Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2003

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

[NO FEE REQUIRED]

For the transition period _____ to _____

Commission File Number 0-16439

Fair Isaac Corporation

(Exact name of registrant as specified in its charter)

DELAWARE	**94-1499887**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*

200 Smith Ranch Road, San Rafael, California 94903
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code:
(415) 472-2211

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [x] No [ ]

The number of shares of common stock outstanding on June 30, 2003 was 48,196,028 (excluding 9,673,462 shares held by the Company as treasury stock).

TABLE OF CONTENTS

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
Item 1. ***Condensed Consolidated Financial Statements***

FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

	June 30, 2003	September 30, 2002
Assets		
Current assets:		
Cash and cash equivalents	$ 136,115	$ 96,834
Marketable securities available for sale	86,770	184,377
Receivables, net	124,984	121,456
Other current assets	18,656	17,498
Deferred income taxes	8,065	8,009
Total current assets	374,590	428,174
Marketable securities available for sale	143,220	140,398
Other investments	8,964	9,804
Property and equipment, net	51,041	62,474
Goodwill	427,617	430,739
Intangibles, net	84,141	89,375
Deferred income taxes	45,384	45,384
Other assets	9,093	6,165
	$1,144,050	$1,212,513
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 12,398	$ 7,603
Accrued compensation and employee benefits	23,304	28,153
Other accrued liabilities	29,414	36,532
Deferred revenue	24,863	17,921
Total current liabilities	89,979	90,209
Convertible subordinated notes, net of discount	140,996	139,922
Other liabilities	6,450	8,910
Total liabilities	237,425	239,041
Stockholders' equity:		
Preferred stock ($0.01 par value; 1,000 authorized; none issued and outstanding)	—	—
Common stock ($0.01 par value; 100,000 shares authorized, 57,869 and 55,619 shares issued and 48,196 and 50,665 shares outstanding at June 30, 2003 and September 30, 2002, respectively)	482	507
Paid-in-capital	998,906	927,169
Treasury stock, at cost (9,673 and 4,954 shares at June 30, 2003 and September 30, 2002, respectively)	(376,828)	(163,038)
Unearned compensation	(4,421)	(7,128)
Retained earnings	288,581	216,041
Accumulated other comprehensive loss	(95)	(79)
Total stockholders' equity	906,625	973,472
	$1,144,050	$1,212,513

See accompanying notes to condensed consolidated financial statements.

FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Quarter Ended June 30,		Nine Months Ended June 30,	
	2003	2002	2003	2002
Revenues	$163,000	$91,014	$468,330	$263,125
Operating expenses:				
Cost of revenues	62,209	40,724	186,904	116,853
Research and development	16,959	6,894	51,325	21,672
Selling, general and administrative	31,277	20,343	95,175	58,587
Amortization of intangibles	3,461	609	10,142	1,743
Restructuring and merger-related	(36)	—	2,580	—
Total operating expenses	113,870	68,570	346,126	198,855
Operating income	49,130	22,444	122,204	64,270
Interest income	1,542	1,050	5,904	4,460
Interest expense on convertible subordinated notes	(2,333)	—	(6,981)	—
Other income (expense), net	101	(434)	595	(21)
Income before income taxes	48,440	23,060	121,722	68,709
Provision for income taxes	18,407	8,708	46,254	26,625
Net income	$ 30,033	$14,352	$ 75,468	$ 42,084
Earnings per share:				
Basic	$ 0.63	$ 0.43	$ 1.56	$ 1.23
Diluted	$ 0.60	$ 0.41	$ 1.48	$ 1.17
Shares used in computing earnings per share:				
Basic	47,488	33,629	48,524	34,113
Diluted	52,957	35,233	50,968	35,832

See accompanying notes to condensed consolidated financial statements.

FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

	Common Stock						Accumulated Other		
	Shares	Par Value	Paid-in-Capital	Treasury Stock	Unearned Compensation	Retained Earnings	Comprehensive Income (Loss)	Total Stockholders' Equity	Comprehensive Income (Loss)
Balance at September 30, 2002	**50,665**	**$507**	**$927,169**	**$(163,038)**	**$(7,128)**	**$216,041**	**$ (79)**	**$ 973,472**	
Exercise of stock options	2,250	22	56,897	—	—	—	—	56,919	
Tax benefit from exercised stock options	—	—	16,582	—	—	—	—	16,582	
Amortization of unearned compensation	—	—	—	—	2,299	—	—	2,299	
Forfeitures of stock options assumed in HNC acquisition	—	—	(408)	—	408	—	—	—	
Repurchases of common stock	(4,938)	(49)	—	(221,920)	—	—	—	(221,969)	
Issuance of ESPP and ESOP shares from treasury	219	2	(1,334)	8,130	—	—	—	6,798	
Dividends paid	—	—	—	—	—	(2,928)	—	(2,928)	
Net income	—	—	—	—	—	75,468	—	75,468	$75,468
Unrealized losses on investments	—	—	—	—	—	—	(313)	(313)	(313)
Cumulative translation adjustments	—	—	—	—	—	—	297	297	297
Balance at June 30, 2003	**48,196**	**$482**	**$998,906**	**$(376,828)**	**$(4,421)**	**$288,581**	**$ (95)**	**$ 906,625**	**$75,452**

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended June 30, 2003	Nine Months Ended June 30, 2002
Cash flows from operating activities		
Net income	$ 75,468	$ 42,084
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33,882	20,531
Share of equity in (earnings) losses and impairment of equity investments	(43)	1,055
Gain on sales of marketable securities	(685)	(1,605)
Amortization of unearned compensation	2,299	748
Tax benefit from exercised stock options	16,582	10,781
Net amortization of premium on marketable securities	2,863	507
Provision for doubtful accounts	3,825	1,059
Amortization of discount on convertible subordinated notes	1,074	—
Loss on sale of property and equipment	27	131
Changes in operating assets and liabilities:		
Receivables	(7,870)	(3,578)
Other assets	(1,106)	(1,507)
Accounts payable	4,795	568
Accrued compensation and employee benefits	(4,849)	(1,463)
Other accrued liabilities and other liabilities	(7,534)	5,437
Deferred revenue	6,788	(281)
Net cash provided by operating activities	125,516	74,467
Cash flows from investing activities		
Purchases of property and equipment	(12,554)	(16,522)
Cash proceeds from sale of product line	3,000	—
Cash paid in acquisitions, net of cash acquired	(7,150)	(2,593)
Purchases of marketable securities	(264,948)	(49,800)
Proceeds from sales of marketable securities	284,182	91,371
Proceeds from maturities of marketable securities	72,915	7,860
Cash paid for cost-method investment	(500)	—
Net cash provided by investing activities	74,945	30,316
Cash flows from financing activities		
Proceeds from issuances of common stock	63,717	20,269
Dividends paid	(2,928)	(1,570)
Repurchases of common stock	(221,969)	(105,937)
Cash paid in lieu of stock for stock split	—	(140)
Net cash used in financing activities	(161,180)	(87,378)
Increase in cash and cash equivalents	39,281	17,405
Cash and cash equivalents, beginning of period	96,834	24,608
Cash and cash equivalents, end of period	$ 136,115	$ 42,013
Supplemental disclosures of cash flow information:		
Cash paid for income taxes	$ 17,479	$ 9,590
Cash paid for interest	$ 3,938	$ 15

See accompanying notes to condensed consolidated financial statements.

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts)
(Unaudited)

1. Nature of Business

Fair Isaac Corporation

Fair Isaac Corporation is a provider of analytic, software and data management products and services that enable businesses to automate and improve decisions. Fair Isaac provides a range of analytical solutions, credit scoring and credit account management products and services to banks, credit reporting agencies, credit card processing agencies, insurers, retailers, telecommunications providers, healthcare organizations and government agencies.

On March 31, 2003, Fair, Isaac and Company, Incorporated changed its name to Fair Isaac Corporation. In this report, Fair Isaac Corporation is referred to as “we,” “us,” “our,” and “Fair Isaac.” HNC Software Inc., which we acquired in August 2002, is referred to as “HNC.”

Basis of Presentation

We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with the instructions to Form 10-Q. Consequently, we have not necessarily included in this Form 10-Q all information and footnotes required for audited financial statements. In our opinion, the accompanying unaudited interim condensed consolidated financial statements in this Form 10-Q reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of our financial position and results of operations. These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with our audited consolidated financial statements and notes thereto presented in our Annual Report on Form 10-K, as amended, for the fiscal year ended September 30, 2002. The interim financial information contained in this report is not necessarily indicative of the results to be expected for any other interim period or for the entire fiscal year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

The condensed consolidated financial statements include the accounts of Fair Isaac and its subsidiaries. All significant inter-company accounts and transactions have been eliminated.

On April 22, 2002, our Board of Directors authorized a three-for-two stock split, effected in the form of a 50% stock dividend to holders of our common stock of record on May 15, 2002. All share and per share amounts within the accompanying condensed consolidated financial statements and notes have been restated to reflect this stock split.

Certain prior period amounts have been reclassified to conform to the current period presentation.

Adoption of New Accounting Pronouncements

We adopted the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 142, *Goodwill and Other Intangible Assets*, on October 1, 2002. Disclosures related to SFAS No. 142 are included in Note 3.

We adopted the provisions of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, on January 1, 2003. SFAS No. 146 revises the accounting for specified employee and contract terminations that are part of restructuring activities and allows recognition of a liability for the cost associated with an exit or disposal activity only when the liability is incurred and can be measured at fair value. This statement applies on a prospective basis to exit or disposal activities that are initiated after December 31, 2002.

We adopted the initial recognition and measurement provisions of Financial Accounting Standards Board (“FASB”) Interpretation (“FIN”) No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect*

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(In thousands, except per share amounts)
(Unaudited)

Guarantees of Indebtedness of Others, on January 1, 2003, which apply on a prospective basis to guarantees issued or modified after December 31, 2002. We adopted the disclosure provisions of FIN No. 45 during the quarter ended December 31, 2002. Related disclosures are included in Note 12. We do not have guarantees that fall within the measurement and recognition provisions of FIN No. 45.

We adopted the interim disclosure provisions of SFAS No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*, during our second quarter ended March 31, 2003. Related interim disclosures are included herein.

Stock-Based Compensation

We measure compensation expense for our employee stock-based compensation awards using the intrinsic value method and provide pro forma disclosures of net income and earnings per share as if a fair value method had been applied. Therefore, compensation cost for employee stock awards is measured as the excess, if any, of the fair value of our common stock at the grant date over the amount an employee must pay to acquire the stock and is amortized over the related service periods using the straight-line method. Compensation expense previously recorded for unvested employee stock-based compensation awards that are forfeited upon employee termination is reversed in the period of forfeiture.

The following table compares net income and earnings per share as reported to the pro-forma amounts that would be reported had compensation expense been recognized for our stock-based compensation plans in accordance with the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*:

	Quarter Ended June 30,		Nine Months Ended June 30,	
	2003	2002	2003	2002
Net income, as reported	$30,033	$14,352	$ 75,468	$42,084
Add: Stock-based employee compensation expense included in reported net income, net of tax impact	451	155	1,426	458
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(4,165)	(2,735)	(13,156)	(8,772)
Pro forma net income	$26,319	$11,772	$ 63,738	$33,770
Earnings per share, as reported:				
Basic	$ 0.63	$ 0.43	$ 1.56	$ 1.23
Diluted	$ 0.60	$ 0.41	$ 1.48	$ 1.17
Pro forma earnings per share:				
Basic	$ 0.55	$ 0.35	$ 1.31	$ 0.99
Diluted	$ 0.53	$ 0.34	$ 1.26	$ 0.95

2. Acquisition and Pro Forma Results of Operations

Spectrum Managed Care, Inc.

On December 31, 2002, we acquired substantially all of the assets of the medical bill review business of Spectrum Managed Care (“Spectrum”), a wholly owned subsidiary of Ward North America Holding, Inc., for cash consideration of $7,150. We placed $250 of the purchase price into escrow to secure potential future indemnification obligations of the seller. This acquisition was consummated in order to expand our outsourced medical bill review service offering and has been accounted for using the purchase method of accounting. The results of operations of Spectrum have been included in the consolidated results of operations beginning on December 31, 2002.

