

GLOBAL PAYMENTS INC
Form 10-Q
October 08, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 31, 2008

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: 001-16111

GLOBAL PAYMENTS INC.

(Exact name of registrant as specified in charter)

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Georgia (State or other jurisdiction of incorporation or organization)	58-2567903 (I.R.S. Employer Identification No.)
10 Glenlake Parkway, North Tower, Atlanta, Georgia (Address of principal executive offices)	30328-3473 (Zip Code)
Registrant's telephone number, including area code: (770) 829-8000	

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

Large accelerated filer

Accelerated filer

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

The number of shares of the issuer's common stock, no par value outstanding as of October 1, 2008 was 80,195,274.

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FORM 10-Q

For the quarterly period ended August 31, 2008

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****GLOBAL PAYMENTS INC.****UNAUDITED CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share data)

	Three Months Ended August 31,	
	2008	2007
Revenues	\$ 405,757	\$ 310,980
Operating expenses:		
Cost of service	144,177	116,309
Sales, general and administrative	168,483	127,436
Restructuring		1,003
	312,660	244,748
Operating income	93,097	66,232
Other income (expense):		
Interest and other income	3,371	5,137
Interest and other expense	(2,404)	(1,873)
	967	3,264
Income before income taxes and minority interest	94,064	69,496
Provision for income taxes	(28,216)	(23,783)
Minority interest, net of tax benefit (provision) of \$35 and \$(88), respectively	(8,321)	(2,138)
Net income	\$ 57,527	\$ 43,575
Basic earnings per share	\$ 0.72	\$ 0.54
Diluted earnings per share	\$ 0.71	\$ 0.53

See Notes to Unaudited Consolidated Financial Statements.

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GLOBAL PAYMENTS INC.
CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	August 31, 2008 (Unaudited)	May 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 287,721	\$ 456,060
Accounts receivable, net of allowances for doubtful accounts of \$567 and \$489, respectively	138,884	100,179
Claims receivable, net of allowances for losses of \$5,919 and \$6,065, respectively	1,852	1,354
Settlement processing assets	19,532	24,280
Inventory, net of obsolescence reserves of \$833 and \$1,028, respectively	6,576	3,821
Deferred income taxes	4,187	4,119
Prepaid expenses and other current assets	25,968	27,597
 Total current assets	 484,720	 617,410
Property and equipment, net of accumulated depreciation of \$151,009 and \$145,971, respectively	153,533	141,415
Goodwill	762,493	497,136
Other intangible assets, net of accumulated amortization of \$167,315 and \$163,358, respectively	285,590	175,636
Other	13,422	14,310
 Total assets	 \$ 1,699,758	 \$ 1,445,907
 LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Lines of credit	\$ 10,633	\$ 1,527
Current portion of term loan	25,000	
Payables to money transfer beneficiaries	13,904	9,276
Accounts payable and accrued liabilities	142,167	138,243
Settlement processing obligations	48,344	56,731
Income taxes payable	30,314	11,975
 Total current liabilities	 270,362	 217,752
Term loan	175,000	
Deferred income taxes	70,780	75,001
Other long-term liabilities	14,752	11,612
 Total liabilities	 530,894	 304,365
 Commitments and contingencies (See Note 12)		
Minority interest in equity of subsidiaries (includes redeemable minority interests with a book value of \$30,639 and an estimated maximum redemption amount of \$517,025 as of August 31, 2008)	42,203	14,724
Shareholders' equity:		
Preferred stock, no par value; 5,000,000 shares authorized and none issued		
Common stock, no par value; 200,000,000 shares authorized; 80,123,032 and 79,636,629 shares issued and outstanding at August 31, 2008 and May 31, 2008, respectively		

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Paid-in capital	387,918	380,741
Retained earnings	677,806	621,875
Accumulated other comprehensive income	60,937	124,202
Total shareholders' equity	1,126,661	1,126,818
Total liabilities and shareholders' equity	\$ 1,699,758	\$ 1,445,907

See Notes to Unaudited Consolidated Financial Statements.

