

HEARTLAND PAYMENT SYSTEMS INC

Form 10-Q

November 08, 2010

[Table of Contents](#)

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, 2010

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 No. 001-32594

HEARTLAND PAYMENT SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of

22-3755714
(I.R.S. Employer

incorporation or organization)

Identification Number)

90 Nassau Street, Princeton, New Jersey 08542

(Address of principal executive offices) (Zip Code)

(609) 683-3831

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the 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 Exchange Act). YES NO

As of November 2, 2010, there were 38,224,575 shares of the registrant's Common Stock, \$0.001 par value, outstanding.

Table of Contents

INDEX

	Page
<u>PART I. CONDENSED FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	
<u>Consolidated Balance Sheets as of September 30, 2010 and December 31, 2009</u>	1
<u>Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and nine months ended September 30, 2010 and 2009</u>	2
<u>Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2010 and 2009</u>	3
<u>Consolidated Statements of Cash Flow for the nine months ended September 30, 2010 and 2009</u>	4
<u>Notes to Consolidated Financial Statements</u>	5
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	56
Item 4. <u>Controls and Procedures</u>	57
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	57
Item 1A. <u>Risk Factors</u>	63
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	63
Item 3. <u>Defaults Upon Senior Securities</u>	63
Item 4. <u>(Removed and Reserved)</u>	63
Item 5. <u>Other Information</u>	63
Item 6. <u>Exhibits</u>	64

Table of Contents**PART I. CONDENSED FINANCIAL INFORMATION****Item 1. Financial Statements****Heartland Payment Systems, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets****(In thousands, except share data)****(unaudited)**

	September 30, 2010	December 31, 2009
Assets		
Current assets:		
Cash	\$ 45,512	\$ 32,113
Funds held for payroll customers	24,660	29,667
Receivables, net	171,893	149,403
Investments held to maturity	1,558	1,450
Inventory	11,350	12,381
Prepaid expenses	5,635	8,874
Current tax asset	23,156	16,266
Current deferred tax assets, net	7,275	42,760
Total current assets	291,039	292,914
Capitalized customer acquisition costs, net	60,450	72,038
Property and equipment, net	101,004	99,989
Goodwill	62,126	60,962
Intangible assets, net	30,785	34,637
Deposits and other assets, net	523	1,666
Total assets	\$ 545,927	\$ 562,206
Liabilities and stockholders equity		
Current liabilities:		
Due to sponsor banks	\$ 81,628	\$ 80,007
Accounts payable	38,753	32,305
Deposits held for payroll customers	24,660	29,667
Current portion of borrowings	111,469	58,547
Current portion of accrued buyout liability	5,854	9,306
Merchant deposits and loss reserves	37,848	27,214
Accrued expenses and other liabilities	27,650	30,456
Reserve for processing system intrusion	1,618	99,911
Total current liabilities	329,480	367,413
Deferred tax liabilities, net	22,162	21,448
Reserve for unrecognized tax benefits	1,542	1,391
Long-term portion of borrowings	2,083	8,419
Long-term portion of accrued buyout liability	23,415	33,580

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Total liabilities	378,682	432,251
Commitments and contingencies (Note 12)		
Equity		
Common Stock, \$0.001 par value, 100,000,000 shares authorized, 38,213,645 and 37,524,298 shares issued and outstanding at September 30, 2010 and December 31, 2009	38	38
Additional paid-in capital	181,940	171,736
Accumulated other comprehensive loss	(308)	(546)
Accumulated deficit	(14,722)	(41,487)
Total stockholders' equity	166,948	129,741
Noncontrolling interests	297	214
Total equity	167,245	129,955
Total liabilities and equity	\$ 545,927	\$ 562,206

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)**

(In thousands, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Total Revenues	\$ 499,074	\$ 442,568	\$ 1,386,111	\$ 1,232,113
Costs of Services:				
Interchange	350,964	305,059	962,749	853,666
Dues, assessments and fees	32,688	27,527	88,962	63,393
Processing and servicing	59,282	50,356	175,622	148,278
Customer acquisition costs	12,573	13,147	38,758	38,479
Depreciation and amortization	3,890	4,006	11,400	11,614
Total costs of services	459,397	400,095	1,277,491	1,115,430
General and administrative	25,479	27,784	76,673	77,247
Total expenses	484,876	427,879	1,354,164	1,192,677
Income from operations	14,198	14,689	31,947	39,436
Other income (expense):				
Interest income	43	29	111	86
Interest expense	(1,240)	(782)	(3,511)	(1,868)
(Provision for) recovery of processing system intrusion costs	(740)	(73,322)	14,770	(105,292)
Other, net	2		2,022	4
Total other income (expense)	(1,935)	(74,075)	13,392	(107,070)
Income (loss) before income taxes	12,263	(59,386)	45,339	(67,634)
Provision for (benefit from) income taxes	4,694	(22,314)	17,352	(25,484)
Net income (loss)	7,569	(37,072)	27,987	(42,150)
Less: Net income attributable to noncontrolling interests	36	24	83	16
Net income (loss) attributable to Heartland	\$ 7,533	\$ (37,096)	\$ 27,904	\$ (42,166)
Net income (loss)	\$ 7,569	\$ (37,072)	\$ 27,987	\$ (42,150)
Other comprehensive income:				
Unrealized gains on investments, net of income tax of \$13, \$16, \$37 and \$24	23	27	60	40
Foreign currency translation adjustment	331	782	178	1,251
Comprehensive income (loss)	7,923	(36,263)	28,225	(40,859)

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Less: Net income attributable to noncontrolling interests	36	24	83	16
Comprehensive income (loss) attributable to Heartland	\$ 7,887	\$ (36,287)	\$ 28,142	\$ (40,875)
Earnings (loss) per common share:				
Basic	\$ 0.20	\$ (0.99)	\$ 0.74	\$ (1.12)
Diluted	\$ 0.19	\$ (0.99)	\$ 0.71	\$ (1.12)
Weighted average number of common shares outstanding:				
Basic	38,130	37,461	37,899	37,484
Diluted	39,444	38,129	39,263	37,896

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Condensed Consolidated Statements of Stockholders' Equity**

(In thousands)

(unaudited)

	Common Stock		Heartland Stockholders' Equity					Total Equity
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	(Accumulated Deficit) Retained Earnings	Treasury Stock	Noncontrolling Minority Interests	
Nine Months Ended								
September 30, 2009:								
Balance, January 1, 2009	37,676	\$ 38	\$ 167,337	\$ (2,145)	\$ 14,014	\$	\$ 119	\$ 179,363
Issuance of Common Stock options exercised	137		548					548
Excess tax benefit on stock options exercised			325					325
Repurchase of Common Stock	(350)					(3,202)		(3,202)
Retirement of Treasury Stock			(1,556)		(1,646)	3,202		
Stock-based compensation			2,811					2,811
Accumulated other comprehensive income (loss):								
Unrealized gain on available for sale investments				40				40
Foreign currency translation adjustment				1,251			29	1,280
Dividends on Common Stock					(1,685)			(1,685)
Net (loss) for the period					(42,166)		16	(42,150)
Balance September 30, 2009	37,463	\$ 38	\$ 169,465	\$ (854)	\$ (31,483)	\$	\$ 164	\$ 137,330
Nine months Ended								
September 30, 2010:								
Balance, January 1, 2010	37,524	\$ 38	\$ 171,736	\$ (546)	\$ (41,487)	\$	\$ 214	\$ 129,955
Issuance of Common Stock options exercised	636		4,713					4,713
Issuance of Common Stock RSU's Vested	53		(522)					(522)
Excess tax benefit on stock options exercised			1,555					1,555
Stock-based compensation			4,458					4,458
Accumulated other comprehensive income (loss):								
Unrealized gain on available for sale investments				60				60
Foreign currency translation adjustment				178				178
Dividends on Common Stock					(1,139)			(1,139)
Net income for the period					27,904		83	27,987

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Balance September 30, 2010	38,213	\$ 38	\$ 181,940	\$	(308)	\$ (14,722)	\$	\$ 297	\$ 167,245
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See accompanying notes to condensed consolidated financial statements.

