

LINCOLN NATIONAL CORP
Form 10-Q
August 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 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, 2016

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number: 1-6028

LINCOLN NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

Indiana (State or other jurisdiction of incorporation or organization)	35-1140070 (I.R.S. Employer Identification No.)
150 N. Radnor Chester Road, Suite A305, Radnor, Pennsylvania (Address of principal executive offices)	19087 (Zip Code)

(484) 583-1400

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report.)

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

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

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

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

Smaller reporting company

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

As of August 1, 2016, there were 232,795,337 shares of the registrant’s common stock outstanding.

Lincoln National Corporation

Table of Contents

Item	Page
PART I	
1. <u>Financial Statements</u>	1
2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	47
<u>Forward-Looking Statements – Cautionary Language</u>	47
<u>Introduction</u>	48
<u>Executive Summary</u>	48
<u>Critical Accounting Policies and Estimates</u>	49
<u>Results of Consolidated Operations</u>	50
<u>Results of Annuities</u>	52
<u>Results of Retirement Plan Services</u>	57
<u>Results of Life Insurance</u>	63
<u>Results of Group Protection</u>	69
<u>Results of Other Operations</u>	72
<u>Realized Gain (Loss) and Benefit Ratio</u>	74
<u>Unlocking Consolidated Investments</u>	76

	<u>Review of</u>	
	<u>Consolidated</u>	
	<u>Financial</u>	
	<u>Condition</u>	89
	<u>Liquidity and</u>	
	<u>Capital</u>	
	<u>Resources</u>	89
	<u>Other Matters</u>	93
	<u>Other Factors</u>	
	<u>Affecting Our</u>	
	<u>Business</u>	93
	<u>Recent</u>	
	<u>Accounting</u>	
	<u>Pronouncements</u>	93
3.	<u>Quantitative and</u>	
	<u>Qualitative</u>	
	<u>Disclosures About</u>	
	<u>Market Risk</u>	93
4.	<u>Controls and</u>	
	<u>Procedures</u>	95

PART II

1.	<u>Legal Proceedings</u>	96
	<u>Unregistered Sales of</u>	
2.	<u>Equity Securities and</u>	
	<u>Use of Proceeds</u>	96
6.	<u>Exhibits</u>	96
	<u>Signatures</u>	97
	<u>Exhibit Index for the E-1</u>	
	<u>Report on Form</u>	
	<u>10-Q</u>	

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	As of June 30, 2016 (Unaudited)	As of December 31, 2015
ASSETS		
Investments:		
Available-for-sale securities, at fair value:		
Fixed maturity securities (amortized cost: 2016 – \$83,033; 2015 – \$81,993)	\$ 91,461	\$ 84,964
Variable interest entities' fixed maturity securities (amortized cost: 2016 – \$598; 2015 – \$596)	600	598
Equity securities (cost: 2016 – \$259; 2015 – \$226)	277	237
Trading securities	1,812	1,854
Mortgage loans on real estate	9,257	8,678
Real estate	21	17
Policy loans	2,507	2,545
Derivative investments	2,613	1,537
Other investments	2,039	1,778
Total investments	110,587	102,208
Cash and invested cash	4,113	3,146

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Deferred acquisition costs and value of business acquired	8,280		9,510											
Premiums and fees receivable	370		376											
Accrued investment income	1,070		1,070											
Reinsurance recoverables	5,540		5,623											
Funds withheld reinsurance assets	628		629											
Times New Roman" SIZE="1">\$	24,003		\$ (171,676)		\$ 312,947		\$ 105,289		\$ (15,144)					
Comprehensive income information:									\$ 255,623					
Net income								11,422	11,422					
Other comprehensive income:														
Foreign currency translation adjustments								4,357	4,357					
Comprehensive income									15,779					
Stock-based compensation							4,533		4,533					
Shares issued and forfeited, net, under stock plans including income tax benefits					4,756		(785)		3,971					
Repurchase of restricted stock for tax withholdings					(366)				(366)					
Balance as of June 30, 2011	\$	204	\$	24,003	\$	(167,286)	\$	316,695	\$	116,711	\$	(10,787)	\$	279,540

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

Table of Contents**ACI WORLDWIDE, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited and in thousands)

	September 30, For the Six Months Ended	September 30, For the Six Months Ended
	2011	2010
Cash flows from operating activities:		
Net income (loss)	\$ 11,422	\$ (2,239)
Adjustments to reconcile net income (loss) to net cash flows from operating activities		
Depreciation	3,528	3,330
Amortization	10,593	9,796
Tax expense of intellectual property shift	917	1,100
Deferred income taxes	5,386	4,895
Stock-based compensation expense	4,533	3,598
Excess tax benefit of stock options exercised	(1,066)	211
Other	210	337
Changes in operating assets and liabilities, net of impact of acquisitions:		
Billed and accrued receivables, net	6,456	16,112
Other current and noncurrent assets	277	(4,415)
Accounts payable	(3,779)	(4,428)
Accrued employee compensation	(4,189)	(4,398)
Accrued liabilities	(5,085)	(5,782)
Current income taxes	(3,404)	(14,887)
Deferred revenue	4,569	15,563
Other current and noncurrent liabilities	(4,884)	(1,695)
Net cash flows from operating activities	25,484	17,098
Cash flows from investing activities:		
Purchases of property and equipment	(7,870)	(2,406)
Purchases of software and distribution rights	(5,288)	(3,926)
Alliance technical enablement expenditures	(256)	(3,055)
Acquisition of businesses, net of cash acquired	(16,850)	
Net cash flows from investing activities	(30,264)	(9,387)
Cash flows from financing activities:		
Proceeds from issuance of common stock	628	537
Proceeds from exercises of stock options	2,375	2,092
Excess tax benefit of stock options exercised	1,066	110
Repurchases of common stock		(15,665)
Repurchase of restricted stock for tax withholdings	(366)	(255)
Payments on debt and capital leases	(867)	(716)
Net cash flows from financing activities	2,836	(13,897)

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Effect of exchange rate fluctuations on cash	1,441	(1,974)
Net decrease in cash and cash equivalents	(503)	(8,160)
Cash and cash equivalents, beginning of period	171,310	125,917
Cash and cash equivalents, end of period	\$ 170,807	\$ 117,757

Supplemental cash flow information

Income taxes paid, net	\$ 11,862	\$ 17,637
Interest paid	\$ 855	\$ 891

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

Table of Contents

ACI WORLDWIDE, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Condensed Consolidated Financial Statements

The unaudited condensed consolidated financial statements include the accounts of ACI Worldwide, Inc. and its wholly-owned subsidiaries (collectively, the Company). All intercompany balances and transactions have been eliminated. The condensed consolidated financial statements as of June 30, 2011, and for the three and six months ended June 30, 2011 and 2010, are unaudited and reflect all adjustments of a normal recurring nature, except as otherwise disclosed herein, which are, in the opinion of management, necessary for a fair presentation, in all material respects, of the financial position and operating results for the interim periods. The condensed consolidated balance sheet as of December 31, 2010 is derived from the audited financial statements.

The condensed consolidated financial statements contained herein should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2010, filed on February 18, 2011. Results for the three and six months ended June 30, 2011, are not necessarily indicative of results that may be attained in the future.

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Comprehensive Income (loss)

The Company's comprehensive income for the three months ended June 30, 2011 was \$10.7 million compared to a \$3.1 million loss for the same period in 2010. The Company's comprehensive income for the six months ended June 30, 2011 was \$15.8 million compared to a \$8.9 million loss for the same period in 2010. The two components of comprehensive income (loss) are net income (loss) and foreign currency translation adjustments. The Company realized a foreign currency translation gain for the three months ended June 30, 2011 of \$0.9 million and compared to a foreign currency loss of \$3.0 million during the same period in 2010. The foreign currency translation gain for the six months ended June 30, 2011 was \$4.4 million compared to a foreign currency translation loss of \$6.7 million during the same period in 2010. Accumulated other comprehensive loss included in the Company's condensed consolidated balance sheet represents the accumulated foreign currency translation adjustment. Since the undistributed earnings of the Company's foreign subsidiaries are considered to be permanently reinvested, the components of accumulated other comprehensive loss have not been tax effected.

Note Payable Under Credit Facility

On September 29, 2006, the Company entered into a five year revolving credit facility with a syndicate of financial institutions, as lenders, providing for revolving loans and letters of credit in an aggregate principal amount not to exceed \$150 million. The facility has a maturity date of September 29, 2011, at which time any principal amounts outstanding are due. Obligations under the facility are unsecured and uncollateralized, but are jointly and severally guaranteed by certain domestic subsidiaries of the Company. As of June 30, 2011, the revolving credit facility is classified as current due to the maturity date being within 12 months. The Company is currently in discussions with various lenders, including its current lenders, for a new credit facility and anticipates closing on the new facility prior to the maturation of the current facility.

Revenue

Update to Revenue Accounting Policies. With the exception of the adoption of the new accounting pronouncements related to revenue recognition, which are discussed below, there have been no material changes to the Company's significant accounting policies, as compared to the significant accounting policies described in its annual report on Form 10-K for the fiscal year ended December 31, 2010.

Table of Contents*Revenue Recognition for Arrangements with Multiple Deliverables.*

Effective January 1, 2011, the Company adopted on a prospective basis for all new or materially modified arrangements entered into on or after that date, the amended accounting guidance for multiple-deliverable revenue arrangements and the amended guidance related to the scope of existing software revenue recognition guidance. The adoption of this guidance did not have a material impact on the Company's condensed consolidated financial statements for the three and six months ended June 30, 2011, nor does the Company expect it to have a material impact on its future financial statements.

A multiple-deliverable arrangement is separated into more than one unit of accounting if the delivered item(s) has value to the customer on a stand-alone basis; if the arrangement includes a general right of return relative to the delivered item(s); and if delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company. If these criteria are not met, the arrangement is accounted for as a single unit of accounting which would result in revenue being recognized ratably over the contract term or being deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. If these criteria are met for each, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative selling price. The selling price for each element is based upon the following selling price hierarchy: vendor-specific objective evidence (VSOE) if available, third party evidence (TPE) if VSOE is not available, or estimated selling price if neither VSOE nor TPE is available.

The Company enters into hosting-related arrangements that may consist of multiple service deliverables including initial implementation and setup services; on-going support services; and other services. The Company's hosted products operate in a highly regulated and controlled environment which requires a highly specialized and unique set of initial implementation and setup services prior to the commencement of hosting-related services. Due to the essential and specialized nature of the implementation and setup services, these services do not qualify as separate units of accounting separate from the hosting service as the delivered services do not have value to the customer on a stand-alone basis. The on-going support and other services are considered as separate units of accounting. The total arrangement consideration is allocated to each of the separate units of accounting based on their relative selling price and revenue is recognized over their respective service periods. As the support and other services periods are the same as the hosting service period, the recognition pattern is similar to what was experienced prior to adopting the amended accounting guidance for multiple-deliverable revenue arrangements.

Vendor-Specific Objective Evidence

Certain of the Company's software license arrangements include post contract customer support (maintenance or PCS) terms that fail to achieve VSOE of fair value due to non-substantive renewal periods, or contain a range of possible PCS renewal amounts. As a result of the maturation of certain retail payment engine products, including BASE24, a higher number of software license arrangements fail to achieve VSOE of fair value for PCS due to non-substantive renewal periods, or contain a range of possible PCS renewal amounts. For these arrangements, VSOE of fair value of PCS does not exist and revenues for the software license, PCS and services, if applicable, are considered to be one accounting unit and are therefore recognized ratably over the longer of the contractual service term or the initial PCS term once the delivery of both services has commenced. The Company typically classifies revenues associated with these arrangements in accordance with the contractually specified amounts, which approximate fair value assigned to the various elements, including software license fees, maintenance fees and services, if applicable.

