

ALLIANCE DATA SYSTEMS CORP

Form 10-Q

November 09, 2009

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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 September 30, 2009

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: 001-15749

ALLIANCE DATA SYSTEMS CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware

31-1429215

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(State or Other Jurisdiction of

(I.R.S. Employer

Incorporation or Organization)

Identification No.)

17655 Waterview Parkway

Dallas, Texas 75252

(Address of Principal Executive Office, Including Zip Code)

(972) 348-5100

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required 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 Regulations 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 definition 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 Act). Yes No

As of November 2, 2009, 52,265,491 shares of common stock were outstanding.

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Table of Contents**PART I****Item 1. Financial Statements.****ALLIANCE DATA SYSTEMS CORPORATION****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2009	December 31, 2008
	(In thousands)	
ASSETS		
Cash and cash equivalents	\$ 449,621	\$ 156,911
Trade receivables, less allowance for doubtful accounts (\$7,486 and \$7,172 at September 30, 2009 and December 31, 2008, respectively)	207,725	219,362
Seller's interest and credit card receivables, less allowance for doubtful accounts (\$55,295 and \$40,718 at September 30, 2009 and December 31, 2008, respectively)	776,359	639,573
Deferred tax asset, net	210,513	201,895
Other current assets	159,510	142,660
Redemption settlement assets, restricted	592,255	531,594
Assets held for sale		32,015
Total current assets	2,395,983	1,924,010
Property and equipment, net	167,291	168,847
Due from securitizations	720,926	701,347
Intangible assets, net	259,735	297,776
Goodwill	1,162,443	1,133,790
Other non-current assets	192,177	116,219
Total assets	\$ 4,898,555	\$ 4,341,989
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	\$ 108,745	\$ 108,369
Accrued expenses	85,347	143,656
Certificates of deposit	537,200	433,900
Current portion of long-term debt	43,447	275,549
Other current liabilities	97,965	106,641
Deferred revenue	973,680	860,455
Liabilities held for sale		20,782
Total current liabilities	1,846,384	1,949,352
Deferred revenue	156,428	135,179
Deferred tax liability, net	165,262	123,476
Certificates of deposit	642,700	255,000
Long-term and other debt	1,768,471	1,215,726
Other liabilities	86,917	115,958
Total liabilities	4,666,162	3,794,691
Stockholders' equity:		
Common stock, \$0.01 par value; authorized 200,000 shares; issued 90,917 shares and 89,029 shares at September 30, 2009 and December 31, 2008, respectively	909	890
Additional paid-in capital	1,218,835	1,115,291
	(1,902,985)	(1,410,339)

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Treasury stock, at cost (38,445 and 26,222 shares at September 30, 2009 and December 31, 2008, respectively)

Retained earnings	992,392	889,305
Accumulated other comprehensive loss	(76,758)	(47,849)
Total stockholders' equity	232,393	547,298
Total liabilities and stockholders' equity	\$ 4,898,555	\$ 4,341,989

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands, except per share amounts)			
Revenues				
Transaction	\$ 91,625	\$ 91,017	\$ 284,409	\$ 257,709
Redemption	120,779	127,925	346,935	376,325
Securitization income and finance charges, net	115,626	140,410	361,283	446,957
Database marketing fees and direct marketing fees	129,317	135,364	364,605	381,481
Other revenue	25,839	16,509	66,620	55,213
Total revenue	483,186	511,225	1,423,852	1,517,685
Operating expenses				
Cost of operations (exclusive of depreciation and amortization disclosed separately below)	327,081	335,117	976,276	1,000,890
General and administrative	30,137	24,344	77,176	57,509
Depreciation and other amortization	15,397	17,363	45,816	52,703
Amortization of purchased intangibles	15,770	16,703	45,833	50,682
Loss on the sale of assets				1,052
Merger (income) costs	30	(2,113)	(486)	2,298
Total operating expenses	388,415	391,414	1,144,615	1,165,134
Operating income	94,771	119,811	279,237	352,551
Interest expense, net	39,044	23,325	105,226	54,370
Income from continuing operations before income taxes	55,727	96,486	174,011	298,181
Provision for income taxes	9,931	37,556	55,826	114,603
Income from continuing operations	45,796	58,930	118,185	183,578
Income (loss) from discontinued operations, net of taxes		5,900	(15,098)	(22,460)
Net income	\$ 45,796	\$ 64,830	\$ 103,087	\$ 161,118
Basic income per share:				
Income from continuing operations	\$ 0.87	\$ 0.87	\$ 2.08	\$ 2.47
Income (loss) from discontinued operations		0.09	(0.27)	(0.30)
Net income per share	\$ 0.87	\$ 0.96	\$ 1.81	\$ 2.17
Diluted income per share:				
Income from continuing operations	\$ 0.83	\$ 0.85	\$ 2.04	\$ 2.41
Income (loss) from discontinued operations		0.08	(0.26)	(0.29)
Net income per share	\$ 0.83	\$ 0.93	\$ 1.78	\$ 2.12
Weighted-average shares basic	52,841	67,442	56,946	74,196
Weighted-average shares diluted	55,136	69,689	57,959	76,254

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine Months Ended September 30,	
	2009	2008
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 103,087	\$ 161,118
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	91,649	111,377
Deferred income taxes	48,168	15,116
Provision for doubtful accounts	46,581	27,961
Non-cash stock compensation	43,353	36,721
Fair value loss (gain) on interest-only strip	2,207	(15,250)
Amortization of discount on convertible senior notes	37,243	6,821
Impairment of long-lived assets		19,004
Loss (gain) on the sale of assets	18,018	(20,661)
Change in operating assets and liabilities, net of acquisitions:		
Change in trade accounts receivable	13,231	(14,893)
Change in merchant settlement activity	(18,907)	(131,230)
Change in other assets	(22,683)	(36,739)
Change in accounts payable and accrued expenses	(68,583)	(65,108)
Change in deferred revenue	(2,731)	395,608
Change in other liabilities	(20,526)	21,811
Proceeds from the sale of credit card receivable portfolios to the securitization trusts	53,240	102,987
Purchase of credit card receivables		(23,123)
Excess tax benefits from stock-based compensation	(7,425)	(2,792)
Other	(9,800)	(10,377)
Net cash provided by operating activities	306,122	578,351
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in redemption settlement assets	29,744	(362,384)
Payments for acquired businesses, net of cash acquired		(2,478)
Net (increase) decrease in seller's interest and credit card receivables	(242,810)	46,577
Change in due from securitizations	(73,755)	(59,445)
Proceeds from the sale of credit card receivable portfolios to the securitization trusts		91,910
Capital expenditures	(39,706)	(37,098)
Proceeds from the sale of businesses		137,960
Proceeds from the sale of assets	8,013	14,098
Change in restricted cash	(64,810)	
Other	4,399	(4,715)
Net cash used in investing activities	(378,925)	(175,575)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under debt agreements	2,396,000	2,532,971
Repayment of borrowings	(2,327,926)	(2,648,829)
Proceeds from issuance of convertible senior notes due 2013		805,000
Proceeds from issuance of convertible senior notes due 2014	345,000	
Certificate of deposit issuances	1,100,400	551,800
Repayments of certificates of deposits	(609,400)	(576,400)
Payment of capital lease obligations	(15,718)	(15,930)
Payment of deferred financing costs	(21,407)	(28,724)
Excess tax benefits from stock-based compensation	7,425	2,792
Proceeds from issuance of common stock	23,780	29,192
Proceeds from sale-leaseback transactions		34,221
Proceeds from the issuance of warrants	30,050	94,185
Payments for convertible note hedges	(80,765)	(201,814)
Payments for prepaid forward contracts	(74,872)	

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Purchase of treasury shares	(417,774)	(860,093)
Net cash provided by (used in) financing activities	354,793	(281,629)
Effect of exchange rate changes on cash and cash equivalents	10,720	(8,803)
Change in cash and cash equivalents	292,710	112,344
Cash and cash equivalents at beginning of period	156,911	265,839
Cash and cash equivalents at end of period	\$ 449,621	\$ 378,183
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 58,579	\$ 56,288
Income taxes paid, net of refunds	\$ 53,890	\$ 101,666

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements included herein have been prepared by Alliance Data Systems Corporation (ADSC or, including its wholly owned subsidiaries, the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on March 2, 2009, and the Company s Current Report on Form 8-K, filed with the SEC on May 22, 2009, which re-issued certain items of the Company s Annual Report on Form 10-K.

The unaudited condensed consolidated financial statements included herein reflect all adjustments (consisting of normal, recurring adjustments) which are, in the opinion of management, necessary to state fairly the results for the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for the fiscal year. The Company has evaluated subsequent events for disclosure through November 9, 2009, the date of issuance of the accompanying unaudited condensed consolidated financial statements.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect (1) the reported amounts of assets and liabilities; (2) disclosure of contingent assets and liabilities at the date of the financial statements; and (3) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company s unaudited condensed consolidated financial statements reflect the Company s adoption of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 470-20, Debt Debt with Conversion and Other Options on January 1, 2009. ASC 470-20 requires that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer s nonconvertible debt borrowing rate. The adoption of ASC 470-20 changed the historical accounting for the Company s \$805.0 million aggregate principal amount of convertible senior notes due 2013 (the Convertible Senior Notes due 2013). All historical statements have been revised to conform to this presentation.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table reflects the results of the adoption of ASC 470-20 in the Company's unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2008:

	Three Months Ended September 30, 2008		Nine Months Ended September 30, 2008	
	As Previously Presented	Following the Adoption of ASC 470-20	As Previously Presented	Following the Adoption of ASC 470-20
	(In thousands, except per share amounts)			
Interest expense, net	\$ 16,504	\$ 23,325	\$ 47,549	\$ 54,370
Income from continuing operations before income taxes	103,307	96,486	305,002	298,181
Provision for income taxes	39,948	37,556	116,995	114,603
Income from continuing operations	63,359	58,930	188,007	183,578
Net income	69,259	64,830	165,547	161,118
Basic income per share				
Income from continuing operations	\$ 0.94	\$ 0.87	\$ 2.53	\$ 2.47
Net income per share	\$ 1.03	\$ 0.96	\$ 2.23	\$ 2.17
Diluted income per share				
Income from continuing operations	\$ 0.91	\$ 0.85	\$ 2.47	\$ 2.41
Net income per share	\$ 0.99	\$ 0.93	\$ 2.17	\$ 2.12

The following table reflects the results of the adoption of ASC 470-20 in the Company's unaudited condensed consolidated statement of cash flows for the nine months ended September 30, 2008:

	Nine Months Ended September 30, 2008	
	As Previously Presented	Following the Adoption of ASC 470-20
	(In thousands)	
Cash flows from operating activities⁽¹⁾		
Net income	\$ 165,547	\$ 161,118
Deferred income taxes	17,508	15,116
Amortization of discount on convertible senior notes		6,821

⁽¹⁾ The adoption of ASC 470-20 had no impact on net cash provided by operating activities.

Statement of Cash Flows Correction

Proceeds from the sale of certain credit card receivables to securitization trusts were previously reported as an operating activity in the Company's statements of cash flows. The related cash outflows for the acquisition of these receivables should have been reported as an investing activity because the receivables were historically classified and accounted for as held-for-investment prior to their sale. As a result, cash flows associated with credit card portfolios purchased with the intent to sell are included in cash flows from operating activities. Cash flows associated with credit card receivables originated for investment are classified as cash flows from investing activities.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In connection with the preparation of its 2008 annual financial statements, and subsequent to the filing of the September 30, 2008 interim financial statements on Form 10-Q, the Company determined that the proceeds from these credit card receivables sales should properly have been classified as an investing activity. As a result, net cash flows provided by operating activities and net cash used in investing activities for the nine months ended September 30, 2008 have been corrected from the amounts previously reported as follows:

	Nine Months Ended September 30, 2008	
	As Previously Reported	As Corrected
	(In thousands)	
Cash flows from operating activities		
Proceeds from sale of credit card receivable portfolios	\$ 194,897	\$ 102,987
Net cash provided by operating activities	670,261	578,351
Cash flows from investing activities		
Proceeds from the sale of credit card receivable portfolios	\$	\$ 91,910
Net cash used in investing activities	(267,485)	(175,575)
The Company has concluded that these corrections are immaterial.		

2. SHARES USED IN COMPUTING NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands, except per share amounts)			
Numerator				
Income from continuing operations	\$ 45,796	\$ 58,930	\$ 118,185	\$ 183,578
Income (loss) from discontinued operations		5,900	(15,098)	(22,460)
Net income	\$ 45,796	\$ 64,830	\$ 103,087	\$ 161,118
Denominator				
Weighted-average shares, basic	52,841	67,442	56,946	74,196
Weighted-average effect of dilutive securities:				
Shares from assumed conversion of convertible senior notes	788			
Net effect of unvested restricted stock	534	979	263	754
Net effect of dilutive stock options	973	1,268	750	1,304
Denominator for diluted calculation	55,136	69,689	57,959	76,254
Basic				
Income from continuing operations per share	\$ 0.87	\$ 0.87	\$ 2.08	\$ 2.47
Income (loss) from discontinued operations per share		0.09	(0.27)	(0.30)

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Net income per share	\$ 0.87	\$ 0.96	\$ 1.81	\$ 2.17
Diluted				
Income from continuing operations per share	\$ 0.83	\$ 0.85	\$ 2.04	\$ 2.41
Income (loss) from discontinued operations per share		0.08	(0.26)	(0.29)
Net income per share	\$ 0.83	\$ 0.93	\$ 1.78	\$ 2.12

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company calculates the effect of the convertible senior notes, including both the Convertible Senior Notes due 2013 and the \$345.0 million aggregate principal amount of convertible senior notes due 2014 (the Convertible Senior Notes due 2014), which can be settled in cash or shares of common stock, on diluted net income per share as if they will be settled in cash as the Company has the intent to settle the convertible senior notes for cash. As a result, the Company uses the treasury stock method to calculate the dilutive effect of the convertible senior notes.

During the second quarter of 2009, the Company entered into prepaid forward contracts to purchase 1,857,400 shares of its common stock for \$74.9 million. The number of shares to be delivered under the prepaid forward contracts is used to reduce weighted-average basic and diluted shares outstanding.

The Company excluded 17.5 million warrants for the three and nine months ended September 30, 2009 and 10.3 million warrants for the three and nine months ended September 30, 2008 from the calculation of earnings per share as the effect was anti-dilutive.

3. DISPOSITIONS

In February 2009, the Company completed the sale of the remainder of its utility services business, including the termination of a services agreement and the resolution of certain contractual disputes, to a former utility client and recognized a pre-tax loss of approximately \$18.0 million, which has been included in loss from discontinued operations in the unaudited condensed consolidated statements of income. In addition, the Company entered into transition services and co-location agreements to provide such former utility client with certain services or access to certain facilities for varying terms through the fourth quarter of 2010. The Company entered into agreements to outsource the majority of its corporate information technology services to Fujitsu America, Inc. commencing with the third quarter of 2009. Pursuant to those agreements, responsibility for these transition services and co-location agreements will be transferred to Fujitsu America, Inc.

The assets and liabilities of the discontinued operations are presented in the unaudited condensed consolidated balance sheets as assets held for sale and liabilities held for sale. The underlying assets and liabilities of the discontinued operations for the periods presented are as follows:

	September 30, 2009	December 31, 2008
	(In thousands)	
Assets:		
Trade receivables, net	\$	\$ 30,663
Other assets		1,307
Property and equipment, net		45
Assets held for sale	\$	\$ 32,015
Liabilities:		
Accrued expenses	\$	\$ 18,738
Other liabilities		2,044
Liabilities held for sale	\$	\$ 20,782

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the operating results of the discontinued operations.

