Incentive Plan and the LTIP are presented in the Proxy Statement filed on April 1, 2013. We recognize non-cash stock-based compensation expense under the graded-vesting attribution method. Each PSU award consists of two vesting cliffs, with sixty percent eligible to vest on December 31, 2015 and forty percent eligible to vest on December 31, 2017. The expense associated with each vesting cliff will be straight-lined over its respective period beginning in May 2013, which will result in greater amounts of non-cash stock-based compensation expense recognized in earlier periods of the grants with declining amounts recognized in later periods. Depending on performance against the target metrics, vesting will be between 0% and 140% of target value for each of the vesting cliffs and the expense will be reviewed and adjusted based on forecasts at the end of each balance sheet period. Assuming 100% achievement against the objective performance criteria, the total expense value of these PSUs would be approximately \$13.2 million as of the grant date, net of estimated forfeitures. The LTIP stock-based compensation expense is in addition to the amortization of both previously and subsequently granted stock awards, including other awards expected to be granted, utilizing the graded-vesting attribution method. We plan to continue to grant equity awards to certain of our existing employees, new employees and board members.

We currently anticipate issuing equity awards with an aggregate estimated expense value between \$7.5 million and \$8.0 million to certain of our existing non-executive employees in mid-November 2013. We will account for these equity awards over a four-year vesting period utilizing an accelerated graded vesting method.

In August 2013, we entered into a new facilities operating lease amendment for our Phoenix facility with \$3.4 million in total future minimum payments through January 2020. We do not expect this new lease amendment to materially increase future rent expense.

*Cost of Revenue*

Cost of revenue, exclusive of amortization of internal use software, increased \$5.8 million, or 31%, from \$18.8 million for the three months ended September 30, 2012 to \$24.6 million for the three months ended September 30, 2013. This increase was due primarily to an increase of \$3.9 million in fees paid to plan providers for connectivity to plan and plan participant data for the three months ended September 30, 2013 compared to the three months ended September 30, 2012, which was due primarily to an increase in professional management revenue and



to a lesser extent to contractual increases in plan provider fees as a result of achieving certain AUM milestones. In addition, there was an increase of \$0.8 million in wages, benefits, employer payroll tax and allocated human resources expenses. Cash incentive compensation expense increased \$0.2 million and non-cash stock-based compensation expense increased \$0.1 million. There was also an increase in printed member materials and printed marketing materials expense for subadvisory relationships of \$0.7 million, as subadvisory participant campaign volume was higher for the three months ended September 30, 2013. Travel and other expenses increased by \$0.1 million. As a percentage of revenue, cost of revenue increased from 39% for the three months ended September 30, 2012 to 40% for the three months ended September 30, 2013. The increase as a percentage of revenue was due primarily to data connectivity fees expense increasing at a faster rate than revenue during the same period as a result of the achievement of an AUM based milestone in early 2013 as well as a shift in the mix of plan providers as our services became available at new sponsors.

#### *Research and Development*

Research and development expense increased \$0.8 million, or 12%, from \$6.5 million for the three months ended September 30, 2012 to \$7.3 million for the three months ended September 30, 2013. There was a \$0.5 million decrease in the amount of internal use software capitalized as more developer hours were dedicated to updating and maintaining existing core services for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. In addition, non-cash stock-based compensation expenses increased \$0.4 million and cash incentive compensation, consulting and other equipment expenses increased by a total of \$0.2 million. These increases were offset by a \$0.3 million decrease in facilities related overhead expenses, including rent and depreciation, as headcount slightly decreased between the comparable periods. As a percentage of revenue, research and development expense decreased from 13% for the three months ended September 30, 2012 to 12% for the three months ended September 30, 2013. The decrease as a percentage of revenue was primarily due to a slower increase in employee-related and facilities-related allocated overhead expenses relative to the increase in revenue during the same period.

#### *Sales and Marketing*

Sales and marketing expense remained constant at \$10.4 million for both the three months ended September 30, 2012 and 2013. There was a \$0.4 million increase in non-cash stock-based compensation expense and a \$0.3 million increase in wages, benefits, employer payroll tax and allocated human resources expenses for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. In addition, there was a \$0.1 million increase in general marketing program expenses and a \$0.1 million increase in commission amortization expense, as well as a \$0.1 million in other expenses. These increases were offset by a \$0.5 million decrease in consulting expense due to higher spending for the three months ended September 30, 2012 as a result of a customer experience design project, a \$0.4 million decrease in cash incentive compensation expense as a result of a senior executive's compensation expense included in general and administrative expense effective January 1, 2013 and a small number of employee terminations. There was also a \$0.1 million decrease in facilities-related allocated overhead expenses. As a percentage of revenue, sales and marketing expense decreased from 22% for the three months ended September 30, 2012 to 17% for the three months ended September 30, 2013. The decrease as a percentage of revenue was primarily due to a slower increase in employee-related and consulting expenses relative to the increase in revenue during the same period.

