

MSCI Inc.
Form 10-Q
May 10, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from _____ to _____

Commission file number 001-33812

MSCI INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State of Incorporation)

13-4038723
(I.R.S. Employer
Identification Number)

7 World Trade Center

250 Greenwich Street, 49th Floor

New York, New York
(Address of Principal Executive Offices)

10007
(Zip Code)

Registrant's telephone number, including area code: (212) 804-3900

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 April 29, 2013, there were 120,720,799 shares of the Registrant's common stock, par value \$0.01, outstanding.

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MSCI INC.

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2013

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AVAILABLE INFORMATION

MSCI Inc. files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). You may read and copy any document we file with the SEC at the SEC's public reference room at 100 F Street, NE, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information that issuers (including MSCI Inc.) file electronically with the SEC. MSCI Inc.'s electronic SEC filings are available to the public at the SEC's internet site, www.sec.gov.

MSCI Inc.'s internet site is www.msci.com. You can access MSCI Inc.'s Investor Relations webpage at <http://ir.msci.com>. MSCI Inc. makes available free of charge, on or through its Investor Relations webpage, its proxy statements, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. MSCI Inc. also makes available, through its Investor Relations webpage, via a link to the SEC's internet site, statements of beneficial ownership of MSCI Inc.'s equity securities filed by its directors, executive officers, 5% or greater shareholders and others under Section 16 of the Exchange Act.

MSCI Inc. has a Corporate Governance webpage. You can access information about MSCI Inc.'s corporate governance at <http://ir.msci.com/governance.cfm>. MSCI Inc. posts the following on its Corporate Governance webpage:

Charters for our Audit Committee, Compensation Committee and Nominating and Governance Committee;

Corporate Governance Policies;

Procedures for Submission of Ethical Accounting Related Complaints; and

Code of Ethics and Business Conduct.

MSCI Inc.'s Code of Ethics and Business Conduct applies to all directors, officers and employees, including its Chief Executive Officer and its Chief Financial Officer. MSCI Inc. will post any amendments to the Code of Ethics and Business Conduct and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, Inc. (NYSE) on its internet site. You can request a copy of these documents, excluding exhibits, at no cost, by contacting Investor Relations, 7 World Trade Center, 250 Greenwich Street, 49th Floor, New York, NY 10007; (212) 804-1583. The information on MSCI Inc.'s internet site is not incorporated by reference into this report.

Table of Contents**PART I****Item 1. Condensed Consolidated Financial Statements****MSCI INC.****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

(in thousands, except share and per share data)

	March 31, 2013	As of December 31, 2012 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 263,029	\$ 183,309
Short-term investments		70,898
Accounts receivable (net of allowances of \$1,016 and \$964 as of March 31, 2013 and December 31, 2012, respectively)	166,915	153,557
Deferred taxes	53,743	49,552
Prepaid taxes	15,385	32,431
Prepaid and other assets	24,261	25,088
Total current assets	523,333	514,835
Property, equipment and leasehold improvements (net of accumulated depreciation of \$62,388 and \$59,078 at March 31, 2013 and December 31, 2012, respectively)	64,608	67,419
Goodwill	1,799,453	1,783,410
Intangible assets (net of accumulated amortization of \$330,370 and \$316,099 at March 31, 2013 and December 31, 2012, respectively)	631,385	641,074
Other non-current assets	13,081	12,901
Total assets	\$ 3,031,860	\$ 3,019,639
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,138	\$ 2,985
Accrued compensation and related benefits	45,556	113,359
Other accrued liabilities	42,581	42,486
Current maturities of long term debt	43,106	43,093
Deferred revenue	350,470	308,022
Total current liabilities	482,851	509,945
Long term debt, net of current maturities	785,856	811,623
Deferred taxes	234,500	234,245
Other non-current liabilities	39,915	38,595
Total liabilities	1,543,122	1,594,408