This allocation methodology has been applied to the following amounts included in revenues in the consolidated statements of operations from arrangements for which VSOE of fair value does not exist for each undelivered element (in thousands):

	September 30, Three Months Ended June 30,		September 30, Six Months Ended June 30,	
	2011	2010	2011	2010
Software license fees	\$ 18,922	\$ 6,617	\$ 41,840	\$ 11,782
Maintenance fees	3,547	2,015	8,812	3,158
Services	336	1,428	459	2,808
Total	\$ 22,805	\$ 10,060	\$ 51,111	\$ 17,748

2. Acquisitions

ISD Holdings, Inc.

On March 18, 2011, the Company closed the acquisition of ISD Holdings, Inc. and its 100% owned subsidiary ISD Corporation (collectively ISD). ISD s suite of products enables retailers to consolidate, manage, secure and route all electronic

Table of Contents

transactions from their point-of-sale systems to third-party processors for authorization and settlement.

The aggregate purchase price of ISD was \$19.2 million, after working capital adjustments in accordance with the terms of the purchase agreement, which included cash acquired of \$2.4 million. The allocation of the purchase price to specific assets and liabilities was based on the relative fair value of all assets and liabilities.

In connection with the acquisition, the Company recorded the following amounts based upon its preliminary purchase price allocation during the six months ended June 30, 2011 (in thousands, except weighted-average useful lives):

	Amount	Weighted- Average Useful Lives
Cash	\$ 2,375	
Accounts Receivable	2,030	
Other current assets	958	
Total current assets acquired	5,363	
Noncurrent assets:		
Property and equipment	519	
Goodwill	11,380	
Intellectual property rights	2,338	5 years
Customer relationships	4,059	9 years
Trade name	247	5 years
Total assets acquired	23,906	
Current liabilities acquired	(4,681)	
Net assets acquired	\$ 19,225	

Factors contributing to the purchase price which resulted in the goodwill (which is not tax deductible) include the acquisition of management, sales, and technology personnel with the skills to market new and existing products of the Company. Pro forma results are not presented because they are not material.

3. Stock-Based Compensation Plans*Employee Stock Purchase Plan*

Under the Company's 1999 Employee Stock Purchase Plan, as amended (the ESPP), a total of 1,500,000 shares of the Company's common stock have been reserved for issuance to eligible employees. Participating employees are permitted to designate up to the lesser of \$25,000 or 10% of their annual base compensation for the purchase of common stock under the ESPP. Purchases under the ESPP are made one calendar month after the end of each fiscal quarter. The price for shares of common stock purchased under the ESPP is 85% of the stock's fair market value on the last business day of the three-month participation period. Shares issued under the ESPP during the six months ended June 30, 2011 and 2010 totaled 20,730 and 30,699, respectively.

Table of Contents*Stock-Based Payments*

A summary of stock options issued pursuant to the Company's stock incentive plans is as follows:

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value of In-the-Money Options
Outstanding as of December 31, 2010	3,510,538	\$ 21.55		
Granted	70,000	29.00		
Exercised	(196,042)	12.11		
Forfeited	(13,737)	21.15		
Outstanding as of June 30, 2011	3,370,759	\$ 22.25	5.36	\$ 39,287,115
Exercisable as of June 30, 2011	2,247,684	\$ 22.14	4.71	\$ 26,595,661

As of June 30, 2011, the Company expects that 94.9% of the options will vest over the vesting period.

The weighted-average grant date fair value of stock options granted during the six months ended June 30, 2011 and 2010 was \$13.69 and \$9.39. The Company issued treasury shares for the exercise of stock options during the six months ended June 30, 2011 and 2010. The total intrinsic value of stock options exercised during the six months ended June 30, 2011 and 2010 was \$3.7 million and \$0.9 million, respectively.

The fair value of options granted during the three and six months ended June 30, 2011 and 2010 was estimated on the date of grant using the Black-Scholes option-pricing model, a pricing model acceptable under U.S. GAAP, with the following weighted-average assumptions:

	September 30, Three Months Ended June 30, 2011	September 30, Six Months Ended June 30, 2011	September 30, Three Months Ended June 30, 2010	September 30, Six Months Ended June 30, 2010
Expected life (years)	5.50	5.50	5.50	5.63
Interest rate	1.6%	1.6%	2.0%	2.3%
Volatility	50.8%	50.8%	51.8%	51.7%

Dividend yield

Expected volatilities are based on the Company's historical common stock volatility derived from historical stock price data for historical periods commensurate with the options' expected life. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The Company used the simplified method for determining the expected life. The simplified method was used as the historical data did not provide a reasonable basis upon which to estimate the expected term due to the extended period during which individuals were unable to exercise options while the Company was not current with its filings with the Securities and Exchange Commission (SEC). The risk-free interest rate is based on the implied yield currently available on United States Treasury zero coupon issues with a term equal to the expected term at the date of grant of the options. The expected dividend yield is zero as the Company has historically paid no dividends and does not anticipate dividends to be paid in the future.

Table of Contents

A summary of nonvested long-term incentive program performance share awards (LTIP performance shares) outstanding as of June 30, 2011 and changes during the period are as follows:

	September 30, Number of Shares at Expected Attainment	September 30, Weighted- Average Grant Date Fair Value
Nonvested LTIP Performance Shares		
Nonvested as of December 31, 2010	499,035	\$ 20.57
Forfeited	(15,520)	19.77
Nonvested as of June 30, 2011	483,515	\$ 20.60

A summary of nonvested restricted share awards (RSAs) as of June 30, 2011 and changes during the period are as follows:

	September 30, Number of Restricted Share Awards	September 30, Weighted-Average Grant Date Fair Value
Nonvested Restricted Share Awards		
Nonvested as of December 31, 2010	192,298	\$ 18.42
Awarded	1,300	29.00
Vested	(43,001)	16.61
Forfeited	(9,000)	17.36
Nonvested as of June 30, 2011	141,597	\$ 19.14

During the six months ended June 30, 2011, 43,001 of the RSAs vested. The Company withheld 13,042 of those shares to pay the employees portion of the minimum payroll withholding taxes.

As of June 30, 2011, there were unrecognized compensation costs of \$5.6 million related to nonvested stock options, \$1.7 million related to the nonvested RSAs, and \$6.0 million related to the LTIP performance shares, which the Company expects to recognize over weighted-average periods of 1.8 years, 1.4 years and 2.1 years, respectively.

The Company recorded stock-based compensation expenses for the three months ended June 30, 2011 and 2010 related to stock options, LTIP performance shares, RSAs, and the ESPP of \$2.1 million and \$1.8 million, respectively, with corresponding tax benefits of \$0.8 million and \$0.7 million, respectively. The Company recorded stock-based compensation expenses for the six months ended June 30, 2011 and 2010 related to stock options, LTIP performance shares, RSAs, and the ESPP of \$4.5 million and \$3.6 million, respectively, with corresponding tax benefits of \$1.7 million and \$1.3 million, respectively. Tax benefits in excess of the option s grant date fair value are classified as financing cash flows. No stock-based compensation costs were capitalized during the six months ended June 30, 2011 and 2010. Estimated forfeiture rates, stratified by employee classification, have been included as part of the Company s calculations of compensation costs. The Company recognizes compensation costs for stock option awards that vest with the passage of time with only service conditions on a straight-line basis over the requisite service period.

Cash received from option exercises for the six months ended June 30, 2011 and 2010 was \$2.4 million and \$2.1 million, respectively. The actual tax benefit realized for the tax deductions from option exercises totaled \$1.4 million and \$0.3 million for the six months ended June 30, 2011 and 2010, respectively.

Table of Contents**4. Goodwill**

Changes in the carrying amount of goodwill during the six months ended June 30, 2011, were as follows (in thousands):

	September 30, Americas	September 30, EMEA	September 30, Asia/Pacific	September 30, Total
Gross Balance prior to December 31, 2010	\$ 187,362	\$ 44,250	\$ 19,755	\$ 251,367
Total impairment prior to December 31, 2010	(47,432)			(47,432)
Balance as of December 31, 2010	139,930	44,250	19,755	203,935
Addition acquisition of ISD (1)	11,380			11,380
Foreign currency translation adjustments	109	3,120	771	4,000
Balance as of June 30, 2011	\$ 151,419	\$ 47,370	\$ 20,526	\$ 219,315

(1) Addition relates to the goodwill acquired in the acquisition of ISD as discussed in Note 2.

5. Software and Other Intangible Assets

At June 30, 2011, software net book value totaling \$25.4 million, net of \$48.6 million of accumulated amortization, includes the net book value of software marketed for external sale of \$12.6 million. The remaining software net book value of \$12.8 million is comprised of various software that has been acquired or developed for internal use.

Quarterly amortization of software marketed for external sale is computed using the greater of the ratio of current revenues to total estimated revenues expected to be derived from the software or the straight-line method over an estimated useful life of three to six years. Software for resale amortization expense recorded in the three months ended June 30, 2011 and 2010 totaled \$1.7 million and \$1.5 million, respectively. Software for resale amortization expense recorded in the six months ended June 30, 2011 and 2010 totaled \$3.3 million and \$3.0 million, respectively. These software amortization expense amounts are reflected in cost of software license fees in the condensed consolidated statements of operations. Amortization of software for internal use of \$2.0 million and \$1.8 million for the three months ended June 30, 2011 and 2010, respectively, is included in depreciation and amortization in the condensed consolidated statements of operations. Amortization of software for internal use was \$3.9 million and \$3.6 million for the six months ended June 30, 2011 and 2010, respectively.

The carrying amount and accumulated amortization of the Company's other intangible assets that were subject to amortization at each balance sheet date are as follows (in thousands):

	September 30, Gross Carrying Amount	September 30, June 30, 2011 Accumulated Amortization	September 30, Net Balance	September 30, Gross Carrying Amount	September 30, December 31, 2010 Accumulated Amortization	September 30, Net Balance
Customer relationships	\$ 41,142	\$ (21,559)	\$ 19,583	\$ 36,393	\$ (18,855)	\$ 17,538
Purchased contracts	10,812	(9,484)	1,328	10,753	(8,504)	2,249
Trademarks and tradenames	1,376	(538)	838	1,062	(422)	640
Covenant not to compete	84	(71)	13	83	(62)	21
	\$ 53,414	\$ (31,652)	\$ 21,762	\$ 48,291	\$ (27,843)	\$ 20,448

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Other intangible assets amortization expense for the three months ended June 30, 2011 and 2010 totaled \$1.7 million and \$1.5 million, respectively. Other intangible assets amortization expense for the six months ended June 30, 2011 and 2010 totaled \$3.3 million and \$3.1 million, respectively.