Table of Contents**GLOBAL PAYMENTS INC.****UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Three Months Ended August 31,	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 57,527	\$ 43,575
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	9,553	6,663
Amortization of acquired intangibles	7,243	3,566
Share-based compensation expense	3,291	3,147
Provision for operating losses and bad debts	5,614	5,926
Minority interest in earnings	8,357	2,050
Deferred income taxes	934	(1,089)
Other, net	(266)	(20)
Changes in operating assets and liabilities, net of the effects of acquisitions:		
Accounts receivable	(41,189)	(12,116)
Claims receivable	(5,445)	(6,265)
Settlement processing assets and obligations, net	(4,206)	(569)
Inventory	(2,500)	(589)
Prepaid expenses and other assets	2,502	(11,573)
Payables to money transfer beneficiaries	4,628	1,355
Accounts payable and accrued liabilities	3,392	(1,044)
Income taxes payable	18,339	5,122
Net cash provided by operating activities	67,774	38,139
Cash flows from investing activities:		
Business and intangible asset acquisitions	(442,123)	(2,625)
Capital expenditures	(7,663)	(9,605)
Proceeds from sale of investment and contractual rights	5,737	
Net cash used in investing activities	(444,049)	(12,230)
Cash flows from financing activities:		
Net borrowings on lines of credit	9,106	133
Proceeds from term loan	200,000	
Proceeds from stock issued under share-based compensation plans	2,910	2,321
Tax benefit from share-based compensation plans	976	2,831
Repurchase of common stock		(67,873)
Dividends paid	(1,596)	(1,622)
Contribution from minority interest holder	8,857	
Distributions to minority interests, net	(2,469)	(2,372)
Net cash provided by (used in) financing activities	217,784	(66,582)
Effect of exchange rate changes on cash	(9,848)	2,345
Decrease in cash and cash equivalents	(168,339)	(38,328)
Cash and cash equivalents, beginning of period	456,060	308,872

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Cash and cash equivalents, end of period	\$ 287,721	\$ 270,544
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See Notes to Unaudited Consolidated Financial Statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business, consolidation and presentation Global Payments Inc. is a high-volume processor of electronic transactions for merchants, multinational corporations, financial institutions, consumers, government agencies and other profit and non-profit business enterprises to facilitate payments to purchase goods and services or further other economic goals. Our role is to serve as an intermediary in the exchange of information and funds that must occur between parties so that a transaction can be completed. We were incorporated in Georgia as Global Payments Inc. in September 2000, and we spun-off from our former parent company in January 2001. Including our time as part of our former parent company, we have provided transaction processing services since 1967.

The unaudited consolidated financial statements include our accounts and the accounts of our majority-owned subsidiaries. These unaudited consolidated financial statements have been prepared on the historical cost basis in accordance with accounting principles generally accepted in the United States and present our financial position, results of operations, and cash flows. Intercompany transactions have been eliminated in consolidation.

We prepared the unaudited consolidated financial statements included herein pursuant to the rules and regulations of the United States Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations, although we believe that the disclosures are adequate and the information presented is not misleading. We suggest that these financial statements be read in conjunction with the consolidated financial statements and notes thereto included in our Form 10-K for the fiscal year ended May 31, 2008.

Use of estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Revenue recognition

North America and International Merchant Services Segments

Our two merchant services segments primarily include processing solutions for credit cards, debit cards, and check-related services. This revenue is recognized as such services are performed. Revenue for processing services provided directly to merchants is recorded net of interchange fees charged by credit card issuing banks. We use two basic business models to market our merchant services offerings. One model, referred to as direct merchant services, features a salaried and commissioned sales force, independent sales organizations, or ISOs, and independent sales representatives, all of whom sell our end-to-end services directly to merchants. Our other model, referred to as indirect merchant services, provides the same basic products and services as direct merchant services, primarily to financial institutions and a limited number of ISOs on an unbundled basis, that in turn resell our products and services to merchants. Direct merchant services revenue is generated on services primarily priced as a percentage of transaction value, whereas indirect merchant services revenue is generated on services primarily priced on a specified amount per transaction. In both merchant services models, we also charge other processing fees unrelated to the number of transactions or the transaction value.

Money Transfer Segment

Our money transfer segment primarily includes processing international money transfer transactions. Money transfer revenue is earned on fees charged to customers based on the nature and amount of the transaction performed on the customers' behalf and is recognized at the time of funds transfer. We also earn money transfer revenue on the difference between the retail exchange rate quoted at the time when the money transfer transaction is requested and the wholesale exchange rate at the time when the currency is purchased. This revenue is recognized when the money transfer transaction is processed through the settlement system and the funds are available to the beneficiary, as this is the point in time when the amount of revenue is determinable.

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Cash and cash equivalents Cash and cash equivalents include cash on hand and all liquid investments with an initial maturity of three months or less when purchased. These amounts also include cash that we hold related to reserve funds collected from our merchants (Merchant reserves) that serve as collateral to minimize contingent liabilities associated with charges properly reversed by a cardholder. While this cash is not restricted and can be used in our general operations, we do not intend to use it, as we believe that designating this cash to collateralize Merchant reserves strengthens our fiduciary standing with our member sponsors and is in accordance with guidelines set by the card associations. As of August 31, 2008 and May 31, 2008, our cash and cash equivalents included \$119.5 million and \$131.6 million, respectively, related to Merchant reserves.

Settlement processing assets and obligations In order to provide credit card transaction processing services, we must be designated as a certified processor by MasterCard and Visa, in addition to a Merchant Service Provider by MasterCard and an Independent Sales Organization by Visa. These designations are dependent upon member clearing banks of either organization sponsoring us and our adherence to the standards of the Visa and MasterCard associations. A financial institution that is a member of the Visa and/or MasterCard card associations (the Member) must sponsor an electronic transaction payment processor such as Global Payments. We have four primary financial institution sponsors in the United States, Canada, the United Kingdom and the Asia-Pacific region with whom we have sponsorship or depository and processing agreements. These agreements allow us to route transactions under the member banks control and identification numbers to clear credit card transactions through Visa and MasterCard. Visa and MasterCard set the standards with which we must comply. Certain of the member financial institutions of Visa and MasterCard are our competitors.