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Condensed Consolidated Statements of Cash Flow****(In thousands)****(unaudited)**

	Nine Months Ended September 30,	
	2010	2009
Cash flows from operating activities		
Net income (loss) attributable to Heartland	\$ 27,904	\$ (42,166)
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of capitalized customer acquisition costs	40,944	42,663
Other depreciation and amortization	19,141	15,823
Addition to loss reserves	7,880	4,375
Provision for doubtful receivables	773	624
Stock-based compensation	4,458	2,811
Deferred taxes	36,157	(18,095)
Net income attributable to noncontrolling interests	83	16
Other	194	6
Changes in operating assets and liabilities:		
Increase in receivables	(23,256)	(9,513)
Decrease (increase) in inventory	1,033	(105)
Payment of signing bonuses, net	(17,956)	(25,504)
Increase in capitalized customer acquisition costs	(11,400)	(12,569)
Decrease in prepaid expenses	3,241	1,070
Increase in current tax asset	(5,336)	(11,951)
Decrease (increase) in deposits and other assets	1,112	(1,142)
Excess tax benefits on options exercised	(1,555)	(325)
Increase (decrease) in reserve for unrecognized tax benefits	151	(452)
Increase in due to sponsor bank	1,622	13,944
Increase in accounts payable	5,423	1,375
Decrease in accrued expenses and other liabilities	(3,334)	(1,490)
Increase in merchant deposits and loss reserves	2,754	13,974
(Decrease) increase in reserve for processing system intrusion	(98,293)	82,911
Payouts of accrued buyout liability	(22,831)	(6,319)
Increase in accrued buyout liability	9,214	8,385
Net cash (used in) provided by operating activities	(21,877)	58,346
Cash flows from investing activities		
Purchase of investments held to maturity	(1,425)	(1,076)
Maturities of investments held to maturity	1,321	1,208
Decrease in funds held for payroll customers	5,103	5,232
Decrease in deposits held for payroll customers	(5,007)	(5,166)
Proceeds from disposal of property and equipment		33
Acquisition of business	(108)	(3,193)
Purchases of property and equipment	(16,367)	(33,585)
Net cash used in investing activities	(16,483)	(36,547)

Cash flows from financing activities			
Proceeds from borrowings		53,000	
Principal payments on borrowings		(6,414)	(6,403)
Proceeds from exercise of stock options		4,713	548
Excess tax benefits on options exercised		1,555	325
Repurchase of common stock			(3,202)
Dividends paid on common stock		(1,139)	(1,685)
Net cash provided by (used in) financing activities		51,715	(10,417)
Net increase in cash		13,355	11,382
Effect of exchange rates on cash		44	57
Cash at beginning of year		32,113	27,589
Cash at end of period		\$ 45,512	\$ 39,028
Supplemental cash flow information:			
Cash paid (received) during the period for:			
Interest		\$ 3,187	\$ 1,844
Income taxes		(13,620)	5,131

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

1. Organization and Operations

Basis of Financial Statement Presentation The accompanying consolidated financial statements include those of Heartland Payment Systems, Inc. (the Company, we, us, or our) and its wholly-owned subsidiaries, Heartland Payroll Company (HPC), Debittek, Inc. (Debittek) and Heartland Acquisition LLC (Network Services), and its 70% owned subsidiary Collective POS Solutions Ltd. (CPOS). The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All intercompany balances and transactions with the Company's subsidiaries have been eliminated upon consolidation.

The accompanying condensed consolidated financial statements are unaudited. In the opinion of the Company's management, the unaudited condensed consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of the Company's financial position at September 30, 2010, its results of operations, changes in stockholders' equity and cash flows for the nine months ended September 30, 2010 and 2009. Results of operations reported for interim periods are not necessarily indicative of the results to be expected for the year ending December 31, 2010. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2009. The December 31, 2009 condensed consolidated balance sheet was derived from the audited 2009 consolidated financial statements.

Business Description The Company's principal business is to provide payment processing services related to bankcard transactions for merchants throughout the United States and Canada. In addition, the Company provides certain other merchant services, including check processing, the sale and rental of terminal equipment, gift and loyalty card processing, and the sale of terminal supplies. HPC provides payroll and related tax filing services throughout the United States. Debittek provides prepaid card and stored-value card solutions throughout the United States. The Company and Debittek also provide campus payment solutions throughout the United States. CPOS is a Canadian provider of payment processing services and secure point-of-sale solutions.

Over 90% of the Company's revenue is derived from processing and settling Visa and MasterCard bankcard transactions for its merchant customers. Because the Company is not a member bank as defined by Visa and MasterCard, in order to process and settle these bankcard transactions for its merchants, the Company has entered into sponsorship agreements with member banks. Visa and MasterCard rules restrict the Company from performing funds settlement or accessing merchant settlement funds and require that these funds be in the possession of the member bank until the merchant is funded. A sponsorship agreement permits the Company to route Visa and MasterCard bankcard transactions under the member bank's control and identification numbers to clear credit bankcard transactions through Visa and MasterCard. A sponsorship agreement also enables the Company to settle funds between cardholders and merchants by delivering funding files to the member bank, which in turn transfers settlement funds to the merchants' bank accounts. These restrictions place the settlement assets and obligations under the control of the member bank.

The sponsorship agreements with the member banks require, among other things, that the Company abide by the by-laws and regulations of the Visa and MasterCard networks, and certain of the bank sponsors require a certificate of deposit or a cash balance in a deposit account. If the Company breaches a sponsorship agreement, the bank sponsor may terminate the agreement and, under the terms of the agreement, the Company would have 180 days to identify an alternative bank sponsor. The Company is dependent on its bank sponsors, Visa and MasterCard for notification of any compliance breaches. As of September 30, 2010, the Company has not been notified of any such issues by its bank sponsors, Visa or MasterCard.

The Company is currently party to three bank sponsorship agreements. The Company entered into a sponsorship agreement with KeyBank, National Association on April 1, 1999 and the agreement expires in March 2012. In 2007, the Company entered into a sponsor bank agreement with Heartland Bank (an unrelated third party), which is based in Saint Louis, Missouri. Our agreement with Heartland Bank

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)**

involves substantially the same terms as apply with KeyBank and it has been renewed through September 2013. The acquisition of Network Services in May 2008 resulted in the addition of World Financial Network National Bank as the sponsor bank for Network Services' large national merchant processing contracts. In August 2008, the Company entered into a sponsorship agreement with SunTrust Bank to replace World Financial Network National Bank as its sponsor bank for Network Services' large national merchant processing portfolio and that portfolio was transferred from World Financial Network National Bank to SunTrust Bank in February 2009. In August 2009, SunTrust Bank provided twelve months' notice to the Company of its intent to withdraw its sponsorship of the Company's large national merchants processing portfolio. In November 2009, the Company entered into a sponsorship agreement with The Bancorp Bank and transferred the sponsorship of its large national merchants from SunTrust Bank to the Bancorp Bank in February 2010. The agreement with The Bancorp Bank expires in November 2014.

Following is a breakout of the Company's total Visa and MasterCard settled bankcard processing volume for the month of September 2010 by percentage processed under its individual bank sponsorship agreements:

Sponsor Bank	% of September 2010 Bankcard Processing Volume
KeyBank, National Association	71.1%
Heartland Bank	14.0%
The Bancorp Bank	14.9%

Processing System Intrusion On January 20, 2009, the Company publicly announced the discovery of a criminal breach of its payment systems environment (the Processing System Intrusion). The Processing System Intrusion involved malicious software that appears to have been used to collect in-transit, unencrypted payment card data while it was being processed by the Company during the trans-action authorization process. The Company believes the breach has been contained and did not extend beyond 2008. See Note 3, Processing System Intrusion for further detail and related events.

Working Capital Our working capital, defined as current assets less current liabilities, was negative by \$38.4 million at September 30, 2010 primarily due to the following: (i) our Revolving Credit Facility, which expires on September 4, 2012, with \$75.0 million in borrowings classified as a current liability and (ii) our \$28.0 million Bridge Loan, which is due on February 17, 2011. See Note 10, Credit Facilities for discussion of Revolving Credit Facility and the Bridge Loan. Management believes that this working capital deficiency will not cause illiquidity and that we will be able to satisfy our obligations in the normal course because: (i) we expect the \$75.0 million Revolving Credit Facility to be refinanced, and we have the flexibility to defer its repayment until 2012 and (ii) we expect the \$28.0 million Bridge Loan to be refinanced. We cannot offer any assurance that we will be able to refinance the Revolving Credit Facility or the Bridge Loan. See Note 3, Processing System Intrusion for information regarding the settlement and payments of claims during the three and nine months ended September 30, 2010.