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
	(In thousands)			
Revenue	\$	\$ 22,101	\$ 4,659	\$ 162,097
Loss before provision for income taxes		(3,983)	(23,122)	(34,449)
Benefit from income taxes		(9,883)	(8,024)	(11,989)
Income (loss) from discontinued operations	\$	\$ 5,900	\$ (15,098)	\$ (22,460)

4. REDEMPTION SETTLEMENT ASSETS

Redemption settlement assets consist of cash and cash equivalents and securities available-for-sale and are designated for settling redemptions by collectors of the AIR MILES® Reward Program in Canada under certain contractual relationships with sponsors of the AIR MILES Reward Program. These assets are primarily denominated in Canadian dollars. Realized gains and losses from the sale of investment securities were not material. The principal components of redemption settlement assets, which are carried at fair value, are as follows:

	September 30, 2009				December 31, 2008			
	Cost	Unrealized		Fair Value	Cost	Unrealized		Fair Value
		Gains	Losses			Gains	Losses	
	(In thousands)							
Cash and cash equivalents	\$ 54,930	\$	\$	\$ 54,930	\$ 125,906	\$	\$	\$ 125,906
Government bonds	40,845	1,369		42,214	40,246	511		40,757
Corporate bonds	485,721	14,184	(4,794)	495,111	371,954	1,562	(8,585)	364,931
Total	\$ 581,496	\$ 15,553	\$ (4,794)	\$ 592,255	\$ 538,106	\$ 2,073	\$ (8,585)	\$ 531,594

The following table shows the gross unrealized losses and fair value for those investments that were in an unrealized loss position as of September 30, 2009 and December 31, 2008, aggregated by investment category and the length of time that individual securities have been in a continuous loss position:

	September 30, 2009		September 30, 2009		Total	
	Less than 12 months	Greater	Less than 12 months	Greater	Less than 12 months	Greater
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Corporate bonds	\$ 83,086	\$ (4,794)	\$	\$	\$ 83,086	\$ (4,794)

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Total	\$ 83,086	\$ (4,794)	\$	\$	\$ 83,086	\$ (4,794)
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	Less than 12 months		December 31, 2008 12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
Corporate bonds	\$ 176,845	\$ (8,170)	\$ 26,704	\$ (415)	\$ 203,549	\$ (8,585)
Total	\$ 176,845	\$ (8,170)	\$ 26,704	\$ (415)	\$ 203,549	\$ (8,585)

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Market values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the security's issuer, and the Company's intent to sell the security and whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. The Company typically invests in highly-rated securities with low probabilities of default and has the ability to hold the investments until maturity.

The unrealized losses on the Company's investments in corporate bonds during the year ended December 31, 2008 were impacted by increased credit spreads resulting from a lack of liquidity in the credit markets, which affected the fair value of the investments. As a result of an improvement in credit spreads during 2009, the fair value of the Company's \$35.4 million investment in BBB-rated securities, issued by the WFN Trusts, which had a \$6.8 million unrealized loss at December 31, 2008, has increased to a fair value that approximates cost as of September 30, 2009. In April 2009, the Company invested an additional \$64.6 million in BBB-rated securities, issued by the WFN Trusts, which the Company expects to hold until maturity, that have an approximate fair value of \$61.5 million as of September 30, 2009.

As of September 30, 2009, the Company does not consider the investments to be other-than-temporarily impaired.

The net carrying value and estimated fair value of the securities at September 30, 2009 by contractual maturity are as follows:

	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	\$ 185,666	\$ 187,570
Due after one year through five years	320,194	324,622
Due after five years through ten years	75,636	80,063
Due after ten years		
Total	\$ 581,496	\$ 592,255

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Intangible assets consist of the following:

	Gross Assets	September 30, 2009 Accumulated Amortization (In thousands)	Net	Amortization Life and Method
<i>Finite Lived Assets</i>				
Customer contracts and lists	\$ 186,428	\$ (115,263)	\$ 71,165	5-10 years straight line
Premium on purchased credit card portfolios	82,520	(42,545)	39,975	3-10 years straight line, accelerated
Collector database	65,470	(54,999)	10,471	30 years 15% declining balance
Customer database	160,518	(52,676)	107,842	4-10 years straight line
Noncompete agreements	2,511	(1,877)	634	3-5 years straight line
Tradenames	11,645	(3,346)	8,299	4-10 years straight line
Purchased data lists	16,515	(7,516)	8,999	1-5 years straight line, accelerated
	\$ 525,607	\$ (278,222)	\$ 247,385	
<i>Indefinite Lived Assets</i>				
Tradenames	12,350		12,350	Indefinite life
Total intangible assets	\$ 537,957	\$ (278,222)	\$ 259,735	

	Gross Assets	December 31, 2008 Accumulated Amortization (In thousands)	Net	Amortization Life and Method
<i>Finite Lived Assets</i>				
Customer contracts and lists	\$ 186,428	\$ (96,435)	\$ 89,993	5-10 years straight line
Premium on purchased credit card portfolios	84,344	(35,925)	48,419	3-10 years straight line, accelerated
Collector database	57,528	(47,096)	10,432	30 years 15% declining balance
Customer database	160,103	(41,194)	118,909	4-10 years straight line
Noncompete agreements	2,425	(1,554)	871	3-5 years straight line
Favorable lease	1,000	(886)	114	4 years straight line
Tradenames	11,542	(2,361)	9,181	4-10 years straight line
Purchased data lists	12,994	(5,487)	7,507	1-5 years straight line, accelerated
	\$ 516,364	\$ (230,938)	\$ 285,426	
<i>Indefinite Lived Assets</i>				
Tradenames	12,350		12,350	Indefinite life
Total intangible assets	\$ 528,714	\$ (230,938)	\$ 297,776	

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Goodwill**

The changes in the carrying amount of goodwill for the nine months ended September 30, 2009 are as follows:

	Loyalty Services	Epsilon Marketing Services	Private Label Services	Private Label Credit	Corporate/ Other	Total
	(In thousands)					
December 31, 2008	\$ 204,507	\$ 667,551	\$ 261,732	\$	\$	\$ 1,133,790
Effects of foreign currency translation	26,642	2,138				28,780
Other, primarily final purchase price adjustments	(127)					(127)
September 30, 2009	\$ 231,022	\$ 669,689	\$ 261,732	\$	\$	\$ 1,162,443

6. SECURITIZATION OF CREDIT CARD RECEIVABLES**Off-Balance Sheet Securitizations**

As part of a securitization program, the Company regularly sells its credit card receivables to the World Financial Network Credit Card Master Trust, World Financial Network Credit Card Master Note Trust and World Financial Network Credit Card Master Trust III (collectively the WFN Trusts) and the World Financial Capital Master Note Trust (the WFC Trust).

In June 2009, the Company sold two portfolios of credit card receivables, which were acquired in 2008, to its securitization trusts. The Company sold a net principal balance of \$60.5 million at par, retaining \$7.3 million in a spread deposit account, which is included in due from securitizations in the unaudited condensed consolidated balance sheets. The gain on the sale was approximately \$4.2 million, which is included in securitization income and finance charges, net in the unaudited condensed consolidated statements of income. The net proceeds from the sale of \$53.2 million are included in net cash provided by operating activities in the unaudited condensed consolidated statements of cash flows.

In March 2009, the Company renewed its 2009-VFC1 conduit facility, increasing its capacity from \$550.0 million to \$666.7 million and extended the maturity of its 2008-VFN conduit facility, increasing its capacity from \$600.0 million to \$664.6 million. As part of these two transactions, the Company increased its retained interests in subordinated notes by \$181.3 million.

In April 2009, World Financial Network Credit Card Master Note Trust issued \$708.9 million of term asset-backed securities to investors, including those participating in the U.S. government's Term Asset-Backed Securities Loan Facility, or TALF, program. The offering consisted of \$560.0 million of Class A Series 2009-A asset-backed notes that have a fixed interest rate of 4.6% per year, \$26.6 million of Class M Series 2009-A asset-backed notes that have a fixed interest rate of 6.0% per year, \$33.7 million of Class B Series 2009-A asset-backed notes that have a fixed interest rate of 7.5% per year and \$88.6 million of Class C Series 2009-A asset-backed notes that have a fixed interest rate of 9.0% per year. These notes will mature in November 2011. As part of this transaction, the Company retained all of the \$148.9 million of subordinated classes of notes. Proceeds of this issuance were used to retire the 2008-VFN conduit facility, including the retained subordinated notes held by the Company.

In August 2009, World Financial Network Credit Card Master Note Trust issued \$949.3 million of term asset-backed securities to investors, including those participating in the U.S. government's TALF program. The

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

offering consisted of \$500.0 million of Series 2009-B asset-backed notes (the Series B Notes), \$139.2 million of Series 2009-C asset-backed notes (the Series C Notes), and \$310.1 million of Series 2009-D asset-backed notes (the Series D Notes). The Series B Notes will mature in July 2012 and are comprised of \$395.0 million of Class A notes that have a fixed interest rate of 3.8% per year and \$18.7 million of Class M, \$23.8 million of Class B, and \$62.5 million of Class C zero-coupon bonds which were retained by the Company. The Series C Notes will mature in July 2010 and are comprised of \$110.0 million of Class A notes that have a fixed interest rate of 2.4% per year and \$5.2 million of Class M, \$6.6 million of Class B, and \$17.4 million of Class C zero-coupon bonds which were retained by the Company. The Series D Notes will mature in July 2013 and are comprised of \$245.0 million of Class A notes that have a fixed interest rate of 4.7% per year and \$11.6 million of Class M, \$14.7 million of Class B, and \$38.8 million of Class C zero-coupon bonds which were retained by the Company.

In September 2009, the Company renewed World Financial Network Credit Card Master Note Trust's 2009-VFN conduit facility, increasing its capacity from \$1.3 billion to \$1.5 billion and extending its maturity to September 2010. As part of this transaction, the Company increased its retained interests in subordinated notes by \$31.1 million, from \$12.0 million to \$43.1 million.

In September 2009, the Company renewed World Financial Capital Master Note Trust's 2009-VFN conduit facility, increasing its capacity from \$167.1 million to \$200.0 million and extending its maturity to September 2010. As part of this transaction, the Company increased its retained interests in subordinated notes by \$20.3 million, from \$12.7 million to \$33.0 million.

The following table shows the maturities of borrowing commitments as of September 30, 2009 for the WFN Trusts and the WFC Trust by year:

	2009	2010	2011	2012	2013 & Thereafter	Total
	(In millions)					
Public notes	\$ 152.8	\$ 211.4	\$ 1,158.9	\$ 500.0	\$ 810.1	\$ 2,833.2
Private conduits ⁽¹⁾		2,322.4				2,322.4
Total	\$ 152.8	\$ 2,533.8	\$ 1,158.9	\$ 500.0	\$ 810.1	\$ 5,155.6

⁽¹⁾ Amount represents borrowing capacity, not outstanding borrowings.

Retained Interests in Securitized Assets and Fair Value Measurement

The Company retains an interest in its securitization programs through seller's interest, retained interest in securitization trust, and interest-only strips.

The following table summarizes the carrying values of the Company's subordinated retained interests reported in due from securitizations:

	September 30, 2009	December 31, 2008
	(In millions)	
Spread deposits	\$ 185,531	\$ 175,384
Interest-only strips	157,965	169,241
Retained interest in securitization trust	375,534	259,612
Excess funding deposits	1,896	97,110

\$ 720,926 \$ 701,347

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The fair values of interest-only strips and other interests retained, including retained interest in securitization trust, are based on a review of actual cash flows and on other factors affecting the amounts and timing of cash flows from each of the underlying credit card receivable pools. Based on this analysis, assumptions are validated or revised, as deemed necessary, the amounts and timing of anticipated cash flows are estimated, and fair values are determined. The Company has one collateral type, credit card receivables, which is comprised of both private label and co-brand retail credit card receivables.

At September 30, 2009, key economic assumptions and the sensitivity of the current fair value of residual cash flows to an immediate 10% and 20% adverse change in those assumptions are as follows:

	Assumptions		Impact on Fair Value of 10% Change (In thousands)	Impact on Fair Value of 20% Change
Fair value of interest-only strips	\$ 157,965			
Weighted-average life	10.5	11.5 months	\$ (12,317)	\$ (22,485)
Discount rate	14.8%	18.0%	(721)	(1,429)
Expected yield, net of dilution	26.7%	28.1%	(42,102)	(82,976)
Base rate ⁽¹⁾	0.3%	1.2%	(209)	(418)
Net charge-off rate	8.5%	12.7%	(13,640)	(27,359)

⁽¹⁾ Base rate assumptions do not factor any changes in spreads with respect to future refinancing.

At September 30, 2009, key economic assumptions and the sensitivity of the current fair value of the Company's seller's interest and retained interest of the subordinated notes to an immediate 10% and 20% adverse change in those assumptions are as follows:

	Assumptions		Impact on Fair Value of 10% Change (In thousands)	Impact on Fair Value of 20% Change
Fair value of seller's interest	\$211,492			
Weighted-average life	10.5	11.5 months	\$ (667)	\$ (1,339)
Discount rate	4.0%		(901)	(1,797)
Expected yield, net of dilution	26.7%	28.1%	(2,544)	(5,088)
Net charge-off rate	8.5%	12.7%	(831)	(1,653)
Fair value of subordinated notes retained ⁽¹⁾	\$472,470			
Discount rate	3.1%	30.9%	(9,602)	(18,816)

⁽¹⁾ Includes those investments held by Loyalty Services and included in redemption settlement assets.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in an assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in practice, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Other Disclosures**

The table below summarizes certain cash flows received from and paid to the securitization trusts:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In millions)			
Proceeds from collections reinvested in previous credit card securitizations	\$ 849.2	\$ 1,646.5	\$ 3,133.4	\$ 4,553.5
Proceeds from new securitizations	1,081.4	225.0	2,150.0	825.0
Proceeds from collections reinvested in revolving period transfers	1,491.6	1,573.0	4,672.2	4,720.0
Purchases of previously transferred financial assets				
Servicing fees received	17.5	16.7	53.5	50.7
<i>Cash flows received on the interests that continue to be held by the transferor</i>				
Cash flows received on interest-only strip	\$ 89.2	\$ 124.0	\$ 304.7	\$ 371.2
Cash flows received on subordinated notes retained	6.7	1.8	19.8	4.1
Cash flows received on seller's interest	9.0	7.1	24.6	20.5

The tables below present quantitative information about the components of total credit card receivables managed, delinquencies and net charge-offs:

	September 30, 2009	December 31, 2008
	(In millions)	
Total credit card receivables managed	\$ 4,380.9	\$ 4,531.4
Less: credit card receivables securitized	3,782.8	4,057.4
Credit card receivables	\$ 598.1	\$ 474.0
Principal amount of managed credit card receivables 90 days or more past due	\$ 145.2	\$ 127.1

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands)			
Net managed charge-offs	\$ 101,303	\$ 66,864	\$ 298,978	\$ 198,722

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The tables below present quantitative information about the components of total securitized credit card receivables, delinquencies and net charge-offs:

	September 30, 2009	December 31, 2008
	(In millions)	
Total credit card receivables securitized	\$ 3,782.8	\$ 4,057.4
Principal amount of securitized credit card receivables 90 days or more past due	\$ 110.2	\$ 111.7

	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2008	
	(In thousands)			
Net securitized charge-offs	\$ 89,937	\$ 56,666	\$ 270,842	\$ 166,657

7. DEBT

Debt consists of the following:

	September 30, 2009	December 31, 2008
	(In thousands)	
Certificates of deposit	\$ 1,179,900	\$ 688,900
Credit facility	525,000	365,000
Senior notes	250,000	500,000
Term loan	161,000	
Convertible senior notes due 2013	600,927	569,100
Convertible senior notes due 2014	234,566	
Capital lease obligations and other debt	40,425	57,175
	2,991,818	2,180,175
Less: current portion	(580,647)	(709,449)
Long-term portion	\$ 2,411,171	\$ 1,470,726

Certificates of Deposit

Terms of the certificates of deposit range from 6 months to 5 years with annual interest rates ranging from 0.8% to 5.7% at September 30, 2009 and 2.8% to 5.7% at December 31, 2008. Interest is paid monthly and at maturity.

Credit Facility

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At September 30, 2009, borrowings under the credit facility were \$525.0 million with a weighted-average interest rate of 0.8%. Total availability under the credit facility at September 30, 2009 was approximately \$225.0 million. The credit facility is unsecured and matures in March 2012. As of September 30, 2009, the Company was in compliance with its covenants.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Senior Notes

On May 16, 2006, the Company entered into a senior note purchase agreement and issued and sold \$250.0 million aggregate principal amount of 6.00% Series A Notes due May 16, 2009 and \$250.0 million aggregate principal amount of 6.14% Series B Notes due May 16, 2011 (the Senior Notes). The Senior Notes are unsecured. The Company repaid the \$250.0 million aggregate principal amount of 6.00% Series A Notes at maturity. As of September 30, 2009, the Company was in compliance with its covenants.