Table of Contents

Based on capitalized software and other intangible assets at June 30, 2011, estimated amortization expense for future fiscal years is as follows (in thousands):

Fiscal Year Ending December 31,	September 30,	September 30,
	Software Amortization	Other Intangible Assets Amortization
Remainder of 2011	\$ 6,952	\$ 3,105
2012	10,697	5,490
2013	4,508	5,235
2014	2,622	3,399
2015	578	1,480
Thereafter		3,053
Total	\$ 25,357	\$ 21,762

6. Derivative Instruments and Hedging Activities

The Company had two interest rate swaps that terminated on October 4, 2010. Neither swap qualified for hedge accounting. Accordingly, the gain (loss) resulting from the change in the fair value of the interest rate swaps of less than \$0.1 million for the three months ended June 30, 2010 and \$(0.1) million for the six months ended June 30, 2010, was reflected as income (expense) in other income (expense), net in the accompanying condensed consolidated statements of operations.

As both interest rate swaps terminated on October 4, 2010, there was no liability reported in the accompanying condensed consolidated balance sheet as of June 30, 2011 and December 31, 2010.

7. Stock Repurchase Plan

The Company's board of directors has approved a stock repurchase program authorizing the Company, from time to time as market and business conditions warrant, to acquire up to \$210 million of its common stock. Under the program to date, the Company has purchased 8,082,180 shares for approximately \$187.1 million. The Company did not repurchase shares under this program during the six months ended June 30, 2011. The maximum remaining dollar value of shares authorized for purchase under the stock repurchase program was approximately \$22.9 million as of June 30, 2011.

8. Earnings (Loss) Per Share

Earnings (loss) per share is computed in accordance with U.S. GAAP. Basic earnings (loss) per share is computed on the basis of weighted average outstanding common shares. Diluted earnings (loss) per share is computed on the basis of basic weighted average outstanding common shares adjusted for the dilutive effect of stock options and other outstanding dilutive securities.

The following table reconciles the average share amounts used to compute both basic and diluted loss per share (in thousands):

	September 30,	September 30,	September 30,	September 30,
	Three Months Ended June 30, 2011	2010	Six Months Ended June 30, 2011	2010
Weighted average share outstanding:				
Basic weighted average shares outstanding	33,446	33,500	33,383	33,612
Add: Dilutive effect of stock options, restricted stock awards and common stock warrants	808		737	

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Diluted weighted average shares outstanding	34,254	33,500	34,120	33,612
---	--------	--------	--------	--------

For the three and six months ended June 30, 2011, 3.2 million options to purchase shares, restricted share awards, common stock warrants and contingently issuable shares were excluded from the diluted earnings per share computation as their effect would be anti-dilutive. For the three and six months ended June 30, 2010, 6.7 million options to purchase shares, restricted share

Table of Contents

awards, common stock warrants and contingently issuable shares were excluded from the diluted earnings per share computation as their effect would be anti-dilutive.

9. Other Income (Expense), net

Other, net is comprised of the following items (in thousands):

	September 30, Three Months Ended June 30,		September 30, Six Months Ended June 30,	
	2011	2010	2011	2010
Foreign currency transaction gain (losses)	\$ 286	\$ (1,678)	\$ 47	\$ (1,622)
Gain (loss) on interest rate swap		21		(137)
Other	(26)	(25)	(89)	(137)
Total	\$ 260	\$ (1,682)	\$ (42)	\$ (1,896)

10. Segment Information

The Company's chief operating decision maker, together with other senior management personnel, currently focus their review of consolidated financial information and the allocation of resources based on reporting of operating results, including revenues and operating income, for the geographic regions of the Americas, Europe/Middle East/Africa (EMEA) and Asia/Pacific. The Company's products are sold and supported through distribution networks covering these three geographic regions, with each distribution network having its own sales force. The Company supplements its distribution networks with independent reseller and/or distributor arrangements. As such, the Company has concluded that its three geographic regions are its operating segments.

The Company's chief operating decision maker reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenues and operating income (loss) by geographical region.

The Company allocated segment support expenses such as global product delivery and development, global customer operations and global product management based upon percentage of revenue per segment. Corporate overhead costs are allocated as a percentage of the headcount by segment. The following is selected segment financial data for the periods indicated (in thousands):

	September 30, Three Months Ended June 30,		September 30, Six Months Ended June 30,	
	2011	2010	2011	2010
Revenues:				
Americas	\$ 57,974	\$ 50,185	\$ 110,304	\$ 96,501
EMEA	41,880	30,466	84,021	62,379
Asia/Pacific	13,512	11,772	23,584	21,286
	\$ 113,366	\$ 92,423	\$ 217,909	\$ 180,166
Operating income (loss):				
Americas	\$ 9,678	\$ 6,829	\$ 15,641	\$ 9,888
EMEA	4,136	358	10,396	217
Asia/Pacific	(3,392)	(2,821)	(8,117)	(6,644)
	\$ 10,422	\$ 4,366	\$ 17,920	\$ 3,461

Table of Contents

	September 30, June 30, 2011	September 30, December 31, 2010
Total assets:		
Americas - United States	\$ 349,556	\$ 335,457
Americas - Other	23,732	21,254
EMEA	177,824	186,209
Asia/Pacific	62,535	58,609
	\$ 613,647	\$ 601,529

No single customer accounted for more than 10% of the Company's consolidated revenues during the three and six months ended June 30, 2011 and 2010. Aggregate revenues attributable to customers in the United Kingdom accounted for 11.2% and 13.0%, respectively, of the Company's consolidated revenues during the three months and six months ended June 30, 2011. No other country outside the United States accounted for more than 10% of the Company's consolidated revenues during the three and six months ended June 30, 2010.

11. Income Taxes

The effective tax rate for the three months ended June 30, 2011 was 6.7%. The effective tax rate for the six months ended June 30, 2011 was 34.0%. The effective tax rate in both periods of 2011 was positively impacted by the favorable adjustment of \$3.9 million to the Company's uncertain tax positions during the three months ended June 30, 2011, partially offset by a reversal of related deferred tax assets of \$1.7 million. The accrual for uncertain tax positions and related deferred tax assets are no longer required as the statute of limitations expired for the tax returns to which they are associated during the three months ended June 30, 2011. The earnings of the Company's foreign entities for the three and six months ended June 30, 2011 were \$10.2 million and \$10.4 million, respectively. The effective tax rate for both periods of 2011 was positively impacted by tax rates in foreign jurisdictions that are less than the Company's domestic rate, partially offset by the recognition of tax expense associated with the transfer of certain intellectual property rights from U.S. to non-U.S. entities.

The effective tax rate for the three months ended June 30, 2010 was 106.6%. The effective tax rate for the six months ended June 30, 2010 was 398.1%. The effective tax rate in both periods in 2010 were negatively impacted by the Company's inability to recognize income tax benefits during the period on losses sustained in certain tax foreign jurisdictions where the future utilization of the losses are uncertain, and by the recognition of tax expense associated with the transfer of certain intellectual property rights from U.S. to non-U.S. entities.

The Company's effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected to the extent earnings are lower in the countries in which it operates that have a lower statutory rate or higher in the countries in which it operates that have a higher statutory rate or the extent it has losses sustained in countries where the future utilization of losses are uncertain. The Company's effective tax rate could also fluctuate due to changes in the valuation of its deferred tax assets or liabilities, or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, the Company is occasionally subject to examination of its income tax returns by tax authorities in the jurisdictions it operates. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of its provision for income taxes.

The amount of unrecognized tax benefits for uncertain tax positions was \$4.6 million as of June 30, 2011 and \$8.4 million as of December 31, 2010, excluding related liabilities for interest and penalties of \$2.3 million as of June 30, 2011 and \$2.2 million as of December 31, 2010.

The Company believes it is reasonably possible that the total amount of unrecognized tax benefits will decrease within the next 12 months by approximately \$2.3 million, due to the settlement of various audits and the expiration of statutes of limitation.

12. Commitments and Contingencies*Legal Proceedings*

From time to time, the Company is involved in various litigation matters arising in the ordinary course of its business. The Company is not currently a party to any legal proceedings, the adverse outcome of which, individually or in the aggregate, the Company believes would be likely to have a material adverse effect on the Company's financial condition or results of operations.

Table of Contents**13. International Business Machines Corporation Alliance**

No costs related to fulfillment of the technical enablement milestones under the International Business Machines Corporation (IBM) Master Alliance Agreement, as amended (the Alliance), were charged against the Alliance agreement liability during the three months ended June 30, 2011. During the three months ended June 30, 2010, the Company incurred \$2.5 million of costs related to fulfillment of the technical enablement milestones under the Alliance. During the six months ended June 30, 2011 and 2010, the Company incurred \$0.3 and \$5.4 million of costs, respectively, related to the fulfillment of the technical enablement milestones. The reimbursement of these costs was recorded as a reduction of the Alliance agreement liability and a reduction in capitalizable costs under U.S. GAAP, in the accompanying condensed consolidated balance sheets and a reduction of operating expenses in the accompanying condensed consolidated statements of operations for the three and six months ended June 30, 2011 and 2010. As of June 30, 2011 and December 31, 2010, \$20.7 million was refundable unless certain future milestones are achieved.

Changes in the Alliance agreement liability during the six months ended June 30, 2011 were as follows (in thousands):

	September 30, Alliance Agreement Liability
Balance as of December 31, 2010	\$ 22,584
Costs related to fulfillment of technical enablement milestones	(317)
Balance as of June 30, 2011	\$ 22,267

Of the \$22.3 million Alliance agreement liability, \$1.6 million is current and \$20.7 million is non-current in the accompanying condensed consolidated balance sheet as of June 30, 2011.

Of the \$22.6 million Alliance agreement liability, \$1.9 million is current and \$20.7 million is non-current in the accompanying condensed consolidated balance sheet as of December 31, 2010.

14. Subsequent Event

On July 26, 2011, the Company announced that it has provided a proposal to the Board of Directors of S1 Corporation to acquire all of their issued and outstanding stock in a stock and cash transaction. The Company has secured a financing commitment from Wells Fargo Bank, N.A. on a new senior secured revolving credit facility and a senior secured term loan subject to reaching an agreement with S1 Corporation, which would be available to fund a substantial part of the cash portion of the transaction.

Table of Contents

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This report contains forward-looking statements based on current expectations that involve a number of risks and uncertainties. Generally, forward-looking statements do not relate strictly to historical or current facts and may include words or phrases such as believes, will, expects, anticipates, intends, and words and phrases of similar impact. The forward-looking statements are made pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as amended.

Forward-looking statements in this report include, but are not limited to, statements regarding future operations, business strategy, business environment, key trends and, in each case, statements related to expected financial and other benefits. Many of these factors will be important in determining our actual future results. Any or all of the forward-looking statements in this report may turn out to be incorrect. They may be based on inaccurate assumptions or may not account for known or unknown risks and uncertainties. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially from those expressed or implied in any forward-looking statements, and our business, financial condition and results of operations could be materially and adversely affected. In addition, we disclaim any obligation to update any forward-looking statements after the date of this report, except as required by law.