#### *General and Administrative*

General and administrative expense increased \$1.7 million, or 48%, from \$3.7 million for the three months ended September 30, 2012 to \$5.4 million for the three months ended September 30, 2013. There was a \$0.8 million increase in non-cash stock-based compensation expense due primarily to expenses associated with the LTIP, which we began

expensing in May 2013. In addition, there was a \$0.4 million increase in wages, benefits, employer payroll tax and allocated human resource expense and a \$0.1 million increase in cash incentive compensation expense for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. Facilities-related allocated overhead expenses, including rent and depreciation, increased \$0.3 million and consulting expenses increased \$0.1 million. As a percentage of revenue, general and administrative expense increased from 8% for the three months ended September 30, 2012 to 9% for the three months ended September 30, 2013. The increase as a percentage of revenue was primarily due to non-cash stock-based compensation expenses increasing at a faster rate than revenue during the same period.

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*Amortization of Internal Use Software*

Amortization of internal use software increased \$0.1 million, or 5%, from \$1.6 million for the three months ended September 30, 2012 to \$1.6 million for the three months ended September 30, 2013 due to the amortization of historically higher capitalized costs.

*Income Taxes*

Income tax expense increased from \$2.7 million for the three months ended September 30, 2012 to \$4.6 million for the three months ended September 30, 2013 due to an increase in taxable income. Our effective tax rate was 36% for both the three months ended September 30, 2012 and 2013. We would 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, 2013, 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 \$1.4 million as of September 30, 2013 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, 2012 and 2013**

	Nine Months Ended September 30, 2012		Nine Months Ended September 30, 2013		Increase (Decrease)	
	(As a percentage of revenue)		(In thousands, except percentages)		Amount	%
<b>Revenue:</b>						
Professional management	80%	84%	\$ 107,639	\$ 146,453	\$ 38,814	36%
Platform	18	15	24,764	24,987	223	1
Other	2	1	2,040	2,290	250	12
<b>Total revenue</b>	<b>100</b>	<b>100</b>	<b>134,443</b>	<b>173,730</b>	<b>39,287</b>	<b>29</b>
<b>Costs and expenses:</b>						
Cost of revenue (exclusive of amortization of internal use software)	38	39	51,423	67,117	15,694	31
Research and development	14	13	18,716	22,527	3,811	20
Sales and marketing	22	18	29,160	31,692	2,532	9
General and administrative	8	9	11,271	15,367	4,096	36
Amortization of internal use software	4	3	4,560	4,993	433	10
<b>Total costs and expenses</b>	<b>86</b>	<b>82</b>	<b>115,130</b>	<b>141,696</b>	<b>26,566</b>	<b>23</b>
<b>Income from operations</b>	<b>14</b>	<b>18</b>	<b>19,313</b>	<b>32,034</b>	<b>12,721</b>	<b>66</b>
Interest income (expense)			(1)	29	30	n/a
Other expense, net				(10)	(10)	n/a
<b>Income before income tax expense</b>	<b>14</b>	<b>18</b>	<b>19,312</b>	<b>32,053</b>	<b>12,741</b>	<b>66</b>
Income tax expense	5	7	7,199	11,372	4,173	58
<b>Net income</b>	<b>9%</b>	<b>12%</b>	<b>\$ 12,113</b>	<b>\$ 20,681</b>	<b>\$ 8,568</b>	<b>71%</b>

**Revenue**

Total revenue increased \$39.3 million, or 29%, from \$134.4 million for the nine months ended September 30, 2012 to \$173.7 million for the nine months ended September 30, 2013. The increase was due primarily to growth in professional management revenue of \$38.8 million for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, as well as a \$0.2 million increase in platform revenue and a \$0.3 million increase in other revenue. Professional management revenue and platform revenue comprised 84% and 15%, respectively, of total revenue for the nine months ended September 30, 2013.

**Professional Management Revenue**

Professional management revenue increased \$38.8 million, or 36%, from \$107.6 million for the nine months ended September 30, 2012 to \$146.5 million for the nine months ended September 30, 2013. This increase was due primarily

to an increase in the average AUM used to calculate fees from approximately \$55.1 billion for the nine months ended September 30, 2012 to approximately \$74.3 billion for the nine months ended September 30, 2013. 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.