Term Loan

On May 15, 2009, the Company, as borrower, and ADS Alliance Data Systems, Inc., ADS Foreign Holdings, Inc., Alliance Data Foreign Holdings, Inc., Epsilon Marketing Services, LLC and Epsilon Data Management, LLC, as guarantors, entered into a term loan agreement with Bank of Montreal, as administrative agent, and various other agents and banks (the Term Loan). The proceeds were used, together with other funds, to repay the Company's \$250.0 million aggregate principal amount of 6.00% Series A Notes due May 16, 2009. At September 30, 2009, borrowings under the Term Loan were \$161.0 million with a weighted-average interest rate of 3.3%.

Amounts borrowed under the Term Loan are scheduled to mature on March 30, 2012, with principal payments of 5.0% of the aggregate principal amount of the loans outstanding to be made on the last day of each fiscal quarter commencing on June 30, 2010. The Term Loan is unsecured.

Advances under the Term Loan are in the form of either base rate loans or eurodollar loans. The interest rate for base rate loans fluctuates and is equal to the highest of (1) Bank of Montreal's prime rate; (2) the Federal funds rate plus 0.5%; and (3) the LIBOR Quoted Rate as defined in the Term Loan plus 1.0%, in each case plus a margin of 2.0% to 3.0% based upon the Company's senior leverage ratio as defined in the Term Loan. The interest rate for eurodollar loans fluctuates based on the rate at which deposits of U.S. dollars in the London interbank market are quoted plus a margin of 3.0% to 4.0% based upon the Company's senior leverage ratio as defined in the Term Loan.

The Term Loan contains usual and customary negative covenants for transactions of this type, including, but not limited to, restrictions on the Company's ability, and in certain instances, its subsidiaries' ability, to consolidate or merge; substantially change the nature of its business; sell, transfer or dispose of assets; create or incur indebtedness; create liens; pay dividends; and make investments. The negative covenants are subject to certain exceptions, as specified in the Term Loan. The Term Loan also requires the Company to satisfy certain financial covenants, including maximum ratios of total leverage and senior leverage as determined in accordance with the Term Loan and a minimum ratio of consolidated operating EBITDA to consolidated interest expense as determined in accordance with the Term Loan. As of September 30, 2009, the Company was in compliance with its covenants.

Convertible Senior Notes

In the second quarter of 2009, the Company issued \$345.0 million aggregate principal amount of Convertible Senior Notes due 2014, which included an over-allotment of \$45.0 million. Holders of the Convertible Senior Notes due 2014 have the right to require the Company to repurchase for cash all or some of their Convertible Senior Notes due 2014 upon the occurrence of certain fundamental changes.

The Convertible Senior Notes due 2014 are governed by an indenture dated June 2, 2009 between the Company and the Bank of New York Mellon Trust Company, National Association, as trustee. Pursuant to the indenture, the Convertible Senior Notes due 2014 are general unsecured senior obligations of the Company, and pay interest semi-annually in arrears at a rate of 4.75% per annum on May 15 and November 15 of each year.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

beginning November 15, 2009, will be convertible during certain periods and under certain circumstances and, subject to earlier repurchase by the Company or conversion, will mature on May 15, 2014. The Company may not redeem the Convertible Senior Notes due 2014 prior to their maturity date.

Holders may convert their Convertible Senior Notes due 2014 at their option at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date of the Convertible Senior Notes due 2014, in equal multiples of \$1,000 principal amounts, under the following circumstances:

during any fiscal quarter (and only during such fiscal quarter) after the fiscal quarter ending December 31, 2009, if the last reported sale price of the Company's common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the conversion price of the Convertible Senior Notes due 2014 on the last day of such preceding fiscal quarter;

during the five business-day period after any five consecutive trading-day period, or the measurement period, in which the trading price per \$1,000 principal amount of the Convertible Senior Notes due 2014 for each day of that measurement period was less than 98% of the product of the last reported sales price of the Company's common stock and the conversion rate of the Convertible Senior Notes due 2014 on each such day; or

upon the occurrence of certain specified corporate transactions.

In addition, holders may convert their Convertible Senior Notes due 2014 at their option at any time beginning on January 13, 2014 and ending on the close of business on the second scheduled trading day immediately preceding the maturity date, without regard to the foregoing circumstances.

The Convertible Senior Notes due 2014 have an initial conversion rate of 21.0235 shares of common stock per \$1,000 principal amount, which is equal to an initial conversion price of approximately \$47.57 per share. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination thereof at the Company's election. It is the Company's current intention and policy to settle the principal amount (or the amount of the Company's conversion obligation, if less) of the Convertible Senior Notes due 2014 in cash upon conversion.

Concurrently with the pricing of the Convertible Senior Notes due 2014 and the exercise of the over-allotment option, the Company entered into convertible note hedge transactions with respect to its common stock with the following affiliates of three of the initial purchasers: J.P. Morgan Securities Inc., as agent to JPMorgan Chase Bank, National Association, London Branch; Bank of America, N.A.; and Barclays Capital Inc., as agent for Barclays Bank PLC (together, the Hedge Counterparties), which cover, subject to customary anti-dilution adjustments, approximately 7.3 million shares of the Company's common stock at an initial strike price equal to the initial conversion price of the Convertible Senior Notes due 2014 (the Convertible Note Hedges).

Separately but also concurrently with the pricing of the Convertible Senior Notes due 2014 and the exercise of the over-allotment option, the Company entered into warrant transactions whereby it sold to the Hedge Counterparties warrants to acquire, subject to customary anti-dilution adjustments, up to approximately 7.3 million shares of its common stock at an initial strike price of approximately \$70.54 (the Convertible Note Warrants). The Convertible Note Warrants will be exercisable and will expire in 79 equal tranches of 45,331 warrants and an 80th tranche of 45,405 warrants for one of the Hedge Counterparties and will be exercisable and will expire in 79 equal tranches of 22,665 warrants and an 80th tranche of either 22,741 or 22,743 warrants with respect to the remaining two Hedge Counterparties, beginning on August 13, 2014 and continuing on each business day through December 4, 2014 as to each of the Hedge Counterparties.

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The cost of the Convertible Note Hedges, reduced by the proceeds to the Company from the sale of the Convertible Note Warrants, was approximately \$50.7 million. The Company accounted for the Convertible Note Hedges and Convertible Note Warrants as equity instruments in accordance with the guidance in ASC 815-40 Derivatives and Hedging Contracts in Entity's Own Equity. Accordingly, the cost of the Convertible Note Hedges and the proceeds from the sale of the Convertible Note Warrants are included in additional paid-in capital in the unaudited condensed consolidated balance sheet at September 30, 2009.

Concurrently with the pricing of the Convertible Senior Notes due 2014, the Company entered into prepaid forward transactions (the Prepaid Forwards) with Merrill Lynch, Pierce, Fenner & Smith Incorporated, as agent for Merrill Lynch International, and Barclays Capital Inc., as agent for Barclays Bank PLC (collectively, the Forward Counterparties). Under the Prepaid Forwards, the Company purchased 1,857,400 shares of its common stock for approximately \$74.9 million with proceeds from the offering. The shares are to be delivered over a settlement period in 2014. Each of the Prepaid Forwards is subject to early settlement, in whole or in part, at any time prior to the final settlement date at the option of the applicable Forward Counterparty, as well as early settlement or settlement with alternative consideration in the event of certain corporate transactions. In the event the Company pays any cash dividends on its common stock, the Forward Counterparties will pay an equivalent amount to the Company. The shares under the Prepaid Forwards were accounted for as a repurchase of common stock and a reduction of stockholders equity.

In the third quarter of 2008, the Company issued \$805.0 million aggregate principal amount of Convertible Senior Notes due 2013, which included an over-allotment of \$105.0 million. It is the Company's current intention and policy to settle the principal amount (or the amount of the Company's conversion obligation, if less) of the Convertible Senior Notes due 2013 in cash upon conversion.

The table below summarizes the carrying value of the components of the Convertible Senior Notes due 2013 and the Convertible Senior Notes due 2014:

	September 30, 2009	December 31, 2008
	(In thousands)	
Carrying amount of equity component	\$ 368,678	\$ 252,828
Principal amount of liability component	\$ 1,150,000	\$ 805,000
Unamortized discount	(314,507)	(235,900)
Net carrying value of liability component	\$ 835,493	\$ 569,100
If-converted value of common stock	\$ 1,069,399	\$ 477,168

The discount on the liability component will be amortized as interest expense over a weighted-average period of 4.1 years, the remaining life of the Convertible Senior Notes due 2013 and the Convertible Senior Notes due 2014.

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Interest expense on the Convertible Senior Notes due 2013 and the Convertible Senior Notes due 2014 recognized in the Company's unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2009 and 2008, respectively, is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands)			
Interest expense calculated on contractual interest rate	\$ 7,619	\$ 2,426	\$ 15,937	\$ 2,426
Amortization of discount on liability component	15,019	6,821	37,243	6,821
Total interest expense on convertible senior notes	\$ 22,638	\$ 9,247	\$ 53,180	\$ 9,247
Effective interest rate (annualized)	11.0%	9.7%	11.0%	9.7%

8. DEFERRED REVENUE

Because management has determined that the earnings process is not complete at the time an AIR MILES reward mile is issued, the recognition of revenue on all fees received at issuance is deferred. The Company allocates the proceeds from the issuance of AIR MILES reward miles into two components based on the relative fair value of the related element:

Redemption element. The redemption element is the larger of the two components. For this component, revenue is recognized at the time an AIR MILES reward mile is redeemed, or for those AIR MILES reward miles that are estimated to go unredeemed by the collector base, known as "breakage," over the estimated life of an AIR MILES reward mile.

Service element. For this component, which consists of marketing and administrative services provided to sponsors, revenue is recognized pro rata over the estimated life of an AIR MILES reward mile.

Under certain of the Company's contracts, a portion of the proceeds is paid to the Company upon the issuance of an AIR MILES reward mile and a portion is paid at the time of redemption and therefore, the Company does not have a redemption obligation related to these contracts. Revenue is recognized at the time of redemption and is not reflected in the reconciliation of the redemption obligation detailed below. Under such contracts, the proceeds received at issuance are initially deferred as service revenue and revenue is recognized pro rata over the estimated life of an AIR MILES reward mile. During the second quarter of 2008, the Company assumed Bank of Montreal's redemption obligation for approximately \$369.9 million and subsequent to that transaction has been included in deferred revenue and reflected in the table below.

A reconciliation of deferred revenue for the AIR MILES Reward Program is as follows:

	Service	Deferred Revenue Redemption (In thousands)	Total
December 31, 2008	\$ 251,172	\$ 744,462	\$ 995,634
Cash proceeds	113,651	317,941	431,592
Revenue recognized	(104,484)	(328,836)	(433,320)
Other		(974)	(974)
Effects of foreign currency translation	35,496	101,680	137,176

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September 30, 2009	\$ 295,835	\$ 834,273	\$ 1,130,108
Amounts recognized in the consolidated balance sheets:			
Current liabilities	\$ 139,407	\$ 834,273	\$ 973,680
Non-current liabilities	\$ 156,428	\$	\$ 156,428

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. STOCKHOLDERS' EQUITY*****Stock Repurchase Program***

On July 17, 2008, the Company's Board of Directors authorized a new stock repurchase program to acquire up to an additional \$1.3 billion of its outstanding common stock through December 2009, subject to any restrictions pursuant to the terms of the Company's credit agreements or otherwise.

For the nine months ended September 30, 2009, the Company acquired a total of 12,222,920 shares of its common stock for approximately \$492.6 million, which includes 1,857,400 shares purchased under prepaid forward contracts for approximately \$74.9 million. See Note 7, Debt, for additional information.

Stock Compensation Expense

Total stock-based compensation expense recognized in the Company's unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2009 and 2008, respectively, is as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
	(In thousands)			
Cost of operations	\$ 7,315	\$ 10,307	\$ 23,451	\$ 19,028
General and administrative	7,293	6,884	19,814	12,165
Total	\$ 14,608	\$ 17,191	\$ 43,265	\$ 31,193

Stock-based compensation expense for the merchant services and utility services businesses was approximately \$0.1 million and \$5.5 million for the nine months ended September 30, 2009 and 2008, respectively, and approximately \$4.8 million for the three months ended September 30, 2008. There was no stock-based compensation expense for the merchant services and utility services businesses for the three months ended September 30, 2009. These amounts have been included in the loss from discontinued operations in the unaudited condensed consolidated statements of income.

During the nine months ended September 30, 2009, the Company awarded 710,303 performance-based restricted stock units with a weighted-average grant date fair value per share of \$27.87. The performance restriction on the awards will lapse upon determination by the Board of Directors or the Compensation Committee of the Board of Directors that the Company's cash earnings per share growth for the period from January 1, 2009 to December 31, 2009 met certain pre-defined performance criteria. Following such determination, the restricted stock units will vest with respect to 33% of the award on February 23, 2010, with respect to an additional 33% of the award on February 23, 2011 and with respect to the final 34% of the award on February 21, 2012, provided that the award recipient is employed by the Company on such vesting date.

During the nine months ended September 30, 2009, the Company awarded 149,019 service-based restricted stock units, which typically vest ratably over three years, with a weighted-average grant date fair value per share of \$37.54.

In March 2009, the Company determined that it was no longer probable that the specified performance measures associated with certain performance-based restricted stock units would be achieved. As a result, 1,242,098 performance-based restricted stock units granted during 2008 and in January 2009 having a weighted-average grant date fair value of \$56.43 per share, are not expected to vest. The Company has not recognized stock-based compensation expense related to those awards no longer expected to vest.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In September 2009, the Board of Directors of the Company amended the 2005 long term incentive plan to provide that, in addition to settlement in shares of the Company's common stock or other securities, equity awards may be settled in cash.

10. INCOME TAXES

The effective tax rate for the three and nine months ended September 30, 2009 was 17.8% and 32.1%, respectively, due to an \$11.7 million income tax benefit recorded during the third quarter of 2009. The Company's 2009 effective tax rate without regard to the \$11.7 million tax benefit remains 38.8%. For the three months and nine months ended September 30, 2008, the Company utilized an effective tax rate of 38.9% and 38.4%, respectively, to calculate its provision for income taxes. In accordance with ASC 740-270, Income Taxes - Interim Reporting, this effective tax rate is the Company's expected annual effective tax rate for calendar year 2009 based on all known variables.

The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits in income tax expense in accordance with ASC 740, Income Taxes. Based on a recent United States Tax Court decision, statute of limitations expirations, and other factors, the Company recognized a tax benefit of \$11.7 million during the period ended September 30, 2009 primarily as a result of the reversal of accrued interest. In addition, based on the recognition of the tax benefit, the Company reclassified an unrecognized tax benefit of \$19.8 million from other liabilities to deferred tax liability in the unaudited condensed consolidated balance sheet as of September 30, 2009, in accordance with ASC 740.

11. COMPREHENSIVE INCOME

The components of comprehensive income, net of tax effect, are as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2009	2008	September 30, 2009	2008
	(In thousands)			
Net income	\$ 45,796	\$ 64,830	\$ 103,087	\$ 161,118
Unrealized loss on securities available-for-sale	(5,678)	(2,015)	(35,126)	(534)
Reclassification adjustment for the foreign currency translation gain realized upon the sale of the utility services business		(7,535)		(7,535)
Foreign currency translation adjustments	(2,908)	(6,318)	6,217	(7,192)
Total comprehensive income	\$ 37,210	\$ 48,962	\$ 74,178	\$ 145,857

12. SEGMENT INFORMATION

The Company has four reportable operating segments as follows:

Loyalty Services, which includes the Company's Canadian AIR MILES Reward Program;

Epsilon Marketing Services, which provides integrated direct marketing solutions that combine database marketing technology and analytics with a broad range of direct marketing services;

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Private Label Services, which provides transaction processing, customer care and collections services for the Company's private label and other retail card programs; and

Private Label Credit, which provides risk management solutions, account origination and funding services for the Company's private label and other retail card programs.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In addition, corporate and all other immaterial businesses are reported collectively as an all other category labeled Corporate/Other. Interest expense, net and income taxes are not allocated to the segments in the computation of segment operating profit for internal evaluation purposes and have also been included in Corporate/Other. The Company's merchant services and utility services business units have been classified as discontinued operations.