We also provide credit card transaction processing for Discover Financial Services or Discover Card (Discover) and are designated as an acquirer by Discover. This designation provides us with a direct relationship between us and Discover, and therefore a Member sponsorship is not required. Our agreement with Discover allows us to route and clear transactions directly through Discover s network. Otherwise, we process Discover transactions similarly to how we process MasterCard and Visa transactions. Discover publishes acquirer operating regulations, with which we must comply. We use our Members to assist in funding merchants for Discover transactions.

Funds settlement refers to the process of transferring funds for sales and credits between card issuers and merchants. Depending on the type of transaction, either the credit card interchange system or the debit network is used to transfer the information and funds between the Member and card issuer to complete the link between merchants and card issuers.

For transactions processed on our systems, we use our network telecommunication infrastructure to deliver funding files to the Member, which creates a file to fund the merchants using country-specific payment networks such as the Federal Reserve s Automated Clearing House system in the United States or the Automated Clearing Settlement System or the Large Value Transfer System in Canada. In our United States portfolio and in most of our Canadian portfolio, merchant funding primarily occurs after the Member receives the funds from the card issuer through the card associations. For certain of our Canadian and Asia-Pacific merchant accounts, the Member funds the merchants before the Member receives the net settlement funds from the card associations, creating a net settlement asset at the Member. In the United Kingdom and the Asia-Pacific region, the Member provides the payment processing operations and related support services on our behalf under a transition services agreement. The Member will continue to provide these operations and services until the integration efforts are completed. After our integration, the Member will continue to provide funds settlement services similar to the functions performed by our Members in the United States and Canada.

Timing differences, interchange expenses, Merchant reserves and exception items cause differences between the amount the Member receives from the card associations and the amount funded to the merchants. The standards of the card associations restrict us from performing funds settlement or accessing merchant settlement funds, and, instead, require that these funds be in the possession of the Member until the merchant is funded. However, in practice and in accordance with the terms of our sponsorship agreements with our Members, we follow a net settlement process whereby, if the incoming amount from the card associations precedes the Member s funding obligation to the merchant, we temporarily hold the surplus on behalf of the Member, in a joint deposit account or in an account at the Member bank, and record a corresponding liability. Conversely, if the Member s funding obligation to the merchant precedes the incoming amount from the card associations, the amount of the Member s net receivable position is either subsequently advanced to the Member by us or the Member satisfies this obligation with its own funds. If the Member uses its own funds, the Member assesses a funding cost, which is included in interest and other expense on the accompanying unaudited consolidated statements of income. Each participant in the transaction process receives compensation for its services.

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The settlement processing assets and obligations represent intermediary balances arising in our settlement process for direct merchants. Settlement processing assets consist primarily of (i) our receivable from merchants for the portion of the discount fee related to reimbursement of the interchange expense (Interchange reimbursement), (ii) our liability to the Members for transactions for which we have not funded merchants on behalf of the Members but for which we have received funding from the Members, (iii) exception items, such as customer chargeback amounts receivable from merchants (Exception items), and (iv) Merchant reserves held to minimize contingent liabilities associated with charges properly reversed by a cardholder. Settlement processing obligations consist primarily of (i) Interchange reimbursement, (ii) our liability to the Members for transactions for which we have not funded merchants on behalf of the Members but for which we have received funding from the Members, (iii) Exception items, (iv) Merchant reserves, (v) the fair value of our guarantees of customer chargebacks (see *Reserve for operating losses* below), and (vi) the reserve for sales allowances. As of August 31, 2008 and May 31, 2008, our settlement processing assets primarily related to our processing for direct merchants in Canada, while our settlement processing obligations primarily related to our processing for direct merchants in the United States and Asia-Pacific. Our reserve for operating losses and reserve for sales allowance relate to our direct merchant services business model. A summary of these amounts as of August 31, 2008 and May 31, 2008 is as follows:

	August 31, 2008	May 31, 2008
	(in thousands)	
Settlement processing assets:		
Interchange reimbursement	\$ 58,661	\$ 60,734
Liability to Members, net	(21,160)	(19,122)
Exception items	891	717
Merchant reserves	(18,860)	(18,049)
Total	\$ 19,532	\$ 24,280
Settlement processing obligations:		
Interchange reimbursement	\$ 120,855	\$ 123,757
Liability to Members, net	(73,438)	(69,823)
Exception items	8,474	6,722
Merchant reserves	(100,667)	(113,523)
Fair value of guarantees of customer chargebacks	(3,087)	(3,375)
Reserves for sales allowances	(481)	(489)