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(In thousands, except per share amounts)
(Unaudited)

The total consideration paid, including accrued acquisition costs of $25, was allocated to the acquired assets as follows:

Assets	
Property and equipment	$ 127
Customer contracts and relationships	4,908
Goodwill	2,140
	$7,175

The acquired contracts and relationships have a weighted average estimated useful life of approximately 10 years and are being amortized over this term based on the forecasted cash flows associated with the assets. All of this goodwill is expected to be deductible for tax purposes.

Pro Forma Results of Operations

During the prior fiscal year ended September 30, 2002, we acquired the following businesses in transactions that were accounted for using the purchase method of accounting: i) acquisition of substantially all of the assets of Nykamp Consulting Group, Inc. ("Nykamp") in December 2001, and ii) acquisition of HNC in August 2002. The following table summarizes the pro forma results of our operations for the nine months ended June 30, 2003 and 2002, and for the quarter ended June 30, 2002, as if the Nykamp, HNC and Spectrum acquisitions had occurred on October 1, 2001, instead of their respective later acquisition dates:

	Nine Months Ended June 30, 2003		Nine Months Ended June 30, 2002		Quarter Ended June 30, 2002	
	Historical	Pro Forma Combined	Historical	Pro Forma Combined	Historical	Pro Forma Combined
Revenues	$468,330	$469,665	$263,125	$435,067	$91,014	$149,410
Net income	$ 75,468	$ 75,552	$ 42,084	$ 39,117	$14,352	$ 14,754
Basic earnings per share	$ 1.56	$ 1.56	$ 1.23	$ 0.74	$ 0.43	$ 0.28
Diluted earnings per share	$ 1.48	$ 1.48	$ 1.17	$ 0.72	$ 0.41	$ 0.27

3. Accounting for Goodwill and Intangible Assets

We adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, on October 1, 2002. Under the provisions of SFAS No. 142, goodwill and intangible assets with indefinite lives are no longer amortized, but instead are tested for impairment at least annually or more frequently if impairment indicators arise. All of our remaining intangible assets have definitive lives and are being amortized in accordance with this statement.

In connection with our adoption of SFAS No. 142, we were also required to assess whether goodwill within our reporting units was impaired at the date of our adoption of this statement using a two-step transitional impairment test. As prescribed by this statement, we have determined that our reporting units are the same as our reportable segments (see Note 9). We completed the first step of our transitional impairment testing during the quarter ended March 31, 2003, and determined that goodwill was not impaired as of October 1, 2002. Accordingly, we were not required to complete the second step of the impairment test.

Intangible assets that are subject to amortization under SFAS No. 142 consist of the following:

	June 30, 2003	September 30, 2002
Completed technology	$ 42,000	$42,000
Customer contracts and relationships	44,764	39,855
Tradename	9,090	9,090
Other	714	714
	96,568	91,659
Less accumulated amortization	(12,427)	(2,284)
	$ 84,141	$89,375

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(In thousands, except per share amounts)
(Unaudited)

Amortization expense associated with our definite-lived intangible assets totaled $3,461 and $10,142 during the quarter and nine months ended June 30, 2003, respectively. Amortization expense associated with our definite-lived intangible assets totaled $84 and $168 during the quarter and nine months ended June 30, 2002, respectively. Estimated future intangible asset amortization expense as of June 30, 2003, is as follows:

Three Months Ending September 30, 2003	$ 3,433
Fiscal Year Ending September 30,	
2004	13,722
2005	13,626
2006	13,474
2007	11,640
2008	3,083
Thereafter	25,163
	$84,141

For comparative purposes, the following table summarizes reported results for the quarter and nine months ended June 30, 2002, adjusted to exclude the amortization of goodwill as if the provisions of SFAS No. 142 had been adopted as of the beginning of these respective periods:

		Earnings Per Share	
	Net Income	Basic	Diluted
Quarter Ended June 30, 2002:			
As reported	$14,352	$0.43	$0.41
Amortization of goodwill, net of tax impact	525	0.01	0.01
As adjusted	$14,877	$0.44	$0.42
Nine Months Ended June 30, 2002:			
As reported	$42,084	$1.23	$1.17
Amortization of goodwill, net of tax impact	1,575	0.05	0.05
As adjusted	$43,659	$1.28	$1.22

The following table summarizes changes to goodwill during the nine months ended June 30, 2003, both in total and as allocated to our operating segments (Note 9).

	Scoring	Strategy Machines	Professional Services	Analytic SW Tools	Total
Balance at September 30, 2002	$85,508	$331,558	$2,706	$10,967	$430,739
Goodwill acquired in Spectrum acquisition (see Note 2)	—	2,140	—	—	2,140
Purchase accounting adjustments	(110)	(421)	371	(14)	(174)
Product line dispositions (see Note 4)	—	(5,088)	—	—	(5,088)
Balance at June 30, 2003	$85,398	$328,189	$3,077	$10,953	$427,617

During the nine months ended June 30, 2003, we adjusted our preliminary allocation of the Nykamp purchase price to reflect the reduction in fair value of certain assets acquired by us, which resulted in a $371 increase to goodwill. During this period we also adjusted our preliminary allocation of the HNC purchase price, which resulted in a $545 net decrease to goodwill. The HNC adjustments reflect primarily a $1,454 reduction in the carrying amount of our cost-method investment in Azure Venture Partners I, L.P. ("Azure"), offset by a $1,999 net reduction in assumed liabilities, principally related to revisions made to our estimate of future facility lease exit costs. The reduction in the Azure investment carrying amount was made based on valuation estimates obtained from Azure management, from which we determined that the fair value of this investment approximated $596 as of the HNC merger date. We had originally recorded this investment at $2,050. During the quarter ended June 30, 2003, we invested an additional $500 into this fund in connection with a capital call, and we are committed to invest an additional $1,700 into this fund. The ultimate timing of this additional investment will be dependent on when the fund managers make additional capital calls. It is possible that additional capital calls may require us to invest some or all of our remaining commitment during fiscal 2003.

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(In thousands, except per share amounts)
(Unaudited)

4. Sales of Product Line Assets

In October 2002, we entered into an agreement with Open Solutions, Inc. ("OSI"), pursuant to which we sold HNC's former Profit Vision product line, associated customer base, intellectual property rights and other related assets in exchange for a $950 secured promissory note from OSI and OSI's assumption of certain related product line liabilities. The promissory note received bears interest at the rate of 4.5% per annum and all principal and interest is payable in full in October 2005. The promissory note is secured by the assets sold to OSI. We discounted this note by $185 to reflect estimated market interest rates and are amortizing this discount over the term of the note using the effective interest method.

In November 2002, we entered into an agreement with Bridium, Inc. ("Bridium"), pursuant to which we sold HNC's former Connectivity Manager product line, associated customer base, intellectual property rights and other related assets in exchange for $3,000 in cash and a $3,000 secured promissory note from Bridium, as well as Bridium's assumption of certain related product line liabilities. The promissory note received bears interest at the rate of 7.0% per annum and is due and payable in twelve quarterly installments commencing in April 2003 and ending in April 2006. The promissory note is secured by the assets sold to Bridium and is also guaranteed by Bridium's parent company. We discounted this note by $415 to reflect estimated market interest rates and are amortizing this discount over the term of the note using the effective interest method.

As the above dispositions of former HNC assets occurred shortly after the HNC acquisition and their fair value did not change significantly from the date of the HNC acquisition, no gain or loss was recorded in connection with these transactions. The difference between the book value of net assets sold and consideration received in each transaction was recorded as an adjustment to goodwill.

5. Credit Agreement

In November 2002, we executed a credit agreement with a financial institution that provides for a $15,000 revolving line of credit through February 2004. Under the agreement we are required to comply with various financial covenants, which include but are not limited to, minimum levels of domestic liquidity, parameters for treasury stock repurchases, dividend payments, and merger and acquisition requirements. At our option, borrowings under this agreement bear interest at the rate of LIBOR plus 1.25% (which was 2.37% at June 30, 2003) or at the financial institution's Prime Rate (which was 4.00% at June 30, 2003), payable monthly. The agreement also includes a letter of credit subfeature that allows us to issue commercial and standby letters of credit up to a maximum amount of $5,000 and a foreign exchange facility that allows us to enter into contracts with the financial institution to purchase and sell certain currencies, subject to a maximum aggregate amount of $20,000 and other specified limits. As of June 30, 2003, no borrowings were outstanding under this agreement and we were in compliance with all related covenants. As of June 30, 2003, this credit facility also served to collateralize certain letters of credit aggregating $680, issued by us in the normal course of business. Available borrowings under this credit agreement are reduced by the principal amount of letters of credit outstanding under the facility.

6. Restructuring and Merger-Related

The following table summarizes activity for the nine months ended June 30, 2003, related to restructuring accruals previously recorded in connection with the HNC acquisition:

	Accrual at September 30, 2002	Cash Payments	Reversals	Accrual at June 30, 2003
Facilities charges	$3,076	$ (652)	—	$2,424
Employee separation	1,530	(1,451)	$(36)	43
	$4,606	$(2,103)	$(36)	$2,467

During the nine months ended June 30, 2003, we also incurred net incremental merger-related expenses totaling $2,580, consisting primarily of retention bonuses.

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(In thousands, except per share amounts)
(Unaudited)

7. Earnings Per Share

The following reconciles the numerators and denominators of basic and diluted earnings per share (“EPS”):

	Quarter Ended June 30,		Nine Months Ended June 30,	
	2003	2002	2003	2002
Numerator for basic earnings per share — net income	$30,033	$14,352	$75,468	$42,084
Interest expense on convertible subordinated notes, net of tax	1,585	—	—	—
Numerator for diluted earnings per share	$31,618	$14,352	$75,468	$42,084
Denominator — shares:				
Weighted average common shares for basic earnings per share	47,488	33,629	48,524	34,113
Effect of dilutive securities	5,469	1,604	2,444	1,719
Dilutive potential shares for diluted earnings per share	52,957	35,233	50,968	35,832
Earnings per share:				
Basic	$ 0.63	$ 0.43	$ 1.56	$ 1.23
Diluted	$ 0.60	$ 0.41	$ 1.48	$ 1.17

The computation of diluted EPS for the quarters ended June 30, 2003 and 2002 excludes stock options to purchase 209 and 1,362 shares of common stock, respectively, and for the nine months ended June 30, 2003 and 2002 excludes stock options to purchase 1,096 and 1,161 shares of common stock, respectively, because the options’ exercise prices exceeded the average market price of our common stock in these periods and their inclusion would be antidilutive. The computation of diluted EPS for the nine months ended June 30, 2003 also excludes 2,703 shares of common stock issuable upon conversion of our convertible subordinated notes, as the inclusion of such shares would have been antidilutive for this period.

8. Repurchases of Common Stock

During the nine months ended June 30, 2003, we repurchased 4,938 shares of our common stock for an aggregate cost of $221,969. The shares were repurchased pursuant to a program approved by our Board of Directors in the prior fiscal year that allowed us to repurchase up to 6,000 shares of our common stock. In March 2003, we concluded our repurchase of all approved shares under this program. In May 2003, our Board of Directors approved a new common stock repurchase program allowing us to purchase up to an additional 2,000 shares of our common stock from time to time in the open market and in negotiated transactions. Through June 30, 2003, we have repurchased no shares under this new program.

9. Segment Information

Following the merger with HNC, we reorganized into four segments worldwide. These segments correspond to the new internal management of our business operations based on products. The reportable segments are Scoring Solutions, Strategy Machine™ Solutions, Professional Services, and Analytic Software Tools.

The Scoring Solutions segment includes scoring services distributed through major credit reporting agencies, ScoreNet® services, PreScore® services and insurance bureau scoring services sold through credit reporting agencies.