2. Summary of Significant Accounting Policies

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates include, among other things, the accrued buyout liability, capitalized customer acquisition costs, goodwill, loss reserves, certain accounts payable and accrued expenses and certain tax assets and liabilities as well as the related valuation allowances, if any. Actual results could differ from those estimates.

Cash and Cash Equivalents At September 30, 2010, cash included approximately \$30.4 million of processing-related cash in transit and collateral, compared to approximately \$25.5 million of processing-related cash in transit and collateral at December 31, 2009.

Table of Contents

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements (Continued)

(unaudited)

Receivables Receivables are stated net of allowance for doubtful accounts. The Company estimates its allowance based on experience with its merchants, customers, and sales force and its judgment as to the likelihood of their ultimate payment. The Company also considers collection experience and makes estimates regarding collectability based on trends in aging. Historically, the Company has not experienced significant charge offs for its merchant receivables.

The Company's primary receivables are from its bankcard processing merchants. These receivables result from the Company's practice of advancing interchange fees to most of its small and mid-sized merchants (referred to as Small and Mid-sized Enterprises, or "SME") during the month and collecting those fees at the beginning of the following month, as well as from transaction fees the Company charges its merchants for processing transactions. The Company does not advance interchange fees to its Network Services merchants.

Generally, the Company uses cash available for investment to fund these advances to SME merchants; when available cash has been expended, the Company directs its sponsor banks to make these advances, thus generating a payable to the sponsor banks. We pay our sponsor banks the prime rate on these payables. At September 30, 2010, the Company used \$23.0 million of its available cash to fund merchant advances and at December 31, 2009, the Company used \$7.0 million of its cash to fund merchant advances. The amount due to sponsor banks for funding advances was \$77.6 million at September 30, 2010 and \$73.2 million at December 31, 2009. The payable to sponsor banks is repaid at the beginning of the following month out of the fees the Company collects from its merchants. Receivables from merchants also include receivables from the sale of point of sale terminal equipment and check processing terminals. Unlike the SME merchants, Network Services' customers are large national accounts which are invoiced monthly, on payment terms that are typical for large national accounts.

Receivables also include amounts resulting from the pre-funding of Discover and American Express transactions to our merchants and are due from the related bankcard networks. These amounts are recovered over the following two business days from the date of processing the transaction.

Receivables also include amounts resulting from the sale, installation, training and repair of payment system hardware and software for prepaid card and stored-value card payment systems and campus payment solutions. These receivables are mostly invoiced on terms of 30 days net from date of invoicing and are typically funded from working capital.

Receivables also include amounts advanced to employees, primarily the Company's sales force, to cover certain expenses. These receivables are recovered from sales and residual commissions earned by the sales force.

Investments and Funds Held for Payroll Customers Investments, including those carried on the Consolidated Balance Sheet as Funds Held for Payroll Customers, consist primarily of fixed income bond funds, corporate debt and equity securities, and certificates of deposit. Funds Held for Payroll Customers also include overnight bank deposits. The majority of investments carried in Funds Held for Payroll Customers are available-for-sale and recorded at fair value based on quoted market prices. Certificates of deposit are classified as held to maturity and recorded at cost. In the event of a sale, cost is determined on a specific identification basis. At September 30, 2010, Funds Held for Payroll Customers included cash and cash equivalents of \$23.2 million and investments available for sale of \$1.5 million.

Capitalized Customer Acquisition Costs, net Capitalized customer acquisition costs consist of (1) up-front signing bonus payments made to Relationship Managers and sales managers (the Company's sales force) for the establishment of new merchant relationships, and (2) a deferred acquisition cost representing the estimated cost of buying out the commissions of vested sales employees. Capitalized customer acquisition costs represent incremental, direct customer acquisition costs that are recoverable through gross margins associated with merchant contracts. The capitalized customer acquisition costs are amortized using a method which approximates a proportional revenue approach over the initial three-year term of the merchant contract.

Table of Contents

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements (Continued)

(unaudited)

The up-front signing bonus is based on the estimated gross margin for the first year of the SME merchant contract. The signing bonus, amount capitalized, and related amortization are adjusted after one year to reflect the actual gross margin generated by the merchant contract during that year. The deferred customer acquisition cost asset is accrued over the first year of merchant processing, consistent with the build-up in the accrued buyout liability, as described below.

Management evaluates the capitalized customer acquisition costs for impairment at each balance sheet date by comparing, on a pooled basis by vintage month of origination, the expected future net cash flows from underlying SME merchant relationships to the carrying amount of the capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the value of the capitalized customer acquisition costs, the impairment loss will be charged to operations. The Company believes that no impairment has occurred as of September 30, 2010 and December 31, 2009.

Merchant Deposits and Loss Reserves The Company maintains merchant deposits to offset potential liabilities from merchant chargeback processing, which is discussed below, as well as deposits representing debit processing and check processing funds in transit. Previously, the debit processing funds in transit were netted against receivables. Disputes between a cardholder and a merchant periodically arise due to the cardholder's dissatisfaction with merchandise quality or the merchant's service, and the disputes may not always be resolved in the merchant's favor. In some of these cases, the transaction is charged back to the merchant and the purchase price is refunded to the cardholder by the credit card-issuing institution. If the merchant is unable to fund the refund, the Company is liable for the full amount of the transaction. The Company's obligation to stand ready to perform is minimal. The Company maintains a deposit or the pledge of a letter of credit from certain merchants as an offset to potential contingent liabilities that are the responsibility of such merchants. The Company evaluates its ultimate risk and records an estimate of potential loss for chargebacks related to merchant fraud based upon an assessment of actual historical fraud loss rates compared to recent bankcard processing volume levels. The Company believes that the liability recorded as loss reserves approximates fair value.

Accrued Buyout Liability The Company's historic focus has been on SME merchants, and it has a sales compensation arrangement in this market that has been essentially unchanged since its inception. Under this approach, Relationship Managers and sales managers are paid residual commissions based on the gross margin generated by monthly SME merchant processing activity. The Company has the right, but is not obligated, to buy out some or all of these commissions, and intends to do so periodically. Such purchases of the commissions are at a fixed multiple of the last twelve months' commissions. Because of the Company's intent and ability to execute purchases of the residual commissions, and the mutual understanding between the Company and the Relationship Managers and sales managers, the Company has accounted for this deferred compensation arrangement pursuant to the substantive nature of the plan. The Company therefore records the amount that it would have to pay (the settlement cost) to buy out non-servicing related commissions in their entirety from vested Relationship Managers and sales managers, and an accrual, based on their progress towards vesting, for those unvested Relationship Managers and sales managers who are expected to vest in the future. As noted above, as the liability increases over the first year of a SME merchant contract, the Company also records a related deferred acquisition cost asset for currently vested Relationship Managers and sales managers. The accrued buyout liability associated with unvested Relationship Managers and sales managers is not included in the deferred acquisition cost asset since future services are required in order to vest. Subsequent changes in the settlement cost, due to account attrition, same-store sales growth and changes in gross margin are included in the same income statement caption as customer acquisition cost amortization expense.

The accrued buyout liability is based on the SME merchants under contract at the balance sheet date, the gross margin generated by those merchants over the prior twelve months, and the contractual buyout multiple. The liability related to a new SME merchant is therefore zero when the merchant is installed, and increases over the twelve months following the installation date. The same procedure is applied to unvested commissions over the expected vesting period, but is further adjusted to reflect the Company's experience that 31% of unvested Relationship Managers and sales managers become vested.

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)**

The classification of the accrued buyout liability between current and non-current liabilities on the Consolidated Balance Sheet is based upon the Company's estimate of the amount of the accrued buyout liability that it reasonably expects to pay over the next twelve months. This estimate is developed by calculating the cumulative annual average percentage that total historical buyout payments represent of the accrued buyout liability. That percentage is applied to the period-end accrued buyout liability to determine the current portion.