*Platform Revenue*

Platform revenue increased \$0.2 million, or 1%, from \$24.8 million for the nine months ended September 30, 2012 to \$25.0 million for the nine months ended September 30, 2013. This increase was due primarily to service availability at new sponsors.

*Other Revenue*

Other revenue increased \$0.3 million, or 12%, from \$2.0 million for the nine months ended September 30, 2012 to \$2.3 million for the nine months ended September 30, 2013. This increase was due primarily to an increase in reimbursable printed fulfillment materials from certain subadvisory relationships.

*Costs and Expenses*

Costs and expenses increased \$26.6 million, or 23%, from \$115.1 million for the nine months ended September 30, 2012 to \$141.7 million for the nine months ended September 30, 2013. This increase was due to a \$15.7 million increase in cost of revenue, exclusive of amortization of internal use software, a \$3.8 million increase in research and development expense, a \$2.5 million increase in sales and marketing expense, a \$4.1 million increase in general and administrative expense and a \$0.4 million increase in amortization of internal use software for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012.

Across functional areas, wages, benefits and employer payroll tax expenses increased for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012 due primarily to headcount growth and annual compensation increases effective April 1, 2013. Non-cash stock-based compensation expense increased due primarily to equity awards granted in November 2012 included in stock-based compensation expense for the nine months ended September 30, 2013, as well as incurring approximately five months of expense associated with the LTIP for the nine months ended September 30, 2013.

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**Table of Contents***Cost of Revenue*

Cost of revenue, exclusive of amortization of internal use software, increased \$15.7 million, or 31%, from \$51.4 million for the nine months ended September 30, 2012 to \$67.1 million for the nine months ended September 30, 2013. This increase was due primarily to an increase of \$12.0 million in fees paid to plan providers for connectivity to plan and plan participant data for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, which was due primarily to an increase in professional management revenue, and to a lesser extent to contractual increases in plan provider fees as a result of achieving certain AUM milestones. In addition, there was a \$1.8 million increase in wages, benefits, employer payroll tax and allocated human resources expenses, and a \$0.3 million increase in cash incentive compensation expense due primarily to increased headcount and marginally higher performance against metrics. There was also a \$0.2 million increase in non-cash stock-based compensation expense and a \$0.2 million increase in facilities-related allocated overhead expenses, including rent and depreciation, due primarily to the new headquarters facility. Additionally, there was a \$0.9 million increase in printed member materials and printed marketing materials expense for subadvisory relationships as volume increased, a \$0.1 million increase in travel expenses and a \$0.2 million increase in consulting and other expenses. As a percentage of revenue, cost of revenue increased from 38% for the nine months ended September 30, 2012 to 39% for the nine months ended September 30, 2013. The increase as a percentage of revenue was due primarily to data connectivity fees expense increasing at a faster rate than revenue during the period as a result of a shift in the mix of plan providers as a result of service availability at new sponsors and the achievement of an AUM based milestone in early 2013.

*Research and Development*

Research and development expense increased \$3.8 million, or 20%, from \$18.7 million for the nine months ended September 30, 2012 to \$22.5 million for the nine months ended September 30, 2013. There was a \$1.1 million increase in wages, benefits, employer payroll tax and allocated human resource expenses, and a \$0.7 million increase in non-cash stock-based compensation expense for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. There was also an increase of \$0.4 million in cash incentive compensation due primarily to annual compensation increases and marginally higher performance against metrics. In addition, there was a \$0.8 million decrease in the amount of internal use software capitalized as more developer hours were dedicated to updating and maintaining existing core services for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, and a \$0.1 million increase in facilities-related allocated overhead expenses, including rent and depreciation expense. There was also a \$0.4 million increase in consulting expense, a \$0.2 million increase in other employee-related expenses, such as recruiting and training, and a \$0.1 million increase in other expenses. As a percentage of revenue, research and development expense decreased from 14% for the nine months ended September 30, 2012 to 13% for the nine months ended September 30, 2013. The decrease as a percentage of revenue was primarily due to a slower increase in employee-related and facilities-related allocated overhead expenses relative to the increase in revenue during the period.