Three Months Ended September 30, 2009	Loyalty Services	Epsilon Marketing Services	Private Label Services	Private Label Credit	Corporate/ Other	Eliminations	Total
	(In thousands)						
Revenues	\$ 177,008	\$ 131,926	\$ 96,745	\$ 165,173	\$ 5,813	\$ (93,479)	\$ 483,186
Income (loss) from continuing operations before income taxes	\$ 43,373	\$ 15,488	\$ 23,709	\$ 38,055	\$ (64,898)	\$	\$ 55,727
Interest expense, net					39,044		39,044
Operating income (loss)	43,373	15,488	23,709	38,055	(25,854)		94,771
Stock compensation expense	3,847	1,705	1,468	295	7,293		14,608
Merger and other costs ⁽¹⁾					878		878
Depreciation and amortization	5,966	18,003	2,357	3,346	1,495		31,167
Adjusted EBITDA ⁽²⁾	53,186	35,196	27,534	41,696	(16,188)		141,424
Three Months Ended September 30, 2008	Loyalty Services	Epsilon Marketing Services	Private Label Services	Private Label Credit	Corporate/ Other	Eliminations	Total
	(In thousands)						
Revenues	\$ 187,657	\$ 130,895	\$ 94,678	\$ 182,357	\$ 7,689	\$ (92,051)	\$ 511,225
Income (loss) from continuing operations before income taxes	\$ 38,045	\$ 17,876	\$ 26,044	\$ 56,198	\$ (41,677)	\$	\$ 96,486
Interest expense, net					23,325		23,325
Operating income (loss)	38,045	17,876	26,044	56,198	(18,352)		119,811
Stock compensation expense	3,957	3,545	2,292	513	6,884		17,191
Merger and other costs (income) ⁽¹⁾		(5)			(1,057)		(1,062)
Depreciation and amortization	7,016	18,681	2,226	2,955	3,188		34,066
Adjusted EBITDA ⁽²⁾	49,018	40,097	30,562	59,666	(9,337)		170,006

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Nine Months Ended September 30, 2009	Loyalty Services	Epsilon Marketing Services	Private Label Services	Private Label Credit	Corporate/ Other	Eliminations	Total
	(In thousands)						
Revenues	\$ 504,985	\$ 372,495	\$ 280,977	\$ 507,863	\$ 28,940	\$ (271,408)	\$ 1,423,852
Income (loss) from continuing operations before income taxes	\$ 120,414	\$ 28,952	\$ 69,904	\$ 126,404	\$ (171,663)		\$ 174,011
Interest expense, net					105,226		105,226
Operating income (loss)	120,414	28,952	69,904	126,404	(66,437)		279,237
Stock compensation expense	10,128	6,930	5,129	1,265	19,813		43,265
Merger and other costs ⁽¹⁾					3,890		3,890
Depreciation and amortization	15,877	51,835	6,967	10,457	6,513		91,649
Adjusted EBITDA ⁽²⁾	146,419	87,717	82,000	138,126	(36,221)		418,041
Nine Months Ended September 30, 2008	Loyalty Services	Epsilon Marketing Services	Private Label Services	Private Label Credit	Corporate/ Other	Eliminations	Total
	(In thousands)						
Revenues	\$ 559,490	\$ 361,744	\$ 285,028	\$ 579,011	\$ 9,760	\$ (277,348)	\$ 1,517,685
Income (loss) from continuing operations before income taxes	\$ 111,246	\$ 25,725	\$ 74,938	\$ 200,515	\$ (114,243)		\$ 298,181
Interest expense, net					54,370		54,370
Operating income (loss)	111,246	25,725	74,938	200,515	(59,873)		352,551
Stock compensation expense	8,386	5,091	4,277	1,274	12,165		31,193
Loss on the sale of assets					1,052		1,052
Merger and other costs ⁽¹⁾		2,633	1,435		4,233		8,301
Depreciation and amortization	23,681	56,740	6,725	8,587	7,652		103,385
Adjusted EBITDA ⁽²⁾	143,313	90,189	87,375	210,376	(34,771)		496,482

⁽¹⁾ Merger and other costs are not allocated to the segments in the computation of segment operating profit for internal evaluation purposes. Merger costs represent investment banking, legal, and accounting costs associated with the proposed merger of the Company with an affiliate of The Blackstone Group and in 2008 includes a reimbursement of \$3.0 million for certain of these costs by the affiliates of the Blackstone Group. Other costs represent compensation charges related to the departure of certain associates.

⁽²⁾ Adjusted EBITDA is a non-GAAP financial measure equal to income from continuing operations, the most directly comparable GAAP financial measure, plus stock compensation expense, provision for income taxes, interest expense, net, depreciation and amortization, loss on sale of assets, and merger and other costs. Adjusted EBITDA is presented in accordance with ASC 280, Segment Reporting as it is the key performance metric by which senior management is evaluated.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****13. FAIR VALUE OF FINANCIAL INSTRUMENTS**

In accordance with ASC 825-10-50, Financial Instruments Overall Disclosure, the Company is required to disclose the fair value of financial instruments for which it is practical to estimate fair value. To obtain fair values, observable market prices are used if available. In some instances, observable market prices are not readily available and fair value is determined using present value or other techniques appropriate for a particular financial instrument. These techniques involve judgment and as a result are not necessarily indicative of the amounts the Company would realize in a current market exchange. The use of different assumptions or estimation techniques may have a material effect on the estimated fair value amounts.

Fair Value of Financial Instruments The estimated fair values of the Company's financial instruments were as follows:

	September 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(In thousands)				
Financial assets				
Cash and cash equivalents	\$ 449,621	\$ 449,621	\$ 156,911	\$ 156,911
Trade receivables, net	207,725	207,725	219,362	219,362
Seller's interest and credit card receivables, net	776,359	772,152	639,573	639,573
Redemption settlement assets, restricted	592,255	592,255	531,594	531,594
Due from securitizations	720,926	720,926	701,347	701,347
Financial liabilities				
Accounts payable	108,745	108,745	108,369	108,369
Debt	2,991,818	3,103,441	2,180,175	2,206,587

The following methods and assumptions were used by the Company in estimating fair values of financial instruments as disclosed herein:

Cash and cash equivalents, trade receivables, net and accounts payable The carrying amount approximates fair value due to the short maturity.

Seller's interest and credit card receivables, net The carrying amount of credit card receivables approximates fair value due to the short maturity, and the average interest rates approximate current market origination rates. Seller's interest is carried at an allocated carrying value based on fair value. The Company determines the fair value of its seller's interest through discounted cash flow models. The estimated cash flows used include assumptions related to rates of payments and defaults, which reflect economic and other relevant conditions. The discount rate used is based on an interest rate curve that is observable in the market place plus an unobservable credit spread.

Redemption settlement assets, restricted Fair values for securities are based on quoted market prices and a valuation model that calculates the present value of estimated future cash flows for each asset.

Due from securitizations The spread deposits, retained interests and interest-only strips are recorded at their fair value. The carrying amount of excess funding deposits approximates its fair value due to the relatively short maturity period and average interest rates, which approximate current market rates. The Company uses a valuation model that calculates the present value of estimated future cash flows for each asset. The model incorporates the Company's own estimates of assumptions market participants use in determining fair value, including estimates of payment rates, defaults, net charge-offs, discount rates and contractual interest and fees.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Debt The fair value was estimated based on the current rates available to the Company for debt with similar remaining maturities.

The following table provides the assets carried at fair value measured on a recurring basis as of September 30, 2009:

	Fair Value at September 30, 2009	Fair Value Measurements at September 30, 2009 Using Quoted Prices in Active Markets for Identical Assets (Level 1)		
		Significant Other Observable Inputs (Level 2) (In thousands)	Significant Unobservable Inputs (Level 3) ⁽⁶⁾	
Cash equivalents ⁽¹⁾	\$ 327,723	\$ 327,723	\$	\$
Government bonds ⁽²⁾	42,214	21,573	20,641	
Corporate bonds ⁽²⁾	495,111	387,771	9,652	97,688
Other available-for-sale securities ⁽³⁾	69,549	69,549		
Retained interest in securitization trust ⁽⁴⁾	374,563			374,563
Spread deposits ⁽⁴⁾	185,531			185,531
Interest-only strips ⁽⁴⁾	157,965			157,965
Excess funding deposits ⁽⁴⁾	1,896		1,896	
Seller's interest ⁽⁵⁾	211,492			211,492
Total assets measured at fair value	\$ 1,866,044	\$ 806,616	\$ 32,189	\$ 1,027,239

(1) Amounts are included in cash and cash equivalents in the unaudited condensed consolidated balance sheet.

(2) Amounts are included in redemption settlement assets in the unaudited condensed consolidated balance sheet.

(3) Amounts are included in other current and non-current assets in the unaudited condensed consolidated balance sheet.

(4) Amounts are included in due from securitizations in the unaudited condensed consolidated balance sheet.

(5) Amounts are included in seller's interest and credit card receivables, net in the unaudited condensed consolidated balance sheet.

(6) Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The use of different techniques to determine fair value of these financial instruments could result in different estimates of fair value at the reporting date.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following tables summarize the changes in fair value of the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820, Fair Value Measurements and Disclosures as of September 30, 2009:

	Corporate Bonds	Retained Interest in Securitization Trust	Spread Deposits (In thousands)	Interest- Only Strips	Seller's Interest
June 30, 2009	\$ 83,559	\$ 373,871	\$ 189,668	\$ 157,515	\$ 183,673
Total gains (losses) (realized or unrealized)					
Included in earnings			85	1,427	(816)
Included in other comprehensive income	14,129	(22,861)		(977)	
Tax effect	(4,582)	10,165		359	
Total in other comprehensive income	9,547	(12,696)		(618)	
Purchases, issuances, and settlements		23,553	(4,222)		28,635
Transfers in or out of Level 3					
September 30, 2009	\$ 97,688	\$ 374,563	\$ 185,531	\$ 157,965	\$ 211,492

Losses for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2009

	\$	\$ (2,600)	\$	\$ (978)	\$
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	Corporate Bonds	Retained Interest in Securitization Trust	Spread Deposits (In thousands)	Interest- Only Strips	Seller's Interest
December 31, 2008	\$ 28,625	\$ 259,612	\$ 175,384	\$ 169,241	\$ 182,428
Total gains (losses) (realized or unrealized)					
Included in earnings			556	(9,149)	7,727
Included in other comprehensive income	4,506	(51,998)		(2,127)	
Tax effect	(1,461)	11,616		754	
Total in other comprehensive income	3,045	(40,382)		(1,373)	
Purchases, issuances, and settlements	64,557	166,949	9,591		21,337
Transfers in or out of Level 3					
September 30, 2009	\$ 97,688	\$ 374,563	\$ 185,531	\$ 157,965	\$ 211,492

Losses for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2009

	\$	\$ (6,280)	\$	\$ (2,588)	\$
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Income (losses) included in earnings for seller's interest, spread deposits and the interest-only strip are included in securitization income and finance charges, net in the unaudited condensed consolidated statements of income.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. COMMITMENTS AND CONTINGENCIES

Regulatory Matters

As part of a portfolio acquisition in 2003 by World Financial Network National Bank (WFNNB), which required approval by the OCC, the OCC required WFNNB to enter into an operating agreement with the OCC (the 2003 Operating Agreement) and a capital adequacy and liquidity maintenance agreement with the Company (the 2003 CALMA). The 2003 Operating Agreement required WFNNB to continue to operate in a manner consistent with its current practices, regulatory guidelines and applicable law, including those related to affiliate transactions, maintenance of capital and corporate governance. In August 2009, the Company entered into a revised operating agreement with WFNNB and the OCC (the 2009 Operating Agreement), which required the Company to enter into both a new capital adequacy and liquidity maintenance agreement (the 2009 CALMA) and a capital and liquidity support agreement (the 2009 CALSA) with WFNNB. The 2009 Operating Agreement has not required any changes in WFNNB s operations. The 2009 CALMA and 2009 CALSA memorialize the Company s current obligations to ensure that WFNNB remains in compliance with its minimum capital requirements.

15. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, the FASB issued ASC 105, Generally Accepted Accounting Principles. ASC 105 identifies the FASB Accounting Standards Codification as the authoritative source of generally accepted accounting principles in the United States. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under federal securities laws are also sources of authoritative GAAP for SEC registrants. ASC 105 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of ASC 105 did not have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued guidance related to accounting for transfers of financial assets. This guidance removes the concept of a qualifying special purpose entity (QSPE) and eliminates the consolidation exception currently available for QSPEs. This guidance is effective for financial asset transfers on or after the beginning of the first annual reporting period beginning on or after November 15, 2009 and early adoption is prohibited. The Company is currently assessing the impact of the adoption of this guidance on its consolidated financial statements.

In June 2009, the FASB issued guidance concerning the consolidation of variable interest entities. This guidance requires an initial evaluation as well as an ongoing assessment of the Company s involvement with the operations of the WFN Trusts and the WFC Trust and its rights or obligations to receive benefits or absorb losses of these securitization trusts that could be potentially significant in order to determine whether those entities will be required to be consolidated on the balance sheet of WFNNB, WFCB or their affiliates, including the Company. The assessment under this guidance is expected to result in the consolidation of the securitization trusts on the balance sheet of WFNNB, WFCB or their affiliates, including the Company, beginning January 1, 2010. This guidance is effective for annual periods beginning after November 15, 2009 and early adoption is prohibited. The Company is currently assessing the impact of the adoption of this guidance on its consolidated financial statements and anticipates that consolidation of the securitization trusts will have a significant impact on the Company s consolidated financial statements.

In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05, Measuring Liabilities at Fair Value (ASU 2009-05). ASU 2009-05 amends ASC 820, Fair Value Measurements and Disclosures, by providing additional guidance clarifying the measurement of liabilities at fair value and addresses several key issues with respect to estimating fair value of liabilities. Among other things, ASU 2009-05 clarifies how the price of a traded debt security (an asset value) should be considered in estimating the fair value of the issuer s

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

liability. ASU 2009-05 is effective for the first reporting period beginning after August 28, 2009. The Company does not expect that the adoption of ASU 2009-05 will have a material impact on its consolidated financial statements.

In October 2009, the FASB issued ASU 2009-13, Multiple-Deliverable Revenue Arrangements. ASU 2009-13 supersedes certain guidance in ASC 605-25, Revenue Recognition Multiple-Element Arrangements and requires an entity to allocate arrangement consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices (the relative-selling-price method). ASU 2009-13 eliminates the use of the residual method of allocation in which the undelivered element is measured at its estimated selling price and the delivered element is measured as the residual of the arrangement consideration, and requires the relative-selling-price method in all circumstances in which an entity recognizes revenue for an arrangement with multiple deliverables subject to ASU 2009-13. ASU 2009-13 will be effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. If the Company elects early adoption and the adoption is during an interim period, the Company will be required to apply this ASU retrospectively from the beginning of the Company's fiscal year. The Company can also elect to apply this ASU retrospectively for all periods presented. The Company is currently evaluating the impact that the adoption of ASU 2009-13 will have on its consolidated financial statements.

16. SUBSEQUENT EVENT

On October 30, 2009, the Company completed the acquisition of the Charming Shoppes' existing credit card accounts and rights to new credit card accounts along with the retained interest in the securitization program, including retained certificates and interests, cash collateral accounts, and an interest-only strip. Under the terms of the agreements, the Company assumed the operation of the Lane Bryant, Fashion Bug, and Catherine's credit card program, portfolio, and securitization master trust, which represents approximately \$500.0 million in accounts receivable. The total purchase price was approximately \$166.3 million. In connection with the acquisition, the Company assumed the operation of the Charming Shoppes' private label credit card programs and service center operations.

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

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes thereto presented in this quarterly report and the audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on March 2, 2009, and our Current Report on Form 8-K, filed with the SEC on May 22, 2009, which re-issued certain items of our Annual Report on Form 10-K.

Year in Review Highlights

Our results for the first nine months of 2009 included the following new and renewed agreements:

In January 2009, we announced the signing of a multi-year agreement with HSN, an interactive lifestyle network and retail destination, to provide both co-brand and private label card services. In addition, we purchased HSN's existing private label card portfolio in December 2008, the conversion of which was completed in the first quarter of 2009.

In February 2009, we announced that Shell Canada Products, a top-5 AIR MILES Reward Program sponsor and a manufacturer, distributor, and marketer of refined petroleum products in Canada, had signed a multi-year renewal agreement.

In February 2009, we announced the signing of a multi-year agreement with America's Gardening Resource, a manufacturer and retailer of gardening tools, products, and supplies, for Epsilon to build and maintain its customer marketing database.

In February 2009, we announced the signing of a long-term agreement with Haband, a multi-channel retailer of men's and women's apparel and home goods via catalog and online, to provide private label credit card services.