Revenue Revenues are mainly comprised of gross processing revenue, payroll processing revenue and equipment-related income. Gross processing revenue primarily consists of discount fees and per-transaction and periodic (primarily monthly) fees from the processing of Visa and MasterCard bankcard transactions for merchants. The Company passes through to its customers any changes in interchange or network fees. Gross processing revenue also includes American Express and Discover fees, customer service fees, fees for processing chargebacks, termination fees on terminated contracts, check processing fees, gift and loyalty card fees and other miscellaneous revenue. Payroll processing revenue includes periodic and annual fees charged by HPC for payroll processing services, and interest earned from investing tax impound funds held for our customers. Revenue is recorded as bankcard and other processing transactions are processed or payroll services are performed.

Equipment-related income includes revenues from the sale, rental and deployment of bankcard and check processing terminals, from the sale of hardware, software and associated services for prepaid card and stored-value card payment systems, and campus payment solutions. Revenues are recorded at the time of shipment, or the provision of service.

Loss Contingencies and Legal Expenses The Company records a liability for loss contingencies when the liability is probable and reasonably estimable. Legal fees associated with loss contingencies are recorded when the legal fees are incurred.

The Company records recoveries from its insurance providers when cash is received from the provider.

Income Taxes The Company accounts for income taxes by recognizing deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statements and the tax basis of assets and liabilities using enacted tax rates.

The provision for/(benefit from) income taxes for the three and nine months ended September 30, 2010 and 2009 and the resulting effective tax rates were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Provision for/(benefit from) income taxes	\$ 4,694	\$ (22,314)	\$ 17,352	\$ (25,484)
Effective tax rate	38.3%	37.6%	38.3%	37.7%

Current Deferred Tax Assets, Net, decreased from \$42.8 million at December 31, 2009 to \$7.3 million at September 30, 2010. The changes in deferred tax assets primarily resulted from the payment of the settlement with the card brands and recoveries from our insurance providers (see Note 3, Processing System Intrusion for more detail).

The Company maintains valuation allowances when it is more likely than not that all or a portion of a deferred tax asset will not be realized. In determining whether a valuation allowance is warranted, the Company evaluates factors such as prior earnings history, expected future earnings, carry back and carry forward periods and tax strategies that could potentially enhance the likelihood of the realization of a deferred tax asset.

Table of Contents

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements (Continued)

(unaudited)

The Company regularly evaluates its tax positions for additional unrecognized tax benefits and associated interest and penalties, if applicable. There are many factors that are considered when evaluating these tax positions including: interpretation of tax laws, recent tax litigation on a position, past audit or examination history, and subjective estimates and assumptions, which have been deemed reasonable by management. However, if management's estimates are not representative of actual outcomes, the Company's results could be materially impacted. The Company does not expect any material changes to unrecognized tax benefits in the next 12 months. At September 30, 2010, the reserve for unrecognized tax benefits related to uncertain tax positions was \$1.5 million, of which \$1.0 million would, if recognized, impact the effective tax rate.

Stock Based Compensation In the second quarter of 2009, the Company's Board of Directors approved grants of 930,000 stock options subject to multiple vesting conditions. Under these stock options, the employee must provide continuous service over four years and a market price condition must be satisfied within those four years. These stock options have a five-year term and could vest in equal amounts in 2010, 2011, 2012 and 2013 only if during the four-year service period, the price of the Company's common stock as reported by the New York Stock Exchange exceeds two or three times the exercise price for 30 consecutive trading days. The grant date fair values of these multiple vesting condition options are recognized as compensation expense over their four-year service periods.

Also in 2009, the Company's Board of Directors approved grants of 362,600 Restricted Share Units. These Restricted Share Units are nonvested share awards which will vest over a four-year service period as employees perform service. The closing price of the Company's common stock on the grant date equals the grant date fair value of these nonvested share awards and will be recognized as compensation expense over their four-year service periods.

Diluted earnings per share for the three and nine months ended September 30, 2010 and 2009 were computed based on the weighted average outstanding common shares plus equivalent shares assuming exercise of stock options, where dilutive. Due to the net loss in 2009, calculating Diluted Earnings Per Share using diluted weighted average shares would be anti-dilutive for 2009 periods. Therefore, weighted average common stock outstanding was used to calculate Diluted Earnings Per Share for 2009.

Foreign Currency The Canadian dollar is the functional currency of CPOS, which operates in Canada. CPOS' revenues and expenses are translated at the average exchange rates prevailing during the period. The foreign currency assets and liabilities of CPOS are translated at the period-end rate of exchange. The resulting translation adjustment is recorded as a component of other comprehensive income and is included in stockholders' equity. At September 30, 2010 and 2009, the cumulative foreign currency translation reflected a loss of \$0.4 million and \$0.9 million, respectively. The Company intends to indefinitely reinvest undistributed earnings of CPOS and has not tax affected the cumulative foreign currency translation gain or loss. Determination of the amount of unrecognized deferred tax liability related to indefinitely reinvested profits is not material.

Noncontrolling Interests Noncontrolling interests represent noncontrolling minority stockholders' share of the equity and after-tax net income or loss of consolidated subsidiaries. Noncontrolling minority stockholders' share of after-tax net income or loss of consolidated subsidiaries is included in Net income attributable to noncontrolling interests in the Consolidated Statement of Operations. The minority stockholders' interests included in Noncontrolling interests in the September 30, 2010 and December 31, 2009 Consolidated Balance Sheet were \$297,000 and \$214,000, respectively, and reflect the original investments by these minority shareholders in the consolidated subsidiaries, along with their proportionate share of the earnings or losses of the subsidiaries.

Subsequent Events The Company evaluated subsequent events with respect to the Consolidated Financial Statements as of and for the nine months ended September 30, 2010.

New Accounting Pronouncements In October 2009, the FASB issued an accounting standard update on multiple deliverable revenue arrangements to establish the accounting for certain revenue

Table of Contents

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements (Continued)

(unaudited)

arrangements in which the vendor or service provider will perform multiple revenue generating activities (e.g., contracts that require an up-front fee along with fees that recur over the life of the arrangement). Specifically, the update addresses how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. This update will be effective for revenue arrangements that are entered into or materially altered after January 1, 2011. The Company is currently evaluating the impact the adoption of this guidance will have on its financial statements.

3. Processing System Intrusion

On January 20, 2009, we publicly announced the discovery of a criminal breach of our payment systems environment (the Processing System Intrusion). The Processing System Intrusion involved malicious software that appears to have been used to collect in-transit, unencrypted payment card data while it was being processed by us during the transaction authorization process. Such data is not required to be encrypted while in transit under current payment card industry guidelines. We had received confirmation of our compliance with the Payment Card Industry Data Security Standard (PCI-DSS) from a third-party assessor each year since the standard was announced, including in April 2008, before the discovery of the Processing System Intrusion. Subsequent to the discovery of the Processing System Intrusion, we were advised by Visa that based on Visa's investigation of the Processing System Intrusion, Visa had removed us from Visa's published list of PCI-DSS compliant service providers. We were similarly advised by MasterCard that, based on MasterCard's investigation of the Processing System Intrusion, MasterCard believed we were in violation of the MasterCard Standards and, based on that belief, MasterCard removed us from MasterCard's published list of Compliant Service Providers. In April 2009, we were re-certified as PCI-DSS compliant and the assessor's report attesting to such re-certification has been reviewed and approved by Visa. As such, we were returned to MasterCard's published list of Compliant Service Providers and Visa's Global List of PCI-DSS Validated Service Providers. Card data that could have been exposed by the Processing System Intrusion included card numbers, expiration dates, and certain other information from the magnetic stripe on the back of the payment card (including, for a small percentage of cards, the cardholder's name). However, the cardholder information that we process does not include addresses or Social Security numbers. Also, we believe that no unencrypted PIN data was captured and that the breach has been contained and did not extend beyond 2008.

Since its announcement of the Processing System Intrusion on January 20, 2009 and through September 30, 2010, the Company has expensed a total of \$145.0 million, before reducing those charges by \$30.7 million of total insurance recoveries. The majority of the total charges, or approximately \$114.7 million, related to settlements of claims. Approximately \$30.3 million of the total charges were for legal fees and costs we incurred for investigations, defending various claims and actions, remedial actions and crisis management services.

