Monotype Imaging Holdings Inc.
Form 10-Q
July 28, 2014

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 June 30, 2014

OR

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

For the transition period from __________ to __________

Commission File Number 001-33612

MONOTYPE IMAGING HOLDINGS INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-3289482**
(State of incorporation)	**(I.R.S. Employer Identification No.)**
500 Unicorn Park Drive Woburn, Massachusetts	**01801**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (781) 970-6000

(Former Name, Former Address and Former Fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant 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 x No ¨

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

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

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

The number of shares outstanding of the registrant s common stock as of July 22, 2014 was 39,174,381.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

MONOTYPE IMAGING HOLDINGS INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited and in thousands, except share and per share data)

	June 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 80,804	$ 78,411
Accounts receivable, net of allowance for doubtful accounts of $167 at June 30, 2014 and $171 at December 31, 2013	9,455	8,317
Income tax refunds receivable	799	3,334
Deferred income taxes	3,558	3,557
Prepaid expenses and other current assets	3,201	3,394
Total current assets	97,817	97,013
Property and equipment, net	5,731	3,568
Goodwill	176,927	176,350
Intangible assets, net	71,525	76,684
Other assets	2,598	2,744
Total assets	$ 354,598	$ 356,359
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 1,520	$ 1,112
Accrued expenses and other current liabilities	18,431	20,439
Deferred revenue	8,935	6,767
Total current liabilities	28,886	28,318
Deferred revenue	750	972
Deferred income taxes	34,158	32,600
Reserve for income taxes, net of current portion	2,795	2,496
Accrued pension benefits	5,212	5,098
Commitments and contingencies *(Note 15)*		
Stockholders equity:		
Preferred stock, $0.001 par value, Authorized shares: 10,000,000; Issued and outstanding: none		
	39	39

Common stock, $0.001 par value, Authorized shares: 250,000,000; Issued: 39,162,101 at June 30, 2014 and 39,277,713 at December 31, 2013		
Additional paid-in capital	219,517	209,376
Treasury stock, at cost, 1,075,375 shares at June 30, 2014 and 204,830 shares at December 31, 2013	(26,160)	(2,279)
Retained earnings	88,564	78,741
Accumulated other comprehensive loss	837	998
Total stockholders equity	282,797	286,875
Total liabilities and stockholders equity	$ 354,598	$ 356,359

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

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MONOTYPE IMAGING HOLDINGS INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited and in thousands, except share and per share data)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Revenue	$ 44,963	$ 41,085	$ 91,035	$ 83,124
Cost of revenue	7,322	6,016	13,830	12,025
Cost of revenue amortization of acquired technology	1,146	1,139	2,291	2,277
Total cost of revenue	8,468	7,155	16,121	14,302
Gross profit	36,495	33,930	74,914	68,822
Operating expenses:				
Marketing and selling	11,987	10,392	23,105	20,311
Research and development	4,910	4,891	10,663	9,863
General and administrative	5,386	4,980	11,584	9,685
Amortization of other intangible assets	1,431	1,487	2,863	2,977
Total operating expenses	23,714	21,750	48,215	42,836
Income from operations	12,781	12,180	26,699	25,986
Other (income) expense:				
Interest expense	256	313	534	731
Interest income	(6)	(5)	(8)	(5)
Loss on foreign exchange	136	263	170	840
Loss on derivatives	158		214	
Other income, net	(3)	(1)	(4)	(37)
Total other expense	541	570	906	1,529
Income before provision for income taxes	12,240	11,610	25,793	24,457
Provision for income taxes	4,549	4,299	9,657	8,530
Net income	$ 7,691	$ 7,311	$ 16,136	$ 15,927
Net income available to common stockholders basic	$ 7,532	$ 7,182	$ 15,847	$ 15,658
Net income available to common stockholders diluted	$ 7,534	$ 7,185	$ 15,847	$ 15,665
Net income per common share:				
Basic	$ 0.19	$ 0.19	$ 0.41	$ 0.42

Diluted	$	0.19	$	0.18	$	0.40	$	0.40
Weighted average number of shares:								
Basic		38,714,178		37,725,082		38,713,432		37,415,514
Diluted		39,623,517		39,029,653		39,865,906		38,758,807
Dividends declared per common share	$	0.08	$	0.06	$	0.16	$	0.12