In March 2009, our private label credit card banking subsidiary, World Financial Network National Bank, completed the renewal of its \$550.0 million conduit facility with Barclays Capital, Royal Bank of Canada, and JP Morgan, increasing its capacity to \$666.7 million.

In April 2009, we announced the signing of a multi-year contract extension with Pacific Sunwear of California, a specialty retailer of casual apparel, accessories, and footwear, to continue providing private label credit card services.

In April 2009, as part of the securitization program for our private label credit card banking subsidiary, World Financial Network Credit Card Master Note Trust issued \$708.9 million of term asset-backed securities to investors, including those participating in the U.S. government's Term Asset-Backed Securities Loan Facility, or TALF program.

In April 2009, we announced that Goodyear Canada, one of the original 13 AIR MILES Reward Program sponsors and retailer of automotive tires and after-market automotive products, had signed a multi-year renewal agreement.

In May 2009, we announced that Epsilon added 19 new clients to its permission-based email and digital solutions business during the first quarter of 2009.

In May 2009, we announced the signing of a long-term expansion and extension agreement with Tween Brands, a specialty retailer, to continue to provide private label credit card services to its Limited Too / Justice brands.

In May 2009, we completed a new three-year term credit facility.

In May 2009, we announced the signing of a multi-year extension agreement with National Geographic Society for Epsilon to continue providing database hosting and marketing services.

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In June 2009, we completed an offering of \$345.0 million aggregate principal amount of convertible senior notes due 2014, which included the exercise of an over-allotment option of \$45.0 million.

In July 2009, we announced an expansion agreement with pharmaceutical company, Astra Zeneca, for Epsilon to provide comprehensive database and permission-based email marketing solutions.

In July 2009, we announced BMO Bank of Montreal's initiative to enhance its AIR MILES credit card program for Canadian BMO MasterCard® cardholders and AIR MILES reward miles collectors to provide an opportunity to substantially increase miles issued.

In July 2009, we announced a multi-year agreement to provide private label credit card services to Big M, Inc., a multi-brand specialty retailer, and to acquire its existing private label credit card portfolio.

In August 2009, we announced a long-term agreement with Charming Shoppes, Inc., a multi-brand apparel retailer, to assume operation of Charming Shoppes' private label credit card programs and to acquire the credit card files and service center operations associated with Charming Shoppes' branded card programs. The acquisition was completed in October 2009.

In August 2009, as part of the securitization program for our private label credit card banking subsidiary, World Financial Network Credit Card Master Note Trust issued \$949.3 million of term asset-backed securities to investors, including those participating in the U.S. government's TALF program.

In September 2009, we announced a multi-year extension agreement with Reed Business Information US, a business-to-business information provider, for Epsilon to continue providing permission-based email marketing services.

In September 2009, we announce a multi-year agreement with business support services provider, Pacific Dental Services to provide patient financing and marketing services via a private label credit card program for dental and orthodontic procedures performed in affiliated dental practices.

In September 2009, our private label credit card banking subsidiary, World Financial Network National Bank, completed the renewal of its \$1.3 billion conduit facility, increasing its capacity to \$1.5 billion and extending its maturity and our industrial bank, World Financial Capital Bank, renewed its \$167.1 million conduit facility increasing its capacity to \$200.0 million and extending its maturity.

In October 2009, we announced an expansion agreement with tobacco company, R.J. Reynolds, for Epsilon to host its consumer database and support its consumer communication programs and that LoyaltyOne acquired a 29 percent interest in CBSM - Companhia Brasileira De Servicos De Marketing, operator of Brazil's dotz loyalty program.

Critical Accounting Policies and Estimates

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Annual Report on Form 10-K for the year ended December 31, 2008.

Use of Non-GAAP Financial Measures

Adjusted EBITDA is a non-GAAP financial measure equal to income from continuing operations, the most directly comparable GAAP financial measure, plus stock compensation expense, provision for income taxes, interest expense, net, loss on the sale of assets, merger and other costs, depreciation and other amortization and amortization of purchased intangibles.

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We use adjusted EBITDA as an integral part of our internal reporting to measure the performance of our reportable segments and to evaluate the performance of our senior management. Adjusted EBITDA is considered

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an important indicator of the operational strength of our businesses. Adjusted EBITDA eliminates the uneven effect across all business segments of considerable amounts of non-cash depreciation of tangible assets and amortization of certain intangible assets that were recognized in business combinations. A limitation of this measure, however, is that it does not reflect the periodic costs of certain capitalized tangible and intangible assets used in generating revenues in our businesses. Management evaluates the costs of such tangible and intangible assets, the impact of related impairments, as well as asset sales through other financial measures, such as capital expenditures, investment spending and return on capital and therefore the effects are excluded from adjusted EBITDA. Adjusted EBITDA also eliminates the non-cash effect of stock compensation expense. Stock compensation expense is not included in the measurement of segment adjusted EBITDA provided to the chief operating decision maker for purposes of assessing segment performance and decision making with respect to resource allocations. Therefore, we believe that adjusted EBITDA provides useful information to our investors regarding our performance and overall results of operations. Adjusted EBITDA is not intended to be a performance measure that should be regarded as an alternative to, or more meaningful than, either operating income or net income as an indicator of operating performance or to cash flows from operating activities as a measure of liquidity. In addition, adjusted EBITDA is not intended to represent funds available for dividends, reinvestment or other discretionary uses, and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP. The adjusted EBITDA measures presented in this Quarterly Report on Form 10-Q may not be comparable to similarly titled measures presented by other companies, and may not be identical to corresponding measures used in our various agreements.

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2009	2008	2009	2008
	(In thousands)			
Income from continuing operations	\$ 45,796	\$ 58,930	\$ 118,185	\$ 183,578
Stock compensation expense	14,608	17,191	43,265	31,193
Provision for income taxes	9,931	37,556	55,826	114,603
Interest expense, net	39,044	23,325	105,226	54,370
Loss on the sale of assets				1,052
Merger and other costs (income) ⁽¹⁾	878	(1,062)	3,890	8,301
Depreciation and other amortization	15,397	17,363	45,816	52,703
Amortization of purchased intangibles	15,770	16,703	45,833	50,682
Adjusted EBITDA	\$ 141,424	\$ 170,006	\$ 418,041	\$ 496,482

⁽¹⁾ Represents expenditures directly associated with the proposed merger of the Company with an affiliate of The Blackstone Group and compensation charges related to the departure of certain associates.

Table of Contents**Results of Continuing Operations***Three months ended September 30, 2009 compared to the three months ended September 30, 2008*

	Three Months Ended September 30,		Change	
	2009	2008	\$	%
	(In thousands, except percentages)			
Revenue:				
Loyalty Services	\$ 177,008	\$ 187,657	\$ (10,649)	(5.7)%
Epsilon Marketing Services	131,926	130,895	1,031	0.8
Private Label Services	96,745	94,678	2,067	2.2
Private Label Credit	165,173	182,357	(17,184)	(9.4)
Corporate/Other	5,813	7,689	(1,876)	(24.4)
Eliminations	(93,479)	(92,051)	(1,428)	1.6
Total	\$ 483,186	\$ 511,225	\$ (28,039)	(5.5)%
Adjusted EBITDA⁽¹⁾:				
Loyalty Services	\$ 53,186	\$ 49,018	\$ 4,168	8.5%
Epsilon Marketing Services	35,196	40,097	(4,901)	(12.2)
Private Label Services	27,534	30,562	(3,028)	(9.9)
Private Label Credit	41,696	59,666	(17,970)	(30.1)
Corporate/Other	(16,188)	(9,337)	(6,851)	73.4
Total	\$ 141,424	\$ 170,006	\$ (28,582)	(16.8)%
Stock compensation expense:				
Loyalty Services	\$ 3,847	\$ 3,957	\$ (110)	(2.8)%
Epsilon Marketing Services	1,705	3,545	(1,840)	(51.9)
Private Label Services	1,468	2,292	(824)	(36.0)
Private Label Credit	295	513	(218)	(42.5)
Corporate/Other	7,293	6,884	409	5.9
Total	\$ 14,608	\$ 17,191	\$ (2,583)	(15.0)%
Depreciation and amortization:				
Loyalty Services	\$ 5,966	\$ 7,016	\$ (1,050)	(15.0)%
Epsilon Marketing Services	18,003	18,681	(678)	(3.6)
Private Label Services	2,357	2,226	131	5.9
Private Label Credit	3,346	2,955	391	13.2
Corporate/Other	1,495	3,188	(1,693)	(53.1)
Total	\$ 31,167	\$ 34,066	\$ (2,899)	(8.5)%
Operating income from continuing operations:				
Loyalty Services	\$ 43,373	\$ 38,045	\$ 5,328	14.0%
Epsilon Marketing Services	15,488	17,876	(2,388)	(13.4)
Private Label Services	23,709	26,044	(2,335)	(9.0)
Private Label Credit	38,055	56,198	(18,143)	(32.3)
Corporate/Other	(25,854)	(18,352)	(7,502)	40.9
Total	\$ 94,771	\$ 119,811	\$ (25,040)	(20.9)%
Adjusted EBITDA margin⁽²⁾:				
Loyalty Services	30.0%	26.1%	3.9%	
Epsilon Marketing Services	26.7	30.6	(3.9)	
Private Label Services	28.5	32.3	(3.8)	

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Private Label Credit	25.2	32.7	(7.5)	
Total	29.3%	33.3%	(4.0)%	
Segment operating data:				
Private label statements generated	31,301	30,661	640	2.1%
Credit sales	\$ 1,921,625	\$ 1,694,113	\$ 227,512	13.4
Average managed receivables	\$ 4,301,211	\$ 3,840,184	\$ 461,027	12.0
AIR MILES reward miles issued	1,169,492	1,137,673	31,819	2.8
AIR MILES reward miles redeemed	777,422	736,789	40,633	5.5%

- (1) Adjusted EBITDA is equal to income from continuing operations, plus stock compensation expense, provision for income taxes, interest expense, net, loss on the sale of assets, merger and other costs, depreciation and amortization.
- (2) Adjusted EBITDA margin is adjusted EBITDA divided by revenue. Management uses adjusted EBITDA margin to analyze the operating performance of the segments and the impact revenue growth has on adjusted operating expenses. For a definition of adjusted EBITDA and a reconciliation to net income, the most directly comparable GAAP financial measure, see [Use of Non-GAAP Financial Measures](#) included in this report.

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Revenue. Total revenue decreased \$28.0 million, or 5.5%, to \$483.2 million for the three months ended September 30, 2009 from \$511.2 million for the comparable period in 2008. The decrease was due to the following:

Loyalty Services. Revenue decreased \$10.6 million, or 5.7%, to \$177.0 million for the three months ended September 30, 2009. The decrease in revenue for the period was driven by the change in foreign currency exchange rates which negatively impacted revenue by approximately \$9.4 million. In Canadian dollars, revenue was generally flat, as increases in service revenue of CAD \$3.6 million and investment revenue of CAD \$1.3 million were offset by a decline in database marketing fees of CAD \$5.2 million.

Epsilon Marketing Services. Revenue increased \$1.0 million, or 0.8%, to \$131.9 million for the three months ended September 30, 2009. Revenue was relatively flat as increases from the segment's largest service offerings (marketing database services, analytical services and digital) of \$6.3 million, resulting from additional client signings, were largely offset by declines from our proprietary data services of \$4.7 million, as Abacus was impacted by the weak economic environment experienced by retailers.

Private Label Services. Revenue increased \$2.1 million, or 2.2%, to \$96.7 million for the three months ended September 30, 2009 as a result of an increase in servicing revenue of \$1.4 million and an increase in services enhancement revenue of \$0.5 million.

Private Label Credit. Revenue decreased \$17.2 million, or 9.4%, to \$165.2 million for the three months ended September 30, 2009. The decrease was due to a \$22.7 million decrease in securitization income and finance charges, net, resulting from increased credit losses of 240 basis points. The impact of the higher credit losses was in part mitigated by positive trends in portfolio growth of 12.0% and credit sales growth of 13.4%.

Corporate/Other. Revenue decreased \$1.9 million to \$5.8 million for the three months ended September 30, 2009 from \$7.7 million in the comparable period in 2008 as a result of a reduction in transition services provided to the acquirers of our merchant services and utility services businesses.

Adjusted EBITDA. For purposes of the discussion below, adjusted EBITDA is equal to income from continuing operations, plus stock compensation expense, provision for income taxes, interest expense, net, loss on the sale of assets, merger and other costs, depreciation and amortization. Total adjusted EBITDA decreased \$28.6 million, or 16.8%, to \$141.4 million for the three months ended September 30, 2009. Total adjusted EBITDA margin, which for purposes of the discussion below is equal to adjusted EBITDA divided by revenue, decreased to 29.3% for the three months ended September 30, 2009 from 33.3% for the comparable period in 2008. The changes in adjusted EBITDA and adjusted EBITDA margins are due to the following:

Loyalty Services. Adjusted EBITDA increased \$4.2 million, or 8.5%, to \$53.2 million for the three months ended September 30, 2009. The increase was driven by reductions in operating expenses, including declines in payroll and benefits expense and data processing expense. These reductions also positively impacted our adjusted EBITDA margin, which increased to 30.0% for the three months ended September 30, 2009 as compared to 26.1% in the comparable period in 2008.

Epsilon Marketing Services. Adjusted EBITDA decreased \$4.9 million, or 12.2%, to \$35.2 million and adjusted EBITDA margin decreased to 26.7% from 30.6% for the three months ended September 30, 2009. The decreases in adjusted EBITDA and adjusted EBITDA margin were driven by weakness in our data service offerings and agency business due to the recession, which resulted in a \$5.6 million and a \$1.3 million decline in adjusted EBITDA, respectively. This was offset in part by double digit growth in the segment's largest service offerings (marketing database services, analytical services and digital).

Private Label Services. Adjusted EBITDA decreased by \$3.0 million, or 9.9%, to \$27.5 million for the three months ended September 30, 2009. Adjusted EBITDA margin decreased to 28.5% for the three months ended September 30, 2009 as compared to

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32.3% in the comparable period in 2008. Adjusted EBITDA and adjusted EBITDA margin were negatively impacted by an increase in operating expenses

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of \$5.1 million associated with the 2.1% increase in statements generated, offset in part by the slight increase in revenue of \$2.1 million as previously described.

Private Label Credit. Adjusted EBITDA decreased \$18.0 million, or 30.1%, to \$41.7 million for the three months ended September 30, 2009. Adjusted EBITDA margin decreased to 25.2% for the three months ended September 30, 2009 as compared to 32.7% in the comparable period in 2008. The decreases were the result of the increase in credit losses as previous described.

Corporate/Other. Adjusted EBITDA decreased \$6.9 million, or 73.4%, to a loss of \$16.2 million for the three months ended September 30, 2009. This decrease was the result of information technology costs incurred to support the transition services provided to the acquirers of the merchant services and utility services businesses. Prior to their sale, such costs had been allocated to the respective businesses.

Stock compensation expense. Stock compensation expense decreased \$2.6 million, or 15.0%, to \$14.6 million for the three months ended September 30, 2009. The decrease was the result of a reduction in expense of \$6.9 million related to performance-based restricted stock unit awards that are no longer expected to vest and for which no expense was recognized during the three months ended September 30, 2009. This increase was partially offset by an increase in expense of \$3.1 million related to equity awards issued to associates in 2009.

Depreciation and Amortization. Depreciation and amortization decreased \$2.9 million, or 8.5%, to \$31.2 million for the three months ended September 30, 2009 primarily due to a \$2.0 million decrease in depreciation and other amortization and a \$0.9 million decrease in amortization of purchased intangibles as certain assets became fully amortized.

Merger and other costs. Merger and other costs were \$0.9 million for the three months ended September 30, 2009 compared to income of \$1.1 million for the comparable period in 2008. Merger and other costs for the three months ended September 30, 2009 represent compensation charges related to the severance of a certain executive. For the comparable period in 2008, amounts include the receipt of \$(3.0) million for reimbursement of costs incurred by us related to the Blackstone entities financing of the proposed merger offset by \$0.9 million of expenditures directly associated with the proposed merger of us with an affiliate of The Blackstone Group and approximately \$1.0 million of other non-routine costs associated with the disposition of non-core operations.

Operating Income. Operating income decreased \$25.0 million, or 20.9%, to \$94.8 million for the three months ended September 30, 2009 from \$119.8 million for the comparable period in 2008. Operating income decreased due to the revenue and expense factors discussed above.