Commitments and Contingencies (see Note 8)**Shareholders equity:**

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Preferred stock (par value \$0.01; 100,000,000 shares authorized; no shares issued)		
Common stock (par value \$0.01; 750,000,000 shares authorized; 124,894,334 and 124,033,980 shares issued and 120,695,497 and 120,114,586 shares outstanding at March 31, 2013 and December 31, 2012, respectively)	1,249	1,240
Treasury shares, at cost (4,198,837 and 3,919,394 shares at March 31, 2013 and December 31, 2012, respectively)	(130,323)	(120,926)
Additional paid in capital	1,016,899	1,000,014
Retained earnings	606,636	547,699
Accumulated other comprehensive income (loss)	(5,723)	(2,796)
Total shareholders equity	1,488,738	1,425,231
Total liabilities and shareholders equity	\$ 3,031,860	\$ 3,019,639

See Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents**MSCI INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(in thousands, except per share data)**

	Three Months Ended	
	March 31,	March 31,
	2013	2012
	(unaudited)	
Operating revenues	\$ 251,909	\$ 229,052
Cost of services	80,185	72,291
Selling, general and administrative	61,631	55,436
Restructuring		(29)
Amortization of intangible assets	14,486	15,959
Depreciation and amortization of property, equipment and leasehold improvements	5,080	4,416
Total operating expenses	161,382	148,073
Operating income	90,527	80,979
Interest income	(268)	(223)
Interest expense	7,020	12,355
Other expense	224	608
Other expense (income), net	6,976	12,740
Income before provision for income taxes	83,551	68,239
Provision for income taxes	24,614	24,273
Net income	\$ 58,937	\$ 43,966
Earnings per basic common share	\$ 0.49	\$ 0.36
Earnings per diluted common share	\$ 0.48	\$ 0.35
Weighted average shares outstanding used in computing earnings per share		
Basic	120,746	121,754
Diluted	121,702	123,113

See Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents**MSCI INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(in thousands)**

	Three Months Ended	
	March 31,	March 31,
	2013	2012
	(unaudited)	
Net income	\$ 58,937	\$ 43,966
Other comprehensive income (loss):		
Foreign currency translation adjustments	(5,462)	3,529
Income tax effect	2,110	(1,390)
Foreign currency translation adjustments, net	(3,352)	2,139
Unrealized gains (losses) on cash flow hedges	593	28
Income tax effect	(226)	(33)
Unrealized gains (losses) on cash flow hedges, net	367	(5)
Unrealized gains on available-for-sale securities	(5)	(9)
Income tax effect	2	3
Unrealized gains on available-for-sale securities, net	(3)	(6)
Pension and other post-retirement adjustments	92	17
Income tax effect	(31)	(5)
Pension and other post-retirement adjustments, net	61	12
Other comprehensive income (loss), net of tax	(2,927)	2,140
Comprehensive income	\$ 56,010	\$ 46,106

See Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents**MSCI INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)**

	Three Months Ended	
	March 31,	March 31,
	2013	2012
	(unaudited)	
Cash flows from operating activities		
Net income	\$ 58,937	\$ 43,966
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	14,486	15,959
Share-based compensation expense	6,811	5,843
Depreciation of property, equipment and leasehold improvements	5,080	4,416
Amortization of debt origination fees	762	1,268
Deferred taxes	(5,143)	(5,687)
Amortization of discount on long-term debt	246	229
Excess tax benefits from share-based compensation	(1,172)	(1,262)
Other non-cash adjustments	(1,108)	(74)
Changes in assets and liabilities, net of assets and liabilities acquired:		
Accounts receivable	(14,213)	8,574
Prepaid income taxes	18,418	22,596
Prepaid and other assets	827	1,761
Accounts payable	(2,179)	(70)
Deferred revenue	43,405	40,951
Accrued compensation and related benefits	(61,639)	(71,230)
Other accrued liabilities	2,814	1,392
Other	4,715	875
Net cash provided by operating activities	71,047	69,507
Cash flows from investing activities		
Proceeds from redemption of short-term investments	70,900	22,695
Purchase of investments		(76,331)
Acquisitions, net of cash acquired	(23,168)	
Capital expenditures	(4,800)	(4,292)
Net cash provided by (used in) investing activities	42,932	(57,928)
Cash flows from financing activities		
Repayment of long-term debt	(26,000)	(2,812)
Repurchase of treasury shares	(9,397)	(2,309)
Proceeds from exercise of stock options	3,764	3,343
Excess tax benefits from share-based compensation	1,172	1,262
Net cash used in financing activities	(30,461)	(516)
Effect of exchange rate changes	(3,798)	2,748
Net increase in cash	79,720	13,811
Cash and cash equivalents, beginning of period	183,309	252,211