All of the forward-looking statements in this report are expressly qualified by the risk factors discussed in our filings with the Securities and Exchange Commission. Such factors include, but are not limited to, risks related to the global financial crisis and the continuing decline in the global economy, restrictions and other financial covenants in our credit facility, volatility and disruption of the capital and credit markets and adverse changes in the global economy, the maturation of our current credit facility, the restatement of our financial statements, consolidations and failures in the financial services industry, the accuracy of management's backlog estimates, the cyclical nature of our revenue and earnings and the accuracy of forecasts due to the concentration of revenue generating activity during the final weeks of each quarter, impairment of our goodwill or intangible assets, exposure to unknown tax liabilities, volatility in our stock price, risks from operating internationally, including fluctuations in currency exchange rates, increased competition, our offshore software development activities, customer reluctance to switch to a new vendor, the performance of our strategic product, BASE24-eps, the maturity of certain products, our strategy to migrate customers to our next generation products, ratable or deferred recognition of certain revenue associated with customer migrations and the maturity of certain of our products, demand for our products, failure to obtain renewals of customer contracts or to obtain such renewals on favorable terms, delay or cancellation of customer projects or inaccurate project completion estimates, business interruptions or failure of our information technology and communication systems, our alliance with International Business Machines Corporation (IBM), our outsourcing agreement with IBM, the complexity of our products and services and the risk that they may contain hidden defects or be subjected to security breaches or viruses, compliance of our products with applicable legislation, governmental regulations and industry standards, our compliance with privacy regulations, the protection of our intellectual property in intellectual property litigation, future acquisitions, strategic partnerships and investments and litigation. The cautionary statements in this report expressly qualify all of our forward-looking statements.

The following discussion should be read together with our financial statements and related notes contained in this report and with the financial statements and related notes and Management's Discussion & Analysis in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed February 18, 2011. Results for the three and six months ended June 30, 2011, are not necessarily indicative of results that may be attained in the future.

Overview

We develop, market, install and support a broad line of software products and services primarily focused on facilitating electronic payments. In addition to our own products, we distribute, or act as a sales agent for, software developed by third parties. Our products are sold and supported through distribution networks covering three geographic regions—the Americas, EMEA and Asia/Pacific. Each distribution network has its own sales force and supplements its sales force with independent reseller and/or distributor networks. Our products and services are used principally by financial institutions, retailers and electronic payment processors, both in domestic and international markets. Accordingly, our business and operating results are influenced by trends such as information technology spending levels, the growth rate of the electronic payments industry, mandated regulatory changes, and changes in the number and type of customers in the financial services industry. Our products are marketed under the ACI Worldwide and ACI Payment Systems brands.

We derive a majority of our revenues from non-domestic operations and believe our greatest opportunities for growth exist largely in international markets. Our global infrastructure is a critical component of driving our growth. Changes in the past few

Table of Contents

years have streamlined our supply chain and provided low-cost centers of expertise to support a growing international customer base. We utilize our Irish subsidiaries to manage certain of our intellectual property rights and to oversee and manage certain international product development and commercialization efforts. We also continue to grow low-cost centers of expertise in Timisoara, Romania and Bangalore, India.

Key trends that currently impact our strategies and operations include:

Global Financial Markets Uncertainty. The continuing uncertainty in the global financial markets has negatively impacted general business conditions. It is possible that a weakening economy could adversely affect our customers, their purchasing plans, or even their solvency, but we cannot predict whether or to what extent this will occur. We have diversified counterparties and customers, but we continue to monitor our counterparty and customer risks closely. While the effects of the economic conditions in the future are not predictable, we believe our global presence, the breadth and diversity of our service offerings and our enhanced expense management capabilities position us well in a slower economic climate. Market analysts, such as Boston Consulting Group, indicate that banks now recognize the importance of payments to their business, so providing services for that aspect of the business is of less risk than for other aspects of their business.

Availability of Credit. There have been significant disruptions in the capital and credit markets during the past two years and many lenders and financial institutions have reduced or ceased to provide funding to borrowers. The availability of credit, confidence in the entire financial sector, and volatility in financial markets have been adversely affected. These disruptions are likely to have some impact on all institutions in the U.S. banking and financial industries, including our lenders and the lenders of our customers. While the Federal Reserve Bank and other Central Banks have provided liquidity into the banking system there is still uncertainty over the strength of short-term borrowing markets and other capital markets. Reduced liquidity in the markets could increase financing costs or reduce the availability of funds to finance our existing operations as well as those of our customers. We are not currently dependent upon short-term funding, and the limited availability of credit in the market has not affected our revolving credit facility or our liquidity or materially impacted our funding costs.

Increasing electronic payment transaction volumes. Electronic payment volumes continue to increase around the world, taking market share from traditional cash and check transactions. In May 2010, Tower Group noted that global noncash payment transactions are expected to grow in volume at 4.95% per year through 2012 to a total of 299 billion items, with varying growth rates based on the type of payment and part of the world. We leverage the growth in transaction volumes through the licensing of new systems to customers whose older systems cannot handle increased volume and through the licensing of capacity upgrades to existing customers.

Increasing competition. The electronic payments market is highly competitive and subject to rapid change. Our competition comes from in-house information technology departments, third-party electronic payment processors and third-party software companies located both within and outside of the United States. Many of these companies are significantly larger than us and have significantly greater financial, technical and marketing resources. As electronic payment transaction volumes increase, third-party processors tend to provide competition to our solutions, particularly among customers that do not seek to differentiate their electronic payment offerings. As consolidation in the financial services industry continues, we anticipate that competition for those customers will intensify.

Adoption of open systems technology. In an effort to leverage lower-cost computing technologies and current technology staffing and resources, many financial institutions, retailers and electronic payment processors are seeking to transition their systems from proprietary technologies to open technologies. Our continued investment in open systems technologies is, in part, designed to address this demand.

Electronic payments fraud and compliance. As electronic payment transaction volumes increase, criminal elements continue to find ways to commit a growing volume of fraudulent transactions using a wide range of techniques. Financial institutions, retailers and electronic payment processors continue to seek ways to leverage new technologies to identify and

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

prevent fraudulent transactions. Due to concerns with international terrorism and money laundering, financial institutions in particular are being faced with increasing scrutiny and regulatory pressures. We continue to see opportunity to offer our fraud detection solutions to help customers manage the growing levels of electronic payment fraud and compliance activity.

Table of Contents

Adoption of smartcard technology. In many markets, card issuers are being required to issue new cards with embedded chip technology. Chip-based cards are more secure, harder to copy and offer the opportunity for multiple functions on one card (e.g. debit, credit, electronic purse, identification, health records, etc.). The EMV standard for issuing and processing debit and credit card transactions has emerged as the global standard, with many regions throughout the world working on EMV rollouts. The primary benefit of EMV deployment is a reduction in electronic payment fraud, with the additional benefit that the core infrastructure necessary for multi-function chip cards is being put in place (e.g., chip card readers in ATM s and POS devices) allowing the deployment of other technologies like contactless. We are working with many customers around the world to facilitate EMV deployments, leveraging several of our solutions.

Single Euro Payments Area (SEPA). The SEPA, primarily focused on the European Economic Community and the United Kingdom, is designed to facilitate lower costs for cross-border payments and reduce timeframes for settling electronic payment transactions. Our retail and wholesale banking solutions facilitate key functions that help financial institutions address these mandated regulations.

Financial institution consolidation. Consolidation continues on a national and international basis, as financial institutions seek to add market share and increase overall efficiency. Such consolidations have increased, and may continue to increase, in their number, size and market impact as a result of the global economic crisis and the financial crisis affecting the banking and financial industries. There are several potential negative effects of increased consolidation activity. Continuing consolidation of financial institutions may result in a smaller number of existing and potential customers for our products and services. Consolidation of two of our customers could result in reduced revenues if the combined entity were to negotiate greater volume discounts or discontinue use of certain of our products. Additionally, if a non-customer and a customer combine and the combined entity in turn decides to forego future use of our products, our revenue would decline. Conversely, we could benefit from the combination of a non-customer and a customer when the combined entity continues use of our products and, as a larger combined entity, increases its demand for our products and services. We tend to focus on larger financial institutions as customers, often resulting in our solutions being the solutions that survive in the consolidated entity.

Electronic payments convergence. As electronic payment volumes grow and pressures to lower overall cost per transaction increase, financial institutions are seeking methods to consolidate their payment processing across the enterprise. We believe that the strategy of using service-oriented-architectures to allow for re-use of common electronic payment functions such as authentication, authorization, routing and settlement will become more common. Using these techniques, financial institutions will be able to reduce costs, increase overall service levels, enable one-to-one marketing in multiple bank channels, leverage volumes for improved pricing and liquidity, and manage enterprise risk. Our product development strategy is, in part, focused on this trend, by creating integrated payment functions that can be re-used by multiple bank channels, across both the consumer and wholesale bank. While this trend presents an opportunity for us, it may also expand the competition from third-party electronic payment technology and service providers specializing in other forms of electronic payments. Many of these providers are larger than us and have significantly greater financial, technical and marketing resources.

Mobile banking and payments. There is a growing demand for the ability to carry out banking services or make payments using a mobile phone. Our customers have been making use of existing products to deploy both mobile banking and mobile payment solutions for their customers in many countries. As the market continues to develop, we expect to extend our product sets as appropriate to support mobile functionality.

The banking, financial services and payments industries have come under increased scrutiny from federal, state and foreign lawmakers and regulators in response to the crises in the financial markets and the global recession. In particular, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which was signed into law July 21, 2010, represents a comprehensive overhaul of the U.S. financial services industry and requires the implementation of many new regulations that will have a direct impact on our customers and potential customers. These regulatory changes may create both opportunities and challenges for us. The application of the new regulations on our customers could create an opportunity for us to market our product capabilities and the flexibility of our solutions to assist our customers in addressing these regulations. At the same time, these regulatory changes may have an adverse impact on our operations and our financial results as we adjust our activities in light of increased compliance costs and customer requirements. It is currently too difficult to predict the actual extent to which the Dodd-Frank Act or the resulting regulations will impact our business and the businesses of our current and potential customers.

Table of Contents

Several other factors related to our business may have a significant impact on our operating results from year to year. For example, the accounting rules governing the timing of revenue recognition in the software industry are complex and it can be difficult to estimate when we will recognize revenue generated by a given transaction. Factors such as maturity of the software product licensed, payment terms, creditworthiness of the customer, and timing of delivery or acceptance of our products often cause revenues related to sales generated in one period to be deferred and recognized in later periods. For arrangements in which services revenue is deferred, related direct and incremental costs may also be deferred. Additionally, while the majority of our contracts are denominated in the United States dollar, a substantial portion of our sales are made, and some of our expenses are incurred, in the local currency of countries other than the United States. Fluctuations in currency exchange rates in a given period may result in the recognition of gains or losses for that period.

We continue to seek ways to grow, through organic sources, partnerships, alliances, and acquisitions. We continually look for potential acquisitions designed to improve our solutions' breadth or provide access to new markets. As part of our acquisition strategy, we seek acquisition candidates that are strategic, capable of being integrated into our operating environment, and financially accretive to our financial performance.

Acquisition

On March 18, 2011, we closed the acquisition of ISD Holdings, Inc. and its 100% owned subsidiary ISD Corporation (collectively "ISD"). ISD's suite of products enables retailers to consolidate, manage, secure and route all electronic transactions from their point-of-sale systems to third party processors for authorization and settlement.

The aggregate purchase price of ISD was \$19.2 million, after working capital adjustments in accordance with the terms of the purchase agreement, including \$2.4 million in cash acquired. The preliminary allocation of the purchase price to specific assets and liabilities was based on the relative fair value of all assets and liabilities.

Subsequent Event

On July 26, 2011, we announced that we have provided a proposal to the Board of Directors of S1 Corporation to acquire all of their issued and outstanding stock in a stock and cash transaction. We have secured a financing commitment from Wells Fargo Bank, N.A. on a new senior secured revolving credit facility and a senior secured term loan subject to reaching an agreement with S1 Corporation, which would be available to fund a substantial part of the cash portion of the transaction.