Interest Expense, net. Interest expense, net increased \$15.7 million, or 67.4%, to \$39.0 million for the three months ended September 30, 2009 from \$23.3 million for the comparable period in 2008. This increase can be attributed in part to additional interest expense of \$13.5 million associated with our convertible senior notes due 2013 and 2014, which were issued in July 2008 and June 2009, respectively. Interest expense on certificates of deposit also increased \$4.7 million as a result of higher average balances during the three months ended September 30, 2009 than during the comparable period in 2008. Interest expense on our credit facilities and senior notes decreased \$5.3 million as a result of lower interest rates and the repayment of \$250.0 million aggregate principal amount of 6.00% Series A senior notes in May 2009. Interest income decreased \$2.3 million due to lower average balances of our short term cash investments, as well as a decrease in the yield earned on those short term cash investments.

Taxes. Income tax expense decreased \$27.7 million to \$9.9 million for the three months ended September 30, 2009 from \$37.6 million for the comparable period in 2008 due to a decrease in taxable income and a decrease in our effective tax rate to 17.8% for the three months ended September 30, 2009 from 38.9% for the comparable period in 2008. During the three months ended September 30, 2009, we recognized an

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\$11.7 million tax benefit related to previously established tax reserves to cover various uncertain tax positions, including the potential impact related to the timing of certain taxable income recognition. Based on a recent United States Tax Court decision, statute of limitations expirations, and other factors, the uncertainty around this taxable income recognition has been removed and, as such, the related reserve, primarily associated with accrued interest, is no longer required.

Discontinued Operations

In February 2009, we completed the plan to dispose of our merchant services and utility services businesses. As a result, there was no activity associated with discontinued operations in our unaudited condensed consolidated statement of income for the three months ended September 30, 2009. In the comparable period in 2008, income from discontinued operations was \$5.9 million, which was the result of a tax benefit resulting from our ability to utilize previously unrealized tax benefits due to the sale of the majority of our utility services business.

Table of Contents**Results of Continuing Operations***Nine months ended September 30, 2009 compared to the nine months ended September 30, 2008*

	Nine Months Ended September 30,		Change	
	2009	2008	\$	%
	(In thousands, except percentages)			
Revenue:				
Loyalty Services	\$ 504,985	\$ 559,490	\$ (54,505)	(9.7)%
Epsilon Marketing Services	372,495	361,744	10,751	3.0
Private Label Services	280,977	285,028	(4,051)	(1.4)
Private Label Credit	507,863	579,011	(71,148)	(12.3)
Corporate/Other	28,940	9,760	19,180	**
Eliminations	(271,408)	(277,348)	5,940	(2.1)
Total	\$ 1,423,852	\$ 1,517,685	\$ (93,833)	(6.2)%
Adjusted EBITDA⁽¹⁾:				
Loyalty Services	\$ 146,419	\$ 143,313	\$ 3,106	2.2%
Epsilon Marketing Services	87,717	90,189	(2,472)	(2.7)
Private Label Services	82,000	87,375	(5,375)	(6.2)
Private Label Credit	138,126	210,376	(72,250)	(34.3)
Corporate/Other	(36,221)	(34,771)	(1,450)	4.2
Total	\$ 418,041	\$ 496,482	\$ (78,441)	(15.8)%
Stock compensation expense:				
Loyalty Services	\$ 10,128	\$ 8,386	\$ 1,742	20.8%
Epsilon Marketing Services	6,930	5,091	1,839	36.1
Private Label Services	5,129	4,277	852	19.9
Private Label Credit	1,265	1,274	(9)	(0.7)
Corporate/Other	19,813	12,165	7,648	62.9
Total	\$ 43,265	\$ 31,193	\$ 12,072	38.7%
Depreciation and amortization:				
Loyalty Services	\$ 15,877	\$ 23,681	\$ (7,804)	(33.0)%
Epsilon Marketing Services	51,835	56,740	(4,905)	(8.6)
Private Label Services	6,967	6,725	242	3.6
Private Label Credit	10,457	8,587	1,870	21.8
Corporate/Other	6,513	7,652	(1,139)	(14.9)
Total	\$ 91,649	\$ 103,385	\$ (11,736)	(11.4)%
Operating income from continuing operations:				
Loyalty Services	\$ 120,414	\$ 111,246	\$ 9,168	8.2%
Epsilon Marketing Services	28,952	25,725	3,227	12.5
Private Label Services	69,904	74,938	(5,034)	(6.7)
Private Label Credit	126,404	200,515	(74,111)	(37.0)
Corporate/Other	(66,437)	(59,873)	(6,564)	11.0
Total	\$ 279,237	\$ 352,551	\$ (73,314)	(20.8)%
Adjusted EBITDA margin⁽²⁾:				
Loyalty Services	29.0%	25.6%	3.4%	
Epsilon Marketing Services	23.5	24.9	(1.4)	
Private Label Services	29.2	30.7	(1.5)	

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Private Label Credit	27.2	36.3	(9.1)	
Total	29.4%	32.7%	(3.3)%	
Segment operating data:				
Private label statements generated	94,632	93,296	1,336	1.4%
Credit sales	\$ 5,474,714	\$ 5,096,018	\$ 378,696	7.4
Average managed receivables	\$ 4,262,720	\$ 3,859,454	\$ 403,266	10.4
AIR MILES reward miles issued	3,278,290	3,300,559	(22,269)	(0.7)
AIR MILES reward miles redeemed	2,321,387	2,224,713	96,674	4.3%

(1) Adjusted EBITDA is equal to income from continuing operations, plus stock compensation expense, provision for income taxes, interest expense, net, loss on the sale of assets, merger and other costs, depreciation and amortization.

(2) Adjusted EBITDA margin is adjusted EBITDA divided by revenue. Management uses adjusted EBITDA margin to analyze the operating performance of the segments and the impact revenue growth has on adjusted operating expenses. For a definition of adjusted EBITDA and a reconciliation to net income, the most directly comparable GAAP financial measure, see [Use of Non-GAAP Financial Measures](#) included in this report.

** Not meaningful

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Revenue. Total revenue decreased \$93.8 million, or 6.2%, to \$1,423.9 million for the nine months ended September 30, 2009 from \$1,517.7 million for the comparable period in 2008. The decrease was due to the following:

Loyalty Services. Revenue decreased \$54.5 million, or 9.7%, to \$505.0 million for the nine months ended September 30, 2009. The decrease in revenue for the period was driven by the change in foreign currency exchange rates, which negatively impacted revenue by approximately \$72.6 million and by a decrease in database marketing fees. These declines were offset by increases in redemption revenue attributable to a 4.3% increase in AIR MILES reward miles redeemed and issuance revenue of 11.2% attributable to strong AIR MILES reward miles issuances in prior years.

Epsilon Marketing Services. Revenue increased \$10.8 million, or 3.0%, to \$372.5 million for the nine months ended September 30, 2009. Revenue from the segment's largest service offerings (marketing database services, analytical services and interactive communications) increased as compared to the nine months ended September 30, 2008 by 8.5%, or \$18.4 million, resulting from additional client signings and our large clients maintaining their commitments to their significant loyalty platforms. Additional revenue increases from proprietary data services of \$4.7 million were offset by a decrease of \$12.3 million in revenue attributable to the segment's agency business.

Private Label Services. Revenue decreased \$4.1 million, or 1.4%, to \$281.0 million for the nine months ended September 30, 2009 as a result of a decrease in servicing revenue of \$5.9 million offset in part by an increase in services enhancement revenue of \$1.2 million.

Private Label Credit. Revenue decreased \$71.1 million, or 12.3%, to \$507.9 million for the nine months ended September 30, 2009. The decrease was due to a decrease in securitization income and finance charges, net, of \$86.6 million, resulting from higher credit losses of 250 basis points. The impact of the higher credit losses was in part mitigated by positive trends in portfolio growth of 10.4%, credit sales growth of 7.4%, and an improvement in our cost of funds.

Corporate/Other. Revenue increased \$19.2 million to \$28.9 million for the nine months ended September 30, 2009 as a result of transition services provided to the acquirers of our merchant services and utility services businesses.

Adjusted EBITDA. For purposes of the discussion below, adjusted EBITDA is equal to income from continuing operations, plus stock compensation expense, provision for income taxes, interest expense, net, loss on the sale of assets, merger and other costs, depreciation and amortization. Adjusted EBITDA decreased \$78.4 million, or 15.8%, to \$418.0 million for the nine months ended September 30, 2009. Adjusted EBITDA margin, which for purposes of the discussion below is equal to adjusted EBITDA divided by revenue, decreased to 29.4% for the nine months ended September 30, 2009 from 32.7% for the comparable period in 2008. The changes in adjusted EBITDA and adjusted EBITDA margin are due to the following:

Loyalty Services. Adjusted EBITDA increased \$3.1 million, or 2.2%, to \$146.4 million for the nine months ended September 30, 2009. Adjusted EBITDA was negatively impacted by the change in foreign exchange rates by approximately \$21.4 million. However, the increase in adjusted EBITDA was driven by the growth in revenue (on a constant currency basis) as previously described combined with a lower cost structure achieved through operating leverage. This positively impacted our adjusted EBITDA margin, which increased to 29.0% for the nine months ended September 30, 2009 as compared to 25.6% for the comparable period in 2008.

Epsilon Marketing Services. Adjusted EBITDA decreased \$2.5 million, or 2.7%, to \$87.7 million and adjusted EBITDA margin declined to 23.5% for the nine months ended September 30, 2009 compared to 24.9% in the same period in 2008. The decreases in adjusted EBITDA and adjusted EBITDA margin were driven by weakness in our data service offering due to the recession, which resulted in a \$10.9 million decline in adjusted EBITDA. This decrease was offset in part by a 16.5% increase in adjusted EBITDA from the largest service offerings (marketing database services, analytical services, and interactive communications).

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Private Label Services. Adjusted EBITDA decreased \$5.4 million, or 6.2%, to \$82.0 million for the nine months ended September 30, 2009. Adjusted EBITDA margin declined to 29.2% for the nine months ended September 30, 2009 compared to 30.7% in the same period in 2008. Adjusted EBITDA and adjusted EBITDA margin were negatively impacted by the decrease in servicing revenue as previously described and an increase in operating expenses of \$1.3 million.

Private Label Credit. Adjusted EBITDA decreased \$72.3 million, or 34.3%, to \$138.1 million for the nine months ended September 30, 2009. Adjusted EBITDA margin decreased to 27.2% for the nine months ended September 30, 2009 as compared to 36.3% for the comparable period in 2008. Both adjusted EBITDA and adjusted EBITDA margin were negatively impacted by the decline in revenue as previously described.

Corporate/Other. Adjusted EBITDA decreased \$1.5 million, or 4.2%, to a loss of \$36.2 million for the nine months ended September 30, 2009. This decrease was the result of information technology costs incurred to support the transition services provided to the acquirers of the merchant services and utility services businesses. Prior to their sale, such costs had been allocated to the respective businesses.

Stock compensation expense. Stock compensation expense increased \$12.1 million, or 38.7%, to \$43.3 million for the nine months ended September 30, 2009. The increase is the result of the issuance of restricted stock toward the end of the second quarter of 2008, which increased expense by \$11.5 million for the nine months ended September 30, 2009.

Depreciation and Amortization. Depreciation and amortization decreased \$11.7 million, or 11.4%, to \$91.6 million for the nine months ended September 30, 2009 primarily due to a \$6.9 million decrease in depreciation and other amortization and a \$4.8 million decrease in amortization of purchased intangibles as certain assets became fully amortized.

Merger and other costs. Merger and other costs decreased \$4.4 million to \$3.9 million for the nine months ended September 30, 2009 from \$8.3 million in the comparable period of 2008. During the nine months ended September 30, 2009, we incurred approximately \$4.4 million in compensation charges related to the departure of certain executives and approximately \$0.2 million of legal costs associated with the termination of our merger with an affiliate of The Blackstone Group. These costs were offset in part by a reimbursement from our insurer in the amount of \$(0.7) million related to payments made to settle certain shareholder litigation associated with the proposed merger. During the nine months ended September 30, 2008, we incurred approximately \$2.3 million of costs associated with the proposed merger including a \$(3.0) million reimbursement of costs incurred by us related to the Blackstone entities financing of the proposed merger. In addition, during the nine months ended September 30, 2008, we incurred \$6.0 million in compensation charges related to the severance of certain employees and other non-routine costs.

Loss on the sale of assets. In March 2008, we incurred a loss of \$1.1 million related to the settlement of certain working capital accounts in connection with the disposition of our mail services business.

Operating Income. Operating income decreased \$73.3 million, or 20.8%, to \$279.2 million for the nine months ended September 30, 2009 from \$352.6 million for the comparable period in 2008. Operating income decreased due to the revenue and expense factors discussed above.

Interest Expense, net. Interest expense, net increased \$50.9 million, or 93.5%, to \$105.2 million for the nine months ended September 30, 2009 from \$54.4 million for the comparable period in 2008. The increase in interest expense was the result of additional interest expense of \$43.9 million associated with our convertible senior notes due 2013 and 2014 which were issued in July 2008 and June 2009, respectively. Interest expense on certificates of deposit increased \$11.3 million as a result of higher average balances during the nine months ended September 30, 2009 than during the comparable period in 2008 and interest expense from the amortization of debt issuance costs increased \$4.2 million. These increases were offset in part by decreases in interest expense on

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our credit facilities and senior notes of \$15.5 million as a result of lower interest rates on our line of credit and the repayment of \$250.0 million aggregate principal amount of 6.00% Series A senior notes in May 2009. Interest income decreased \$7.2 million due to lower average balances of our short term cash investments, as well as a decrease in the yield earned on those short term cash investments.

Taxes. Income tax expense decreased \$58.8 million to \$55.8 million for the nine months ended September 30, 2009 from \$114.6 million for the comparable period in 2008 due to a decrease in taxable income combined with a decrease in our effective tax rate to 32.1% for the nine months ended September 30, 2009 from 38.4% for the comparable period in 2008. During the nine months ended September 30, 2009, we recognized an \$11.7 million tax benefit related to previously established tax reserves to cover various uncertain tax positions, including the potential impact related to the timing of certain taxable income recognition. Based on a recent United States Tax Court decision, statute of limitations expirations, and other factors, the uncertainty around this taxable income recognition has been removed and, as such, the related reserve, associated with accrued interest, is no longer required.

Discontinued Operations

In March 2008, we determined that our merchant services and utility services businesses were not aligned with our long-term strategy and committed to a disposition plan for these businesses. These businesses have been reported as a discontinued operation in our unaudited condensed consolidated financial statements. On an after tax basis, losses from discontinued operations decreased \$7.4 million to \$15.1 million for the nine months ended September 30, 2009 from \$22.5 million in the comparable period in 2008. The loss recorded for the nine months ended September 30, 2009 was the result of an \$18.0 million pre-tax loss recognized in connection with the sale of the remaining portion of our utility services business in February 2009. The loss recorded for the comparable period in 2008 resulted from the sale of the core portion of our utility services business, offset in part by a gain attributable to the sale of our merchant services business in May 2008. The sale of the remainder of the utility services business in February 2009 completed the disposition plan.

Asset Quality

Our delinquency and net charge-off rates reflect, among other factors, the credit risk of our private label credit card receivables, the average age of our various private label credit card account portfolios, the success of our collection and recovery efforts, and general economic conditions. The average age of our private label credit card portfolio affects the stability of delinquency and loss rates of the portfolio. We continue to focus resources on refining our credit underwriting standards for new accounts and on collections and post charge-off recovery efforts to minimize net losses.

An older private label credit card portfolio generally drives a more stable performance in the portfolio. At September 30, 2009, 62.1% of our managed accounts with balances and 60.4% of managed receivables were for accounts with origination dates greater than 24 months old. At September 30, 2008, 61.2% of managed accounts with balances and 61.4% of receivables were for managed accounts with origination dates greater than 24 months old.

Delinquencies. A credit card account is contractually delinquent if we do not receive the minimum payment by the specified due date on the cardholder's statement. When an account becomes delinquent, we print a message on the cardholder's billing statement requesting payment. After an account becomes 30 days past due, a proprietary collection scoring algorithm automatically scores the risk of the account rolling to a more delinquent status. The collection system then recommends a collection strategy for the past due account based on the collection score and account balance and dictates the contact schedule and collections priority for the account. If we are unable to make a collection after exhausting all in-house efforts, we engage collection agencies and outside attorneys to continue those efforts.

