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Asia Pacific – Middle East

## Special Industry Report for Members Only

# Business Information: Green Shoots of Recovery - Part 2

**In the first of this series of articles Phil Cotter, BIIA's contributing Editor, looked at how Dun & Bradstreet, Experian, Equifax and TransUnion had fared over the last 12 months. There were encouraging signs that all of them were returning to growth but there were still challenges ahead in securing long term sustainable growth.**

**In this article we review one of the leading global analytics businesses, FICO and focus on its progress and what challenges and opportunities lay ahead for them.**

### *FICO (Fair Isaac Corporation)*

In January FICO announced the departure of CEO Dr Mark Greene and his replacement by William J Lansing. Dr Greene joined FICO from IBM, where he had been General Manager of their banking division, in February 2007. During his tenure he has had to try to steer FICO through a period of unprecedented turbulence in the market place and the impact of the Credit Crunch not only on FICO's revenues but also on the credibility of its scores. In the end it appears that Dr Greene ran out of time, although he returned the business to growth in 2011, he had previously presided over four years of declining revenues and profits and when he left the company, its share price had fallen to $27, almost $12 lower than when he joined the company.

In fairness to Dr Greene the rot had already set in under previous CEO Tom Grudnowski who resigned in 2006, following a fall in revenues and a stagnant share price. It was Grudnowski who set in motion the unsuccessful law suit against the three credit bureaus, Equifax, Experian and TransUnion, in an attempt to prevent them launching the Vantage score to compete with FICO's bureau scores. This move served to damage relations with organisations that had historically accounted for 18-20% of FICO's total revenues.

William J Lansing, has served on FICO's board for six years as a director, most recently he had, up until 2010 been CEO of Infospace, the business best known perhaps for its metasearch technology; prior to that he was CEO of Valuevision Media, a direct to consumer retailing business with television and internet shopping channels. Mr Lansing has also served as a director of several other public companies including Digital River and RightNow Technologies. With undoubted experience in leading and directing technology companies, it will be interesting to see what qualities he will bring to leading FICO's software and analytics business.

On April 2 2012, FICO announced the appointment of James M Wehmann as Executive Vice President, responsible for the Scores Division. Mr Wehmann had previously held a number of senior marketing positions at Digital River, Brylane Inc. and Bank One the credit card issuer.

### *2011 Overview*

In 2011 FICO returned to growth delivering total revenues of $620m, compared to $606m in 2010, growth of 2.0%. Net income increased to $72m from $64m (+11%) primarily due to reduced costs as a result of the restructuring the business had undergone during the year.