Backlog

Included in backlog estimates are all software license fees, maintenance fees and services fees specified in executed contracts, as well as revenues from assumed contract renewals to the extent that we believe recognition of the related revenue will occur within the corresponding backlog period. We have historically included assumed renewals in backlog estimates based upon automatic renewal provisions in the executed contract and our historic experience with customer renewal rates.

Our 60-month backlog estimate represents expected revenues from existing customers using the following key assumptions:

Maintenance fees are assumed to exist for the duration of the license term for those contracts in which the committed maintenance term is less than the committed license term.

License and facilities management arrangements are assumed to renew at the end of their committed term at a rate consistent with our historical experiences.

Non-recurring license arrangements are assumed to renew as recurring revenue streams.

Foreign currency exchange rates are assumed to remain constant over the 60-month backlog period for those contracts stated in currencies other than the U.S. dollar.

Our pricing policies and practices are assumed to remain constant over the 60-month backlog period.

In computing our 60-month backlog estimate, the following items are specifically not taken into account:

Anticipated increases in transaction volumes in customer systems.

Optional annual uplifts or inflationary increases in recurring fees.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Services engagements, other than facilities management, are not assumed to renew over the 60-month backlog period.

The potential impact of merger activity within our markets and/or customers.

We review our customer renewal experience on an annual basis. The impact of this review and subsequent update may result in

Table of Contents

a revision to the renewal assumptions used in computing the 60-month and 12-month backlog estimates. In the event a revision to renewal assumptions is determined to be necessary, prior periods will be adjusted for comparability purposes. Based on our annual review of customer renewal experience completed during the three months ended December 31, 2010, backlog results for all reported periods have been updated to reflect our most current customer renewal experience.

The following table sets forth our 60-month backlog estimate, by geographic region, as of June 30, 2011, March 31, 2011 and December 31, 2010 (in millions). Dollar amounts reflect foreign currency exchange rates as of each period end.

	September 30, June 30, 2011	September 30, March 31, 2011	September 30, December 31, 2010
Americas	\$ 907	\$ 895	\$ 871
EMEA	539	526	506
Asia/Pacific	194	192	189
Total	\$ 1,640	\$ 1,613	\$ 1,566

Included in our 60-month backlog estimates are amounts expected to be recognized during the initial license term of customer contracts (Committed Backlog) and amounts expected to be recognized from assumed renewals of existing customer contracts (Renewal Backlog). Amounts expected to be recognized from assumed contract renewals are based on our historical renewal experience.

The following table sets forth our 60-month Committed Backlog and Renewal Backlog estimates as of June 30, 2011, March 31, 2011 and December 31, 2010 (in millions). Dollar amounts reflect foreign currency exchange rates as of each period end.

	September 30, June 30, 2011	September 30, March 31, 2011	September 30, December 31, 2010
Committed	\$ 931	\$ 890	\$ 857
Renewal	709	723	709
Total	\$ 1,640	\$ 1,613	\$ 1,566

We also estimate 12-month backlog, segregated between monthly recurring and non-recurring revenues, using a methodology consistent with the 60-month backlog estimate. Monthly recurring revenues include all monthly license fees, maintenance fees and processing services fees. Non-recurring revenues include other software license fees and services fees. Amounts included in our 12-month backlog estimate assume renewal of one-time license fees on a monthly fee basis if such renewal is expected to occur in the next 12 months. The following table sets forth our 12-month backlog estimate, by geographic region, as of June 30, 2011, March 31, 2011 and December 31, 2010 (in millions). For all periods reported, approximately 87% of our 12-month backlog estimate is Committed Backlog and approximately 13% of our 12-month backlog estimate is Renewal Backlog. Dollar amounts reflect foreign currency exchange rates as of each period end.

Table of Contents

	September 30, Monthly Recurring	September 30, June 30, 2011 Non- Recurring	September 30, Total
Americas	\$ 162	\$ 49	\$ 211
EMEA	100	35	135
Asia/Pacific	40	14	54
Total	\$ 302	\$ 98	\$ 400

	September 30, Monthly Recurring	September 30, March 31, 2011 Non- Recurring	September 30, Total	September 30, Monthly Recurring	September 30, December 31, 2010 Non- Recurring	September 30, Total
Americas	\$ 166	\$ 39	\$ 205	\$ 164	\$ 43	\$ 207
EMEA	101	34	135	103	27	130
Asia/Pacific	37	14	51	34	10	44
Total	\$ 304	\$ 87	\$ 391	\$ 301	\$ 80	\$ 381

Estimates of future financial results are inherently unreliable. Our backlog estimates require substantial judgment and are based on a number of assumptions as described above. These assumptions may turn out to be inaccurate or wrong, including for reasons outside of management's control. For example, our customers may attempt to renegotiate or terminate their contracts for a number of reasons, including mergers, changes in their financial condition, or general changes in economic conditions in the customer's industry or geographic location, or we may experience delays in the development or delivery of products or services specified in customer contracts which may cause the actual renewal rates and amounts to differ from historical experiences. Changes in foreign currency exchange rates may also impact the amount of revenue actually recognized in future periods. Accordingly, there can be no assurance that amounts included in backlog estimates will actually generate the specified revenues or that the actual revenues will be generated within the corresponding 12-month or 60-month period. Additionally, because backlog estimates are operating metrics, the estimates are not required to be subject to the same level of internal review or controls as a GAAP financial measure.

RESULTS OF OPERATIONS

The following table presents the condensed consolidated statements of operations as well as the percentage relationship to total revenues of items included in our condensed consolidated statements of operations (amounts in thousands):

Table of Contents

	September 30, 2011	September 30, Three Months Ended June 30, 2011	September 30, 2010	September 30, 2010	September 30, 2011	September 30, Six Months Ended June 30, 2011	September 30, 2010	September 30, 2010
	Amount	% of Total Revenue	Amount	% of Total Revenue	Amount	% of Total Revenue	Amount	% of Total Revenue
Revenues:								
Initial license fees (ILFs)	\$ 12,704	11.2%	\$ 11,113	12.0%	\$ 25,269	11.6%	\$ 20,856	11.6%
Monthly license fees (MLFs)	33,381	29.4%	20,286	21.9%	64,540	29.6%	39,860	22.1%
Software license fees	46,085	40.7%	31,399	34.0%	89,809	41.2%	60,716	33.7%
Maintenance fees	37,195	32.8%	34,207	37.0%	72,265	33.2%	67,629	37.5%
Services	18,673	16.5%	17,187	18.6%	34,044	15.6%	31,805	17.7%
Software hosting fees	11,413	10.1%	9,630	10.4%	21,791	10.0%	20,016	11.1%
Total revenues	113,366	100.0%	92,423	100.0%	217,909	100.0%	180,166	100.0%
Expenses:								
Cost of software licenses fees	4,136	3.6%	3,107	3.4%	7,578	3.5%	6,181	3.4%
Cost of maintenance, services, and hosting fees	31,818	28.1%	29,303	31.7%	61,425	28.2%	57,195	31.7%
Research and development	23,784	21.0%	18,798	20.3%	46,914	21.5%	37,194	20.6%
Selling and marketing	21,791	19.2%	15,989	17.3%	41,085	18.9%	32,834	18.2%
General and administrative	15,804	13.9%	15,735	17.0%	32,166	14.8%	33,197	18.4%
Depreciation and amortization	5,611	4.9%	5,125	5.5%	10,821	5.0%	10,104	5.6%
Total expenses	102,944	90.8%	88,057	95.3%	199,989	91.8%	176,705	98.1%
Operating income	10,422	9.2%	4,366	4.7%	17,920	8.2%	3,461	1.9%
Other income (expense):								
Interest income	196	0.2%	126	0.1%	434	0.2%	250	0.1%
Interest expense	(374)	-0.3%	(541)	-0.6%	(1,017)	-0.5%	(1,064)	-0.6%
Other, net	260	0.2%	(1,682)	-1.8%	(42)	0.0%	(1,896)	-1.1%
Total other income (expense)	82	0.1%	(2,097)	-2.3%	(625)	-0.3%	(2,710)	-1.5%
Income before income taxes	10,504	9.3%	2,269	2.5%	17,295	7.9%	751	0.4%
Income tax expense	704	0.6%	2,419	2.6%	5,873	2.7%	2,990	1.7%

Net income												
(loss)	\$	9,800	8.6%	\$	(150)	-0.2%	\$	11,422	5.2%	\$	(2,239)	-1.2%

Three-Month Period Ended June 30, 2011 Compared to Three-Month Period June 30, 2010

Revenues

Total revenues for the three months ended June 30, 2011 increased \$20.9 million, or 22.7%, as compared to the same period in 2010. Total revenues increased as a result of a \$14.7 million, or 46.8%, increase in software license fee revenues, a \$3.0 million, or 8.7%, increase in maintenance fee revenue, a \$1.5 million, or 8.6%, increase in services revenues, and a \$1.8 million, or 18.5%, increase in software hosting fees revenue.

The increase in total revenues was driven by increases in the Americas, EMEA and Asia/Pacific reportable operating segments of \$7.8 million, \$11.4 million and \$1.7 million, respectively.

Software License Fees Revenue

Customers purchase the right to license ACI software for the term of their agreement which term is generally 60 months. Within these agreements are specified capacity limits typically based on customer transaction volumes. ACI employs measurement tools that monitor the number of transactions processed by customers and if contractually specified limits are exceeded, additional fees are charged for the overage. Capacity overages may occur at varying times throughout the term of the agreement

Table of Contents

depending on the product, the size of the customer, and the significance of customer transaction volume growth. Depending on specific circumstances, multiple overages or no overages may occur during the term of the agreement.

As a result of the maturation of certain retail payment engine products, a higher percentage of our initial license fees are being recognized ratably over an extended period. Initial license and capacity fees that are recognized as revenue ratably over an extended period are included in our monthly license fee revenues. Due to the compounding effect of this, our MLF revenues have increased significantly during the three months ended June 30, 2011 as compared to the same period in 2010. This shift of software license fees from ILF revenues to MLF revenues is expected to continue in future periods.

Initial License Fees (ILF) Revenue

ILF revenue includes license and capacity revenues that do not recur on a monthly or quarterly basis. Included in ILF revenues are license and capacity fees that are recognizable at the inception of the agreement and license and capacity fees that are recognizable at interim points during the term of the agreement, including those that are recognizable annually due to negotiated customer payment terms. ILF revenues during the three months ended June 30, 2011 compared to the same period in 2010, increased by \$1.6 million, or 14.3%, primarily due to an increase in sales. ILF revenue in the EMEA and Asia/Pacific reportable operating segments increased by \$2.7 million and \$1.4 million, respectively, offset by a decline of \$2.5 million in the Americas reportable operating segment. Included in the above is a decline in capacity related revenues of \$0.8 million primarily in the EMEA reportable operating segment within the three months ended June 30, 2011 as compared to the same period in 2010.

Monthly License Fees (MLF) Revenue

MLF revenues are license and capacity revenues that are paid monthly or quarterly due to negotiated customer payment terms as well as initial license and capacity fees that are recognized as revenue ratably over an extended period as MLF revenue. MLF revenues increased \$13.1 million, or 64.6%, during the three months ended June 30, 2011, as compared to the same period in 2010 with the Americas, EMEA and Asia/Pacific reportable operating segments increasing by \$4.6 million, \$8.1 million and \$0.4 million, respectively. The increase in MLF revenues is primarily due to the cumulative effect of ILF revenue that is being recognized ratably over an extended period as a result of the maturation of certain retail payment engine products.