The Strategy Machine Solutions segment primarily includes revenues derived from the following products: TRIAD™ credit account management services distributed through third-party bankcard processors, Fair Isaac MarketSmart Decision System® solution, CompAdvisor® and AutoAdvisor® Medical Bill Review and Outsourced Cost Containment Services, RoamEx® Roamer Data Exchanger, LiquidCredit® service, TelAdaptive® service, CardAlert™ Fraud Manager and consumer services available

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(In thousands, except per share amounts)
(Unaudited)

through our myFICO.com web site and strategic alliance partners' web sites, List Processing and Strategy Science products, as well as software license and maintenance revenues related to our Falcon™ Fraud Manager, Capstone® Decision Manager, and TRIAD™ end-user products.

The Professional Services segment includes all consulting, implementation and custom analytics services.

The Analytic Software Tools segment principally includes software license and maintenance revenues associated with Fair Isaac Blaze Decision System™ software, Fair Isaac Blaze Advisor™ software, Decision Optimizer™ software, and Model Builder software products.

Our Chief Executive Officer evaluates segment financial performance based on segment revenues and operating income. Segment operating expenses consist of direct and indirect costs principally related to personnel, facilities, consulting, travel, depreciation and amortization. Indirect costs are allocated to the segments generally based on relative segment revenues, fixed rates established by management based upon estimated expense contribution levels and other assumptions that management considers reasonable. Our Chief Executive Officer does not evaluate the financial performance of each segment based on its respective assets or capital expenditures; rather, depreciation and amortization amounts are allocated to the segments from their internal cost centers as described above.

The following tables summarize segment information for the quarters and nine months ended June 30, 2003 and 2002. Segment information during the quarter and nine months ended June 30, 2002, has been restated to conform to the current segment presentation.

	Quarter Ended June 30, 2003				
	Scoring	Strategy Machines	Professional Services	Analytic SW Tools	Total
Revenues	$ 34,547	$ 97,399	$ 21,852	$ 9,202	$ 163,000
Operating expenses	(16,256)	(72,867)	(18,832)	(5,951)	(113,906)
Segment operating income	$ 18,291	$ 24,532	$ 3,020	$ 3,251	49,094
Unallocated restructuring and merger-related					36
Operating income					49,130
Unallocated interest expense — convertible subordinated notes					(2,333)
Unallocated interest and other income, net					1,643
Income before income taxes					$ 48,440
Depreciation and amortization	$ 2,858	$ 6,218	$ 1,397	$ 351	$ 10,824

	Quarter Ended June 30, 2002				
	Scoring	Strategy Machines	Professional Services	Analytic SW Tools	Total
Revenues	$ 33,781	$ 39,852	$ 13,909	$ 3,472	$ 91,014
Operating expenses	(14,640)	(36,535)	(14,741)	(2,654)	(68,570)
Segment operating income (loss)	$ 19,141	$ 3,317	$ (832)	$ 818	22,444
Unallocated interest and other income, net					616
Income before income taxes					$ 23,060
Depreciation and amortization	$ 1,756	$ 4,216	$ 814	$ 156	$ 6,942

FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(In thousands, except per share amounts)
(Unaudited)

	Nine Months Ended June 30, 2003				
	Scoring	Strategy Machines	Professional Services	Analytic SW Tools	Total
Revenues	$101,507	$ 283,951	$ 62,333	$ 20,539	$ 468,330
Operating expenses	(47,201)	(219,829)	(57,945)	(18,571)	(343,546)
Segment operating income	$ 54,306	$ 64,122	$ 4,388	$ 1,968	124,784
Unallocated restructuring and merger-related					(2,580)
Operating income					122,204
Unallocated interest expense — convertible subordinated notes					(6,981)
Unallocated interest and other income, net					6,499
Income before income taxes					$ 121,722
Depreciation and amortization	$ 8,967	$ 19,424	$ 4,392	$ 1,099	$ 33,882

	Nine Months Ended June 30, 2002				
	Scoring	Strategy Machines	Professional Services	Analytic SW Tools	Total
Revenues	$ 94,491	$ 119,974	$ 40,747	$ 7,913	$ 263,125
Operating expenses	(43,320)	(105,780)	(43,345)	(6,410)	(198,855)
Segment operating income (loss)	$ 51,171	$ 14,194	$ (2,598)	$ 1,503	64,270
Unallocated interest and other income, net					4,439
Income before income taxes					$ 68,709
Depreciation and amortization	$ 5,250	$ 12,270	$ 2,581	$ 430	$ 20,531

Our revenues and percentage of revenues by reportable market segments are as follows for the quarters and nine months ended June 30, 2003 and 2002, the majority of which are derived from the sale of products and services within the consumer credit, financial services and insurance industries:

	Quarter Ended June 30,				Nine Months Ended June 30,			
	2003		2002		2003		2002	
Scoring Solutions	$ 34,547	21%	$33,781	37%	$101,507	22%	$ 94,491	36%
Strategy Machine Solutions	97,399	60%	39,852	44%	283,951	61%	119,974	46%
Professional Services	21,852	13%	13,909	15%	62,333	13%	40,747	15%
Analytic SW Tools	9,202	6%	3,472	4%	20,539	4%	7,913	3%
	$163,000	100%	$91,014	100%	$468,330	100%	$263,125	100%

In addition, our revenues and percentage of revenues on a geographical basis are summarized below for the quarters and nine months ended June 30, 2003 and 2002. No single country outside of the United States accounted for 10% or more of revenue in either quarter or nine month period.

	Quarter Ended June 30,				Nine Months Ended June 30,			
	2003		2002		2003		2002	
United States	$128,639	79%	$73,022	80%	$371,890	79%	$211,765	80%
International	34,361	21%	17,992	20%	96,440	21%	51,360	20%
	$163,000	100%	$91,014	100%	$468,330	100%	$263,125	100%

(In thousands, except per share amounts)

Table of Contents

10. San Diego Lease Commitment

During the quarter ended March 31, 2003, we executed a non-cancelable seven-year lease agreement that commences in August 2003 for a new San Diego, California office facility. The lease also provides for two five-year renewal options. Minimum future commitments under this lease as of June 30, 2003, are as follows:

Three Months Ending September 30, 2003	$ 633
Fiscal Year Ending September 30,	
2004	3,799
2005	3,799
2006	3,799
2007	3,799
2008	3,908
Thereafter	8,305
	$28,042

The lease agreement also grants us the right to use certain furniture and fixtures during the lease term and provides us with the option to purchase such assets at the end of the initial lease term for one dollar.

11. Contingencies

We are involved in various claims and legal actions arising in the ordinary course of business. We believe that these claims and actions will not have a material adverse impact on our results of operations, liquidity or financial condition. However, the amount of the liabilities associated with these claims and actions, if any, cannot be determined with certainty.

12. Guarantees

In the ordinary course of business, we are not subject to potential obligations under guarantees that fall within the scope of FIN No. 45 except for standard indemnification and warranty provisions that are contained within many of our customer license and service agreements, as well as standard indemnification agreements that we have executed with certain of our officers and directors, and give rise only to the disclosure requirements prescribed by FIN No. 45. In addition, under previously existing accounting principles generally accepted in the United States of America, we continue to monitor the conditions that are subject to the guarantees and indemnifications to identify whether it is probable that a loss has occurred, and would recognize any such losses under the guarantees and indemnifications when those losses are estimable.

Indemnification and warranty provisions contained within our customer license and service agreements are generally consistent with those prevalent in our industry. The duration of our product warranties generally does not exceed 90 days following delivery of our products. We have not incurred significant obligations under customer indemnification or warranty provisions historically and do not expect to incur significant obligations in the future. Accordingly, we do not maintain accruals for potential customer indemnification or warranty-related obligations. The indemnification agreements that we have executed with certain of our officers and directors would require us to indemnify such officers and directors in certain instances. We have not incurred obligations under these indemnification agreements historically and do not expect to incur significant obligations in the future. Accordingly, we do not maintain accruals for potential officer or director indemnification obligations. The maximum potential amount of future payments that we could be required to make under the indemnification provisions in our customer license and service agreements, and officer and director agreements is unlimited.

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

FORWARD LOOKING STATEMENTS

Statements contained in this Report that are not statements of historical fact should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In addition, certain statements in our future filings with *the Securities and Exchange Commission ("SEC"), in press releases, and in oral and written statements made by us or with our approval that are not statements of historical fact constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenue, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other statements concerning future financial performance; (ii) statements of our plans and objectives by our management or Board of Directors, including those relating to products or services; (iii) statements concerning our merger with HNC, expected synergies, execution of integration plans and increases in shareholder value as a result of the merger; (iv) statements of assumptions underlying such statements, (v) statements regarding business relationships with vendors, customers or collaborators; and (vi) statements regarding products, their characteristics, performance, sales potential or effect in the hands of customers. Words such as "believes," "anticipates," "expects," "intends," "targeted," "should," "potential," "goals," "strategy," and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to, those described in Management's Discussion and Analysis of Financial Condition and Results of Operations-Risk Factors, below. The performance of our business and our securities may be adversely affected by these factors and by other factors common to other businesses and investments, or to the general economy. Forward-looking statements are qualified by some or all of these risk factors. Therefore, you should consider these risk factors with caution and form your own critical and independent conclusions about the likely effect of these risk factors on our future performance. Such forward-looking statements speak only as of the date on which statements are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events or circumstances. Readers should carefully review the disclosures and the risk factors described in this and other documents we file from time to time with the SEC, including our reports on Forms 10-K, 10-Q and 8-K.*

RESULTS OF OPERATIONS

Overview

We are a leader in enterprise decision management, providing analytic, software and data management products and services that enable businesses to automate and improve their decisions. Our predictive modeling, decision analysis, intelligence management, decision management systems and consulting services power more than 25 billion decisions a year. We help companies acquire customers more efficiently, increase customer value, reduce fraud and credit losses, lower operating expenses and enter new markets more profitably. Most leading banks and credit card issuers rely on our solutions, as do many insurers, retailers, telecommunications providers, healthcare organizations and government agencies. We also serve consumers through online services that enable people to purchase and understand their FICO® scores, the standard measure of credit risk, to manage their financial health.

Most of our revenues are derived from the sale of products and services within the consumer credit, financial services and insurance industries, and during the quarter and nine months ended June 30, 2003, approximately 82% and 82%, respectively, of our revenues were derived from within these industries. A significant portion of our remaining revenues is derived from the telecommunications, healthcare and retail industries, as well as the government sector. Our clients utilize our products and services to facilitate a variety of business processes, including customer marketing and acquisition, account origination, credit and underwriting risk management, fraud loss prevention and control, and client account and policyholder management. A significant portion of our revenues is derived from recurring sources, generally including, but not limited to, transactional-based software license fees, license fees that recur annually under long-term software license arrangements, transactional fees derived under scoring, network service or internal hosted software arrangements, and software maintenance fees. Transactional-based and other recurring revenues are, to a significant degree, dependent upon our clients' continued usage of our products and services in their business activities. The more significant activities underlying the use of our products in these areas include: credit and debit card usage or active account levels; lending acquisition, origination and account management activity; workers' compensation and automobile medical injury insurance claims; and wireless and wireline calls and subscriber levels. The portion of our revenues that is derived from non-recurring sources generally includes, but is not limited to, perpetual or time-based licenses with upfront, non-recurring payment terms and non-recurring professional service arrangements.

On August 5, 2002, we completed our acquisition of HNC, a provider of analytic and decision management software. Results of operations of HNC are included prospectively from the date of acquisition. As a result of this acquisition, and to lesser degrees the Nykamp acquisition consummated in December 2001 and the Spectrum acquisition consummated in December 2002, our financial results during the quarter and nine months ended June 30, 2003, are not directly comparable to those during the quarter and nine months ended June 30, 2002.

Following our acquisition of HNC, we changed our reportable business segments to reflect the new primary method in which management organizes and evaluates internal financial information to make operating decisions and assess performance. Our current reportable segments are: Scoring Solutions, Strategy Machine Solutions, Professional Services and Analytic Software Tools. Segment information for the quarter and nine months ended June 30, 2002, has been restated to conform to the quarter and nine months ended June 30, 2003 presentation for comparability. Comparative segment revenues, operating income, and related financial information for the quarter and nine month periods ended June 30, 2003 and 2002 are set forth in Note 9 to the Condensed Consolidated Financial Statements.