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

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MONOTYPE IMAGING HOLDINGS INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited and in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Net income	$ 7,691	$ 7,311	$ 16,136	$ 15,927
Other comprehensive income (loss), net of tax:				
Unrecognized actuarial gain		11		11
Foreign currency translation adjustments	(166)	363	(161)	(680)
Comprehensive income	$ 7,525	$ 7,685	$ 15,975	$ 15,258

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

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MONOTYPE IMAGING HOLDINGS INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and in thousands)

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Cash flows from operating activities		
Net income	$ 16,136	$ 15,927
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,970	6,019
Loss on retirement of fixed assets	9	4
Amortization of deferred financing costs and accretion of interest	227	151
Adjustment to contingent consideration	(552)	
Share based compensation	5,016	3,835
Excess tax benefit on stock options	(1,951)	(4,110)
Provision for doubtful accounts		35
Deferred income taxes	1,772	3,246
Unrealized currency (gain) loss on foreign denominated intercompany transactions	(140)	5
Changes in operating assets and liabilities:		
Accounts receivable	(1,039)	(944)
Prepaid expenses and other assets	353	3
Accounts payable	405	139
Accrued income taxes	4,614	(55)
Accrued expenses and other liabilities	(2,540)	(1,353)
Deferred revenue	1,920	1,726
Net cash provided by operating activities	30,200	24,628
Cash flows from investing activities		
Purchases of property and equipment	(2,472)	(632)
Acquisition of business, net of cash acquired	(1,015)	(72)
Net cash used in investing activities	(3,487)	(704)
Cash flows from financing activities		
Payments on line of credit		(22,321)
Excess tax benefit on stock options	1,951	4,110
Common stock dividends paid	(5,528)	(3,788)
Purchase of treasury stock	(23,881)	
Proceeds from exercises of common stock options	3,111	10,570
Net cash used in financing activities	(24,347)	(11,429)
Effect of exchange rates on cash and cash equivalents	27	(166)

Increase in cash and cash equivalents	2,393	12,329
Cash and cash equivalents at beginning of period	78,411	39,340
Cash and cash equivalents at end of period	$ 80,804	$ 51,669

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

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MONOTYPE IMAGING HOLDINGS INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

1. Nature of the Business

Monotype Imaging Holdings Inc. (the Company or we) is a leading provider of type, technology and expertise for creative applications and consumer electronics, or CE, devices. Our end-user and embedded solutions for print, web and mobile environments enable people to create and consume dynamic content on any and every device. Our technologies and fonts enable the display and printing of high quality digital text. Our technologies and fonts have been widely deployed across, and embedded in, a range of CE devices including laser printers, digital copiers, mobile phones, e-book readers, tablets, automotive displays, digital cameras, navigation devices, digital televisions, set-top boxes and consumer appliances, as well as in numerous software applications and operating systems. We also provide printer drivers, page description language interpreters, printer user interface technology and color imaging solutions to printer manufacturers and OEMs (original equipment manufacturers). We license our fonts and technologies to CE device manufacturers, independent software vendors and creative and business professionals and we are headquartered in Woburn, Massachusetts. We operate in one business segment: the development, marketing and licensing of technologies and fonts. We also maintain various offices worldwide for selling and marketing, research and development and administration. We conduct our operations through three domestic operating subsidiaries, Monotype Imaging Inc., Monotype ITC Inc. and MyFonts Inc., and five foreign operating subsidiaries, Monotype Ltd., Monotype GmbH, Monotype Solutions India Pvt. Ltd., Monotype Hong Kong Ltd. and Monotype KK.

2. Basis of Presentation

The accompanying unaudited condensed consolidated interim financial statements as of June 30, 2014 and for the three and six months ended June 30, 2014 and 2013 include the accounts of the Company and its wholly-owned subsidiaries and have been prepared in conformity with accounting principles generally accepted in the United States (GAAP) for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for Quarterly Reports on Form 10-Q and Article 10 of Regulation S-X. Accordingly, such financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. GAAP requires the Company s management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. The results for interim periods are not necessarily indicative of results to be expected for the year or for any future periods.

In management s opinion, these unaudited condensed consolidated interim financial statements contain all adjustments of a normal recurring nature necessary for a fair presentation of the financial statements for the interim periods presented.

These unaudited condensed consolidated interim financial statements should be read in conjunction with the Company s audited consolidated financial statements for the year ended December 31, 2013 as reported in the Company s Annual Report on Form 10-K.