*Sales and Marketing*

Sales and marketing expense increased \$2.5 million, or 9%, from \$29.2 million for the nine months ended September 30, 2012 to \$31.7 million for the nine months ended September 30, 2013. There was a \$2.0 million increase in wages, benefits, employer payroll tax expense and allocated human resources expenses, a \$0.6 million increase in non-cash stock-based compensation expense and a \$0.1 million increase in commission amortization expense for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. Additionally, there was a \$0.4 million increase in advisory printed enrollment materials expense as direct response advertising capitalization decreased and amortization increased. There was also a \$0.4 million increase in general marketing programs expense, a \$0.2 million increase in facilities-related allocated overhead expenses, including rent

and depreciation, and a \$0.2 million increase in travel and other expenses. These increases were offset by a \$0.7 million decrease in cash incentive compensation expense due primarily to a senior executive whose compensation expense is now included in general and administrative expense effective January 1, 2013, as well as a \$0.7 million decrease in consulting expenses due to higher spending for the nine months ended September 30, 2012 related to a customer experience design project. As a percentage of revenue, sales and marketing expense decreased from 22% for the nine months ended September 30, 2012 to 18% for the nine months ended September 30, 2013. The decrease as a percentage of revenue was primarily due to a slower increase in employee-related and consulting expenses relative to the increase in revenue during the same period.

#### *General and Administrative*

General and administrative expense increased \$4.1 million, or 36%, from \$11.3 million for the nine months ended September 30, 2012 to \$15.4 million for the nine months ended September 30, 2013. There was a \$1.3 million increase in non-cash stock based compensation expense, a \$1.1 million increase in wages, benefits, employer payroll tax and allocated human resource expenses for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. In addition, cash incentive compensation expense increased by \$0.5 million due primarily to a senior executive whose compensation expense is included in general and administrative expense effective January 1, 2013. There was also a \$0.3 million increase in professional services expenses, as well as a \$0.3 million increase in consulting expense. Additionally, there was a \$0.4 million increase in facilities related allocated overhead expenses, including rent and depreciation expense, and a \$0.2 million increase in equipment and travel expenses. As a percentage of revenue, general and administrative expense increased from 8% for the nine months ended September 30, 2012 to 9% for the nine months ended September 30, 2013. The increase as a percentage of revenue was primarily due to employee-related expenses increasing at a faster rate than revenue during the same period.

#### *Amortization of Internal Use Software*

Amortization of internal use software increased \$0.4 million, or 10%, from \$4.6 million for the nine months ended September 30, 2012 to \$5.0 million for the nine months ended September 30, 2013 due to the amortization of historically higher capitalized costs.

#### *Income Taxes*

Income tax expense increased from \$7.2 million for the nine months ended September 30, 2012 to \$11.4 million for the nine months ended September 30, 2013 due to an increase in taxable income. Our effective tax rates were 37% and 35% for the nine months ended September 30, 2012 and 2013, respectively. The decrease in the effective tax rate was due primarily to the reinstatement of the federal research and development credit as well as an increase in disqualifying stock dispositions during the nine months ended September 30, 2013.

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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 expense. 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.

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, 2012 and will be used for the year ended December 31, 2013 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 income taxes, 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

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:

<b>Non-GAAP Adjusted EBITDA</b>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2012</b>	<b>September 30, 2013</b>	<b>September 30, 2012</b>	<b>September 30, 2013</b>
	<b>(In thousands)</b>			
Net income	\$ 4,778	\$ 8,146	\$ 12,113	\$ 20,681
Interest expense (income)	5	(19)	1	(29)
Income tax expense	2,718	4,581	7,199	11,372
Depreciation	878	967	2,075	2,888
Amortization of internal use software	1,456	1,534	4,263	4,679
Amortization and impairment of direct response advertising	1,393	1,521	3,695	4,491
Amortization of deferred sales commissions	565	465	1,464	1,432
Non-cash stock-based compensation	2,518	4,232	7,500	10,442
<b>Non-GAAP Adjusted EBITDA</b>	<b>\$ 14,311</b>	<b>\$ 21,427</b>	<b>\$ 38,310</b>	<b>\$ 55,956</b>

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:

<b>Non-GAAP Adjusted Net Income and Adjusted EPS</b>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2012</b>	<b>September 30, 2013</b>	<b>September 30, 2012</b>	<b>September 30, 2013</b>
	<b>(In thousands, except per share amounts)</b>			
Net income	\$ 4,778	\$ 8,146	\$ 12,113	\$ 20,681
Non-cash stock-based compensation, net of tax <sup>(1)</sup>	1,556	2,615	4,635	6,453
<b>Non-GAAP Adjusted Net Income</b>	<b>\$ 6,334</b>	<b>\$ 10,761</b>	<b>\$ 16,748</b>	<b>\$ 27,134</b>
Non-GAAP Adjusted Earnings Per Share	\$ 0.13	\$ 0.20	\$ 0.33	\$ 0.52
Shares of common stock outstanding	46,889	49,934	46,469	49,145
Dilutive restricted stock and stock options	3,305	2,743	3,557	2,929
<b>Non-GAAP adjusted weighted common shares outstanding</b>	<b>50,194</b>	<b>52,677</b>	<b>50,026</b>	<b>52,074</b>

(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.