Revenues

The following table displays (a) the percentage of revenues by segment during the quarters and nine months ended June 30, 2003 and 2002, and (b) the percentage change in segment revenues from the corresponding periods in the prior fiscal year.

	Percentage of Revenues Quarter Ended June 30,			Percentage of Revenues Nine Months Ended June 30,		
Segment	2003	2002	Period-to-Period Percentage Change	2003	2002	Period-to-Period Percentage Change
Scoring Solutions	21%	37%	2%	22%	36%	7%
Strategy Machine Solutions	60%	44%	144%	61%	46%	137%
Professional Services	13%	15%	57%	13%	15%	53%
Analytic Software Tools	6%	4%	165%	4%	3%	160%
Total Revenues	100%	100%	79%	100%	100%	78%

Total revenues increased by $72.0 million from $91.0 million during the quarter ended June 30, 2002, to $163.0 million during the quarter ended June 30, 2003. **Scoring Solutions** segment revenues increased by $0.7 million from $33.8 million during the quarter ended June 30, 2002, to $34.5 million during the quarter ended June 30, 2003, primarily due to a $0.9 million increase in PreScore service revenues and a $0.6 million increase in revenues derived from risk scoring services at the credit reporting agencies, partially offset by a $0.8 million net decrease in various other product revenues. The increase in PreScore revenues is attributable primarily to a higher level of marketing efforts by credit card issuers. The growth in risk scoring services resulted primarily from increased sales of scores for account review as well as mortgage origination and refinancing. During the quarter ended June 30, 2003, revenues generated from our agreements with Equifax, TransUnion and Experian collectively accounted for approximately 19% of our total revenues, including revenues from these customers that are recorded in our other segments. **Strategy Machine Solutions** segment revenues increased by $57.5 million from $39.9 million during the quarter ended June 30, 2002, to $97.4 million during the quarter ended June 30, 2003, primarily due to the addition of $46.8 million of revenues derived from products and services previously offered by HNC, a $5.5 million increase in Strategy Science revenues, a $2.4 million increase in revenues derived from consumer score services through myFICO.com and strategic alliance partners’ web sites and a $2.8 million net increase in various other product revenues. The increase in Strategy Science revenues is primarily attributable to $3.0 million in fees associated with the perpetual license of our newly available Decision Optimizer software tool with embedded strategies to a customer that was previously licensing these strategies from us on an outsourced basis under a multi-year agreement with monthly term license fees. The remainder of the increase in Strategy Science revenues was principally due to increases in transactionally-based revenues resulting from the growth of our Strategy Science customer base as well as increases in gain-share revenues from this customer base. The increase in consumer score services revenue is attributable primarily to an increase in customer volume. **Professional Services** segment revenues increased by $8.0 million from $13.9 million during the quarter ended June 30, 2002, to $21.9 million during the quarter ended June 30, 2003, primarily due to the addition of $7.9 million of revenues resulting from the acquisition of HNC along with a $0.1 million net increase in various other professional service offerings. **Analytic Software Tools** segment revenues increased by $5.7 million from $3.5 million during the quarter ended June 30, 2002, to $9.2 million during the quarter ended June 30, 2003, primarily due to the addition of $5.2 million of revenues derived from products previously offered by HNC and a $2.0 million increase in Decision Optimizer revenues, partially offset by a $1.5 million net decrease in revenues associated with various other products. The increase in Decision Optimizer revenues is attributable to the sale of two perpetual licenses with embedded strategies as noted above.

Total revenues increased by $205.2 million from $263.1 million during the nine months ended June 30, 2002, to $468.3 million during the nine months ended June 30, 2003. **Scoring Solutions** segment revenues increased by $7.0 million from $94.5 million during the nine months ended June 30, 2002, to $101.5 million during the nine months ended June 30, 2003, primarily due to a $5.5 million increase in PreScore service revenues and a $3.2 million increase in revenues derived from risk scoring services at the credit reporting agencies, partially offset by a $1.7 million net decrease in various other product revenues. The increase in PreScore revenues is attributable primarily to a higher level of marketing efforts by credit card issuers. The growth in risk scoring services resulted primarily from increased sales of scores for account review as well as mortgage origination and refinancing. During the nine months ended June 30, 2003, revenues generated from our agreements with Equifax, TransUnion and Experian collectively accounted for approximately 19% of our total revenues, including revenues from these customers that are recorded in our other segments. **Strategy Machine Solutions** segment revenues increased by $164.0 million from $120.0 million during the nine months ended June 30, 2002, to $284.0 million during the nine months ended June 30, 2003, due primarily to the addition of $140.4 million of revenues derived from products and services previously offered by HNC, a $9.8 million increase in revenues derived from consumer score services through myFICO.com and strategic alliance partners' web sites, a $7.1 million increase in Strategy Science revenues, a $5.9 million increase in TRIAD revenues and a $0.8 million net increase in various other product revenues. The increase in consumer score services revenue is attributable primarily to an increase in customer volume. The increase in Strategy Science revenues includes $3.0 million in fees associated with the perpetual license of our newly available Decision Optimizer software tool with embedded strategies to a customer that was previously licensing these strategies from us on an outsourced basis under a multi-year agreement with monthly term license fees. The remainder of the increase in Strategy Science revenues was principally due to increases in transactionally-based revenues resulting from the growth of our Strategy Science customer base as well as increases in gain-share revenues from this customer base. The increase in TRIAD revenues is attributable primarily to an increase in perpetual license sales and an increase in transactional volume associated with our Processor Triad services period over period. **Professional Services** segment revenues increased by $21.6 million from $40.7 million during the nine months ended June 30, 2002, to $62.3 million during the nine months ended June 30, 2003, primarily due to increased revenues of $21.4 million resulting from the acquisition of HNC along with a $0.2 million net increase associated with various other professional service offerings. **Analytic Software Tools** segment revenues increased by $12.6 million from $7.9 million during the nine months ended June 30, 2002, to $20.5 million during the nine months ended June 30, 2003, primarily due to the addition of $13.5 million of revenues derived from products previously offered by HNC and a $2.0 million increase in Decision Optimizer revenues, partially offset by a $2.9 million net decrease in revenues associated with various other products. The increase in Decision Optimizer revenues is attributable to the sale of two perpetual licenses with embedded strategies as noted above.

Revenues derived from clients outside the United States totaled $34.4 million and $18.0 million during the quarters ended June 30, 2003 and 2002, respectively, representing 21% and 20% of total consolidated revenues in each of these periods. Revenues derived from clients outside the United States totaled $96.4 million and $51.4 million during the nine months ended June 30, 2003 and 2002, respectively, representing 21% and 20% of total consolidated revenues in each of these periods.

Operating Expenses and Other Income (Expense)

The following table sets forth for the fiscal periods indicated (a) the percentage of revenues represented by certain line items in our Condensed Consolidated Statements of Income and (b) the percentage change in the amount of each such line item in the quarter and nine months ended June 30, 2003, from the corresponding periods in the prior fiscal year.

	Percentage of Revenues Quarter Ended June 30,		Period-to-Period Percentage Change	Percentage of Revenues Nine Months Ended June 30,		Period-to-Period Percentage Change
	2003	2002		2003	2002	
Revenues	100%	100%	79%	100%	100%	78%
Operating expenses:						
Cost of revenues	38%	44%	53%	40%	45%	60%
Research and development	11%	8%	146%	11%	8%	137%
Selling, general and administrative	19%	22%	54%	21%	22%	62%
Amortization of intangibles	2%	1%	468%	2%	1%	482%
Restructuring and merger-related	—	—	100%	—	—	100%
Total operating expenses	70%	75%	66%	74%	76%	74%
Operating income	30%	25%	119%	26%	24%	90%
Interest income	1%	1%	47%	1%	2%	32%
Interest expense on convertible subordinated notes	(2)%	—	100%	(1)%	—	100%
Other income (expense), net	—	—	123%	—	—	100%
Income before income taxes	29%	26%	110%	26%	26%	77%
Provision for income taxes	11%	10%	111%	10%	10%	74%
Net income	18%	16%	109%	16%	16%	79%

Cost of Revenues

Cost of revenues consists primarily of employee salaries and benefits for personnel directly involved in creating, installing and supporting revenue products; travel and related overhead costs; costs of computer service bureaus; amounts payable to credit reporting agencies for scores; third party software costs; and expenses related to our consumer score services through myFICO.com.

The quarter over quarter increase in cost of revenues was principally due to the HNC acquisition. Cost of revenues, as a percentage of revenues, decreased in the quarter ended June 30, 2003, as compared to the quarter ended June 30, 2002. This percentage decrease was attributable primarily to the addition of higher margin product offerings from the HNC acquisition, including Falcon Fraud Manager, Capstone Decision Manager, RoamEx and Blaze Advisor, an increase in higher margin Strategy Science and Decision Optimizer revenues and higher margins achieved by our consumer score services through myFICO.com due to increased revenues and related cost efficiencies.

The year to date period over year to date period increase in cost of revenues was principally due to the HNC acquisition. Cost of revenues, as a percentage of revenues, decreased in the nine months ended June 30, 2003, as compared to the nine months ended June 30, 2002. This percentage decrease was attributable primarily to the addition of higher margin product offerings from the HNC acquisition, including Falcon Fraud Manager, Capstone Decision Manager, RoamEx and Blaze Advisor, an increase in higher margin Strategy Science and Decision Optimizer revenues, an increase in high margin TRIAD perpetual license sales and higher margins achieved by our consumer score services through myFICO.com due to increased revenues and related cost efficiencies.

Research and Development

Research and development expenses include the personnel and related overhead costs incurred in development of new products and services, including primarily the research of mathematical and statistical models and the development of other Strategy Machine Solutions and Analytic Software Tools.

The quarter over quarter increase in research and development expenses was principally due to the HNC acquisition. Research and development expenses, as a percentage of revenues, increased in the quarter ended June 30, 2003, as compared to the quarter ended June 30, 2002. This percentage increase was attributable primarily to a higher level of research and development efforts associated with product lines acquired from HNC.

The year to date period over year to date period increase in research and development expenses was principally due to the HNC acquisition. Research and development expenses, as a percentage of revenues, increased in the nine months ended June 30, 2003, as compared to the nine months ended June 30, 2002. This percentage increase was attributable primarily to a higher level of research and development efforts associated with product lines acquired from HNC.

Selling, General and Administrative

Selling, general and administrative expenses consist principally of employee salaries and benefits, travel, overhead, advertising and other promotional expenses, corporate facilities expenses, legal expenses, business development expenses, and the cost of operating computer systems.

The quarter over quarter increase in selling, general and administrative expenses was principally due to the HNC acquisition. Selling, general and administrative expenses, as a percentage of revenues, decreased in the quarter ended June 30, 2003, as compared to the quarter ended June 30, 2002. This percentage decrease was attributable primarily to a reduction in selling, general and administrative personnel and other costs due to efficiencies achieved by the HNC merger.

The year to date period over year to date period increase in selling, general and administrative expenses was principally due to the HNC acquisition. Selling, general and administrative expenses, as a percentage of revenues, decreased in the nine months ended June 30, 2003, as compared to the nine months ended June 30, 2002. This percentage decrease was attributable primarily to a reduction in selling, general and administrative personnel and other costs due to efficiencies achieved by the HNC merger, offset partially by a $2.8 million increase in our provision for doubtful accounts and a $2.5 million increase in media expenditures.

Amortization of Intangibles

Amortization of intangibles consists of amortization expense that we have recorded on intangible assets recorded in connection with acquisitions accounted for by the purchase method of accounting. Effective October 1, 2002, we adopted SFAS No. 142 and accordingly, ceased the amortization of goodwill and indefinite-lived intangible assets. Amortization expense for the quarter ended June 30, 2003, totaled $3.5 million as compared to amortization expense of $0.6 million for the quarter ended June 30, 2002. The increase is attributable primarily to the incremental amortization of intangible assets recorded in connection with the HNC acquisition on August 5, 2002, and to a lesser degree the full quarter of amortization of intangible assets resulting from our acquisition of assets from Spectrum Managed Care in December 2002.

