Blue Diamond Investing

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Fair Isaac Corp

From Ratings to Returns

Overview

Fair Isaac Corp (FICO) is a dominant data analytics company that specializes in two segments: Scores and Software. FICO's primary focus is on providing businesses and organizations with software solutions and services that enable a company to harness the power of analytics to optimize, automate, and connect decisions to achieve business performance. Founded in 1956, the business has grown to operate in 120 countries with over 3,400 employees. Its popular credit scoring model, FICO Score, is used amongst 90% of the top 100 largest U.S. lenders and is a leader in the industry. These lenders use the company's credit scoring model to assess credit worthiness of consumers, in fact 98.8% of total U.S. Securitizations solely cited FICO Scores as a credit risk measure.

90%
Of U.S. consumer credit lending decisions use FICO Scores

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FICO Revenue Streams

Fair Isaac Corporation's FICO Score is used to determine 65% of all credit card application decisions with financial institutions. One revenue stream the company has is charging institutions fees for accessing the credit reporting system. The company continuously releases new versions of its model with different weightings compared to previous models. For example, the FICO Score 9 considers rent payments, unlike the FICO Score 8, which does not include this factor in its calculation. However, it's important to note that not all landlords report rent payments to credit bureaus. Additionally, Fair Isaac Corporation has the capacity to develop customized scoring models tailored to the unique requirements of clients across different industries.

Another revenue stream is downloading credit reports and accessing FICO scores on the consumer side. In addition, consumers are able to purchase identify theft and fraud protection services through myFICO. While the business may be able to expand this portion of the business in the future, the heavy growth driver will remain with B2B sales.

FICO offers Decision Management Software (DMS) design to automate and optimize decision-making processes across various business functions such as risk management, customer engagement, fraud detection, marketing optimization, and operational efficiency.

January 27, 2024

Ticker: FICO
Price: $1,196.36
Rating: BUY

Investment Rationale

- Continued usage of credit cards and increase in # of credit transactions
- Dominant player in the industry with a strong leadership team
- Conservative balance sheet, leading the company to success in various economic conditions

Potential Risks

- Technology disruptions including the emergence of new credit scoring models built by ML that could replace the use of FICO's traditional scoring business
- Economic fluctuations can lead to a decrease in credit transactions, resulting in less credit scoring service needs

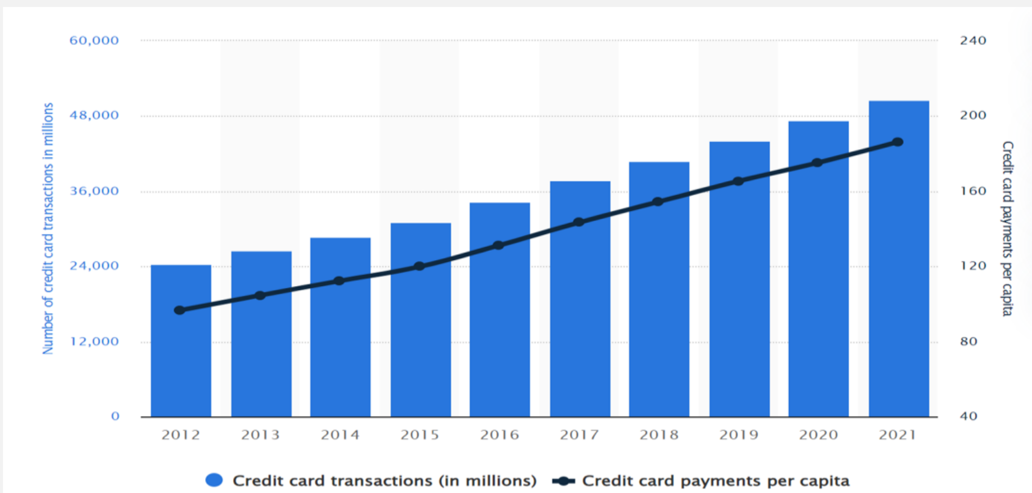
Recent Earnings

- Slight miss vs Street estimates
- 11% increase in total revenues
- 8% increase in operating income
- 24% increase in net income
- 25% increase in diluted EPS

Credit Transactions on the Rise

n an era dominated by digital transactions, the once-unquestioned reign of cash is steadily waning, transitioning from a necessity to a mere convenience. According to a report by FIS, the global share of Point of Sale (POS) transactions conducted in cash is projected to plummet to less than 10%, a significant decline from its 27% standing in 2018. Conversely, credit card transactions have experienced remarkable growth, soaring from 24 billion in 2012 to an impressive 50 billion in 2021, with The Nilson Report forecasting a further surge in credit card purchase volume to reach $6.3 trillion by 2026.

As cash transactions decline, so do those made with debit cards. The increase in credit card transactions is poised to trigger a surge in credit card applications, subsequently driving demand for FICO's scoring model. This surge is expected to translate into higher revenues for FICO as institutions increasingly rely on their scoring solutions to assess creditworthiness in the burgeoning digital economy.



The Bottom Line:
Fair Isaac Corporation is positioned for continued growth with a fantastic balance sheet and market demand. While the company may have slightly missed its most recent earnings, I believe this could be a fantastic time to establish a position as revenues still increased 11% yoy and margins grew as well. FICO will continue to develop spectacular scoring models with the usage of AI/ML in its business while fostering relationships with large institutions to help improve business performance.