Maintenance Fees Revenue

Maintenance fee revenue includes standard and enhanced maintenance or any post contract support fees received from customers for the provision of product support services. Maintenance fee revenues increased \$3.0 million, or 8.7%, during the three months ended June 30, 2011, as compared to the same period in 2010. Maintenance fee revenue increased in the Americas and EMEA reportable segments by \$2.7 million and \$0.9 million, respectively, while the Asia/Pacific reportable segment declined by \$0.6 million. Increases in maintenance fee revenues are primarily driven by an increase in the customer installation base as well as expanded product usage.

Services Revenue

Services revenue includes fees earned through implementation services, professional services and facilities management services. Implementation services include product installations, product configurations, and retrofit custom software modifications (CSMs). Professional services include business consultancy, technical consultancy, on-site support services, CSMs, product education, and testing services. These services include new customer implementations as well as existing customer migrations to new products or new releases of existing products. During the period in which non-essential services revenue is being deferred, direct and incremental costs related to the performance of these services are also being deferred. During the period in which essential services revenue is being deferred, direct and indirect costs related to the performance of these services are also being deferred.

Services revenue increased \$1.5 million, or 8.6%, for the three months ended June 30, 2011, as compared to the same period in 2010 primarily as a result of an increase in implementation and professional services revenue in the Americas and Asia/Pacific reportable operating segments of \$1.5 million and \$0.5 million, respectively, partially offset by a decline in the EMEA reportable operating segment of \$0.5 million.

Software Hosting Fees Revenue

Software hosting fee revenue includes fees earned through hosting and on-demand arrangements. All revenues from hosting and on-demand arrangements that do not qualify for treatment as separate units of accounting, which may include set-up fees, implementation or customization services, and product support services, are included in software hosting fee revenue.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Software hosting fees revenue increased \$1.8 million, or 18.5%, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. Software hosting fee revenue increased in the Americas and EMEA reportable segments by

Table of Contents

\$1.5 million and \$0.3 million, respectively, and can be attributed to new customers adopting our on-demand or hosted offerings and existing customers adding new functionality or services.

Expenses

Total operating expenses for the three months ended June 30, 2011 increased \$14.9 million, or 16.9%, as compared to the same period of 2010. Total expenses increased primarily as a result of a \$5.8 million, or 36.3%, increase in selling and marketing expenses, a \$5.0 million, or 26.5%, increase in research and development expenses, a \$2.5 million, or 8.6%, increase in the cost of maintenance, services, and hosting fees, a \$1.0 million, or 33.1%, increase in the cost of software license fees, a \$0.5 million or 9.5%, increase in depreciation and amortization, and a \$0.1 million, or 0.4%, increase in general and administrative expenses.

Cost of Software License Fees

The cost of software licenses for our products sold includes third-party software royalties as well as the amortization of purchased and developed software for resale. In general, the cost of software licenses for our products is minimal because we internally develop most of the software components, the cost of which is reflected in research and development expense as it is incurred as technological feasibility coincides with general availability of the software components.

Cost of software licenses fees increased \$1.0 million, or 33.1%, in the three months ended June 30, 2011 compared to the same period in 2010. Third-party software royalty expense increased \$0.8 million as a result of an increase in license revenue associated with certain products that include a corresponding royalty expense. Additionally, amortization for purchased or developed technology for resale increased \$0.2 million.

Cost of Maintenance, Services, and Hosting fees

Cost of maintenance, services and hosting fees includes costs to provide hosting services and both the costs of maintaining our software products as well as the service costs required to deliver, install and support software at customer sites. Maintenance costs include the efforts associated with providing the customer with upgrades, 24-hour help desk, post go-live (remote) support and production-type support for software that was previously installed at a customer location. Service costs include human resource costs and other incidental costs such as travel and training required for both pre go-live and post go-live support. Such efforts include project management, delivery, product customization and implementation, installation support, consulting, configuration, and on-site support.

Cost of maintenance, services, and hosting fees for the three months ended June 30, 2011 increased \$2.5 million, or 8.6%, compared to the same period in 2010 primarily due to \$2.9 million increase in personnel and related costs, and a \$0.2 million decrease in net deferred expenses associated with project implementations, which were partially offset by a \$0.6 million decrease in third-party maintenance and services related fees.

Research and Development

Research and development (R&D) expenses are primarily human resource costs related to the creation of new products, improvements made to existing products and the costs related to regulatory requirements and processing mandates as well as compatibility with new operating system releases and generations of hardware.

R&D expense for the three months ended June 30, 2011 increased \$5.0 million, or 26.5%, compared to the same period in 2010 primarily due to a \$2.8 million increase in personnel and related costs and a \$2.2 million decrease in net deferred expenses associated with various product development efforts.

Selling and Marketing

Selling and marketing includes both the costs related to selling our products to current and prospective customers as well as the costs related to promoting the Company, its products and the research efforts required to measure customers' future needs and satisfaction levels. Selling costs are primarily the human resource and travel costs related to the effort expended to license our products and services to current and potential customers within defined territories and/or industries as well as the management of the overall relationship with customer accounts. Selling costs also include the costs associated with assisting distributors in their efforts to sell our products and services in their respective local markets. Marketing costs include costs needed to promote the Company and its products as well as perform or acquire market research to help us better understand what products our customers are looking for in the future. Marketing costs also include the costs associated with measuring customers' opinions toward the Company, our products and personnel.

Selling and marketing expense for the three months ended June 30, 2011 increased \$5.8 million, or 36.3%, compared to the

Table of Contents

same period in 2010 due to \$5.4 million increase in personnel and related expenses and \$0.4 million in additional advertising and professional expenses.

General and Administrative

General and administrative expenses are primarily human resource costs including executive salaries and benefits, personnel administration costs, and the costs of corporate support functions such as legal, administrative, human resources and finance and accounting.

General and administrative expense for the three months ended June 30, 2011 increased \$0.1 million, or 0.4%, compared to the same period in 2010 due to \$1.3 million of additional professional fees, partially offset by a \$1.2 million decrease in personnel and related expenses.

Depreciation and Amortization

Depreciation and amortization expense includes charges for depreciation of property and equipment and amortization of acquired intangibles excluding amortization of purchased or developed technology for resale. Amortization of acquired intangibles include customer relationships, trade names, non-competes and other intangible assets.

Depreciation and amortization expense for the three months ended June 30, 2011 increased \$0.5 million, or 9.5%, compared to the same period in 2010 as a result of higher capital expenditures.

Other Income and Expense

Other income and expense includes interest income and expense, foreign currency gains and losses, and other non-operating items. Fluctuating currency rates impacted the three months ended June 30, 2011 by \$0.3 million in net foreign currency gains, as compared with \$1.7 million in net losses during the same period in 2010. Interest income was flat for the three months ended June 30, 2011 as compared to the corresponding period of 2010, while interest expense decreased \$0.2 million due to lower interest rates.

Income Taxes

The effective tax rate for the three months ended June 30, 2011 was 6.7%. The effective tax rate for the three months ended June 30, 2011 was positively impacted by the favorable adjustment of \$3.9 million to our uncertain tax positions during the three months ended June 30, 2011, partially offset by a reversal of related deferred tax assets of \$1.7 million. The accrual for uncertain tax positions and related deferred tax assets are no longer required as the statute of limitations expired for the tax returns to which they are associated during the three months ended June 30, 2011. The earnings of our foreign entities for the three months ended June 30, 2011 were \$10.2 million. Our effective tax rate was positively impacted by tax rates in foreign jurisdictions that are less than our domestic rate, partially offset by the recognition of tax expense associated with the transfer of certain intellectual property rights from U.S. to non-U.S. entities.

The effective tax rate for the three months ended June 30, 2010 was 106.6%. The effective tax rate for the three months ended June 30, 2010 was negatively impacted by our inability to recognize income tax benefits during the period on losses sustained in certain tax jurisdictions where the future utilization of the losses are uncertain, and by the recognition of tax expense associated with the transfer of certain intellectual property rights from U.S. to non-U.S. entities.

Our effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected to the extent earnings are lower in the countries in which we operate that have a lower statutory rate or higher in the countries in which we operate that have a higher statutory rate or the extent we have losses sustained in countries where the future utilization of losses are uncertain. Our effective tax rate could also fluctuate due to changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are occasionally subject to examination of our income tax returns by tax authorities in the jurisdictions we operate. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Six-Month Period Ended June 30, 2011 Compared to Six-Month Period June 30, 2010

Revenues

Table of Contents

Total revenues for the six months ended June 30, 2011 increased \$37.7 million, or 20.9%, as compared to the same period in 2010. Total revenues increased as a result of a \$29.1 million, or 47.9%, increase in software license fee revenues, a \$4.6 million, or 6.9%, increase in maintenance fee revenue, a \$2.2 million, or 7.0%, increase in services revenues, and a \$1.8 million, or 8.9%, increase in software hosting fee revenue.

The increase in total revenues was driven by increases in the Americas, EMEA and Asia/Pacific reportable operating segments of \$13.8 million, \$21.6 million and \$2.3 million, respectively.

Software License Fees Revenue

As a result of the maturation of certain retail payment engine products, a higher percentage of our initial license fees are being recognized ratably over an extended period. Initial license and capacity fees that are recognized as revenue ratably over an extended period are included in our monthly license fee revenues. Due to the compounding effect of this, our MLF revenues have increased significantly during the six months ended June 30, 2011 as compared to the same period in 2010. This shift of software license fees from ILF revenues to MLF revenues is expected to continue in future periods.

Initial License Fees (ILF) Revenue

ILF revenues during the six months ended June 30, 2011 compared to the same period in 2010, increased by \$4.4 million, or 21.2%, primarily due to an increase in sales. ILF revenue in the EMEA and Asia/Pacific reportable operating segments increased by \$4.2 million and \$1.4 million, respectively, offset by a decline of \$1.2 million in the Americas reportable operating segment. Included in the above is a decline in capacity related revenues of \$0.4 million within the six months ended June 30, 2011 as compared to the same period in 2010.

Monthly License Fees (MLF) Revenue

MLF revenues increased \$24.7 million, or 61.9%, during the six months ended June 30, 2011, as compared to the same period in 2010 with the Americas, EMEA and Asia/Pacific reportable operating segments increasing by \$7.8 million, \$16.4 million and \$0.5 million, respectively. The increase in MLF revenues is primarily due to the cumulative effect of ILF revenue that is being recognized ratably over an extended period as a result of the maturation of certain retail payment engine products.

Maintenance Fees Revenue

Maintenance fee revenue includes standard and enhanced maintenance or any post contract support fees received from customers for the provision of product support services. Maintenance fee revenues increased \$4.6 million, or 6.9%, during the six months ended June 30, 2011, as compared to the same period in 2010. Maintenance fee revenue increased in the Americas and EMEA reportable segments by \$3.1 million and \$2.3 million, respectively, while the Asia/Pacific reportable segment declined by \$0.8 million. Increases in maintenance fee revenues are primarily driven by an increase in the customer installation base as well as expanded product usage.

Services Revenue

Services revenue increased \$2.2 million, or 7.0%, for the six months ended June 30, 2011, as compared to the same period in 2010, primarily as a result of an increase in implementation and professional services revenue in the Americas and Asia/Pacific reportable operating segments of \$2.6 million and \$1.2 million, respectively, partially offset by a decline in the EMEA reportable operating segment of \$1.6 million.