Amortization expense for the nine months ended June 30, 2003, totaled $10.1 million as compared to amortization expense of $1.7 million for the nine months ended June 30, 2002. The increase is attributable primarily to the incremental amortization of intangible assets recorded in connection with the HNC acquisition on August 5, 2002, and to a lesser degree the full nine months of amortization of intangible assets resulting from our acquisition of assets from Nykamp Consulting Group in December 2001 and six months of amortization of intangible assets resulting from our acquisition of assets from Spectrum Managed Care in December 2002.

Our definite-lived intangible assets are being amortized using the straight-line method or based on forecasted cash flows associated with the assets over periods ranging from three to fifteen years.

Restructuring and Merger-related

During the quarter ended June 30, 2003, we recorded a credit of less than $0.1 million related to the adjustment of severance amounts previously accrued in connection with a corporate restructuring. During the nine months ended June 30, 2003, we incurred incremental HNC-related merger expenses totaling $2.6 million, consisting primarily of retention bonuses. No such amounts were recorded in the same prior year periods.

Interest Income

Interest income is derived primarily from the investment of funds in excess of our immediate operating requirements. Interest income totaled $1.5 million for the quarter ended June 30, 2003, as compared to $1.1 million for the quarter ended June 30, 2002. Interest income totaled $5.9 million for the nine months ended June 30, 2003, as compared to $4.5 million for the nine months ended June 30, 2002. The period over period increases were attributable primarily to higher average cash and investment balances, principally resulting from our acquisition of HNC on August 5, 2002, partially offset by lower interest and investment income yields due to lower market rates of return.

Interest Expense on Convertible Subordinated Notes

As a result of the HNC acquisition and subsequent merger of the HNC entity into Fair Isaac, we are the issuer of $150.0 million in 5.25% Convertible Subordinated Notes (the “Notes”) due in September 2008. The Notes were recorded at their fair value of $139.7 million on the acquisition date, as determined based on their quoted market price, which resulted in our recognition of a $10.3 million note discount. The carrying amount of the Notes is being accreted to $150.0 million over their remaining term using the effective interest method, resulting in an effective interest rate of approximately 6.64% per annum. Interest expense on the notes recorded by us totaled $2.3 million and $7.0 million during the quarter and nine months ended June 30, 2003, respectively.

Other Income (Expense), Net

Other income, net totaled less than $0.1 million during the quarter ended June 30, 2003, as compared to other expense, net of $0.4 million recorded during the quarter ended June 30, 2002. The increase in other income, net was attributable primarily to our recognition of $0.1 million foreign exchange rate gain during the quarter ended June 30, 2003 as compared to our recognition of a $0.4 million foreign exchange rate loss during the quarter ended June 30, 2002.

Other income, net totaled $0.6 million during the nine months ended June 30, 2003, as compared to other expense, net of less than $0.1 million during the nine months ended June 30, 2002. The increase in other income, net is attributable primarily to the non-recurrence of a $1.1 million loss associated with the impairment and write-off of an equity investment recorded during the nine months ended June 30, 2002 and to a $0.4 million reduction in foreign exchange rate losses recorded during the nine months ended June 30, 2003, as compared to the nine months ended June 30, 2002, partially offset by a $0.9 million reduction in gains recorded from the sale of marketable securities during the nine months ended June 30, 2003, as compared to the nine months ended June 30, 2002.

Provision for Income Taxes

Our effective tax rate was 38.0% and 37.78% during the quarters ended June 30, 2003 and 2002, respectively, and 38.0% and 38.75% during the nine months ended June 30, 2003 and 2002, respectively. The year to date period over period decrease is primarily due to the increased availability of research and development tax credits. The provision for income taxes during interim quarterly reporting periods is based on our estimates of the effective tax rates for the respective full fiscal year.

Operating Income

Operating income increased from $22.4 million for the quarter ended June 30, 2002 to $49.1 million for the quarter ended June 30, 2003. This increase was attributable primarily to the HNC acquisition and to a lesser degree increased revenues and operating income associated with legacy Fair Isaac product offerings. At the segment level, the quarter over quarter increase in operating income was attributable primarily to a $21.2 million increase in segment operating income within our Strategy Machines Solutions segment, and to a lesser degree increased segment operating income within our Professional Services and Analytical Software Tools segments of $3.9 million and $2.4 million, respectively. The quarter over quarter increase in Strategy Machines Solutions segment operating income was driven primarily by the growth of segment revenues and operating margins, principally as a result of additional revenues derived from products and services previously offered by HNC, but also to the increase in Strategy Science product revenues and revenues derived from consumer score services through myFICO.com and strategic alliance partners’ web sites. HNC merger-related cost efficiencies also contributed to the increase in Strategy Machines Solutions segment operating income quarter over quarter. The quarter over quarter increase in Professional Services segment operating income was driven primarily by the increase in segment revenues, including those derived from legacy HNC services as well as an increase in higher margin professional service revenues associated with legacy Fair Isaac product offerings. The quarter over quarter increase in Analytical Software Tools segment operating income was driven primarily by the addition of higher margin Blaze Advisor revenues previously offered by HNC as well as the increase in higher margin Decision Optimizer software license revenues.

Operating income increased from $64.3 million for the nine months ended June 30, 2002 to $122.2 million for the nine months ended June 30, 2003. This increase was attributable primarily to the HNC acquisition and to a lesser degree increased revenues and operating income associated with legacy Fair Isaac product offerings, partially offset by $2.6 million in HNC merger-related expenses incurred during the nine months ended June 30, 2003. At the segment level, the period over period increase in operating income was attributable primarily to a $49.9 million increase in segment operating income within our Strategy Machines Solutions segment, and to a lesser degree increased segment operating income within our Professional Services and Scoring Solutions segments of $7.0 million and $3.1 million, respectively. The period over period increase in Strategy Machines Solutions segment operating income was driven primarily by the growth of segment revenues and operating margins, principally as a result of additional revenues derived from products and services previously offered by HNC, but also to the increase in Strategy Science product revenues, revenues derived from consumer score services through myFICO.com and strategic alliance partners' web sites, and an increase in TRIAD revenues. HNC merger-related cost efficiencies also contributed to the increase in Strategy Machines Solutions segment operating income period over period. The period over period increase in Professional Services segment operating income was driven primarily by the increase in segment revenues, including those derived from legacy HNC services as well as an increase in higher margin professional service revenues associated with legacy Fair Isaac product offerings. The period over period increase in Scoring Solutions segment operating income was driven primarily by an increase in PreScore revenues and an increase in revenues derived from risk scoring services at the credit reporting agencies.

Capital Resources and Liquidity

Our working capital at June 30, 2003 and September 30, 2002, totaled $284.6 million and $338.0 million, respectively. The decrease in working capital during the nine months ended June 30, 2003 is attributable primarily to a $58.3 million decline in cash and cash equivalents and short-term marketable securities, offset by an aggregate $4.9 million increase in other net working capital accounts. The decline in cash and cash equivalents and short-term marketable securities is principally due to the use of $222.0 million for stock repurchases, offset by net cash provided by operating, investing and other financing activities during the nine months ended June 30, 2003, as described below. The increase in other net working capital balances consisted primarily of a $3.5 million increase in net receivables, a $1.2 million increase in other current assets, a $4.8 million decrease in accrued compensation and employee benefits and a $7.1 million decrease in other accrued liabilities, offset by a $4.8 million increase in accounts payable and a $6.9 million increase in deferred revenue. The increase in net receivables was attributable primarily to an increase in revenues during the quarter ended June 30, 2003, as compared to the quarter preceding September 30, 2002, partially offset by an increase in our allowance for doubtful accounts. The increase in other current assets was attributable primarily to an increase in prepaid expenditures, partially offset by a net decrease in other current assets. The decrease in accrued compensation and employee benefits was attributable primarily to a decrease in accrued salaries, accrued incentive compensation and accrued employee stock purchase plan withholdings. The decrease in other accrued liabilities was attributable primarily to a reduction in HNC merger-related accruals, partially offset by a net increase in income taxes payable and other miscellaneous accruals. The increase in accounts payable was attributable primarily to the timing of vendor disbursements. The increase in deferred revenue was attributable primarily to an increase in customer prepayments.

Our primary method for funding operations and growth has been through cash flows generated from operations. Net operating cash flows increased from $74.5 million during the nine months ended June 30, 2002 to $125.5 million during the nine months ended June 30, 2003, reflecting an increase in net earnings before non-cash charges and the effect of other net working capital changes, as discussed herein.

Net cash provided by investing activities totaled $74.9 million and $30.3 million during the nine months ended June 30, 2003 and 2002, respectively. The increase in net cash provided by investing activities during the nine months ended June 30, 2003, as compared to the nine months ended June 30, 2002, is attributable primarily to $42.7 million increase in sales and maturities of marketable securities, net of purchases, a $4.0 million reduction in property and equipment purchases and the receipt of $3.0 million in cash proceeds from the sale of a product line in the current period, offset by a $4.6 million increase in net cash paid for acquisitions period over period and $0.5 million in cash paid for a cost-method investment in the current year period only.

Net cash used in financing activities totaled $161.2 million and $87.4 million during the nine months ended June 30, 2003 and 2002, respectively. The increase in net cash used in financing activities during the nine months ended June 30, 2003, as compared to the nine months ended June 30, 2002, is attributable primarily to the use of $222.0 million in cash to repurchase common stock in the current period, as compared to the use of $105.9 million to repurchase common stock in the prior year period, and to a $1.4

million increase in dividends paid period over period, partially offset by a $43.4 million increase in proceeds from the issuance of common stock period over period.

From time to time, we repurchase our common stock in the open market pursuant to programs approved by our Board of Directors. During the nine months ended June 30, 2003, we expended $222.0 million in connection with our repurchase of approximately 4.9 million shares of common stock pursuant to a 6.0 million share repurchase program announced in August 2002. In March 2003, we concluded our repurchase of all approved shares under this program. In May 2003, our Board of Directors approved a new common stock repurchase program allowing us to purchase up to an additional 2.0 million shares of our common stock from time to time in the open market and in negotiated transactions. Through June 30, 2003, we have repurchased no shares under this new program.

We paid quarterly dividends of two cents per share, or a total of six cents per share, during the nine months ended June 30, 2003 and 2002. Our dividend rate is set by the Board of Directors on a quarterly basis taking into account a variety of factors, including among others, our operating results and cash flows, general economic and industry conditions, our obligations, changes in applicable tax laws and other factors deemed relevant by the Board. Although we expect to continue to pay dividends at the current rate, our dividend rate is subject to change from time to time based on the Board's business judgment with respect to these and other relevant factors.

We are the issuer of $150.0 million of 5.25% Convertible Subordinated Notes (the "Notes") that mature on September 1, 2008. The Notes are convertible into shares of Fair Isaac common stock at a conversion rate of approximately 18.02 shares of Fair Isaac common stock per $1,000 principal amount of the Notes, subject to anti-dilution adjustment. The Notes are general unsecured obligations of Fair Isaac and are subordinated in right of payment to all existing and future senior indebtedness of Fair Isaac. Interest on the Notes is payable on March 1 and September 1 of each year until maturity. We may redeem the Notes on or after September 5, 2004, or earlier if the price of Fair Isaac common stock reaches certain levels. If we redeem the Notes prior to September 1, 2007, we will be required to pay a redemption premium as prescribed by the indenture.

We are party to a credit agreement with a financial institution that provides for a $15.0 million revolving line of credit through February 2004. Under the agreement we are required to comply with various financial covenants, which include but are not limited to, minimum levels of domestic liquidity, parameters for treasury stock repurchases, dividend payments, and merger and acquisition requirements. At our option, borrowings under this agreement bear interest at the rate of LIBOR plus 1.25% or at the financial institution's Prime Rate, payable monthly. The agreement also includes a letter of credit subfeature that allows us to issue commercial and standby letters of credit up to a maximum amount of $5.0 million and a foreign exchange facility that allows us to enter contracts with the financial institution to purchase and sell certain currencies, subject to a maximum aggregate amount of $20.0 million and other specified limits. As of June 30, 2003, no borrowings were outstanding under this agreement and we were in compliance with all related covenants. As of June 30, 2003, this credit facility also served to collateralize certain letters of credit aggregating $0.7 million, issued by us in the normal course of business. Available borrowings under this credit agreement are reduced by the principal amount of letters of credit outstanding under the facility.