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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, 2012 and 2013 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 twelve months, and in the longer term, we expect that our cash and liquidity needs will be met by existing resources, consisting of cash, cash equivalents and short-term investments 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, 2013, we had total cash, cash equivalents and short term investments of \$232.0 million, compared to \$181.2 million as of December 31, 2012.

*Consolidated Cash Flow Data*

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2012</b>	<b>2013</b>
	<b>(In thousands)</b>	
Net cash provided by operating activities	\$ 25,422	\$ 39,003
Net cash used in investing activities	(14,535)	(95,679)
Net cash provided by financing activities	10,493	17,394
Net increase (decrease) in cash and cash equivalents	\$ 21,380	\$ (39,282)
Cash and cash equivalents, end of period	\$ 166,382	\$ 141,949

*Operating Activities*

Net cash provided by operating activities for the nine months ended September 30, 2013 increased \$13.6 million compared to net cash provided by operating activities for the nine months ended September 30, 2012. Operating activities for the nine months ended September 30, 2013 resulted in cash provided of \$39.0 million, as net income of \$20.7 million and adjustments for non-cash expenses of \$21.4 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 \$3.1 million. The decrease in cash related to operating assets and liabilities was due primarily to an increase in accounts receivable driven by an increase in revenue and the capitalization of direct response advertising, offset by a decrease in deferred tax assets due to utilization and an increase in accounts payable due to an increase in expenses. 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, 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.

We incurred reduced facilities cash outflows in the first quarter of 2013, as our new headquarters lease provided for a 10-month free rent period. Effective April 2013, we are incurring an average of \$0.2 million per month for the year ended December 31, 2013 in cash outflows associated with this lease, with escalating payments through the lease term.

In August 2013, we entered into a new facilities lease amendment for our Phoenix facility. We expect cash expenditures associated with capital equipment purchases related to the build-out of the facility to be approximately \$1.2 million over the period of October 2013 through February 2014.

#### *Investing Activities*

Net cash used in investing activities was \$95.7 million for the nine months ended September 30, 2013 compared to \$14.5 million for the nine months ended September 30, 2012. For the nine months ended September 30, 2013, cash used for the purchase of short-term investments was \$90.0 million. The purchase of property and equipment decreased \$7.9 million due to higher spending in 2012 related to our new headquarters facility. As a result, we spent \$3.1 million related to capital expenditures during the nine months ended September 30, 2013 compared to \$11.0 million for the nine months ended September 30, 2012. For the nine months ended September 30, 2013, we capitalized \$3.3 million of internal use software costs compared to \$4.1 million for the nine months ended September 30, 2012. 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 and for the three months ended September 30, 2013, there was \$0.8 million of cash that became unrestricted as our bank removed the collateral requirements associated with the letters of credit related to our operating facilities.

#### *Financing Activities*

Net cash provided by financing activities was \$17.4 million for the nine months ended September 30, 2013 compared to net cash provided by financing activities of \$10.5 million for the nine months ended September 30, 2012. For the nine months ended September 30, 2013, we received \$19.5 million of proceeds from the issuance of common stock due to the exercise of stock options compared to \$9.1 million during the nine months ended September 30, 2012.

Prior to fiscal 2013, we did not pay any cash dividends on our common stock. In April and July 2013, we incurred cash dividend payments totaling \$4.9 million, with an additional payment of \$2.5 million in October 2013. Any future determination with respect to the declaration and payment of dividends will be at the discretion of our Board of Directors.

We expect to incur cash payments in an amount necessary to satisfy the minimum tax withholding obligations for restricted stock units previously granted to employees that vest in mid-November 2013, 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 as of September 30, 2013 of \$59.44 and assuming a 40% tax rate, the estimated minimum tax withholding obligations would be approximately \$3.1 million.

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**Off-Balance Sheet Arrangements**

As of September 30, 2013, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have a current or future effect on our financial condition, changes in our financial condition, revenues, or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

**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, 2013, 84% of our revenue was derived from fees based on the market value of AUM compared to 81% for the year ended December 31, 2012. 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, 2012. There have been no material changes from the risk factors disclosed in our 2012 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, 2013, we issued 595,212 shares of unregistered common stock for an aggregate purchase price of \$4.1 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***

<b>Exhibit</b>	
<b>Number</b>	<b>Description</b>
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)

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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 5, 2013

FINANCIAL ENGINES, INC.

/s/ Jeffrey N. Maggioncalda  
Jeffrey N. Maggioncalda  
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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