Cash and cash equivalents, end of period	\$ 263,029	\$ 266,022
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 5,240	\$ 10,863
Cash paid for income taxes	\$ 10,175	\$ 7,123
Supplemental disclosure of non-cash investing activities:		
Property, equipment and leasehold improvements in other accrued liabilities	\$ 1,255	\$ 3,256

See Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents**MSCI INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****1. INTRODUCTION AND BASIS OF PRESENTATION**

MSCI Inc. together with its wholly-owned subsidiaries (the Company or MSCI) is a global provider of investment decision support tools, including indices, portfolio risk and performance analytics and corporate governance products and services. The Company's flagship products are its global equity indices and environmental, social and governance (ESG) products marketed under the MSCI and MSCI ESG brands, its portfolio risk and performance analytics covering global equity and fixed income markets marketed under the Barra brand, its market and credit risk analytics marketed under the RiskMetrics and Barra brands, its governance research and outsourced proxy voting and reporting services, and executive compensation analytics tools marketed under the ISS brand, its valuation models and risk management software for the energy and commodities markets marketed under the FEA brand, its private real estate benchmarks marketed under the IPD brand and its products for monitoring, analysis and reporting on institutional assets for institutional investment consultants marketed under the InvestorForce brand.

MSCI operates as two segments, the Performance and Risk business and the Governance business. The Performance and Risk business is a global provider of investment decision support tools, including equity indices, real estate indices and benchmarks, portfolio risk and performance analytics, credit analytics and ESG products. The Governance business is a provider of corporate governance products, services and data solutions to institutional shareholders and corporations around the world. (See Note 12, Segment Information, for further information about MSCI's operating segments.)

Basis of Presentation and Use of Estimates

These unaudited condensed consolidated financial statements include the accounts of MSCI Inc. and its subsidiaries and include all adjustments of a normal, recurring nature necessary to present fairly the financial condition as of March 31, 2013 and December 31, 2012, the results of operations and comprehensive income for the three months ended March 31, 2013 and 2012 and cash flows for the three months ended March 31, 2013 and 2012. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in MSCI's Annual Report on Form 10-K for the year ended December 31, 2012. The condensed consolidated financial statement information as of December 31, 2012 has been derived from the 2012 audited consolidated financial statements. The results of operations for interim periods are not necessarily indicative of results for the entire year.

The Company's unaudited condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These accounting principles require the Company to make certain estimates and judgments that can affect the reported amounts of assets and liabilities as of the date of the unaudited condensed consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Significant estimates and assumptions made by management include the deferral and recognition of revenue, research and development and software capitalization, the allowance for doubtful accounts, impairment of long-lived assets, accrued compensation, income taxes and other matters that affect the unaudited condensed consolidated financial statements and related disclosures. The Company believes that estimates used in the preparation of these unaudited condensed consolidated financial statements are reasonable; however, actual results could differ materially from these estimates.

Inter-company balances and transactions are eliminated in consolidation.

Adjustment to Revenues

During the three months ended March 31, 2012, as a result of a one-time adjustment, the Company recorded a \$5.2 million cumulative revenue reduction to correct an immaterial error related to revenues previously reported through December 31, 2011. The effect of recording this adjustment in the three months ended March 31, 2012 resulted in a one-time decrease to the energy and commodity analytics products revenues in the Company's Unaudited Condensed Consolidated Statement of Income and an increase in deferred revenues in the Company's Unaudited Condensed Consolidated Statement of Financial Condition. It was determined that under Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) Subtopic 985-605, *Software Revenue Recognition*, the Company incorrectly established vendor specific objective evidence (VSOE) for certain energy and commodity analytics products and as a result should not have been recognizing a substantial portion of the revenue immediately upon delivery or renewal of a time based subscription license, the terms of which are generally one year. Rather, the entire license fee should have been recognized ratably over the term of the license. As such, the Company made the cumulative adjustment effective January 1, 2012 and started recognizing

Table of Contents**MSCI INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)**

revenue related to all contracts still in effect as of this date ratably over the remainder of the term. The Company began recognizing revenue ratably over the contract term for any new contracts entered into on or after January 1, 2012. Based upon an evaluation of all relevant factors, management believes the correcting adjustment did not have a material impact on the Company's previously reported results and, accordingly, has determined that restatement of previously issued financial statements is not necessary.