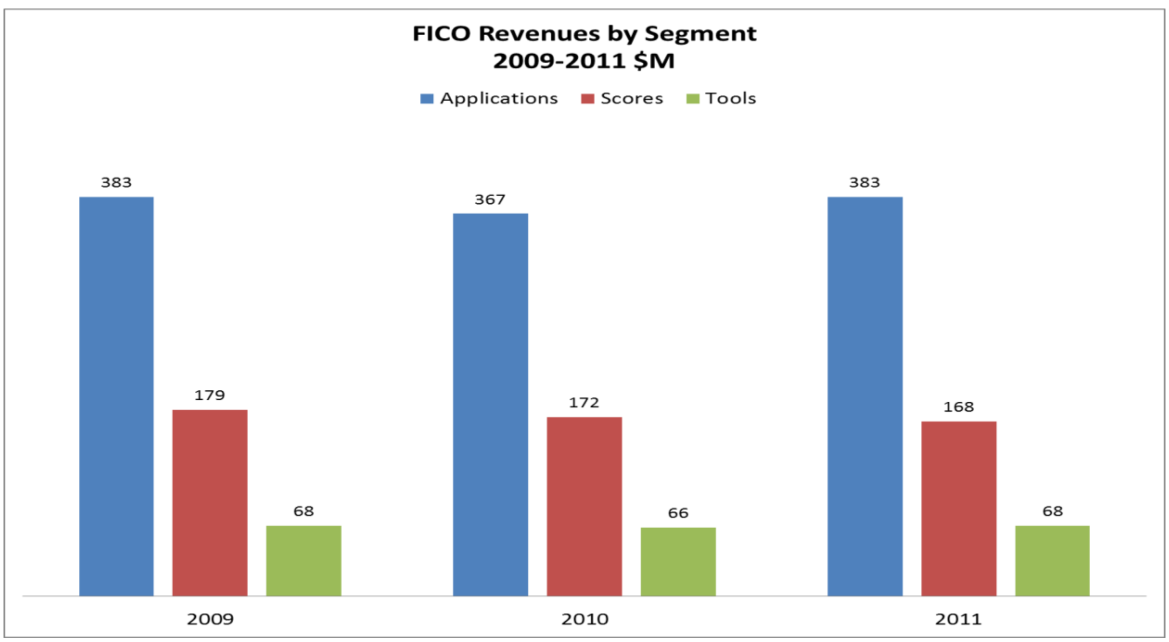
During the year FICO released upgrades to core platforms FICO Origination Manager, FICO Debt Manager and FICO Insurance Fraud Manager. In its scores business it continued to drive adoption of FICO8, its latest version of its credit score, and announced new alliances with ***CoreLogic,*** to develop an advanced mortgage scoring solution for the US and with Equifax in the UK to grow its market share in banking, insurance and retailing sectors. In its Tools business it released upgrades to its Xpress Optimization and Model Builder software, used by in house analysts to develop optimization and scoring models.

It also announced a number of innovations during the year of which the FICO Medication Adherence Score is probably the most interesting, being an example of the lateral thinking that BIG Data can bring to solving problems. The new score is designed to address the costs and social implications of patients not adhering to their prescriptions, a problem reputed to cost the US medical industry $200-$300bn per annum.

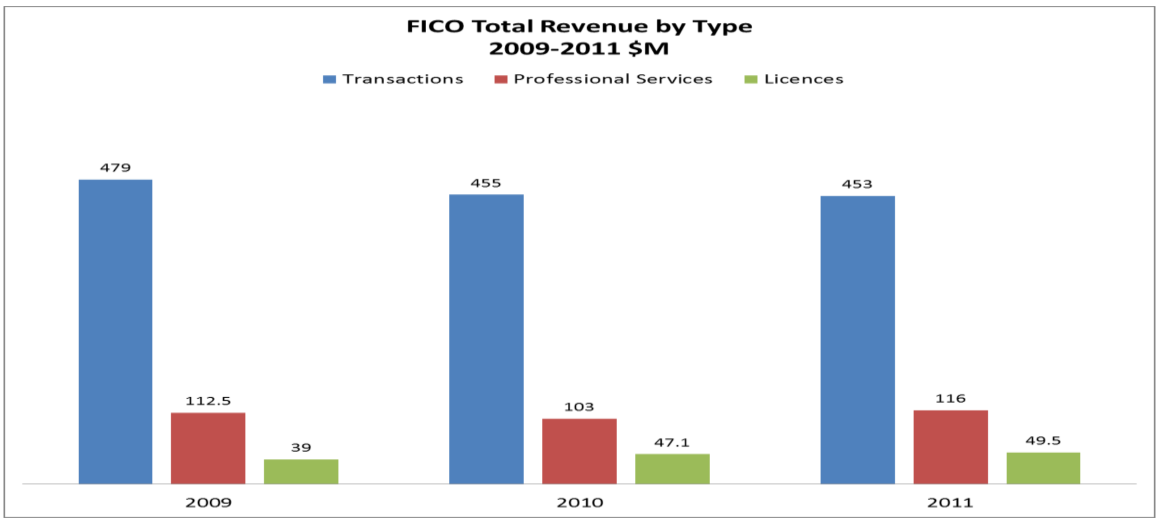
### *2011 Revenues*

Looking at the detail contained within FICO's 2011 Annual Report one gets an understanding as to where the opportunities and challenges lie in the future. The three year revenue trend for FICO's three core segments Applications, Scores and Tools is shown in the graph below:

What is immediately apparent is the continuing decline in revenues from its Scores segment. This is attributed to a decline of $2.1m in sales of ***myFICO*** business to consumer scores, which was due to lower royalties received from the three US credit bureaus for scores sold to consumers. FICO's, ill-judged in many peoples opinion, law suit against Equifax, Experian and TransUnion to prevent the launch of the Vantage Score, an action they eventually lost, continues to impact them. Experian ceased their relationship in this area with FICO in 2010 at a cost of c$7m revenue. FICO remain very exposed to the credit bureaus as a source of revenue with 18% of their total revenues dependent on the bureaus in one way or another. Continuing decline in revenues from Scores would be expected to place pressure on the bottom line as it is estimated that this is FICO's most profitable segment.



Further analysis reveals challenges in moving forward towards sustainable growth. Transaction revenues, which are generated by usage of their various solutions, continue to decline, particularly in scores where transaction revenues fell by $5m. In essence growth in 2011 was generated by an increase in professional services, revenues generated from consultancy and similar activities, which grew by $13m on the previous year. Almost all of this growth came in the Applications segment where professional service fees grew by $14m to $101m. Nearly 20% of FICOs revenues are now dependent on them being able to win consultancy engagements each year, a notoriously difficult thing to achieve.




### *2011 Costs*

Analysing the costs for 2011, the impact of the higher Professional Services Revenues is immediately apparent. Selling costs increased by 3%, against revenue growth of 2%, the growth in these costs being attributed to increases in salaries and *"related benefit costs as a result of increased consulting services activities, and an increase in incentive cost*".

Elsewhere the two main cost changes to the prior year was a $12m charge for restructuring ($1.6m 2010) and a ***reduction*** in R&D expenditure of $11m, $62m compared to $73m in 2010. This costs savings were largely achieved through reduction in R&D headcount related costs ($8.7m).

It could be argued that at a time when the business is still experiencing difficulty in achieving sustainable growth cutting back on R&D is not a wise thing to do. Management have indicated that investment is likely to remain at 2011 levels, 10% of revenues, in 2012, than the 12% level seen in prior years.

### *Quarter 1 2012*

FICO's 2012 Q1 results, released on 2nd February 2012 (their financial year runs September to September) shows a continuance of the trend established in 2011, with an increasing reliance on Professional Services and Licence revenues for growth. In the Quarter ending 31st December 2011, total revenues grew from $155m to $170m on the same quarter FY2011. Revenue growth was almost entirely driven by an increase of $14m in licence fees from the Applications segment. Growth in this segment was achieved by $19.0m increase in fraud solutions revenues, offset by a $6.4m decrease in revenues in other areas. The fraud solutions revenues were mainly due to the two large multi-year licences where the revenue was recognised in the quarter. Elsewhere revenues from Scores increased by $2.0m due to an increase in Pre-Screen and Credit Bureau related volumes. In total revenues from transaction related activities remained flat.

### *Conclusion*

FICO's new CEO appears to have inherited a business that is increasingly behaving as a software company rather than an analytics company. Whilst there is nothing wrong with this model and many would argue that the future of BIG Data is about platforms as much as data and analytics, maintaining revenue growth based on increasing consultancy and licencing fees can be challenging.

The performance of such businesses can also be less transparent, because the revenue recognition treatment of licence fees can vary widely dependent on whether they are perpetual licences or annually recurring licences. The good news for Mr Lansing is that he takes over the leadership of the company when there are growing signs of increased activity in the US consumer credit market, which should bring increased revenues for the Scoring division through increased volumes.

What FICO's long term strategy will be under his leadership and how it will react to the increasing competition in the US and other global markets from the likes of Experian is not yet clear. Undoubtedly his first priority will be to continue to build on the growth achieved in 2011 and to restore FICO's reputation as the leading global player in the Analytics and Decision Management space.

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BIIA is indebted to Phil Cotter for sharing his insights with BIIA Members.