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The following table presents the delinquency trends of our managed credit card portfolio:

	September 30, 2009	% of total	December 31, 2008	% of total
(In thousands, except percentages)				
Receivables outstanding	\$ 4,380,894	100%	\$ 4,531,442	100%
Receivables balances contractually delinquent:				
31 to 60 days	90,596	2.1	84,221	1.9
61 to 90 days	67,851	1.5	59,001	1.3
91 or more days	145,235	3.3	127,143	2.8
Total	\$ 303,682	6.9%	\$ 270,365	6.0%

Net Charge-Offs. Net charge-offs comprise the principal amount of losses from cardholders unwilling or unable to pay their account balances, as well as bankrupt and deceased cardholders, less current period recoveries. The following table presents our net charge-offs for the periods indicated on a managed basis. Average managed receivables represents the average balance of the cardholder receivables at the end of each month in the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
(In thousands)				
Average managed receivables	\$ 4,301,211	\$ 3,840,184	\$ 4,262,720	\$ 3,859,454
Net charge-offs	101,303	66,864	298,978	198,722
Net charge-offs as a percentage of average managed receivables (annualized)	9.4%	7.0%	9.4%	6.9%

See Note 6, Securitization of Credit Card Receivables, of our unaudited condensed consolidated financial statements for additional information related to the securitization of our credit card receivables.

Liquidity and Capital Resources

Operating Activities. We have historically generated cash flows from operations, although such amounts may vary based on fluctuations in working capital and the timing of merchant settlement activity. Our operating cash flow is seasonal, with cash utilization peaking at the end of December due to increased activity in our Private Label Credit segment related to holiday retail sales.

We generated cash flow from operating activities of \$306.1 million for the nine months ended September 30, 2009 as compared to \$578.4 million for the comparable period in 2008. Cash flows in the nine months ended September 30, 2008 were impacted by an increase in deferred revenue related to a change in contractual terms with BMO Bank of Montreal. In May 2008, we assumed BMO Bank of Montreal's liability for the cost of redemptions for their outstanding AIR MILES reward miles, for which we received \$369.9 million in cash.

We utilize our cash flow from operations for ongoing business operations, acquisitions and capital expenditures.

Investing Activities. Cash used in investing activities was \$378.9 million for the nine months ended September 30, 2009 compared to \$175.6 million for the comparable period in 2008. Significant components of investing activities are as follows:

Redemption Settlement Assets. Cash provided by redemption settlement assets was \$29.7 million for the nine months ended September 30, 2009 compared to investments in redemption settlement assets of \$362.4 million for the comparable period in 2008. In connection with the May 2008 transaction with BMO Bank of Montreal, we received \$369.9 million in cash to assume their liability for the redemption of outstanding AIR MILES reward miles they previously issued, which we placed in our redemption

settlement asset account.

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Securitized and Receivables Funding. We generally fund all private label credit card receivables through a securitization program that provides us with both liquidity and lower borrowing costs. As of September 30, 2009, we had over \$3.8 billion of securitized credit card receivables. Securitizations require credit enhancements in the form of cash, spread accounts and additional receivables. The credit enhancement is partially funded through the use of certificates of deposit issued through our subsidiaries, World Financial Network National Bank (WFNNB) and World Financial Capital Bank (WFCB). Net securitization and credit card receivable activity used cash flows of \$316.6 million for the nine months ended September 30, 2009 compared to \$12.9 million in the comparable period in 2008. In addition, for the nine months ended September 30, 2009, we also generated \$91.9 million of proceeds from the sale of credit card receivable portfolios to the securitization trusts. We intend to utilize our securitization program for the foreseeable future.

Capital Expenditures. Our capital expenditures for the nine months ended September 30, 2009 were \$39.7 million compared to \$37.1 million for the comparable period in 2008. We anticipate capital expenditures to be approximately 3% of annual revenue for the foreseeable future.

Financing Activities. Cash provided by financing activities was \$354.8 million for the nine months ended September 30, 2009 as compared to cash used by financing activities of \$281.6 million for the comparable period in 2008. Our financing activities during the nine months ended September 30, 2009 relate primarily to borrowings and repayments of debt and certificates of deposit, proceeds from the issuance of our convertible senior notes due 2014, proceeds from the issuance of warrants, payments made for convertible note hedges and repurchases of our common stock.

Liquidity Sources. In addition to cash generated from operating activities, our primary sources of liquidity include: securitization program, certificates of deposit issued by WFNNB and WFCB, our credit facility and issuances of equity securities.

In addition to our efforts to renew and expand our current facilities, we continue to seek new sources of liquidity. Certain of the announced government programs, such as the Term Asset-Backed Securities Loan Facility, have facilitated the issuance of asset-backed securities and improved market conditions, thus enabling us to replace maturing or short-term funding as discussed in Note 6, Securitization of Credit Card Receivables, of our unaudited condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q. We have also expanded our brokered certificates of deposit to supplement liquidity for our credit card receivables.

We believe that internally generated funds and other sources of liquidity discussed above will be sufficient to meet working capital needs, capital expenditures, and other business requirements for at least the next 12 months.

Securitization Program and Off-Balance Sheet Transactions. Since January 1996, we have sold a majority of the credit card receivables originated by WFNNB to WFN Credit Company, LLC and WFN Funding Company II, LLC, which in turn sold them to World Financial Network Credit Card Master Trust, World Financial Network Credit Card Master Note Trust and World Financial Network Credit Card Master Trust III (the WFN Trusts) as part of our securitization program. In September 2008, we initiated a securitization program for the credit card receivables originated by WFCB, selling them to World Financial Capital Credit Company, LLC which in turn sold them to World Financial Capital Credit Card Master Note Trust (the WFC Trust). These securitization programs are the primary vehicle through which we finance WFNNB s and WFCB s credit card receivables.

Historically, we have used both public and private asset-backed securities term transactions as well as private conduit facilities as sources of funding for our credit card receivables. Private conduit facilities have been used to accommodate seasonality needs and to bridge to completion of asset-backed securitization transactions.

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We have secured and continue to secure the necessary commitments to fund our portfolio of securitized credit card receivables originated by WFNNB and WFCB. However, certain of these commitments are short-term in nature and subject to renewal. There is not a guarantee that these funding sources, when they mature, will be renewed on similar terms or at all. Due to recent market events, the asset-backed securitization market has not been available at historical volumes and pricing levels and it is difficult to predict if, or when, asset-backed securitization markets will return to their historical capacity and pricing levels with or without the support of government programs.

As of September 30, 2009, the WFN Trusts and the WFC Trust had approximately \$3.8 billion of securitized credit card receivables. Securitizations require credit enhancements in the form of cash, spread deposits and additional receivables. The credit enhancement is principally based on the outstanding balances of the series issued by the WFN Trusts and the WFC Trust and by the performance of the private label credit cards in these securitization trusts.

In March 2009, we renewed our 2009-VFC1 conduit facility, increasing its capacity from \$550.0 million to \$666.7 million and extended the maturity of our 2008-VFN conduit facility, increasing its capacity from \$600.0 million to \$664.6 million.

In April 2009, World Financial Network Credit Card Master Note Trust issued \$708.9 million of term asset-backed securities to investors, including those participating in the U.S. government's Term Asset-Backed Securities Loan Facility, or TALF program. The offering consisted of \$560.0 million of Class A Series 2009-A asset backed notes that have a fixed interest rate of 4.6% per year, \$26.6 million of Class M Series 2009-A asset backed notes that have a fixed interest rate of 6.0% per year, \$33.7 million of Class B Series 2009-A asset backed notes that have a fixed interest rate of 7.5% per year and \$88.6 million of Class C Series 2009-A asset backed notes that have a fixed interest rate of 9.0% per year. These notes will mature in November 2011.

In August 2009, World Financial Network Credit Card Master Note Trust issued \$949.3 million of term asset-backed securities to investors, including those participating in the U.S. government's TALF program. The offering consisted of \$500.0 million of Series 2009-B asset-backed notes, \$139.2 million of Series 2009-C asset-backed notes, and \$310.1 million of Series 2009-D asset-backed notes, which mature in July 2012, July 2010, and July 2013, respectively. We retained \$118.7 million of Class C zero-coupon bonds in connection with this transaction. See Note 6, Securitization of Credit Card Receivables, of our unaudited condensed consolidated financial statements for additional information.

In September 2009, we renewed World Financial Network Credit Card Master Note Trust's 2009-VFN conduit facility, increasing its capacity from \$1.3 billion to \$1.5 billion and extending its maturity.

In September 2009, we renewed World Financial Capital Master Note Trust's 2009-VFN conduit facility, increasing its capacity from \$167.1 million to \$200.0 million and extending its maturity.

Certificates of Deposit. We utilize certificates of deposit to finance the operating activities and fund securitization enhancement requirements of our credit card bank subsidiaries, WFNNB and WFCB. WFNNB and WFCB issue certificates of deposit in denominations of \$100,000 in various maturities ranging between 6 months and 5 years and with effective annual fixed rates ranging from 0.8% to 5.7%. As of September 30, 2009, we had \$1.2 billion of certificates of deposit outstanding. Certificate of deposit borrowings are subject to regulatory capital requirements.

Credit Facility. As of September 30, 2009, borrowings under the credit facility were \$525.0 million with a weighted-average interest rate of 0.8%. Total availability under the credit facility at September 30, 2009 was approximately \$225.0 million. The credit facility is unsecured and matures in March 2012. We utilize our credit facility and excess cash flows from operations to fund working capital, capital expenditures, and our stock repurchase program. We were in compliance with the covenants under our credit facility as of September 30, 2009.

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Term Loan. In May 2009, we entered into a term loan agreement with Bank of Montreal, as administrative agent, and various other agents and banks. At September 30, 2009, borrowings under the term loan were \$161.0 million with a weighted-average interest rate of 3.3%. The amounts borrowed under the term loan were used, together with other funds, to repay our \$250.0 million aggregate principal amount of 6.00% Series A notes due May 16, 2009.

The term loan contains usual and customary negative covenants for transactions of this type and requires us to satisfy certain financial covenants. The term loan is unsecured and matures in March 2012, with principal payments of 5.0% of the aggregate principal amount of the loans outstanding to be made on the last day of each fiscal quarter commencing June 30, 2010. As of September 30, 2009, we were in compliance with these covenants.

See Note 7, *Debt*, of our unaudited condensed consolidated financial statements for additional information.

Convertible Senior Notes due 2014. In June 2009, we issued \$345.0 million aggregate principal amount of convertible senior notes due 2014, including the exercise of an over-allotment option of \$45.0 million. Holders of the convertible senior notes due 2014 have the right to require us to repurchase for cash all or some of their convertible senior notes due 2014 upon the occurrence of certain fundamental changes.

Concurrently with the pricing of the convertible senior notes due 2014 and the exercise of the over-allotment option, we entered into convertible note hedge transactions with respect to our common stock, which cover, subject to customary anti-dilution adjustments, approximately 7.3 million shares of our common stock at an initial strike price equal to the initial conversion price of the convertible senior notes due 2014. Separately, but also concurrently with the pricing of the convertible senior notes due 2014 and the exercise of the over-allotment option, we entered into warrant transactions whereby we sold warrants to acquire, subject to customary anti-dilution adjustments, up to approximately 7.3 million shares of our common stock at an initial strike price of approximately \$70.54. The cost of the convertible note hedges, reduced by the proceeds to us from the sale of the convertible note warrants, was approximately \$50.7 million. They are being accounted for as equity instruments and are included in additional paid-in capital in the unaudited condensed consolidated balance sheet at September 30, 2009.

Concurrently with the pricing of the convertible senior notes due 2014, we also entered into prepaid forward transactions under which we purchased 1,857,400 shares of our common stock for approximately \$74.9 million with proceeds from the offering. The shares are to be delivered over a settlement period in 2014. The shares purchased under the prepaid forward transactions were accounted for as a repurchase of common stock and a reduction of stockholders' equity.

See Note 7, *Debt*, of our unaudited condensed consolidated financial statements for additional information.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. Our primary market risks include off-balance sheet risk, interest rate risk, credit risk, foreign currency exchange rate risk and redemption reward risk.

There has been no material change from our Annual Report on Form 10-K for the year ended December 31, 2008 related to our exposure to market risk from off-balance sheet risk, credit risk, and redemption reward risk. We are presenting interest rate risk to reflect the changes since December 31, 2008 in both our on- and off-balance sheet borrowing activities and foreign currency exchange rate risk to reflect changes since December 31, 2008 in the Canadian exchange rate.

Table of Contents**Interest Rate Risk**

Interest rate risk affects us directly in our lending and borrowing activities. Our total interest expense incurred was approximately \$227.7 million for the nine months ended September 30, 2009, which includes both on- and off-balance sheet transactions. Of this total, \$106.6 million of the interest expense for nine months ended September 30, 2009 was attributable to on-balance sheet indebtedness and the remainder was attributable to our securitized credit card receivables, which are financed off-balance sheet. To manage our risk from market interest rates, we actively monitor the interest rates and the interest sensitive components both on- and off-balance sheet to minimize the impact that changes in interest rates have on the fair value of assets, net income and cash flow. To achieve this objective, we manage our exposure to fluctuations in market interest rates by matching asset and liability repricings and through the use of fixed-rate debt instruments to the extent that reasonably favorable rates are obtainable with such arrangements. In addition, we enter into derivative financial instruments such as interest rate swaps and treasury locks to mitigate our interest rate risk on a related financial instrument or to lock the interest rate on a portion of our variable debt. We do not enter into derivative or interest rate transactions for trading or other speculative purposes. At September 30, 2009, we had \$6.6 billion of debt, including \$3.6 billion of off-balance sheet debt from our securitization programs.

	As of September 30, 2009		
	Fixed Rate	Variable Rate	Total
	(In millions)		
Off-balance sheet	\$ 3,026.0	\$ 553.8	\$ 3,579.8
On-balance sheet	1,125.9	1,865.9	2,991.8
Total	\$ 4,151.9	\$ 2,419.7	\$ 6,571.6

At September 30, 2009, our fixed rate off-balance sheet debt was locked at a current effective interest rate of 3.4% through interest rate swap agreements.

At September 30, 2009, our fixed rate on-balance sheet debt was subject to fixed rates with a weighted-average interest rate of 9.8%.

The approach we use to quantify interest rate risk is a sensitivity analysis which we believe best reflects the risk inherent in our business. This approach calculates the impact on pre-tax income from an instantaneous and sustained increase in interest rates of 1.0%. For the nine months ended September 30, 2009, a 1.0% increase in interest rates would have resulted in a decrease to fiscal year pre-tax income of approximately \$22.7 million. Conversely, a corresponding decrease in interest rates would have resulted in a comparable increase to pre-tax income. Our use of this methodology to quantify the market risk of financial instruments should not be construed as an endorsement of its accuracy or the appropriateness of the related assumptions. The foregoing sensitivity analysis is limited to the potential impact of an interest rate increase of 1.0% on cash flows and fair values, and does not address default or credit risk.

Foreign Currency Exchange Rate Risk

We are exposed to fluctuations in the exchange rate between the U.S. and the Canadian dollars through our significant Canadian operations. We do not hedge any of our net investment exposure in our Canadian subsidiary. A 10% increase in the Canadian exchange rate would have resulted in an increase in pre-tax income of \$11.6 million for the nine months ended September 30, 2009. Conversely, a corresponding decrease in the exchange rate would result in a comparable decrease to pre-tax income.

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Item 4. Controls and Procedures. Evaluation

As of September 30, 2009, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Interim Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Interim Chief Financial Officer concluded that as of September 30, 2009 (the end of our third fiscal quarter), our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and include controls and procedures designed to ensure that information we are required to disclose in such reports is accumulated and communicated to management, including our Chief Executive Officer and Interim Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

During the third quarter of 2009, we outsourced the majority of our corporate information technology services to Fujitsu America, Inc. There have been no other changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

FORWARD-LOOKING STATEMENTS

This Form 10-Q and the documents incorporated by reference herein contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may use words such as anticipate, believe, estimate, expect, intend, predict, project and similar expressions as they relate to us or our management. When we make forward-looking statements, we are basing them on our management's beliefs and assumptions, using information currently available to us. Although we believe that the expectations reflected in the forward-looking statements are reasonable, these forward-looking statements are subject to risks, uncertainties and assumptions, including those discussed in the "Risk Factors" section in our Annual Report on Form 10-K for the year ended December 31, 2008 and Item 1A of this Quarterly Report.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary materially from what we projected. Any forward-looking statements contained in this quarterly report reflect our current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. We have no intention, and disclaim any obligation, to update or revise any forward-looking statements, whether as a result of new information, future results or otherwise.