As of June 30, 2003, we had $366.1 million in cash, cash equivalents and marketable security investments. We believe that these balances, including interest to be earned thereon, and anticipated cash flows from operating activities will be sufficient to fund our working and other capital requirements over the course of the next twelve months and for the foreseeable future. In the normal course of business, we evaluate the merits of acquiring technology or businesses, or establishing strategic relationships with or investing in these businesses. We may elect to use available cash and cash equivalents and marketable security investments to fund such activities in the future. In the event additional needs for cash arise, we may raise additional funds from a combination of sources including the potential issuance of debt or equity securities. Additional financing might not be available on terms favorable to us, or at all, particularly in light of the current decline in the capital markets. If adequate funds were not available or were not available on acceptable terms, our ability to take advantage of unanticipated opportunities or respond to competitive pressures could be limited.

We are a limited partner in Azure Venture Partners I, L.P., a venture capital investment management fund, and are committed to invest an additional $1.7 million into this fund. The ultimate timing of this additional investment will be dependent on when the fund managers make additional capital calls. The most recent capital call required us to invest an additional $0.5 million into this fund in May 2003. It is possible that additional capital calls may require us to invest some or all of our remaining commitment during fiscal 2003.

During the quarter ended March 31, 2003, we executed a non-cancelable seven-year lease agreement that commences in

August 2003 for a new San Diego, California office facility. The lease also provides for two five-year renewal options. Minimum future commitments under this lease aggregate $28.0 million, payable as follows: $0.6 million from commencement of the lease through the end of fiscal 2003, $3.8 million during each year of fiscal 2004 through 2007, $3.9 million during fiscal 2008 and $8.3 million thereafter.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to investors.

Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. These accounting principles require management to make certain judgments and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We periodically evaluate our estimates including those relating to revenue recognition, the allowance for doubtful accounts, goodwill and other intangible assets resulting from business acquisitions, capitalized software development costs, internal-use software, income taxes and contingencies and litigation. We base our estimates on historical experience and various other assumptions that we believe to be reasonable based on the specific circumstances, the results of which form the basis for making judgments about the carrying value of certain assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements:

Revenue Recognition

We recognize software license revenue upon delivery, provided that persuasive evidence of an arrangement exists, fees are fixed or determinable, collections are probable, objective evidence of fair value for all undelivered elements has been established, and we are not involved in significant production, customization, or modification of the software or services that are essential to the functionality of the software.

If the arrangement involves significant production, customization, or modification of software or service essential to the functionality of the software, the revenue is generally recognized under the percentage-of-completion method of contract accounting. In order to apply the percentage of completion of method, management is required to estimate the input measures, generally based on hours incurred to date compared to total estimated hours of the project, with consideration also given to output measures, such as contract milestones, when applicable. As a result, recognized revenues and profits are subject to revisions as the contract progresses to completion.

Revenues from multiple element arrangements are allocated to each element based on the relative fair values of the elements. The determination of fair value is based on objective evidence that is specific to our business. If such evidence of fair value for each element of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value for each element does exist or until all elements of the arrangement are delivered. If in a multiple element arrangement, fair value does not exist for one or more of the delivered elements in the arrangement, but fair value does exist for all of the undelivered elements, then the residual method of accounting is applied. Under the residual method, the fair value of the undelivered elements is deferred, and the remaining portion of the arrangement fee is recognized as revenue.

Revenue determined by the percentage-of-completion method in excess of contract billings is recorded in unbilled receivables. Such amounts are generally billable upon reaching certain performance milestones as defined by individual contracts. Billings received in advance of performance under contracts are recorded as deferred revenue.

Revenues recognized from our credit scoring, data processing, data management, internet delivery services and consulting are generally recognized as these services are performed, provided all significant obligations have been met, persuasive evidence of an arrangement exists, fees are fixed or determinable, and collections are probable.

Transactional-based license fees under software license arrangements, network service and internally-hosted software agreements are recognized as revenue based on system usage or when fees based on system usage exceed monthly minimum license fees.

We record revenue on a net basis for those sales in which we have in substance acted as an agent or broker in the transaction.

Revenues from post-contract customer support, such as maintenance, are recognized on a straight-line basis over the term of the contract.

Allowance for Doubtful Accounts

We make estimates regarding the collectibility of our accounts receivable. When we evaluate the adequacy of our allowance for doubtful accounts, we closely analyze specific accounts receivable balances, historical bad debts, customer creditworthiness, current economic trends and changes in our customer payment cycles. Material differences may result in the amount and timing of expense for any period if we were to make different judgments or utilize different estimates. If the financial condition of our customers deteriorates resulting in an impairment of their ability to make payments, or if payments from customers are significantly delayed, additional allowances might be required.

Business Acquisitions; Valuation of Goodwill and Other Intangible Assets

Our business acquisitions typically result in the recognition of goodwill and other intangible assets, and in certain cases one-time charges associated with the write-off of in-process research and development, which affect the amount of current and future period charges and amortization expense. The determination of value of these components of a business combination, as well as associated asset useful lives, requires management to make various estimates and assumptions. Estimates using different, but each reasonable, assumptions could produce significantly different results.

We continually review the events and circumstances related to our financial performance and economic environment for factors that would provide evidence of the impairment of goodwill. We adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, on October 1, 2002, and as a result have ceased amortization of goodwill. As required by SFAS No. 142, we have determined that our reporting units are the same as our reportable segments. In addition, we were required to assess whether goodwill within our reporting units was impaired at the date of the adoption of this statement using a two-step transitional impairment test. We completed the first step during the quarter ended March 31, 2003, and determined that goodwill was not impaired on October 1, 2002. Accordingly, we were not required to complete the second step of the impairment test. There are many management assumptions and estimates underlying the determination of an impairment loss, and estimates using different, but each reasonable, assumptions could produce significantly different results. Therefore, the timing and recognition of impairment losses by us in the future, if any, may be highly dependent upon our estimates and assumptions.

Capitalized Software Development Costs

We capitalize certain software development costs after establishment of a product’s technological feasibility. Such costs are then amortized over the estimated life of the related product. Periodically, we compare a product’s unamortized capitalized cost to the product’s estimated net realizable value. To the extent unamortized capitalized costs exceed net realizable value based on the product’s estimated future gross revenues, reduced by the estimated future costs of completing and disposing of the product, the excess is written off. This analysis requires us to estimate future gross revenues associated with certain products, and the future costs of completing and disposing of certain products. If these estimates change, write-offs of capitalized software costs could result.

Internal-use Software

Costs incurred to develop internal-use software during the application development stage are capitalized and reported at the lower of cost or fair value. Application development stage costs generally include costs associated with internal-use software configuration, coding, installation and testing. Costs of significant upgrades and enhancements that result in additional functionality are also capitalized whereas costs incurred for maintenance and minor upgrades and enhancements are expensed as incurred. We assess potential impairment of capitalized internal-use software whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future net cash flows that are expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Income Taxes

We use the asset and liability approach to account for income taxes. This methodology recognizes deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax base of assets and liabilities. We then record a valuation allowance to reduce deferred tax assets to an amount that more likely than not will be realized. We consider future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance. If we determine during any period that we could realize a larger net deferred tax asset than the recorded amount, we would adjust the deferred tax asset to increase income for the period. Conversely, if we determine that we would be unable to realize a portion of our recorded deferred tax asset, we would adjust the deferred tax asset to record a charge to income for the period.

Contingencies and Litigation

We are subject to various proceedings, lawsuits and claims relating to product, technology, labor, shareholder and other matters. We are required to assess the likelihood of any adverse outcomes and the potential range of probable losses in these matters. The amount of loss accrual, if any, is determined after analysis of each matter, and is subject to adjustment if warranted by new developments or revised strategies.

New Accounting Pronouncements

In November 2002, the Emerging Issues Task Force (“EITF”) reached a consensus on Issue 00-21, *Revenue Arrangements with Multiple Deliverables*. EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services, and/or rights to use assets. The provisions of EITF Issue No. 00-21 apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. We do not expect the adoption of EITF Issue No. 00-21 to have a material impact on our financial position or results of operations.

In January 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities*. FIN No. 46 expands upon existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. A variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN No. 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity’s activities or is entitled to receive a majority of the entity’s residual returns or both. The consolidation requirements of FIN No. 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. We do not expect the adoption of FIN No. 46 to have a material impact on our financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities.* This statement amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement is effective for contracts entered into or modified after June 30, 2003, and the guidance should be applied prospectively. We do not expect the adoption of SFAS No. 149 to have a material impact on our financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. The provisions of SFAS No. 150 apply immediately to all financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. We do not expect the adoption of SFAS No. 150 to have a material impact on our financial position or results of operations.

RISK FACTORS

We derive a substantial portion of our revenues from a small number of products and services, and our revenue will decline if the market does not continue to accept these products and services.

We expect that revenues from some or all of our Falcon Fraud Manager, Decision Manager for Medical Bill Review, Outsourced Bill Review and account management products and services, and agreements with TransUnion, Equifax and Experian, will account for a substantial portion of our total revenues for the foreseeable future. Our revenues will decline if the market does not continue to accept these products and services. Factors that might affect the market acceptance of these products and services include the following:

- changes in the business analytics industry;
- technological change;
- our inability to obtain or use state fee schedule or claims data in our insurance products;
- saturation of market demand;
- loss of key customers;
- industry consolidation;
- inability to successfully sell our products in new vertical markets; and
- events that reduce the effectiveness of or need for fraud detection capabilities.

Our ability to increase our revenues will depend to some extent upon introducing new products and services, and if the marketplace does not accept these new products and services, our revenues may decline.

We have a significant share of the available market in our Scoring segment and for certain services in our Strategy Machine Solutions segment (specifically, the markets for account management services at credit card processors and credit card fraud detection software). To increase our revenues, we must enhance and improve existing products and continue to introduce new products and new versions of existing products that keep pace with technological developments, satisfy increasingly sophisticated customer requirements and achieve market acceptance. We believe much of our future growth prospects will rest on our ability to continue to expand into newer markets for our products and services, such as direct marketing, insurance, small business lending, retail, telecommunications, personal credit management, the design of business strategies using Strategy Science technology and internet services. These areas are relatively new to our product development and sales and marketing personnel. Products that we plan to market in the future are in various stages of development. We cannot assure you that the marketplace will accept these products. If our current or potential customers are not willing to switch to or adopt our new products and services, our revenues will decrease.

We will continue to depend upon major contracts with credit reporting agencies, and our future revenues and operating income could decline if the terms of these relationships change.

We derive a substantial portion of our revenues and operating income from contracts with the three major credit reporting agencies. These contracts, which normally have a term of five years or less, accounted for approximately 19% of our revenues in the quarter and nine months ended June 30, 2003. While we have been successful in extending or renewing our agreements with credit reporting agencies in the past, the loss of one or more of such agreements or an adverse change in agreement terms could have a material adverse effect on our revenues and results of operations.

Since our revenues depend, to a great extent, upon conditions in the consumer credit, financial services and insurance industries, and to some extent on general economic conditions, an industry specific or general downturn may harm our results of operations.

During the quarter and nine months ended June 30, 2003, approximately 82% and 82%, respectively, of our revenues were derived from sales of products and services to the consumer credit, financial services and insurance industries. A downturn in the consumer credit, the financial services or the insurance industry, including a downturn caused by increases in interest rates or a tightening of credit, among other factors, could harm our results of operations. Since 1990, while the rate of account growth in the U.S. bankcard industry has been slowing and many of our large institutional clients have merged and consolidated, we have generated most of our revenue growth from our bankcard-related scoring and account management businesses by selling and cross-selling our products and services to large banks and other credit issuers. As this industry continues to consolidate, we may have fewer opportunities for revenue growth due to changing demand for our products and services that support clients' customer acquisition programs. In addition, industry consolidation could affect the base of recurring revenues derived from contracts in which we are paid on a per-transaction basis if consolidated customers combine their operations under one contract. We cannot assure you that we will be able effectively to promote future revenue growth in our businesses.