Concentrations

Financial instruments that may potentially subject the Company to concentrations of credit risk consist principally of cash deposits and short-term investments. At March 31, 2013 and December 31, 2012, cash and cash equivalent amounts were \$263.0 million and \$183.3 million, respectively. The Company held no short-term investments at March 31, 2013. At December 31, 2012, the Company had invested \$70.9 million in U.S. Treasury Securities with maturity dates ranging from 91 to 360 days from the date of purchase. The Company receives interest at prevailing money market fund rates on its cash deposits.

For the three months ended March 31, 2013 and 2012, no single customer accounted for 10.0% or more of the Company's operating revenues.

2. RECENT ACCOUNTING STANDARDS UPDATES

In February 2013, the FASB issued Accounting Standards Update No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, or ASU 2013-02. The amendments in this update require an entity to provide information about the amounts reclassified from accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the income statement or in the notes thereto, significant amounts reclassified from accumulated other comprehensive income by the respective net income line item. This new guidance is to be applied prospectively for interim and annual periods beginning after December 15, 2012. The adoption of ASU 2013-02 did not have a material impact on the Company's unaudited condensed consolidated financial statements.

3. RECLASSIFICATIONS OUT OF ACCUMULATED OTHER COMPREHENSIVE INCOME

As required by ASC Subtopic 220-10, *Comprehensive Income Overall*, the following table presents the amounts reclassified from accumulated other comprehensive income by the respective line item in the Unaudited Condensed Consolidated Statements of Income:

Reclassifications Out of Accumulated Other Comprehensive Income ^(a)

(in thousands)

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income Three Months Ended March 31, 2013	Affected Line Item in the Unaudited Condensed Consolidated Statement of Income
Unrealized losses on cash flow hedges		
Interest rate contracts	\$ (593)	Interest expense
	226	Tax benefit

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	\$	(367)	Net of tax
Unrealized gains on available-for-sale securities			
Insignificant items	\$	5	Interest income
		(2)	Tax expense
	\$	3	Net of tax
Total reclassifications for the period, net of tax			
	\$	(364)	

(a) Amounts in parenthesis indicate losses moved to the Unaudited Condensed Consolidated Statements of Income.

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Basic earnings per share (EPS) is computed by dividing income available to MSCI common shareholders by the weighted average number of common shares outstanding during the period. Shares of common stock outstanding include common stock and vested restricted stock unit awards where recipients have satisfied either the explicit vesting terms or retirement-eligible requirements. Diluted EPS reflects the assumed conversion of all dilutive securities. There were no restricted stock units or stock options excluded from the calculation of diluted EPS for the three months ended March 31, 2013 or 2012 because of their anti-dilutive effect.

The Company computes EPS using the two-class method and determines whether instruments granted in share-based payment transactions are participating securities. The following table presents the computation of basic and diluted EPS:

	Three Months Ended	
	March 31,	March 31,
	2013	2012
(in thousands, except per share amounts)		
Net income	\$ 58,937	\$ 43,966
Less: Allocations of earnings to unvested restricted stock units ⁽¹⁾	(237)	(271)
Earnings available to MSCI common shareholders	\$ 58,700	\$ 43,695
Basic weighted average common shares outstanding	120,746	121,754
Basic weighted average common shares outstanding	120,746	121,754
Effect of dilutive securities:		
Stock options and restricted stock units	956	1,359
Diluted weighted average common shares outstanding	121,702	123,113
Earnings per basic common share	\$ 0.49	\$ 0.36
Earnings per diluted common share	\$ 0.48	\$ 0.35

(1) Restricted stock units granted prior to 2013 have a right to participate in all of the earnings of the Company in the computation of basic EPS and, therefore, these restricted stock units are not included as incremental shares in the diluted EPS computation.