The accompanying condensed consolidated financial statements reflect the application of certain significant accounting policies as described below and elsewhere in these notes to the condensed consolidated financial statements. As of June 30, 2014, the Company s significant accounting policies and estimates, which are detailed in the Company s Annual Report on Form 10-K for the year ended December 31, 2013 have not changed.

3. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update 2014-9, *Revenue from Contracts with Customers (Topic 606),* which provides a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. This guidance is effective for annual reporting and interim periods beginning after December 15, 2016 and allows for either full retrospective or modified retrospective application, with early adoption not permitted. Accordingly, the standard is effective for the Company on January 1, 2017. The Company is currently evaluating the adoption method it will apply and the impact that this guidance will have on its financial statements and related disclosures.

4. Acquisition

Mark Boulton Design

On April 7, 2014, the Company purchased all of the outstanding stock of Mark Boulton Design Limited, a privately-held Web design studio located in Cardiff, Wales, United Kingdom, for approximately $0.8 million in cash. The Company issued approximately $1.0 million in restricted stock awards in connection with the acquisition, which vest based upon continued employment over four years. In preliminary purchase accounting, the majority of the purchase price, or approximately $0.7 million, has been allocated to goodwill. Following the acquisition, Mark Boulton Design Limited became a wholly owned subsidiary of the Company. Seven former employees of Mark Boulton Design Limited joined the Company in connection with the acquisition.

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5. Derivative Financial Instruments

From time to time, we may incur foreign currency exchange gains and losses related to certain customers that are invoiced in U.S. dollars, but who have the option to make an equivalent payment in their own functional currencies at a specified exchange rate as of a specified date. In the period from that date until payment in the customer s functional currency is received and converted into U.S. dollars, we can incur realized gains and losses. At June 30, 2014 there were no currency contracts outstanding. At December 31, 2013 there was one currency contract outstanding, which was entered into on that date, and accordingly, the fair value was materially equivalent to its book value.

We also incur foreign currency exchange gains and losses on certain intercompany assets and liabilities denominated in foreign currencies. We are currently utilizing 30-day forward contracts to mitigate our exposure on these currency fluctuations. These contracts are generally set to expire and are settled at month end. The instruments are not designated as hedging instruments, and accordingly, the gain or loss is recognized upon cash settlement and is included in loss on derivatives in the accompanying consolidated statements of income. At June 30, 2014 and December 31, 2013 there was one contract outstanding, to purchase and sell two different currencies forward, which was entered into on those dates. See Note 6 for details regarding the fair value of these instruments.

The following table presents the losses on our derivative financial instruments which are included in loss on derivatives in our accompanying condensed consolidated statements of income (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Currency swaps	$ 158	$	$ 214	$
Total	$ 158	$	$ 214	$

6. Fair Value Measurements

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

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

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

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

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

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

		Fair Value Measurement at June 30, 2014		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents money market funds	$ 3,180	$ 3,180	$	$
Cash equivalents commercial paper	9,948		9,948	
Cash equivalents corporate bonds	5,384		5,384	
Total assets	$ 18,512	$ 3,180	$ 15,332	$

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	Fair Value Measurement at June 30, 2014			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Contingent acquisition consideration	$ 1,444	$	$	$ 1,444
Total liabilities	$ 1,444	$	$	$ 1,444

	Fair Value Measurement at December 31, 2013			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents money market funds	$ 832	$ 832	$	$
Cash equivalents commercial paper	8,998		8,998	
Cash equivalents corporate bonds	8,585		8,585	
Total assets	$ 18,415	$ 832	$ 17,583	$
Liabilities:				
Contingent acquisition consideration	$ 2,302	$	$	$ 2,302
Total liabilities	$ 2,302	$	$	$ 2,302

The Company s recurring fair value measures relate to short-term investments, which are classified as cash equivalents, derivative instruments and contingent consideration. The fair value of our cash equivalents are either based on quoted prices for similar assets or other observable inputs such as yield curves at commonly quoted intervals and other market corroborated inputs. The fair value of our derivative instruments is based on quoted market prices from various banking institutions or an independent third party provider for similar instruments. In determining the fair value, we consider our non-performance risk and that of our counterparties. At June 30, 2014, we had one 30-day forward contract to sell 3.5 million British pounds sterling and purchase $6.0 million that together, had an immaterial fair value. At December 31, 2013, we had one 30-day forward contract outstanding to sell 3.0 million British pounds sterling and purchase $5.0 million that together, had an immaterial fair value.