During the nine months ended September 30, 2010, the Company recovered from its insurance providers approximately \$26.8 million of the costs it incurred for the Processing System Intrusion and expensed approximately \$12.0 million for accruals, legal fees and costs it incurred for defending various claims and actions, resulting in a net recovery of \$14.8 million, or \$0.23 per share. For the three months ended September 30, 2010, the Company expensed a total of \$0.7 million, or about \$0.01 per share, respectively, associated with the Processing System Intrusion.

For the three and nine months ended September 30, 2009, the Company expensed a total of \$73.3 million and \$105.3 million, respectively, or about \$1.22 and \$1.74 per share, respectively, for settlement accruals, legal fees and costs it incurred for defending various claims and actions associated with the Processing System Intrusion.

At September 30, 2010, the Company carried a \$1.6 million Reserve for Processing System Intrusion on its Consolidated Balance Sheet. The majority of this Reserve related to settlements which have been agreed upon but are unpaid as of the date of the Balance Sheet. During the three months ended September 30, 2010, the Company settled claims and disputes with DFS Services, LLC (Discover) and MasterCard Worldwide (MasterCard) from its cash reserves as follows:

On August 31, 2010, the Company and Discover entered into an agreement of settlement and release (the Settlement Agreement) to resolve potential claims and other disputes among the Company and Discover (and its affiliates and certain of its issuers) with

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respect to the Processing System Intrusion. On September 2, 2010, the Company paid Discover \$5.0 million in full and final satisfaction of any and all claims of Discover, its affiliates and certain of its issuers arising from or relating to the Processing System Intrusion. The Settlement Agreement contains mutual releases by and between the Company and Discover (on behalf of itself and its affiliates) relating to the Processing System Intrusion.

Table of Contents

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements (Continued)

(unaudited)

On May 19, 2010, the Company entered into a settlement agreement with MasterCard (the MasterCard Settlement Agreement) to resolve potential claims and other disputes among the Company, Heartland Bank, Key Bank National Association (Key Bank and together with Heartland Bank, the Sponsor Banks) and MasterCard related to the Processing System Intrusion. Under the MasterCard Settlement Agreement, alternative recovery offers totaling \$41.4 million were made to eligible MasterCard issuers with respect to losses alleged to have been incurred by them as a result of the Processing System Intrusion. The \$41.4 million included a \$6.6 million credit for fines previously collected by MasterCard during 2009, so the maximum amount payable under the settlement was \$34.8 million if all MasterCard issuers had accepted the settlement. The Company paid approximately \$34.4 million because certain issuers did not accept settlement. Those issuers, who represent less than 1% of the accounts eligible for the settlement, have been preliminarily awarded \$367,172 by MasterCard, and the Company is contesting that award. On September 3, 2010 and September 14, 2010, the Company paid the remaining settlement amounts.

Claims and disputes with other Card Brands, which were settled and paid prior to the three months ended September 30, 2010, were as follows:

On December 17, 2009, we entered into a settlement agreement and release with American Express to resolve potential claims and other disputes among us and American Express (and its issuers) with respect to the Processing System Intrusion, and subsequently we paid approximately \$3.5 million in full and final satisfaction of any and all claims of American Express and its issuers arising from or relating to the Processing System Intrusion. Such settlement agreement and release contains mutual releases by and between us and American Express (on behalf of itself and its issuers) relating to the Processing System Intrusion.

On January 7, 2010, the Company, the Sponsor Banks, and Visa U.S.A. Inc., Visa International Service Association and Visa Inc. (collectively, Visa) entered into a settlement agreement (the Settlement Agreement) to resolve potential claims and other disputes among the Company, the Sponsor Banks and Visa with respect to the potential rights and claims of Visa and certain issuers of Visa-branded credit and debit cards related to the Processing System Intrusion. After including a \$780,000 credit for fines previously collected by Visa during 2009, the amount paid by the Company under the Settlement Agreement was \$59.3 million. The costs of this settlement were included in the Company's Provision for Processing System Intrusion on its Consolidated Statement of Operations for the year ended December 31, 2009 and in its Reserve for Processing System Intrusion on its Consolidated Balance Sheet as of December 31, 2009.

On February 18, 2010, the Company entered into a bridge loan agreement (the Bridge Loan Agreement) with KeyBank, as administrative agent, and KeyBank and Heartland Bank as bridge lenders. On that date, KeyBank made a bridge loan to the Company in the amount of \$20.0 million and Heartland Bank made a bridge loan in the amount of \$8.0 million (collectively, the Bridge Loan), which are the maximum amounts that the Company may borrow under the Bridge Loan Agreement. The Company must repay the Bridge Loan by February 17, 2011. See Note 10, Credit Facilities for additional terms of the Bridge Loan.

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)**

On February 18, 2010, the Company also entered into a Commitment Increase Agreement (the Commitment Increase Agreement) pursuant to the Amended and Restated Credit Agreement by and between the Company and JPMorgan Chase Bank, N.A., as administrative agent, and certain lenders who may become a party to the Amended and Restated Credit Agreement from time to time (the Amended and Restated Credit Agreement) dated as of May 30, 2008 whereby KeyBank, as one of the lenders under the Amended and Restated Credit Agreement, agreed to increase its revolving credit commitment to the Company under the Amended and Restated Credit Agreement by \$25.0 million (the Increased Credit Commitment). The terms of the Increased Credit Commitment are similar to the terms of the Revolving Credit Facility (See Note 10, Credit Facilities).

The proceeds of the Bridge Loan and the Increased Credit Commitment, together with a portion of the Company's cash reserves, were used to fund the settlement with Visa. The Settlement Agreement was consummated on February 18, 2010, with a payment of \$58.6 million.

These settlement amounts were previously provided for in the Company's Provision for Processing System Intrusion and carried in its Reserve for Processing System Intrusion. The Company is prepared to vigorously defend itself against any unsettled claims relating to the Processing System Intrusion that have been asserted against it and its sponsor banks to date. The Company feels it has strong defenses to all the claims that have been asserted against it and its sponsor banks relating to the Processing System Intrusion.

Additional costs the Company expects to incur for legal fees and costs for defending various claims and actions associated with the Processing System Intrusion will be recognized as incurred. Such costs could be material and could adversely impact the Company's results of operations, financial condition and cash flow.

4. Receivables

A summary of receivables by major class was as follows at September 30, 2010 and December 31, 2009:

	September 30, 2010	December 31, 2009
	(In thousands)	
Accounts receivable from merchants	\$ 153,061	\$ 138,761
Receivables from bankcard networks	15,771	7,790
Accounts receivable from others	3,700	3,311
	172,532	149,862
Less allowance for doubtful accounts	(639)	(459)
Total receivables, net	\$ 171,893	\$ 149,403

Included in accounts receivable from others are \$1.5 million and \$1.8 million which are due from employees at September 30, 2010 and December 31, 2009, respectively. Accounts receivable related to bankcard networks reflect amounts we have pre-funded to merchants for their Discover and American Express bankcard transactions.

A summary of the activity in the allowance for doubtful accounts for the three and nine months ended September 30, 2010 and 2009 was as follows:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Beginning balance	\$ 984	\$ 560	\$ 459	\$ 499
Additions to allowance	189	75	773	624
Charges against allowance	(534)	(79)	(593)	(567)
Ending balance	\$ 639	\$ 556	\$ 639	\$ 556

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)****5. Funds Held for Payroll Customers and Investments**

A summary of Funds Held for Payroll Customers and Investments, including the cost, gross unrealized gains (losses) and estimated fair value for investments held to maturity and investments available-for-sale by major security type and class of security were as follows at September 30, 2010 and December 31, 2009:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(In thousands)				
September 30, 2010				
Funds Held for Payroll Customers:				
Fixed income bond fund	\$ 968	\$ 187	\$	\$ 1,155
Corporate debt securities	273	19		292
Corporate equity securities	29	13		42
Total investments available-for-sale	1,270	219		1,489
Cash held for payroll customers	23,171			23,171
Total Funds Held for Payroll Customers	\$ 24,441	\$ 219	\$	\$ 24,660
Investments:				
Investments held to maturity Certificates of deposit	\$ 1,558	\$	\$	\$ 1,558
Total investments	\$ 1,558	\$	\$	\$ 1,558

- (a) Certificates of deposit have remaining terms ranging from 2 months to 23 months.