Software Hosting Fees Revenue

Software hosting fees revenue increased \$1.8 million, or 8.9%, for the six months ended June 30, 2011, as compared to the same period in 2010. Software hosting fee revenue increased in the Americas and EMEA reportable segments by \$1.5 million and \$0.3 million, respectively, and can be attributed to new customers adopting our on-demand or hosted offerings and existing customers adding new functionality or services.

Expenses

Total operating expenses for the six months ended June 30, 2011 increased \$23.3 million, or 13.2%, as compared to the same period in 2010. Total expenses increased primarily as a result of a \$9.7 million, or 26.1%, increase in research and development, an \$8.3 million, or 25.1%, increase in selling and marketing, a \$4.2 million, or 7.4%, increase in the cost of maintenance, services and hosting fees, a \$1.4 million, or

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

22.6%, increase in cost of software license fees, and a \$0.7 million, or 7.1%, increase in depreciation and amortization, partially offset by a \$1.0 million, or 3.1%, decrease in general and administrative expenses.

Table of Contents*Cost of Software License Fees*

Cost of software licenses fees increased \$1.4 million, or 22.6%, for the six months ended June 30, 2011 compared to the same period in 2010. Third-party software royalty expense increased \$1.1 million as a result of an increase in license revenue associated with certain products that include a corresponding royalty expense. Additionally, purchased or developed technology for resale amortization increased \$0.3 million for the six months ended June 30, 2011.

Cost of Maintenance, Services, and Hosting fees

Cost of maintenance, services, and hosting fees for the six months ended June 30, 2011 increased \$4.2 million, or 7.4%, compared to the same period in 2010 primarily due to \$4.2 million increase in personnel and related expenses and a \$1.0 million decrease in net deferred expenses associated with project implementations, partially offset by a \$1.0 million decrease in third-party maintenance and services related fees.

Research and Development

R&D expense for the six months ended June 30, 2011 increased \$9.7 million, or 26.1%, as compared to the same period in 2010. This increase is due to \$3.8 million in additional personnel and related costs, a \$4.7 million decrease in net deferred expenses associated with various product development efforts, \$0.8 million increase in third party contractors, and a \$0.4 million increase in professional fees.

Selling and Marketing

Selling and marketing expense for the six months ended June 30, 2011 increased \$8.3 million, or 25.1%, compared to the same period in 2010 due to a \$7.5 million increase in personnel and related costs and \$0.8 million in additional external professional, advertising and promotional expenses.

General and Administrative

General and administrative expense for the six months ended June 30, 2011 decreased \$1.0 million, or 3.1%, compared to the same period in 2010 due to a \$0.8 million reduction in bad debt allowance and a \$1.8 million decrease in personnel and related costs, partially offset by \$1.6 million in additional professional fees.

Depreciation and Amortization

Depreciation and amortization expense for the six months ended June 30, 2011 increased \$0.7 million, or 7.1%, compared to the same period in 2010 as a result of higher capital expenditures.

Other Income and Expense

Fluctuating currency rates impacted the six months ended June 30, 2011 by less than \$0.1 million in net foreign currency gains, as compared with \$1.6 million in net losses during the same period in 2010. The fair value of interest rate swaps resulted in a \$0.1 million loss during the six months ended June 30, 2010. Interest expense was flat for the six months ended June 30, 2011 as compared to the corresponding period of 2010, while interest income was up by \$0.2 million due to greater cash balances.

Income Taxes

The effective tax rate for the six months ended June 30, 2011 was 34.0%. The effective tax rate in for the six months ended June 30, 2011 was positively impacted by the favorable adjustment of \$3.9 million to our uncertain tax positions during the three months ended June 30, 2011, partially offset by a reversal of related deferred tax assets of \$1.7 million. The accrual for uncertain tax positions and related deferred tax assets are no longer required as the statute of limitations expired for the tax returns to which they are associated during the six months ended June 30, 2011. The earnings of our foreign entities for the six months ended June 30, 2011 were \$10.4 million. Our effective tax rate is positively impacted by tax rates in foreign jurisdictions that are less than our domestic rate, partially offset by the recognition of tax expense associated with the transfer of certain intellectual property rights from U.S. to non-U.S. entities.

The effective tax rate for the six months ended June 30, 2010 was 398.1%. The effective tax rate for the six months ended June 30, 2010 was negatively impacted by our inability to recognize income tax benefits during the period on losses sustained in certain tax jurisdictions where the

future utilization of the losses are uncertain, and by the recognition of tax expense associated with the transfer of certain intellectual property rights from U.S. to non-U.S. entities.

Table of Contents

Our effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected to the extent earnings are lower in the countries in which we operate that have a lower statutory rate or higher in the countries in which we operate that have a higher statutory rate or the extent we have losses sustained in countries where the future utilization of losses are uncertain. Our effective tax rate could also fluctuate due to changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are occasionally subject to examination of our income tax returns by tax authorities in the jurisdictions we operate. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Segment Results

The following table presents revenues and operating income (loss) for the periods indicated by geographic region (in thousands):

	September 30, Three Months Ended June 30,		September 30, Six Months Ended June 30,	
	2011	2010	2011	2010
Revenues:				
Americas	\$ 57,974	\$ 50,185	\$ 110,304	\$ 96,501
EMEA	41,880	30,466	84,021	62,379
Asia/Pacific	13,512	11,772	23,584	21,286
	\$ 113,366	\$ 92,423	\$ 217,909	\$ 180,166
Operating income (loss):				
Americas	\$ 9,678	\$ 6,829	\$ 15,641	\$ 9,888
EMEA	4,136	358	10,396	217
Asia/Pacific	(3,392)	(2,821)	(8,117)	(6,644)
	\$ 10,422	\$ 4,366	\$ 17,920	\$ 3,461

Reportable segment results are impacted by both direct expenses and allocated shared function costs such as global product delivery and development, global customer operations, global product management and corporate overhead costs. Shared function costs are allocated to the reportable segments as a percentage of revenue or as a percentage of headcount.

Operating income in the Americas and EMEA reportable segments increased for the three and six months ended June 30, 2011 as compared to the same period in 2010 primarily due to increased revenues. Operating loss in the Asia/Pacific reportable segment increased for the three and six months ended June 30, 2011 as compared to the same period in 2010 primarily due to increased allocated costs as a result of the headcount growth relative to the other reportable segments.

Liquidity and Capital Resources

As of June 30, 2011, we had \$170.8 million in cash and cash equivalents. Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less.

As of June 30, 2011, \$83.7 million of the \$170.8 million of cash and cash equivalents was held by our foreign subsidiaries. If these funds were needed for our operations in the U.S. we would be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

As of June 30, 2011, we had up to \$75.0 million of unused borrowings under our revolving credit facility. The amount of unused borrowings actually available under the revolving credit facility varies in accordance with the terms of the agreement. The current credit facility will mature on September 29, 2011, at which time any principal amounts outstanding are due. We are currently in discussions with various lenders, including our current lenders, for a new credit facility and anticipate closing on the new facility prior to the maturation of the current facility. The revolving credit facility contains certain affirmative and negative covenants, including limitations on the incurrence of indebtedness, asset

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

dispositions, acquisitions, investments, dividends and other restricted payments, liens and transactions with affiliates. The revolving credit facility also contains financial covenants relating to maximum permitted leverage ratio and the minimum interest coverage ratio. The facility does not contain any subjective acceleration features and does not have any required payment or principal reduction schedule and is included as a current liability in our consolidated balance sheet. At June 30, 2011 and December 31, 2010, (and at all times during these

Table of Contents

periods) we were in compliance with our debt covenants. The interest rate in effect at June 30, 2011 was 0.95%.

We are not currently dependent upon short-term funding, and the limited availability of credit in the market has not affected our revolving credit facility, our liquidity or materially impacted our funding costs. However, due to the existing uncertainty in the capital and credit markets and the impact of the current economic crisis on our operating results and financial conditions, the amount of available unused borrowings under our existing credit facility may be insufficient to meet our needs and/or our access to capital outside of our existing credit facility may not be available on terms acceptable to us or at all. Additionally, if one or more of the financial institutions in our syndicate were to default on its obligation to fund its commitment, the portion of the committed facility provided by such defaulting financial institution would not be available to us. We cannot assure you that alternative financing on acceptable terms would be available to replace any defaulted commitments. The existing uncertainty in the capital and credit markets and the current economic crisis may also impact our ability to successfully negotiate a new credit facility with our existing lenders or alternative lenders. We cannot guarantee that a new credit facility will be available to us or that we will be able to negotiate terms and conditions acceptable to us. In the event we are unable to successfully negotiate a new credit facility, all outstanding amounts under the existing credit facility will become due and payable.

We believe that our existing sources of liquidity, including cash on hand and cash provided by operating activities, will satisfy our projected liquidity requirements, which primarily consists of working capital requirements, for the next twelve months, even in the unlikely event that we are unable to successfully negotiate a new credit facility and all outstanding amounts under the existing credit facility become due and payable.

Our board of directors has approved a stock repurchase program authorizing us, from time to time as market and business conditions warrant, to acquire up to \$210 million of our common stock. Under the program to date, we have purchased 8,082,180 shares for approximately \$187.1 million. We did not repurchase shares under this program during the six months ended June 30, 2011. The maximum remaining dollar value of shares authorized for purchase under the stock repurchase program was approximately \$22.9 million as of June 30, 2011. There is no guarantee as to the exact number of shares that will be repurchased by us. Repurchased shares are returned to the status of authorized but unissued shares of common stock. In March 2005, our board of directors approved a plan under Rule 10b5-1 of the Securities Exchange Act of 1934 to facilitate the repurchase of shares of common stock under the existing stock repurchase program. Under our Rule 10b5-1 plan, we have delegated authority over the timing and amount of repurchases to an independent broker who does not have access to inside information about the Company. Rule 10b5-1 allows us, through the independent broker, to purchase shares at times when we ordinarily would not be in the market because of self-imposed trading blackout periods, such as the time immediately preceding the end of the fiscal quarter through a period three business days following our quarterly earnings release. We did not purchase any shares under the repurchase plan during the six months ended June 30, 2011.

We may also decide to use cash to acquire new products and services or enhance existing products and services through acquisitions of other companies, product lines, technologies and personnel, or through investments in other companies.

Cash Flows

The following table sets forth summary cash flow data for the periods indicated. Please refer to this summary as you read our discussion of the sources and uses of cash in each period.

	September 30, Six Months Ended June 30,	
	2011	2010
	(amounts in thousands)	
Net cash provided by (used by):		
Operating activities	\$ 25,484	\$ 17,098
Investing activities	(30,264)	(9,387)
Financing activities	2,836	(13,897)
Net cash flows provided by operating activities for the six months ended June 30, 2011 amounted to \$25.5 million as compared		

Table of Contents

to \$17.1 million during the same period in 2010. The comparative period increase in net cash flows from operating activities of \$8.4 million was principally the result of an increase in cash generated from higher customer cash receipts partially offset by an increase in operating expenses and cash taxes paid.

Net cash flows used by investing activities totaled \$30.3 million in the six months ended June 30, 2011 as compared to \$9.4 million used by investing activities during the same period in 2010. This increase was largely driven by the \$16.9 million of cash paid, net of \$2.4 million in cash acquired, to acquire ISD during the six months ended June 30, 2011. In addition, during the six months ended June 30, 2011, we used cash of \$13.2 million to purchase software, property and equipment and \$0.3 million for costs related to fulfillment of the technical enablement milestones under the Alliance. During the six months ended June 30, 2010, we used cash of \$6.3 million to purchase software, property and equipment and \$3.1 million for costs related to fulfillment of the technical enablement milestones under the Alliance.