For the contingent acquisition consideration, the Company estimated the fair value of the liability by probability weighting the range of possible achievement of the criteria upon which the contingent consideration to be paid will be determined. The resulting estimated amount was then adjusted to its estimated net present value based upon a present value factor that was derived by applying a risk adjusted discount rate over the applicable contingency period. The contingent acquisition consideration decreased by $0.6 million in the second quarter of 2014, as the estimated liability was revised based on changes in performance estimates. In the first quarter of 2014, the liability decreased due to the payment of $0.4 million in accordance with the terms of the underlying agreement. These decreases were partially offset by the accretion of the net present value of the liability.

The Company s non-financial assets and non-financial liabilities subject to non-recurring measurements include goodwill and intangible assets.

7. Property and Equipment

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

	June 30, 2014	December 31, 2013
Computer equipment and software	$ 14,297	$ 11,371
Furniture and fixtures	1,214	1,170
Leasehold improvements	881	866
Total cost	16,392	13,407
Less accumulated depreciation and amortization	(10,661)	(9,839)
Property and equipment, net	$ 5,731	$ 3,568

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At June 30, 2014, computer equipment and software includes $2.6 million of unamortized software costs related to internal use software projects in process.

8. Intangible Assets

Intangible assets consist of the following (dollar amounts in thousands):

		June 30, 2014			December 31, 2013		
	Weighted-Average Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer relationships	10	$ 57,293	$ (45,290)	$ 12,003	$ 57,319	$ (42,482)	$ 14,837
Acquired technology	12	51,258	(32,029)	19,229	51,206	(29,734)	21,472
Non-compete agreements	4	12,068	(11,939)	129	12,077	(11,903)	174
Indefinite-lived intangible assets:							
Trademarks		35,764		35,764	35,801		35,801
Domain names		4,400		4,400	4,400		4,400
Total		$ 160,783	$ (89,258)	$ 71,525	$ 160,803	$ (84,119)	$ 76,684

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9. Debt

On July 13, 2011, the Company entered into a credit agreement with Wells Fargo Capital Finance, LLC, or the Credit Facility, which provides the Company with a five-year, $120.0 million secured revolving credit facility. Borrowings under the Credit Facility bear interest at a variable rate based upon, at the Company s option, either LIBOR or the base rate (which is the highest of (i) the prime rate, (ii) 0.5% plus the overnight federal funds rate, or (iii) 1.0% in excess of the three-month LIBOR rate), plus in each case, an applicable margin. The applicable margin for LIBOR loans, based on the applicable leverage ratio, is either 2.25% or 2.50% per annum, and the applicable margin for base rate loans, based on the applicable leverage ratio, is either 1.25% or 1.50% per annum. At June 30, 2014 our rate, inclusive of applicable margins, was 3.75% for prime. At June 30, 2014, the Company had no outstanding debt under the Credit Facility. The Company, in accordance with the Credit Facility, is permitted to request that the Lenders, at their election, increase the secured credit facility to a maximum of $140.0 million. The Company is required to pay an unused line fee equal to 0.375% per annum on the undrawn portion available under the revolving credit facility and variable per annum fees in respect of outstanding letters of credit, if any. Such fees are included in interest expense in the accompanying condensed consolidated statements of income. The Credit Facility contains financial covenants which include (i) a maximum ratio of consolidated total debt to consolidated adjusted EBITDA of 3.00:1.00, and (ii) a minimum consolidated fixed charge coverage ratio of 1.25:1.00. Adjusted EBITDA, under the Credit Facility, is defined as consolidated net earnings (or loss), plus net interest expense, income taxes, depreciation and amortization and share based compensation expense, plus acquisition expenses not to exceed $2.0 million, plus restructuring, issuance costs, cash non-operating costs and other expenses or losses minus cash non-operating gains and other non-cash gains; provided however that the aggregate of all cash non-operating expense shall not exceed $250 thousand and all such fees, costs and expenses shall not exceed $1.5 million on a trailing twelve months basis. Failure to comply with these covenants, or the occurrence of an event of default, could permit the Lenders under the Credit Facility to declare all amounts borrowed under the Credit Facility, together with accrued interest and fees, to be immediately due and payable. In addition, the Credit Facility is secured by substantially all of our assets and places limits on the Company s and its subsidiaries ability to incur debt or liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, engage in mergers, acquisitions and asset sales, transact with affiliates and alter its business. We were in compliance with all covenants under our Credit Facility as of June 30, 2014.