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(In thousands)				
December 31, 2009				
Funds Held for Payroll Customers:				
Fixed income bond fund	\$ 968	\$ 113	\$	\$ 1,081
Corporate debt securities	273	10		283
Corporate equity securities	29			29
Total investments available-for-sale	1,270	123		1,393

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Cash held for payroll customers	28,274			28,274
Total Funds Held for Payroll Customers	\$ 29,544	\$ 123	\$	\$ 29,667
Investments:				
Investments held to maturity Certificates of deposit	\$ 1,450	\$	\$	\$ 1,450
Total investments	\$ 1,450	\$	\$	\$ 1,450

The Company's framework for measuring fair value provides a three-level hierarchy, which prioritizes the factors (inputs) used to calculate the fair value of assets and liabilities as follows:

Level 1. Level 1 inputs are unadjusted quoted prices, such as a New York Stock Exchange closing price, in active markets for identical assets. Level 1 is the highest priority in the hierarchy.

Level 2. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as other significant inputs that are observable at commonly quoted intervals, such as interest rates, foreign exchange rates, and yield curves.

Level 3. Level 3 are unobservable inputs which are based on company assumptions due to little, if any, observable market information. Level 3 is the lowest priority in the hierarchy.

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)**

At September 30, 2010 and December 31, 2009, all investments in available-for-sale securities held by the Company were measured using Level 1 inputs and all held to maturity investments held by the Company were measured using Level 2 inputs.

During the nine months ended September 30, 2010, the Company did not experience any other-than-temporary losses on its investments. During the twelve months ended December 31, 2009, the Company recognized \$31,000 of other-than-temporary impairment losses on its corporate debt securities.

The maturity schedule of all available-for-sale debt securities and held to maturity investments along with amortized cost and estimated fair value as of September 30, 2010 is as follows:

	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	\$ 2,610	\$ 2,804
Due after one year through five years	126	130
Due after five years	63	71
	\$ 2,799	\$ 3,005

6. Capitalized Customer Acquisition Costs, Net

A summary of net capitalized customer acquisition costs as of September 30, 2010 and December 31, 2009 was as follows:

	September 30, 2010	December 31, 2009
	(In thousands)	
Capitalized signing bonuses	\$ 103,710	\$ 119,560
Less accumulated amortization	(58,305)	(63,299)
	45,405	56,261
Capitalized customer deferred acquisition costs	39,056	39,230
Less accumulated amortization	(24,011)	(23,453)
	15,045	15,777
Capitalized customer acquisition costs, net	\$ 60,450	\$ 72,038

A summary of the activity in capitalized customer acquisition costs, net for the three and nine month periods ended September 30, 2010 and 2009 was as follows:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Balance at beginning of period	\$ 63,556	\$ 75,246	\$ 72,038	\$ 77,737
Plus additions to:				
Capitalized signing bonuses, net	6,551	7,739	17,956	25,504
Capitalized customer deferred acquisition costs	3,674	4,374	11,400	12,569
	10,225	12,113	29,356	38,073
Less amortization expense on:				
Capitalized signing bonuses, net	(9,333)	(10,123)	(28,811)	(30,737)
Capitalized customer deferred acquisition costs	(3,998)	(4,089)	(12,133)	(11,926)
	(13,331)	(14,212)	(40,944)	(42,663)
Balance at end of period	\$ 60,450	\$ 73,147	\$ 60,450	\$ 73,147

Net signing bonus adjustments from estimated amounts to actual were \$(0.4) million and \$(0.8) million, respectively, for the three months ended September 30, 2010 and 2009, and \$(2.0) million and \$(0.9) million, respectively, for the nine months ended September 30, 2010 and 2009. Net signing bonus

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)**

adjustments are netted against additions in the table above. Positive signing bonus adjustments occur when the actual gross margin generated by the merchant contract during the first year exceeds the estimated gross margin for that year, resulting in the underpayment of the up-front signing bonus and would be paid to the relevant salesperson. Negative signing bonus adjustments result from the prior overpayment of signing bonuses and would be recovered from the relevant salesperson.

Fully amortized signing bonuses of \$11.9 million and \$8.7 million respectively, were written off during the three month periods ended September 30, 2010 and 2009, and \$33.8 million and \$25.0 million respectively, were written off during the nine month periods ended September 30, 2010 and 2009. In addition, fully amortized customer deferred acquisition costs of \$3.9 million and \$3.2 million, respectively, were written off during the three months ended September 30, 2010 and 2009, and \$11.6 million and \$10.7 million, respectively, were written off during the nine months ended September 30, 2010 and 2009.

The Company believes that no impairment of capitalized customer acquisition costs has occurred as of September 30, 2010 and December 31, 2009.

7. Intangible Assets and Goodwill

Intangible Assets Intangible assets consisted of the following as of September 30, 2010 and December 31, 2009:

	September 30, 2010			Amortization Life and Method
	Gross Assets	Accumulated Amortization (In thousands)	Net Asset	
<i>Finite Lived Assets:</i>				
Customer relationships	\$ 28,675	\$ 3,388	\$ 25,287	3 to 18 years proportional cash flow
Merchant Portfolio (a)	3,345	993	2,352	7 years proportional cash flow
Software	9,154	6,450	2,704	3 to 5 years straight line
Non-compete agreements	994	698	296	3 to 5 years straight line
Other	532	386	146	2 to 4 years straight line
	\$ 42,700	\$ 11,915	\$ 30,785	

- (a) Includes the July 31, 2009 purchase for \$3.2 million of the existing Discover merchant portfolio, which the Company was already processing. This purchase related to the Company's 2008 agreement with DFS Services, LLC, which enables the Company to offer bankcard merchants a streamlined process that enables them to accept Discover Network cards on the Company's processing platform. This asset is being amortized for the next 70 months in proportion to estimated future cash flows.

	December 31, 2009			Amortization Life and Method
	Gross Assets	Accumulated Amortization (In thousands)	Net Asset	
<i>Finite Lived Assets:</i>				
Customer relationships	\$ 28,663	\$ 2,471	\$ 26,192	3 to 18 years proportional cash flow

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Merchant Portfolio (a)	3,237	386	2,851	7 years	proportional cash flow
Software	9,154	4,330	4,824	3 to 5 years	straight line
Non-compete agreements	994	490	504	3 to 5 years	straight line
Other	512	246	266	2 to 4 years	straight line
	\$ 42,560	\$ 7,923	\$ 34,637		

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)**

Amortization expense related to the intangible assets was \$1.3 million and \$1.3 million, respectively, for the three months ended September 30, 2010 and 2009 and \$4.0 million and \$3.6 million, respectively, for the nine months ended September 30, 2010 and 2009. The estimated remaining amortization expense related to intangible assets is as follows:

For the Twelve Months Ending September 30,		(In thousands)
2011	\$	4,091
2012		2,389
2013		2,552
2014		2,234
2015		2,208
Thereafter		17,311
	\$	30,785

Goodwill The changes in the carrying amount of goodwill for the nine months ended September 30, 2010 and 2009 were as follows:

	Nine Months Ended	
	September 30,	
	2010	2009
	(In thousands)	
Beginning balance	\$ 60,962	\$ 58,456
Effects of foreign currency translation	145	1,078
Other (a)	1,019	(161)
Ending balance	\$ 62,126	\$ 59,373

(a) Reflects estimated earnout payments due to the former shareholders of Chockstone and adjustments to allocations of purchase price.

8. Merchant Deposits and Loss Reserves

The majority of merchant deposits held by the Company include funds in transit associated with pin debit processing and check processing in addition to merchant funds held that are associated with bankcard processing. As of September 30, 2010 and December 31, 2009, the Company held merchant deposits and funds in transit totaling \$36.3 million and \$25.9 million, respectively, of which \$8.1 million and \$8.8 million respectively, related to deposits held for bankcard processing. In addition, the Company held letters of credit related to merchant bankcard processing totaling \$388,000 and \$463,000 at September 30, 2010 and December 31, 2009, respectively.