In addition, a softening of demand for our decisioning solutions or other products and services caused by a weakening of the economy generally may result in decreased revenues or lower growth rates. Due to the current slowdown in the economy generally, we believe that many of our existing and potential customers are reassessing or reducing their planned technology investments and deferring purchasing decisions. As a result, there is increased uncertainty with respect to our expected revenues. Further delays or reductions in business spending for business analytics could seriously harm our revenues and operating results.

Quarterly revenues and operating results have varied in the past and this variability may occur in the future and could lead to substantial declines in the market price for our common stock.

Our revenues and operating results varied in the past and future fluctuations in our operating results are possible. Consequently, we believe that you should not rely on period-to-period comparisons of financial results as an indication of future performance. Our future operating results may fall below the expectations of market analysts and investors, and in this event the market price of our common stock would likely fall. In addition, most of our operating expenses will not be affected by short-term fluctuations in revenues; thus, short-term fluctuations in revenues may significantly impact operating results. Factors that will affect our revenues and operating results include the following:

- variability in demand from our existing customers;
- the lengthy and variable sales cycle of many products, combined with the relatively large size of orders for our products, increase the likelihood of short term fluctuation in revenues;
- consumer dissatisfaction with, or problems caused by, the performance of our products;
- the timing of new product announcements and introductions in comparison with our competitors;
- the level of our operating expenses;
- changes in competitive conditions in the consumer credit, financial services and insurance industries;
- fluctuations in domestic and international economic conditions;
- our ability to complete large installations on schedule and within budget;
- acquisition-related expenses and charges; and
- timing of orders for and deliveries of software systems.

We may not be able to forecast our revenues accurately because our products have a long and variable sales cycle.

We cannot predict the timing of the recognition of our revenues accurately because the length of our sales cycles makes it difficult for us to predict the quarter in which sales to expected customers will occur. The long sales cycle for our products may cause license revenue and operating results to vary significantly from period to period. The sales cycle to license our products can typically range from 60 days to 18 months. Customers are often cautious in making decisions to acquire our products, because purchasing our products typically involves a significant commitment of capital, and may involve shifts by the customer to a new software and/or hardware platform or changes in the customer's operational procedures. Delays in completing sales can arise while customers complete their internal procedures to approve large capital expenditures and test and accept our applications. Consequently, we face difficulty predicting the quarter in which sales to expected customers will occur. This has contributed, and we expect it to continue to contribute, to fluctuations in our operating results.

Although we expect that the merger between Fair Isaac and HNC will benefit us, we may not realize those benefits because of integration and other challenges.

On August 5, 2002, we completed the acquisition of HNC, previously announced on April 29, 2002. Our failure to meet the challenges involved in successfully integrating the operations of Fair Isaac and HNC could seriously harm our results of operations. Realizing the benefits of the recently completed merger will depend in part on the continued integration of products, technologies, operations, and personnel. Although we have made progress since the merger was completed, the continued integration is a complex, time-consuming and expensive process that, even with proper planning and implementation, could significantly disrupt our business. In many recent mergers, especially mergers involving technology companies, merger partners have experienced difficulties integrating the combined businesses, and we have not previously faced an integration challenge as substantial as the one presented by the recently completed merger. The challenges involved in this integration include the following:

- continuing to persuade employees that the business cultures of Fair Isaac and HNC are compatible, maintaining employee morale and retaining key employees;
- managing a workforce over expanded geographic locations;
- demonstrating to our customers that the merger will not lower client service standards, interfere with business focus, adversely affect product quality or alter current product development plans;
- consolidating and rationalizing corporate IT and administrative infrastructures;
- combining product offerings; and
- coordinating and rationalizing research and development activities to enhance introduction of well designed new products and technologies.

We may not be able to sustain the revenue growth rates previously experienced by HNC and Fair Isaac individually.

We cannot assure you that we will experience the same rate of revenue growth following the merger as HNC and Fair Isaac experienced individually because of the difficulty of maintaining high percentage increases as the base of revenue increases. If our revenue does not increase at or above the rate analysts expect, the trading price for our common stock may decline.

Government regulations that apply to us or to our customers may expose us to liability, or render our products obsolete.

Legislation and governmental regulation inform how our business is conducted. Both our core businesses and our newer consumer initiatives are affected by regulation. Significant regulatory areas include:

- federal and state regulation of consumer report data and consumer reporting agencies, such as the Fair Credit Reporting Act, or FCRA;
- regulation designed to insure that lending practices are fair and non-discriminatory, such as the Equal Credit Opportunity Act;
- privacy law, including but not limited to the provisions of the Financial Services Modernization Act of 1999 and the Health Insurance Portability and Accountability Act of 1996;
- regulations governing the extension of credit to consumers and by Regulation E under the Electronic Fund Transfers Act, as well as non-governmental VISA and MasterCard electronic payment standards;

- Fannie Mae and Freddie Mac regulations, among others, for our mortgage services products;
- insurance regulations related to our insurance products; and
- consumer protection laws, such as federal and state statutes governing the use of the Internet and telemarketing.

In connection with our core activities, these statutes directly govern our operations to some degree. For example, the Financial Services Modernization Act and other privacy laws restrict our use and transmittal of nonpublic personal information, grant consumers opt out rights, require us to make disclosures to consumers about our collection and use of personal information, govern when and how we may deliver credit score explanation services to consumers, and otherwise constrain our business operations. Many foreign jurisdictions relevant to our business also regulate our operations. For example, the European Union's Privacy Directive creates minimum standards for the protection of personal data. In addition, some EU member states have enacted protections which go beyond the requirements of the Privacy Directive. We will be subject to the risk of possible regulatory enforcement actions or other legal action if we fail to comply with any of the statutes governing our operations.

Additionally, existing regulation and legislation is subject to change or more restrictive interpretation by enforcement agencies, and new restrictive legislation might pass. For example, new credit reporting or privacy legislation might restrict the sharing of information by affiliated entities, mandate providing credit scores to consumers, narrow the permitted uses of consumer report data, or otherwise restrict the use of data that is vital to our products. Currently, the permitted uses of consumer report data in connection with customer acquisition efforts are governed primarily by the FCRA, whose national uniformity provisions effectively expire in 2004. Unless extended, this expiration could lead to greater state regulation with a variety of possible consequences for our vendors, internals processes and customers, which might add to our costs, or to our ability to produce or market certain products, or our customers' ability to purchase or use those products. In addition, legislation to extend the uniformity provisions could contain other changes to the FCRA that could affect our results, for example provisions mandating credit risk score disclosure. State regulation could cause financial institutions to pursue new strategies, reducing the demand for our products. In addition, in many states, including California, there have been periodic legislative efforts to reform workers' compensation laws in order to reduce workers' compensation insurance costs and to curb abuses of the workers' compensation system. Simplifying state workers' compensation laws, regulations or fee schedules could diminish the need for, and the benefits provided by our Decision Manager for Medical Bill Review products and Outsourced Bill Review services. Any changes to existing regulation or legislation, new regulation or legislation, or more restrictive interpretation of existing regulation could harm our business, results of operations and financial condition. Some of the legislation and regulation germane to our products and services authorizes private rights of action. Lawsuits pursuant to such legislation or regulation, even if baseless, could expose us to unexpected costs and risks.

Finally, governmental regulation influences our current and prospective clients' activities, as well as their expectations and needs in relation to our products and services. We must appropriately design products and services to function in regulated industries or risk liability to our customers for our products' non-compliance.

Our revenue growth could decline if any major customer cancels, reduces or delays a purchase or implementation of our products.

Most of our customers are relatively large enterprises, such as banks, insurance companies, healthcare firms, retailers and telecommunications carriers. Our future success will depend upon the timing and size of future licenses, if any, from these customers and new customers and, in some cases, how quickly our customers implement our products after purchase. Many of our customers and potential customers are significantly larger than we are and may have sufficient bargaining power to demand reduced prices and favorable nonstandard terms. The loss of any major customer, or the delay of significant revenue from these customers, could reduce or delay our recognition of revenue.

Defects, failures and delays associated with our introduction of new products could seriously harm our business.

Significant undetected errors or delays in new products or new versions of products, especially in the area of customer relationship management, may affect market acceptance of our products and could harm our business, results of operations or financial position. If we were to experience delays in commercializing and introducing new or enhanced products, if our customers were to experience significant problems with implementing and installing our products, or if our customers were dissatisfied with our products' functionality or performance, our business, results of operations or financial position could be harmed. In the past, we have experienced delays while developing and introducing new products and product enhancements, primarily due to difficulties developing models, acquiring data and adapting to particular operating environments. Errors or defects in our products that are significant, or are perceived to be significant, could result in the rejection of our products, damage to our reputation, lost revenues, diverted development resources, potential product liability claims and increased service and support costs and warranty claims. In some cases, our products are priced based on the economic benefits our customers obtain. In such cases, the performance of our products and services directly affects our revenues, and failure of these products and services to perform as expected can harm our results.

If we fail to keep up with rapidly changing technologies, our products could become less competitive or obsolete.

In our markets, technology changes rapidly, and there are continuous improvements in computer hardware, network operating systems, programming tools, programming languages, operating systems, database technology and the use of the Internet. If we fail to enhance our current products and develop new products in response to changes in technology or industry standards, our products could rapidly become less competitive or obsolete. For example, the rapid growth of the Internet environment creates new opportunities, risks and uncertainties for businesses, such as ours, which develop software that must also be designed to operate in Internet, intranet and other online environments. Our future success will depend, in part, upon our ability to:

- internally develop new and competitive technologies;
- use leading third-party technologies effectively;
- continue to develop our technical expertise;
- anticipate and effectively respond to changing customer needs;
- initiate new product introductions in a way that minimizes the impact of customers delaying purchases of existing products in anticipation of new product releases; and
- influence and respond to emerging industry standards and other technological changes.

Any failure to recruit and retain additional qualified personnel, more challenging in light of uncertainty following the HNC acquisition, could hinder our ability to successfully manage our business.

Our future success will likely depend in large part on our ability to attract and retain experienced sales, research and development, marketing, technical support and management personnel. Employee retention may be particularly challenging in connection with the HNC acquisition as a result of employee uncertainty about their future roles, the distractions of integration, and morale challenges posed by workforce reductions that occurred after completion of the acquisition. Moreover, the complexity of our products requires highly trained customer service and technical support personnel to assist customers with product installation and deployment. The labor market for these persons is very competitive due to the limited number of people available with the necessary technical skills and understanding. We have experienced difficulty in recruiting qualified personnel, especially technical and sales personnel, and we may need additional staff to support new customers and/or increased customer needs. We may also recruit and employ skilled technical professionals from other countries to work in the United States. Limitations imposed by federal immigration laws and the availability of visas could hinder our ability to attract necessary qualified personnel and harm our business and future operating results. There is a risk that even if we invest significant resources in attempting to attract, train and retain qualified personnel, we will not succeed in our efforts, and our business could be harmed.

If requirements relating to accounting treatment for employee stock options are changed, we may be forced to change our business practices.

We currently account for the issuance of stock options under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. If proposals currently under consideration by accounting standards organizations and governmental authorities are adopted, we may be required to change our practice and treat the value of stock options granted to employees as a compensation expense. As a result, we could decide to reduce the number of stock options granted to employees or to grant options to fewer employees. This could affect our ability to retain existing employees and attract qualified candidates, and increase the cash compensation we would have to pay to them. In addition, such a change could have a negative effect on our earnings.

New product introductions and pricing strategies by our competitors could decrease our product sales and market share, or could pressure us to reduce our product prices in a manner that reduces our margins.

We may not be able to compete successfully against our competitors, and this inability could impair our capacity to sell our products. The market for business analytics is new, rapidly evolving and highly competitive, and we expect competition in this market to persist and intensify. Our competitors vary in size and in the scope of the products and services they offer, and include:

- in-house analytics departments;
- credit reporting agencies;
- computer service providers;
- regional risk management, marketing, systems integration and data warehousing competitors;
- application software companies, including enterprise software vendors;
- management information system departments of our customers and potential customers, including financial institutions, insurance companies and telecommunications carriers;
- third-party professional services and consulting organizations;
- internet companies;
- hardware suppliers that bundle or develop complementary software;
- network and telecommunications switch manufacturers, and service providers that seek to enhance their value-added services;
- neural network tool suppliers; and
- managed care organizations.