10. Defined Benefit Pension Plan

Our German subsidiary maintains an unfunded defined benefit pension plan which covers substantially all employees who joined the company prior to the plan s closure to new participants in 2006. Participants are entitled to benefits in the form of retirement, disability and surviving dependent pensions. Benefits generally depend on years of service and the salary of the employees.

The components of net periodic benefit cost included in the accompanying condensed consolidated statements of income were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Service cost	$ 29	$ 30	$ 59	$ 59
Interest cost	44	40	88	79

Net periodic benefit cost	$ 73	$ 70	$ 147	$ 138

11. Income Taxes

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

	Three Months Ended June 30,			
	2014		2013	
Provision for income taxes at statutory rate	$ 4,284	35.0%	$ 4,063	35.0%
State and local income taxes, net of federal tax benefit	225	1.8%	178	1.5%
Stock compensation	78	0.6%	70	0.6%
Research credits			(51)	(0.4)%
Disqualifying dispositions of incentive stock options	(25)	(0.2)%	(32)	(0.3)%
Other, net	(13)		71	0.6%
Reported income tax provision	$ 4,549	37.2%	$ 4,299	37.0%

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	Six Months Ended June 30,			
	2014		2013	
Provision for income taxes at statutory rate	$ 9,028	35.0%	$ 8,560	35.0%
State and local income taxes, net of federal tax benefit	481	1.9%	369	1.5%
Stock compensation	165	0.6%	140	0.6%
Research credits			(376)	(1.5)%
Disqualifying dispositions of incentive stock options	(42)	(0.2)%	(181)	(0.8)%
Other, net	25	0.1%	18	0.1%
Reported income tax provision	$ 9,657	37.4%	$ 8,530	34.9%

At June 30, 2014, the reserve for uncertain tax positions was approximately $6.5 million. Of this amount, $3.7 million is recorded as a reduction of deferred tax assets and $2.8 million is classified as long term liabilities.

12. Net Income Per Share

Basic and diluted earnings per share are computed pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating security according to their respective participation rights in undistributed earnings. Unvested restricted stock awards granted to employees are considered participating securities as they receive non-forfeitable rights to cash dividends at the same rate as common stock. In accordance with ASC Topic No. 260, diluted net income per share is calculated using the more dilutive of the following two approaches:

1. Assume exercise of stock options and vesting of restricted stock using the treasury stock method.

2. Assume exercise of stock options using the treasury stock method, but assume participating securities (unvested restricted stock) are not vested and allocate earnings to common shares and participating securities using the two-class method.

For the three months ended June 30, 2014 and the three and six months ended June 30, 2013, the two-class method was used in the computation of diluted net income per share as this approach was more dilutive. For the six months ended June 30, 2014, the treasury stock method was used in the computation of diluted net income per share, as this approach was more dilutive. The following presents a reconciliation of the numerator and denominator used in the calculation of basic and diluted net income per share (in thousands, except share and per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net income, as reported	$ 7,691	$ 7,311	$ 16,136	$ 15,927
Less: net income attributable to participating securities	(159)	(129)	(289)	(269)

Net income available to common shareholders basic	$	7,532	$	7,182	$	15,847	$	15,658
Denominator:								
Basic:								
Weighted-average shares of common stock outstanding		39,555,875		38,420,617		39,438,705		38,070,822
Less: weighted-average shares of unvested restricted common stock outstanding		(841,697)		(695,535)		(725,273)		(655,308)
Weighted-average number of common shares used in computing basic net income per common share		38,714,178		37,725,082		38,713,432		37,415,514
Net income per share applicable to common shareholders basic	$	0.19	$	0.19	$	0.41	$	0.42

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	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Numerator:				
Net income available to common shareholders basic	$ 7,532	$ 7,182	$ 15,847	$ 15,658
Add-back: undistributed earnings allocated to unvested shareholders (1)	96	91	N/A	195
Less: undistributed earnings reallocated to unvested shareholders (1)	(94)	(88)	N/A	(188)
Net income available to common shareholders diluted	$ 7,534	$ 7,185	$ 15,847	$ 15,665
Denominator:				
Diluted:				
Weighted-average shares of common stock outstanding	39,555,875	38,420,617	39,438,705	38,070,822
Less: weighted-average shares of unvested restricted common stock outstanding	(841,697)	(695,535)	(725,273)	(655,308)
Weighted-average number of common shares issuable upon exercise of outstanding stock options, based on the treasury stock method	909,339	1,304,571	973,470	1,343,293
Weighted-average number of restricted stock, based on the treasury stock method (2)	N/A	N/A	179,004	N/A