The Company's merchants have the liability for any charges properly reversed by the cardholder through a mechanism known as a chargeback. If the merchant is unable to pay this amount, the Company will be liable to the card brand networks for the reversed charges. The Company has

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determined that the fair value of its obligation to stand ready to perform is minimal. The Company requires personal guarantees, merchant deposits and letters of credit from certain merchants to minimize its obligation.

The card brand networks generally allow chargebacks up to four months after the later of the date the transaction is processed or the delivery of the product or service to the cardholder. As the majority of the Company's SME merchant transactions involve the delivery of the product or service at the time of the transaction, a reasonable basis for determining an estimate of the Company's exposure to chargebacks is the last four months' processing volume on the SME portfolio, which was \$22.8 billion and \$19.6 billion for the four months ended September 30, 2010 and December 31, 2009, respectively. However, for the four months ended September 30, 2010 and December 31, 2009, the Company was presented with \$10.6 million and \$11.1 million, respectively, in chargebacks by issuing banks. In the nine months ended September 30, 2010 and September 30, 2009, the Company incurred merchant credit losses of \$7.3 million and \$4.1 million, respectively, on total SME bankcard dollar volumes processed of \$48.2 billion and \$43.8 billion, respectively. These credit losses are included in processing and servicing costs in the Company's Consolidated Statement of Operations.

The loss recorded by the Company for chargebacks associated with any individual merchant is typically small, due both to the relatively small size and the processing profile of the Company's SME merchants. However, from time to time the Company will encounter instances of merchant fraud, and the resulting chargeback losses may be considerably more significant to the Company. The Company has

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)**

established a contingent reserve for estimated currently existing credit and fraud losses on its Consolidated Balance Sheet, amounting to \$1.5 million on September 30, 2010 and \$1.3 million on December 31, 2009. This reserve is determined by performing an analysis of the Company's historical loss experience applied to current processing volume and exposures.

A summary of the activity in the loss reserve for the three and nine month periods ended September 30, 2010 and 2009 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Beginning balance	\$ 1,467	\$ 1,157	\$ 1,336	\$ 1,097
Additions to reserve	1,918	1,172	7,880	4,375
Charges against reserve (a)	(1,838)	(1,093)	(7,669)	(4,236)
Ending balance	\$ 1,547	\$ 1,236	\$ 1,547	\$ 1,236

(a) Included in these amounts are payroll segment losses of \$46,000 and \$49,000, respectively, for the three months ended September 30, 2010 and 2009, and \$246,000 and \$150,000, respectively, for the nine months ended September 30, 2010 and 2009. Chargebacks originating from large national merchant bankcard processing are processed and carried by Fifth Third Processing Solutions, which is the Company's third-party outsourced processor for settling large national merchant accounts.

9. Accrued Buyout Liability

A summary of the accrued buyout liability was as follows as of September 30, 2010 and December 31, 2009:

	September 30, 2010	December 31, 2009
	(In thousands)	
Vested Relationship Managers and sales managers	\$ 27,630	\$ 41,157
Unvested Relationship Managers and sales managers	1,639	1,729
	29,269	42,886
Less current portion	(5,854)	(9,306)
Long-term portion of accrued buyout liability	\$ 23,415	\$ 33,580

In calculating the accrued buyout liability for unvested Relationship Managers and sales managers, the Company has assumed that 31% of the unvested Relationship Managers and sales managers will vest in the future, which represents the Company's historical vesting rate. A 5% increase to 36% in the expected vesting rate would have increased the accrued buyout liability for unvested Relationship Managers and sales managers by \$0.3 million at September 30, 2010 and December 31, 2009.

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A summary of the activity in the accrued buyout liability for the three and nine month periods ended September 30, 2010 and 2009 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Beginning balance	\$ 45,648	\$ 41,212	\$ 42,886	\$ 41,040
Increase in settlement obligation, net	2,916	3,309	9,214	8,385
Buyouts	(19,295)	(1,415)	(22,831)	(6,319)
Ending balance	\$ 29,269	\$ 43,106	\$ 29,269	\$ 43,106

During the three months ended September 30, 2010, the Company exercised its rights to buy out a substantial portion of residual commissions owned by Relationship Managers and sales managers (also

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)**

referred to as portfolio equity). As a result of these buyouts, the Company reduced the settlement obligation by the approximately \$17.7 million of cash payments made. The Company expects to realize an ongoing reduction of approximately \$0.6 million in monthly residual commission expense, which is recorded in Processing and Servicing costs on the Consolidated Statement of Operations. The amount of future reductions in residual commission expense will be impacted by merchant attrition. Partially offsetting the impact of these buyouts are increases in the settlement obligation due to new SME merchant account signings, as adjusted for changes in same-store sales growth, changes in gross margin for existing merchant relationships, and the impact of SME merchant attrition.

10. Credit Facilities

Amended and Restated Credit Agreement. On May 30, 2008, the Company entered into the Amended and Restated Credit Agreement with JPMorgan Chase Bank, N.A., as administrative agent, and certain lenders who may become a party to the Credit Agreement from time to time. The Amended and Restated Credit Agreement amended and restated in its entirety the previous credit agreement entered into on September 5, 2007 between the same parties that are parties to the Amended and Restated Credit Agreement. On August 3, 2009, the Company and JPMorgan Chase Bank, N.A. amended the Amended and Restated Credit Agreement to exclude a certain amount of charges related to the Processing System Intrusion that may be incurred or accrued by the Company in determining the Company's compliance with the financial covenants in the Amended and Restated Credit Agreement, provide the lenders with a security interest in the assets of the Company, and increase the interest margin charged on borrowings.

The Amended and Restated Credit Agreement provides for a revolving credit facility in the aggregate amount of up to \$50 million (the Revolving Credit Facility), of which up to \$5 million may be used for the issuance of letters of credit and up to \$5 million is available for swing line loans. Upon the prior approval of the administrative agent, the Company was able to increase the total commitments by \$25 million for a total commitment under the Revolving Credit Facility of \$75 million. On February 18, 2010, the Company entered into the Commitment Increase Agreement to increase the total commitment under the Revolving Credit Facility by \$25 million. The terms of the Increased Credit Commitment are identical to the terms of the Revolving Credit Facility. The Revolving Credit Facility is available to the Company on a revolving basis until September 4, 2012.

The Amended and Restated Credit Agreement also provides for a term credit facility in the aggregate amount of up to \$25 million (the Term Credit Facility). The Term Credit Facility requires amortizing payments in the amount of \$2,083,333 on the last business day of each fiscal quarter commencing March 31, 2009. All principal and interest not previously paid on the Term Credit Facility will mature and be due and payable on December 31, 2011. Amounts borrowed and repaid under the Term Credit Facility may not be re-borrowed. Principal payments due under the Term Credit Facility as of September 30, 2010 were as follows:

Twelve Months Ended September 30,	(In thousands)
2011	\$ 8,333
2012	2,083
	\$ 10,416

The Amended and Restated Credit Agreement contains covenants, which include the maintenance of certain leverage and fixed charge coverage ratios, limitations on the Company's indebtedness, liens on its properties and assets, investments in, and loans to, other business units, the Company's ability to enter into business combinations and asset sales, and certain other financial and non-financial covenants. The Company was in compliance with these covenants as of September 30, 2010.

Under the terms of the Amended and Restated Credit Agreement, the Company may borrow, at its option, at interest rates equal to one, two, three or nine month adjusted LIBOR rates or equal to the greater of prime and the federal funds rate plus 0.50%, in each case plus a margin determined by the Company's current leverage ratio.

Table of Contents

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements (Continued)

(unaudited)

At December 31, 2009, there was \$50.0 million outstanding under the Revolving Credit Facility and \$16.7 million outstanding under the Term Credit Facility. At September 30, 2010, there was \$75.0 million outstanding under the Revolving Credit Facility and \$10.4 million outstanding under the Term Credit Facility. The weighted average interest rate at September 30, 2010 was 3.1%. Total fees and direct costs paid for the Amended and Restated Credit Agreement through September 30, 2010 were \$514,000. These costs are being amortized to interest expense over the life of the Amended and Restated Credit Agreement.

Bridge Loan Agreement and Increased Credit Commitment. A condition of the January 7, 2010 Settlement Agreement with Visa was for the Company to obtain a loan of at least \$53.0 million from KeyBank and Heartland Bank, the proceeds of which were to be used by the Company to fund the settlement amount. See Note 3, Processing System Intrusion for more detail.