5. SHORT-TERM INVESTMENTS

In the three months ended March 31, 2013, the Company began investing excess cash in money market funds and other similar cash equivalents rather than in U.S. Treasury securities and other short-term investments as it had in prior periods. As a result, the Company held no short-term investments as of March 31, 2013. The fair value and gross unrealized gains and losses of securities available-for-sale as of December 31, 2012

were as follows:

(in thousands)	Amortized Cost plus Accrued Interest	Gross unrealized gains	Gross unrealized losses	Estimated Fair value
Debt securities available-for-sale				
U.S. Treasury securities	\$ 70,893	\$ 5	\$	\$ 70,898

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Property, equipment and leasehold improvements at March 31, 2013 and December 31, 2012 consisted of the following:

	March 31, 2013	As of December 31, 2012
	(in thousands)	
Computer & related equipment	\$ 68,910	\$ 67,529
Furniture & fixtures	7,642	7,847
Leasehold improvements	48,800	48,405
Work-in-process	1,644	2,716
Subtotal	126,996	126,497
Accumulated depreciation and amortization	(62,388)	(59,078)
Property, equipment and leasehold improvements, net	\$ 64,608	\$ 67,419

Depreciation and amortization expense of property, equipment and leasehold improvements was \$5.1 million and \$4.4 million for the three months ended March 31, 2013 and 2012, respectively.

7. GOODWILL AND INTANGIBLE ASSETS**Goodwill.**

The Company carries goodwill as a result of its acquisitions of Barra, LLC (Barra), RiskMetrics Group, LLC (RiskMetrics), Measurisk, LLC (Measurisk), IPD Group Limited (IPD) and Investor Force Holdings, Inc. (InvestorForce), as reflected in the table below:

(in thousands)	Performance and Risk	Governance	Total
Goodwill at December 31, 2012	\$ 1,552,293	\$ 231,117	\$ 1,783,410
Changes to goodwill ⁽¹⁾	21,423	(468)	20,955
Foreign exchange translation adjustment	(4,912)		(4,912)
Goodwill at March 31, 2013	\$ 1,568,804	\$ 230,649	\$ 1,799,453

⁽¹⁾ Resulting from the acquisition of InvestorForce, which contributed \$19.0 million to the Performance and Risk segment, adjustments to the valuation of acquired IPD assets and liabilities, which contributed \$2.4 million to the Performance and Risk segment, and the disposal of

the CFRA product line, which removed \$0.5 million from the Governance segment.

Intangible Assets.

Amortization expense related to intangible assets was \$14.5 million and \$16.0 million for the three months ended March 31, 2013 and 2012, respectively.

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The gross carrying amounts and accumulated amortization totals related to the Company's identifiable intangible assets are as follows:

(in thousands)	March 31, 2013	As of December 31, 2012
Gross intangible assets:		
Customer relationships	\$ 478,736	\$ 474,236
Trademarks/trade names	257,282	256,582
Technology/software	196,492	193,192
Proprietary process	3,800	3,800
Proprietary data	28,527	28,527
Subtotal	964,837	956,337
Foreign exchange translation adjustment	(3,082)	836
Total gross intangible assets	\$ 961,755	\$ 957,173
Accumulated amortization:		
Customer relationships	\$ (100,804)	\$ (92,631)
Trademarks/trade names	(65,501)	(62,270)
Technology/software	(161,598)	(159,375)
Proprietary process	(1,794)	(1,636)
Proprietary data	(715)	(184)
Subtotal	(330,412)	(316,096)
Foreign exchange translation adjustment	42	(3)
Total accumulated amortization	\$ (330,370)	\$ (316,099)
Net intangible assets:		
Customer relationships	\$ 377,932	\$ 381,605
Trademarks/trade names	191,781	194,312
Technology/software	34,894	33,817
Proprietary process	2,006	2,164
Proprietary data	27,812	28,343
Subtotal	634,425	640,241
Foreign exchange translation adjustment	(3,040)	833
Total net intangible assets	\$ 631,385	\$ 641,074

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The estimated amortization expense for succeeding years is presented below:

Fiscal Year	Amortization Expense (in thousands)
Remainder of 2013	\$ 43,327
2014	57,619
2015	57,542
2016	55,404
2017	49,294
2018	46,791
Thereafter	321,408
 Total	 \$ 631,385

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MSCI INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

8. COMMITMENTS AND CONTINGENCIES

Legal matters. From time to time, the Company is party to various litigation matters incidental to the conduct of its business. The Company is not presently party to any legal proce