Table of Contents**PART II****Item 1. Legal Proceedings.**

From time to time we are involved in various claims and lawsuits arising in the ordinary course of our business that we believe will not have a material adverse affect on our business or financial condition, including claims and lawsuits alleging breaches of our contractual obligations.

Item 1A. Risk Factors.

Other than as set forth below, there have been no material changes to the Risk Factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008 or our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2009 or June 30, 2009.

Interest rate increases could significantly reduce the amount we realize from the spread between the yield on our assets and our cost of funding.

Interest Rate Risk. Interest rate risk affects us directly in our lending and borrowing activities. Our total interest incurred was approximately \$227.7 million through September 30, 2009, which includes both on- and off-balance sheet transactions. Of this total, \$106.6 million of the interest expense for nine months ended September 30, 2009 was attributable to on-balance sheet indebtedness and the remainder was attributable to our securitized credit card receivables, which are financed off-balance sheet. To manage our risk from market interest rates, we actively monitor the interest rates and the interest sensitive components both on- and off-balance sheet to minimize the impact that changes in interest rates have on the fair value of assets, net income and cash flow. To achieve this objective, we manage our exposure to fluctuations in market interest rates by matching asset and liability repricings and through the use of fixed-rate debt instruments to the extent that reasonably favorable rates are obtainable with such arrangements. In addition, we enter into derivative financial instruments such as interest rate swaps and treasury locks to mitigate our interest rate risk on a related financial instrument or to lock the interest rate on a portion of our variable debt. We do not enter into derivative or interest rate transactions for trading or other speculative purposes. At September 30, 2009, we had \$6.6 billion of debt, including \$3.6 billion of off-balance sheet debt from our securitization programs.

	Fixed Rate	As of September 30, 2009 Variable Rate (In millions)	Total
Off-balance sheet	\$ 3,026.0	\$ 553.8	\$ 3,579.8
On-balance sheet	1,125.9	1,865.9	2,991.8
Total	\$ 4,151.9	\$ 2,419.7	\$ 6,571.6

At September 30, 2009, our fixed rate off-balance sheet debt was locked at a current effective interest rate of 3.4% through interest rate swap agreements.

At September 30, 2009, our fixed rate on-balance sheet debt was subject to fixed rates with a weighted-average interest rate of 9.8%.

The approach we use to quantify interest rate risk is a sensitivity analysis which we believe best reflects the risk inherent in our business. This approach calculates the impact on pre-tax income from an instantaneous and sustained increase in interest rates of 1.0%. For the nine months ended September 30, 2009, a 1.0% increase in interest rates would have resulted in a decrease to fiscal year pre-tax income of approximately \$22.7 million. Conversely, a corresponding decrease in interest rates would have resulted in a comparable increase to pre-tax income. Our use of this methodology to quantify the market risk of financial instruments should not be construed as an endorsement of its accuracy or the appropriateness of the related assumptions. The foregoing sensitivity analysis is limited to the potential impact of an interest rate increase of 1.0% on cash flows and fair values, and does not address default or credit risk.

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As a result of our significant Canadian operations, our reported financial information will be affected by fluctuations in the exchange rate between the U.S. and Canadian dollars.

Foreign Currency Exchange Rate Risk. We are exposed to fluctuations in the exchange rate between the U.S. and the Canadian dollars through our significant Canadian operations. We do not hedge any of our net investment exposure in our Canadian subsidiary. A 10% increase in the Canadian exchange rate would have resulted in an increase in pre-tax income of \$11.6 million for the nine months ended September 30, 2009. Conversely, a corresponding decrease in the exchange rate would result in a comparable decrease to pre-tax income.

Newly issued accounting standards could have a significant impact on the Company, the WFN Trusts, the WFC Trust or our bank subsidiaries.

On June 12, 2009, the FASB issued guidance related to accounting for transfers of financial assets and the consolidation of variable interest entities. The new accounting standards are effective for annual periods beginning after November 15, 2009, with earlier application prohibited.

Currently, significant portions of the credit card receivables originated by World Financial Network National Bank (WFNNB) or World Financial Capital Bank (WFCB) and ultimately sold to the WFN Trusts or the WFC Trust, which are Qualifying Special Purpose Entities (QSPEs), as part of our securitization program are exempt from consolidation on the balance sheet of WFNNB, WFCB or any of their affiliates, including us.

The new guidance amends the accounting for transfers of financial assets to QSPEs and thus will impact the accounting for our securitization program. Furthermore, under the new guidance, the WFN Trusts and the WFC Trust will no longer be exempt from consolidation. This new guidance requires an initial evaluation as well as an ongoing assessment of our involvement with the operations of the WFN Trusts and the WFC Trust and our rights or obligations to receive benefits or absorb losses of these securitization trusts that could be potentially significant in order to determine whether those entities will be required to be consolidated on the balance sheet of WFNNB, WFCB or their affiliates, including us. The assessment under this guidance is expected to result in the consolidation of the securitization trusts on the balance sheet of WFNNB, WFCB or their affiliates, including us beginning January 1, 2010.

Consolidation of the securitization trusts will have a significant impact on our consolidated financial statements. With the addition of the securitized credit card receivables to their balance sheets resulting from the accounting change, under existing regulatory capital requirements, WFNNB and WFCB s required capital may increase. In addition, if WFNNB or WFCB were to fall below the well-capitalized levels, it may have an adverse impact on their liquidity and cost of funds, as well as limiting their ability to issue brokered deposits. Covenants in our credit facilities and senior note purchase agreement also require that we cause our bank subsidiaries to be classified as well-capitalized at all times. It is not clear at this time how the new accounting will be implemented, how regulatory authorities will respond or how our bank subsidiaries or we will be affected. It is possible that the implementation of these new accounting standards will have an adverse impact on WFNNB, WFCB or their affiliates, including us.

Our bank subsidiaries are subject to extensive federal regulation that may require us to make capital contributions to them, and that may restrict the ability of these subsidiaries to make cash available to us.

Federal and state laws and regulations extensively regulate the operations of our credit card services bank subsidiary, WFNNB, as well as our industrial bank, WFCB. Many of these laws and regulations are intended to maintain the safety and soundness of WFNNB and WFCB, and they impose significant restraints on them to which other non-regulated entities are not subject. As a national bank, WFNNB is subject to overlapping supervision by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the

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Currency, or the OCC, and the Federal Deposit Insurance Corporation, or the FDIC. As an industrial bank, WFCB is subject to overlapping supervision by the FDIC and the State of Utah. WFNNB and WFCB must maintain minimum amounts of regulatory capital. If WFNNB and WFCB do not meet these capital requirements, their respective regulators have broad discretion to institute a number of corrective actions that could have a direct material effect on our financial statements. WFCB, as an institution insured by the FDIC, must maintain certain capital ratios, paid-in capital minimums and adequate allowances for loan losses. WFNNB must meet specific guidelines that involve measures and ratios of its assets, liabilities, regulatory capital, interest rate exposure and certain off-balance sheet items under regulatory accounting standards, among other factors. As part of a portfolio acquisition in 2003 by WFNNB, which required approval by the OCC, the OCC required WFNNB to enter into an operating agreement with it (the 2003 Operating Agreement) and a capital adequacy and liquidity maintenance agreement with us (the 2003 CALMA). The 2003 Operating Agreement required WFNNB to continue to operate in a manner consistent with its current practices, regulatory guidelines and applicable law, including those related to affiliate transactions, maintenance of capital and corporate governance. On August 14, 2009, we entered into a revised operating agreement with WFNNB and the OCC (the 2009 Operating Agreement), which required us to enter into both a new capital adequacy and liquidity maintenance agreement (the 2009 CALMA) and a capital and liquidity support agreement (the 2009 CALSA) with WFNNB. The 2009 Operating Agreement has not required any changes in WFNNB's operations. The 2009 CALMA and 2009 CALSA memorialize our current obligations to ensure that WFNNB remains in compliance with its minimum capital requirements. If either WFNNB or WFCB were to fail to meet any of the capital requirements to which it is subject, we may be required to provide them with additional capital, which could impair our ability to service our indebtedness.

Before WFNNB can pay dividends to us, it must obtain prior regulatory approval if all dividends declared in any calendar year would exceed its net profits for that year plus its retained net profits for the preceding two calendar years, less any transfers to surplus. In addition, WFNNB may pay dividends only to the extent that retained net profits, including the portion transferred to surplus, exceed bad debts. Moreover, to pay any dividend, WFNNB must maintain adequate capital above regulatory guidelines. Further, if a regulatory authority believes that WFNNB is engaged in or is about to engage in an unsafe or unsound banking practice, which, depending on its financial condition, could include the payment of dividends, that regulatory authority may require, after notice and hearing, that WFNNB cease and desist from the unsafe practice. To pay any dividend, WFCB must also maintain adequate capital above regulatory guidelines. Accordingly, neither WFNNB nor WFCB may be able to make any of its cash or other assets available to us, including servicing our indebtedness.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

On July 30, 2008, we announced that our Board of Directors authorized a stock repurchase program to acquire up to an additional \$1.3 billion of our outstanding common stock through December 2009, subject to any restrictions pursuant to the terms of our credit agreements or otherwise.

The following table presents information with respect to those purchases of our common stock made during the three months ended September 30, 2009.

Period	Total Number of Shares Purchased ⁽¹⁾	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs ⁽²⁾ (In millions)
During 2009:				
July 1-31	591,659	\$ 43.76	589,927	\$ 380.3
August 1-31	1,073,814	56.53	1,072,100	319.7
September 1-30	278,812	59.79	277,170	303.2
Total	1,944,285	\$ 53.11	1,939,197	\$ 303.2

⁽¹⁾ During the period represented by the table, the administrator of our 401(k) and Retirement Saving Plan purchased 5,088 shares of our common stock for the benefit of the employees who participated in that portion of the plan. In June 2009, under the terms of prepaid forward contracts, we purchased 1,857,400 shares of our common stock to be delivered over a settlement period in 2014, for approximately \$74.9 million. See Note 7, Debt, of our unaudited condensed consolidated financial statements for additional information.

⁽²⁾ On July 30, 2008, we announced that our Board of Directors authorized a stock repurchase program to acquire up to an additional \$1.3 billion of our outstanding common stock through December 31, 2009, subject to any restrictions pursuant to the terms of our credit agreements or otherwise.

Item 3. Defaults Upon Senior Securities.

None

Item 4. Submission of Matters to a Vote of Security Holders.

None

Item 5. Other Information.

(a) None

(b) None

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Item 6. Exhibits.

(a) Exhibits:

EXHIBIT INDEX

Exhibit No.	Description
3.1	Second Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit No. 3.1 to our Registration Statement on Form S-1 filed with the SEC on March 3, 2000, File No. 333-94623).
3.2	Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.2 to our Registration Statement on Form S-1 filed with the SEC on March 3, 2000, File No. 333-94623).
3.3	First Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.3 to our Registration Statement on Form S-1 filed with the SEC on May 4, 2001, File No. 333-94623).
3.4	Second Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.4 to our Annual Report on Form 10-K, filed with the SEC on April 1, 2002, File No. 001-15749).
3.5	Third Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.2 to our Current Report on Form 8-K, filed with the SEC on February 18, 2009, File No. 001-15749).
4	Specimen Certificate for shares of Common Stock of the Registrant (incorporated by reference to Exhibit No. 4 to our Quarterly Report on Form 10-Q, filed with the SEC on August 8, 2003, File No. 001-15749).
+10.1	Separation Agreement and General Release of Claims by and between Dwayne Tucker and ADS Alliance Data Systems, Inc. (incorporated by reference to Exhibit No. 10.1 to our Current Report on Form 8-K, filed with the SEC on August 18, 2009, File No. 001-15749).
10.2	Capital Assurance and Liquidity Maintenance Agreement, dated as of August 14, 2009, by and between World Financial Network National Bank and Alliance Data Systems Corporation (incorporated by reference to Exhibit No. 10.1 to our Current Report on Form 8-K, filed with the SEC on September 17, 2009, File No. 001-15749).
10.3	Capital and Liquidity Support Agreement, dated as of August 14, 2009, by and among the Office of the Comptroller of the Currency, World Financial Network National Bank and Alliance Data Systems Corporation (incorporated by reference to Exhibit No. 10.2 to our Current Report on Form 8-K, filed with the SEC on September 17, 2009, File No. 001-15749).
10.4	Series 2009-B Indenture Supplement, dated as of August 13, 2009 (incorporated by reference to Exhibit No. 4.1 to the Current Report on Form 8-K filed by World Financial Network Credit Card Master Note Trust and WFN Credit Company, LLC with the SEC on August 17, 2009, File Nos. 333-113669 and 333-60418).
10.5	Series 2009-C Indenture Supplement, dated as of August 13, 2009 (incorporated by reference to Exhibit No. 4.2 to the Current Report on Form 8-K filed by World Financial Network Credit Card Master Note Trust and WFN Credit Company, LLC with the SEC on August 17, 2009, File Nos. 333-113669 and 333-60418).
10.6	Series 2009-D Indenture Supplement, dated as of August 13, 2009 (incorporated by reference to Exhibit No. 4.3 to the Current Report on Form 8-K filed by World Financial Network Credit Card Master Note Trust and WFN Credit Company, LLC with the SEC on August 17, 2009, File Nos. 333-113669 and 333-60418).

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Exhibit No.	Description
10.7	Third Amended and Restated Service Agreement, dated as of May 15, 2008, between World Financial Network National Bank and ADS Alliance Data Systems, Inc. (incorporated by reference to Exhibit No. 99.1 to the Current Report on Form 8-K filed by World Financial Network Credit Card Master Note Trust and WFN Credit Company, LLC with the SEC on August 17, 2009, File Nos. 333-113669 and 333-60418).
+*10.8	Amendment Number One to Alliance Data Systems Corporation 2005 Long Term Incentive Plan, dated as of September 24, 2009
*31.1	Certification of Chief Executive Officer of Alliance Data Systems Corporation pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
*31.2	Certification of Chief Financial Officer of Alliance Data Systems Corporation pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
*32.1	Certification of Chief Executive Officer of Alliance Data Systems Corporation pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code.
*32.2	Certification of Chief Financial Officer of Alliance Data Systems Corporation pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code.

* Filed herewith

+ Management contract, compensatory plan or arrangement

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SIGNATURES

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

ALLIANCE DATA SYSTEMS CORPORATION

By: /s/ EDWARD J. HEFFERNAN
Edward J. Heffernan
President and Chief Executive Officer

Date: November 9, 2009

By: /s/ MICHAEL D. KUBIC
Michael D. Kubic
*Senior Vice President, Interim Chief Financial Officer,
Corporate Controller, and Chief Accounting Officer
(Principal Financial and Accounting Officer)*

Date: November 9, 2009

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Exhibit No.	Description
3.1	Second Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit No. 3.1 to our Registration Statement on Form S-1 filed with the SEC on March 3, 2000, File No. 333-94623).
3.2	Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.2 to our Registration Statement on Form S-1 filed with the SEC on March 3, 2000, File No. 333-94623).
3.3	First Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.3 to our Registration Statement on Form S-1 filed with the SEC on May 4, 2001, File No. 333-94623).
3.4	Second Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.4 to our Annual Report on Form 10-K, filed with the SEC on April 1, 2002, File No. 001-15749).
3.5	Third Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.2 to our Current Report on Form 8-K, filed with the SEC on February 18, 2009, File No. 001-15749).
4	Specimen Certificate for shares of Common Stock of the Registrant (incorporated by reference to Exhibit No. 4 to our Quarterly Report on Form 10-Q, filed with the SEC on August 8, 2003, File No. 001-15749).
+10.1	Separation Agreement and General Release of Claims by and between Dwayne Tucker and ADS Alliance Data Systems, Inc. (incorporated by reference to Exhibit No. 10.1 to our Current Report on Form 8-K, filed with the SEC on August 18, 2009, File No. 001-15749).
10.2	Capital Assurance and Liquidity Maintenance Agreement, dated as of August 14, 2009, by and between World Financial Network National Bank and Alliance Data Systems Corporation (incorporated by reference to Exhibit No. 10.1 to our Current Report on Form 8-K, filed with the SEC on September 17, 2009, File No. 001-15749).
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*	Filed herewith
+	Management contract, compensatory plan or arrangement