Net cash flows provided by financing activities totaled \$2.8 million in the six months ended June 30, 2011 as compared to net cash flows used by financing activities of \$13.9 million during the same period in 2010. During the six months ended June 30, 2010, we used \$15.7 million to repurchase shares of our common stock under our stock repurchase plan. We made payments to third-party institutions, primarily related to debt and capital leases, totaling \$0.9 million and \$0.7 million during the six months ended June 30, 2011 and 2010, respectively. During the six months ended June 30, 2011 and 2010, we received proceeds of \$3.4 million and \$2.2 million, respectively, including corresponding excess tax benefits, from the exercises of stock options and \$0.6 million and \$0.5 million, respectively, for the issuance of common stock under our 1999 Employee Stock Purchase Plan, as amended.

We also realized a \$1.4 million increase in cash during the six months ended June 30, 2011 related to foreign exchange rate variances compared to a \$2.0 million decrease during the same period in 2010.

We believe that our existing sources of liquidity, including cash on hand and cash provided by operating activities, will satisfy our projected liquidity requirements to meet our working capital needs for at least the next twelve months.

Contractual Obligations and Commercial Commitments

There have been no material changes to the contractual obligations and commercial commitments disclosed in Item 7 of our Form 10-K for the fiscal year ended December 31, 2010.

Critical Accounting Estimates

The preparation of the condensed consolidated financial statements requires that we make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and other assumptions that we believe to be proper and reasonable under the circumstances. We continually evaluate the appropriateness of estimates and assumptions used in the preparation of our condensed consolidated financial statements. Actual results could differ from those estimates.

The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Revenue Recognition
- Allowance for Doubtful Accounts
- Intangible Assets and Goodwill
- Stock-Based Compensation
- Accounting for Income Taxes

During the six months ended June 30, 2011, there were no significant changes to our critical accounting policies and estimates other than as discussed below. Please refer to Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for our fiscal year ended December 31, 2010, filed on February 18, 2011, for a more complete discussion of our critical accounting policies and estimates.

Revenue Recognition for Arrangements with Multiple Deliverables

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Effective January 1, 2011 we adopted on a prospective basis for all new or materially modified arrangements entered into on or after that date, the amended accounting guidance for multiple-deliverable revenue arrangements and the amended guidance related to the scope of existing software revenue recognition guidance. The adoption of this guidance did not have a material

Table of Contents

impact on our condensed consolidated financial statements for the three and six months ended June 30, 2011, nor do we expect it to have a material impact on our future financial statements.

A multiple-deliverable arrangement is separated into more than one unit of accounting if the delivered item(s) has value to the customer on a stand-alone basis; if the arrangement includes a general right of return relative to the delivered item(s); and if delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company. If these criteria are not met, the arrangement is accounted for as a single unit of accounting which would result in revenue being recognized ratably over the contract term or being deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. If these criteria are met for each, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative selling price. The selling price for each element is based upon the following selling price hierarchy: vendor-specific objective evidence (VSOE) if available, third party evidence (TPE) if VSOE is not available, or estimated selling price if neither VSOE nor TPE is available.

We enter into hosting-related arrangements that may consist of multiple service deliverables including initial implementation and setup services; on-going support services; and other services. Our hosted products operate in a highly regulated and controlled environment which requires a highly specialized and unique set of initial implementation and setup services prior to the commencement of hosting-related services. Due to the essential and specialized nature of the implementation and setup services, these services do not qualify as separate units of accounting separate from the hosting service as the delivered services do not have value to the customer on a stand-alone basis. The on-going support and other services are considered as separate units of accounting. The total arrangement consideration is allocated to each of the separate units of accounting based on their relative selling price and revenue is recognized over their respective service periods. As the support and other services periods are the same as the hosting service period, the recognition pattern is similar to what was experienced prior to adopting the amended accounting guidance for multiple-deliverable revenue arrangements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Excluding the impact of changes in interest rates, there have been no material changes to our market risk for the six months ended June 30, 2011. We conduct business in all parts of the world and are thereby exposed to market risks related to fluctuations in foreign currency exchange rates. The U.S. dollar is the single largest currency in which our revenue contracts are denominated. Thus, any decline in the value of local foreign currencies against the U.S. dollar results in our products and services being more expensive to a potential foreign customer, and in those instances where our goods and services have already been sold, may result in the receivables being more difficult to collect. Additionally, any decline in the value of the U.S. dollar in jurisdictions where the revenue contracts are denominated in U.S. dollars and operating expenses are incurred in local currency will have an unfavorable impact to operating margins. We at times enter into revenue contracts that are denominated in the country's local currency, principally in Australia, Canada, the United Kingdom and other European countries. This practice serves as a natural hedge to finance the local currency expenses incurred in those locations. We have not entered into any foreign currency hedging transactions. We do not purchase or hold any derivative financial instruments for the purpose of speculation or arbitrage.

The primary objective of our cash investment policy is to preserve principal without significantly increasing risk. Based on our cash investments and interest rates on these investments at June 30, 2011, and if we maintained this level of similar cash investments for a period of one year, a hypothetical 10 percent increase or decrease in effective interest rates would increase or decrease interest income by less than \$0.1 million annually.

Item 4. CONTROLS AND PROCEDURES*Disclosure Controls and Procedures*

Our management, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, performed an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report, June 30, 2011. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective as of June 30, 2011.

Changes in Internal Control over Financial Reporting

Our management, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer evaluated any change in the Company's internal control over financial reporting that occurred during the quarter covered by this report and determined that there was no change in the Company's internal control over financial reporting during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****Item 1. LEGAL PROCEEDINGS**

From time to time, we are involved in various litigation matters arising in the ordinary course of our business. We are not currently a party to any legal proceedings, the adverse outcome of which, individually or in the aggregate, we believe would be likely to have a material adverse effect on our financial condition or results of operations.

Item 1A. RISK FACTORS

There have been no material changes to the risk factors disclosed in Item 1A of our Form 10-K for the fiscal year ended December 31, 2010. Additional risks and uncertainties, including risks and uncertainties not presently known to us, or that we currently deem immaterial, could also have an adverse effect on our business, financial condition and/or results of operations.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**Issuer Purchases of Equity Securities**

The following table provides information regarding the Company's repurchases of its common stock during the three months ended June 30, 2011:

Period	September 30,	September 30,	September 30,	September 30,
	Total Number of Shares Purchased as Part of Publicly Announced Program	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
April 1 through April 30, 2011		\$		\$ 22,920,000
May 1 through May 31, 2011				\$ 22,920,000
June 1 through June 30, 2011	681(1)	29.68		\$ 22,920,000
Total	681	\$ 29.68		

- (1) Pursuant to our 2005 Incentive Plan, we granted restricted share awards (RSAs). These awards have requisite service periods of either three or four years and vest in increments of either 33% or 25% on the anniversary dates of the grants. Under each arrangement, stock is issued without direct cost to the employee. During the three months ended June 30, 2011, 2,167 shares of the RSAs vested. We withheld 681 of those shares to pay the employees' portion of applicable payroll taxes.

In fiscal 2005, we announced that our board of directors approved a stock repurchase program authorizing us, from time to time as market and business conditions warrant, to acquire up to \$80 million of our common stock, and that we intend to use existing cash and cash equivalents to fund these repurchases. In May 2006, our board of directors approved an increase of \$30 million to the stock repurchase program, bringing the total of the approved program to \$110 million. In March 2007, our board of directors approved an increase of \$100 million to its current repurchase authorization, bringing the total authorization to \$210 million, of which approximately \$22.9 million remains available. In June 2007, we implemented this previously announced increase to our share repurchase program. There is no guarantee as to the exact number of shares that will be repurchased by us. Repurchased shares are returned to the status of authorized but unissued shares of common stock. In March 2005, our board of directors approved a plan under Rule 10b5-1 of the Securities Exchange Act of 1934 to facilitate the repurchase of shares of common

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

stock under the existing stock repurchase program. Under our Rule 10b5-1 plan, we have delegated authority over the timing and amount of repurchases to an independent broker who does not have access to inside information about the Company. Rule 10b5-1 allows us, through the independent broker, to purchase shares at times when we ordinarily would not be in the market because of self-imposed trading blackout periods, such as the time immediately preceding the end of the fiscal quarter through a period three business days following our quarterly earnings release. We did not repurchase any shares under this program during the three months ended June 30, 2011.

Table of Contents**Item 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

Item 5. OTHER INFORMATION

Not applicable.

Item 6. EXHIBITS

The following lists exhibits filed as part of this quarterly report on Form 10-Q:

Exhibit		
No.		Description
3.01 (1)		Amended and Restated Certificate of Incorporation of the Company, and amendments thereto
3.02 (2)		Amended and Restated Bylaws of the Company
4.01 (3)		Form of Common Stock Certificate
31.01		Certification of Principal Executive Officer pursuant to SEC Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.02		Certification of Principal Financial Officer pursuant to SEC Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01	*	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.02	*	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	**	XBRL Instance Document
101.SCH	**	XBRL Taxonomy Extension Schema
101.CAL	**	XBRL Taxonomy Extension Calculation Linkbase
101.LAB	**	XBRL Taxonomy Extension Label Linkbase
101.PRE	**	XBRL Taxonomy Extension Presentation Linkbase
101.DEF	**	XBRL Taxonomy Extension Definition Linkbase

* This certification is not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates it by reference.

** Furnished, not filed

(1) Incorporated herein by reference to registrant's current report on Form 8-K filed July 30, 2007.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

- (2) Incorporated herein by reference to Exhibit 3.2 to the registrant's current report on Form 8-K filed December 18, 2008.
- (3) Incorporated herein by reference to Exhibit 4.01 to the registrant's Registration Statement No. 33-88292 on Form S-1.

Table of Contents

SIGNATURE

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

ACI WORLDWIDE, INC.

(Registrant)

Date: August 1, 2011

By:

/s/ SCOTT W. BEHRENS
Scott W. Behrens
*Senior Vice President, Chief Financial Officer
and Chief Accounting Officer*

(Principal Financial Officer)

Table of Contents**EXHIBIT INDEX**

Exhibit		
No.		Description
3.01 (1)		Amended and Restated Certificate of Incorporation of the Company, and amendments thereto
3.02 (2)		Amended and Restated Bylaws of the Company
4.01 (3)		Form of Common Stock Certificate
31.01		Certification of Principal Executive Officer pursuant to SEC Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.02		Certification of Principal Financial Officer pursuant to SEC Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01	*	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.02	*	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	**	XBRL Instance Document
101.SCH	**	XBRL Taxonomy Extension Schema
101.CAL	**	XBRL Taxonomy Extension Calculation Linkbase
101.LAB	**	XBRL Taxonomy Extension Label Linkbase
101.PRE	**	XBRL Taxonomy Extension Presentation Linkbase
101.DEF	**	XBRL Taxonomy Extension Definition Linkbase

* This certification is not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates it by reference.

** Furnished, not filed

(1) Incorporated herein by reference to registrant's current report on Form 8-K filed July 30, 2007.

(2) Incorporated herein by reference to Exhibit 3.2 to the registrant's current report on Form 8-K filed December 18, 2008.

(3) Incorporated herein by reference to Exhibit 4.01 to the registrant's Registration Statement No. 33-88292 on Form S-1.