We expect to experience additional competition from other established and emerging companies, as well as from other technologies. For example, our Falcon Fraud Manager and Falcon Fraud Manager for Merchants products compete against other methods of preventing credit card fraud, such as credit cards that contain the cardholder’s photograph, smart cards, cardholder verification and authentication solutions and other card authorization techniques. Many of our anticipated competitors have greater financial, technical, marketing, professional services and other resources than we do. As a result, they may be able to respond more quickly to new or emerging technologies and changes in customer requirements. They may also be able to devote greater resources than we can to develop, promote and sell their products. Many of these companies have extensive customer relationships, including relationships with many of our current and potential customers. Furthermore, new competitors or alliances among competitors may emerge and rapidly gain significant market share. If we are unable to respond as quickly or effectively to changes in customer requirements as our competition, our ability to expand our business and sell our products will be negatively affected.

Our competitors may be able to sell products competitive to ours at lower prices individually or as part of integrated suites of several related products. This ability may cause our customers to purchase products of our competitors that directly compete with our products. Price reductions by our competitors could negatively impact our margins and results of operations, and could also harm our ability to obtain new long-term contracts and renewals of existing long-term contracts on favorable terms.

We will continue to rely upon proprietary technology rights, and if we are unable to protect them, our business could be harmed.

Our success will depend, in part, upon our proprietary technology and other intellectual property rights. To date, we have relied primarily on a combination of copyright, patent, trade secret, and trademark laws, and nondisclosure and other contractual restrictions on copying and distribution to protect our proprietary technology. Because the protection of our proprietary technology is limited, our proprietary technology could be used by others without our consent. In addition, patents may not be issued with respect to our pending or future patent applications, and our patents may not be upheld as valid or may not prevent the development of competitive products. Any disclosure, loss, invalidity of, or failure to protect our intellectual property could negatively impact our competitive position, and ultimately, our business. We cannot assure you that our means of protecting our intellectual property rights in the United States or abroad will be adequate or that others, including our competitors, will not use our proprietary technology without our consent. Furthermore, litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of resources and could harm our business, operating results and financial condition.

In addition, some of our technologies were developed under research projects conducted under agreements with various United States government agencies or subcontractors. Although we have commercial rights to these technologies, the United States government typically retains ownership of intellectual property rights and licenses in the technologies developed by us under these contracts, and in some cases can terminate our rights in these technologies if we fail to commercialize them on a timely basis. Under these contracts with the United States government, the results of research may be made public by the government, limiting our competitive advantage with respect to future products based on our research.

We may be subject to possible infringement claims that could harm our business.

With recent developments in the law that permit patenting of business methods, we expect that products in the industry segments in which we will compete, including software products, will increasingly be subject to claims of patent infringement as the number of products and competitors in our industry segments grow and the functionality of products overlaps. We may need to defend claims that our products infringe patent, copyright or other rights, and as a result may:

- incur significant defense costs or substantial damages;
- be required to cease the use or sale of infringing products;
- expend significant resources to develop or license a substitute non-infringing technology;
- discontinue the use of some technology; or
- be required to obtain a license under the intellectual property rights of the third party claiming infringement, which license may not be available or might require substantial royalties or license fees that would reduce our margins.

Security is important to our business, and breaches of security, or the perception that e-commerce is not secure, could harm our business.

Our business requires the appropriate and secure utilization of consumer and other sensitive information. Internet-based, electronic commerce requires the secure transmission of confidential information over public networks. Several of our products are accessed through the Internet, including our new consumer services accessible through the www.myFICO.com website. Security breaches in connection with the delivery of our products and services, including products and services utilizing the Internet, or well-publicized security breaches affecting the Internet in general, could significantly harm our business, operating results and financial condition. We cannot be certain that advances in computer capabilities, new discoveries in the field of cryptography, or other developments will not compromise or breach the technology protecting the networks that access our netsourced products, consumer services and proprietary database information.

We may incur risks related to acquisitions or significant investment in businesses.

We have made in the past, and may make in the future, acquisitions of, or significant investments in, businesses that offer complementary products, services and technologies. Any acquisitions or investments will be accompanied by the risks commonly encountered in acquisitions of businesses. Such risks include:

- the possibility that we will pay more than the acquired companies or assets are worth;
- the difficulty of assimilating the operations and personnel of the acquired businesses;

- the potential product liability associated with the sale of the acquired companies' products;
- the potential disruption of our ongoing business;
- the potential dilution of our existing stockholders and earnings per share;
- unanticipated liabilities, legal risks and costs;
- the distraction of management from our ongoing business; and
- the impairment of relationships with employees and clients as a result of any integration of new management personnel.

These factors could harm our business, results of operations or financial position, particularly in the event of a significant acquisition.

Failure or inability to obtain data from our clients to update and re-develop or to create new models could harm our business.

To develop, install and support our products, including consumer credit, financial services, predictive modeling, decision analysis, intelligence management, credit card fraud control and profitability management, loan underwriting and insurance products, we will require periodic updates of our technologies and models. We must develop or obtain a reliable source of sufficient amounts of current and statistically relevant data to analyze transactions and update our models. In most cases, these data must be periodically updated and refreshed to enable our products to continue to work effectively in a changing environment. We do not own or control much of the data that we require, most of which are collected privately and maintained in proprietary databases. Our customers and key business alliances agree to provide us the data we require to analyze transactions, report results and build new models. If we fail to maintain good relationships with our customers and business alliances, or if they decline to provide such data due to legal privacy concerns or prohibitions or a lack of permission from their own customers, we could lose access to required data and our products might become less effective. In addition, our Decision Manager for Medical Bill Review products use data from state workers' compensation fee schedules adopted by state regulatory agencies. Third parties have previously asserted copyright interests in these data. These assertions, if successful, could prevent us from using these data. Any interruption of our supply of data could seriously harm our business, financial condition or results of operations.

Our operations outside the United States subject us to unique risks that may harm our results of operations.

A growing portion of our revenues is derived from international sales. During the quarter and nine months ended June 30, 2003, approximately 21% of our revenues were derived from business outside the United States. As part of our growth strategy, we plan to continue to pursue opportunities outside the United States. Accordingly, our future operating results could be negatively affected by a variety of factors arising out of international commerce, some of which are beyond our control. These factors include:

- the general economic and political conditions in countries where we sell our products and services;
- incongruent tax structures;
- difficulty in staffing our operations in various countries;
- the effects of a variety of foreign laws and regulations;
- import and export licensing requirements;
- longer payment cycles;
- potentially reduced protection for intellectual property rights;
- currency fluctuations;

- changes in tariffs and other trade barriers; and
- difficulties and delays in translating products and related documentation into foreign languages.

We cannot assure you that we will be able to successfully address each of these challenges in the near term.

Additionally, some of our business will be conducted in currencies other than the U.S. dollar. Foreign currency transaction gains and losses are not currently material to our financial position, results of operations or cash flows. However, an increase in our foreign revenues could subject us to increased foreign currency transaction risks in the future.

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

Market Risk Disclosures

The following discussion about our market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. We believe that our equity risks are not material. We do not use derivative financial instruments for speculative or trading purposes.

Interest Rate Sensitivity

We maintain an investment portfolio consisting mainly of income securities with an average maturity of less than five years. These available-for-sale securities are subject to interest rate risk and will fall in value if market interest rates increase. We have the ability to hold our fixed income investments until maturity, and therefore we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on our securities portfolio. The following table presents the principal amounts and related weighted-average yields for our fixed rate interest-bearing investment portfolio at June 30, 2003 and September 30, 2002 (in thousands):

	June 30, 2003			September 30, 2002		
	Cost Basis	Carrying Amounts	Average Yield	Cost Basis	Carrying Amounts	Average Yield
Cash and cash equivalents	$129,356	$129,346	1.11%	$ 76,195	$ 76,189	1.66%
Short-term investments	86,408	86,770	1.47%	184,434	184,377	2.39%
Long-term investments	139,002	139,723	1.55%	135,788	136,971	3.27%
	$354,766	$355,839	1.37%	$396,417	$397,537	2.55%

We are also subject to interest rate risk related to our 5.25% Convertible Subordinated Notes. To the extent that general market interest rates fluctuate, the fair value of the notes may increase or decrease.

Forward Foreign Currency Contracts

We maintain a hedging program to manage our foreign currency exchange rate risk on existing foreign currency receivable and bank balances by entering into forward contracts to sell or buy foreign currency. At period end, foreign-denominated receivables and cash balances held by our U.S. reporting entities are remeasured into the U.S. dollar functional currency at current market rates. The change in value from this remeasurement is then reported as a foreign exchange gain or loss for that period in our consolidated statements of income and the resulting gain or loss on the forward contract mitigates the exchange rate risk of the associated assets. All of our forward foreign currency contracts have maturity periods of less than six months. Such derivative financial instruments are subject to market risk.

The following table summarizes our outstanding forward foreign currency contracts, by currency, with contract amounts representing the expected payments to be made under these instruments at June 30, 2003 (in thousands):

	Contract Amount			
	Foreign Currency		US $	Fair Value US $
Sell foreign currency:				
British Pound (GBP)	GBP	3,000	$4,971	$4,959
EURO (EUR)	EUR	1,200	1,377	1,377
Japanese Yen (YEN)	YEN	40,000	335	334
			$6,683	$6,670

Item 4. ***Controls and Procedures***

An evaluation was carried out under the supervision and with the participation of Fair Isaac's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of Fair Isaac's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this quarterly report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that Fair Isaac's disclosure controls and procedures are effective to ensure that information required to be disclosed by Fair Isaac in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

No change in Fair Isaac's internal control over financial reporting was identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act that occurred during the period covered by this quarterly report and that has materially affected, or is reasonably likely to materially affect, Fair Isaac's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6. ***Exhibits and Reports on Form 8-K***

(a) Exhibits:

Exhibit Number	Description
99.1	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 for Thomas G. Grudnowski.
99.2	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 for Kenneth J. Saunders.

(b) Reports on Form 8-K:

i. On July 23, 2003, we furnished a Current Report on Form 8-K to the SEC, including the Company's press release announcing financial results for the quarter and nine months ended June 30, 2003.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FAIR ISAAC CORPORATION

DATE: July 23, 2003

By /s/ Kenneth J. Saunders

Kenneth J. Saunders
Vice President and Chief Financial Officer
(for Registrant as duly authorized officer and as Principal Financial Officer)

DATE: July 23, 2003

By /s/ Russell C. Clark

Russell C. Clark
Vice President, Finance and Corporate Controller (Principal Accounting Officer)

Table of Contents

CERTIFICATIONS

I, Thomas G. Grudnowski, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fair Isaac Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and

   c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 23, 2003

/s/ THOMAS G. GRUDNOWSKI

Thomas G. Grudnowski
Chief Executive Officer

I, Kenneth J. Saunders, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fair Isaac Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and

   c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 23, 2003

/s/ KENNETH J. SAUNDERS

Kenneth J. Saunders
Chief Financial Officer

EXHIBIT INDEX

Exhibit Number	Description	Method of Filing
99.1	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 for Thomas G. Grudnowski.	Filed Electronically
99.2	Certification under Section 906 of the Sarbanes-Oxley Act of 2002 for Kenneth J. Saunders.	Filed Electronically

EXHIBIT 99.1

CERTIFICATION UNDER SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned certifies that this periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this periodic report fairly presents, in all material respects, the financial condition and results of operations of Fair Isaac Corporation.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Fair Isaac Corporation and will be retained by Fair Isaac Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

Date: July 23, 2003

/s/ Thomas G. Grudnowski

Thomas G. Grudnowski
Chief Executive Officer

EXHIBIT 99.2

CERTIFICATION UNDER SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned certifies that this periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this periodic report fairly presents, in all material respects, the financial condition and results of operations of Fair Isaac Corporation.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Fair Isaac Corporation and will be retained by Fair Isaac Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

Date: July 23, 2003

/s/ Kenneth J. Saunders

Kenneth J. Saunders
Chief Financial Officer