On February 18, 2010, the Company entered into the Bridge Loan Agreement with KeyBank, as administrative agent, and KeyBank and Heartland Bank as bridge lenders. On that date, KeyBank made a bridge loan to the Company in the amount of \$20.0 million and Heartland Bank made a bridge loan in the amount of \$8.0 million, which represents the maximum amounts that the Company may borrow under the Bridge Loan Agreement. The Company must repay the Bridge Loan by February 17, 2011. It may optionally prepay the Bridge Loan at any time in whole or in part. However, it must prepay the Bridge Loan with any net cash proceeds from certain asset sales, the net cash proceeds of certain equity and debt issuances, and the net cash proceeds of certain recovery events.

The Bridge Loan bears interest at a rate of 1.0% plus the Alternate Base Rate. The Alternate Base Rate is the greater of (i) KeyBank's prime rate, (ii) 0.5% plus the weighted average of the overnight Federal funds rate and (iii) 1.0% plus one-month LIBOR. If principal, interest or fees on the Bridge Loan are not paid when due, whether at stated maturity, upon acceleration or otherwise, such overdue amount shall bear interest at a rate per annum equal to the Alternate Base Rate plus 3.0%.

The Bridge Loan Agreement contains covenants, which include maintenance of certain leverage and fixed charge coverage ratios, limitations on indebtedness, investments in, and loans to, other business units, the Company's ability to enter into business combinations and asset sales, and certain other financial and non-financial covenants. These covenants also apply to certain of the Company's subsidiaries. The Bridge Loan Agreement is secured by a first priority security interest in the Company's service center located in Jeffersonville, Indiana (the Service Center) and in certain other assets relating to the ownership and occupancy of the Service Center.

The proceeds of the Bridge Loan and the Increased Credit Commitment, together with a portion of the Company's cash reserves, were used to fund the settlement with Visa. The Settlement Agreement was consummated on February 18, 2010, with a payment of \$58.6 million.

11. Stockholders' Equity

Common Stock Repurchases. No common stock was repurchased during the nine months ended September 30, 2010. During the nine months ended September 30, 2009, the Company repurchased 350,400 shares of its common stock at average per share costs of \$9.14 under authorizations from its Board of Directors. Under these authorizations, the Company repurchased an aggregate of 2,924,684 shares of its common stock through September 30, 2010 at a cost of \$65.1 million, or an average cost of \$22.25 per share. At September 30, 2010, the Company has remaining authorization to repurchase up to 175,316 additional shares of its common stock.

On February 28, 2008, the Company's Board of Directors resolved to retire all common shares repurchased and include the retired shares in the authorized and unissued shares of the Company. Until February 28, 2008, the final disposition of the repurchased shares had not been decided. The excess of the purchase price of the treasury stock over the stated value was allocated between additional paid-in capital and retained earnings.

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)**

(unaudited)

Dividends on Common Stock. During the nine months ended September 30, 2010 and the twelve months ended December 31, 2009, the Company's Board of Directors declared the following quarterly cash dividends on common stock:

Date Declared	Record Date	Date Paid	Amount Paid Per Common Share
Nine Months Ended September 30, 2010:			
February 18, 2010	March 5, 2010	March 15, 2010	\$ 0.01
May 4, 2010	May 25, 2010	June 15, 2010	\$ 0.01
August 3, 2010	August 25, 2010	September 15, 2010	\$ 0.01
Twelve Months Ended December 31, 2009:			
February 20, 2009	March 9, 2009	March 16, 2009	\$ 0.025
May 7, 2009	May 25, 2009	June 15, 2009	\$ 0.01
August 3, 2009	August 25, 2009	September 15, 2009	\$ 0.01
November 3, 2009	November 23, 2009	December 15, 2009	\$ 0.01

On November 2, 2010, the Company's Board of Directors declared a quarterly cash dividend of \$0.01 per share of common stock, payable on December 15, 2010 to stockholders of record as of November 23, 2010.

12. Commitments and Contingencies

Litigation The Company is involved in certain legal proceedings and claims, which arise in the ordinary course of business. In the opinion of the Company, based on consultations with outside counsel, the results of any of these ordinary course matters, individually and in the aggregate, are not expected to have a material effect on its results of operations, financial condition or cash flows.

The Company is also subject to lawsuits, claims, and investigations which are the result of the Processing System Intrusion. See **Contingencies** below and Note 3 for a description of the Processing System Intrusion.

Contingencies The Company collects and stores sensitive data about its merchant customers and bankcard holders. If the Company's network security is breached or sensitive merchant or cardholder data is misappropriated, the Company could be exposed to assessments, fines or litigation costs.

On January 20, 2009, the Company publicly announced the discovery of a criminal breach of its payment systems environment (the Processing System Intrusion). The Processing System Intrusion involved malicious software that appears to have been used to collect in-transit, unencrypted payment card data while it was being processed by the Company during the transaction authorization process. See Note 3, Processing System Intrusion for further detail and information regarding the Processing System Intrusion and the settlement and payment of a claim.

Leases The Company leases various office spaces and certain equipment under operating leases with remaining terms ranging up to eight years. The majority of the office space lease agreements contain renewal options and generally require the Company to pay certain operating expenses.

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)**

Future minimum lease commitments under non-cancelable leases as of September 30, 2010 were as follows:

Twelve Months Ended September 30,	(In thousands)	
	Capital Leases	Operating Leases
2011	\$ 141	\$ 6,472
2012		5,257
2013		3,229
2014		1,975
2015		1,629
Thereafter		4,089
Total Minimum Payments	141	\$ 22,651
Interest Amount	(6)	
Present Value of Minimum Payments	\$ 135	

Rent expense for leased property was \$870,000 and \$760,000, respectively, for the three months ended September 30, 2010 and 2009, and \$2.6 million and \$2.3 million, respectively, for the nine months ended September 30, 2010 and 2009.

Commitments Certain officers of the Company have entered into employee confidential information and non-competition agreements under which they are entitled to severance pay equal to their base salary and medical benefits for 12 months and a pro-rated bonus in the event they are terminated by the Company other than for cause. There were no payouts under these agreements in 2010.

The following table reflects the Company's other significant contractual obligations, including leases from above, as of September 30, 2010:

Contractual Obligations	Total	Payments Due by Period			
		Less than 1 year	1 to 3 Years	3 to 5 years	More than 5 years
		(In thousands)			
Processing providers (a)	\$ 11,392	\$ 7,394	\$ 3,731	\$ 267	\$
Telecommunications providers	9,237	4,147	5,090		
Office and equipment leases	22,651	6,472	8,486	3,604	4,089
Term Credit Facility (b)	10,416	8,333	2,083		
Bridge Loan (c)	28,000	28,000			
Capital lease obligations	141	141			
	\$ 81,837	\$ 54,487	\$ 19,390	\$ 3,871	\$ 4,089

- (a) The Company has agreements with several third-party processors to provide to us on a non-exclusive basis payment processing and transmittal, transaction authorization and data capture services, and access to various reporting tools. Our agreements with third-party processors require the Company to submit a minimum monthly number of transactions or volume for processing. If the Company submits a number of transactions or volume that is lower than the minimum, it is required to pay the third-party processors the fees that they would have received if the Company had submitted the required minimum number or volume of transactions.
- (b) Interest rates on the Term Credit Facility are variable. If interest rates were to remain at the September 30, 2010 level, the Company would make interest payments of \$226,000 in the next 1 year and \$16,000 in the next 1 to 3 years, or a total of \$242,000. In addition, the Company has \$75 million outstanding under our Revolving Credit Facility at September 30, 2010. The Revolving Credit Facility is available on a revolving basis until September 4, 2012.
- (c) Interest rates on the Bridge Loan are variable. If interest rates were to remain at the September 30, 2010 level, the Company would make interest payments of \$456,000 in the next year.

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)****(unaudited)****13. Segments**

The determination of the Company's business segments is based on how the Company monitors and manages the performance of its operations. The Company's operating segments are strategic business units that offer different products and services. They are managed separately because each business requires different marketing strategies, personnel skill sets and technology.

The Company has two reportable segments, as follows: (1) Card, which provides payment processing and related services for bankcard transactions; and (2) Other. The Card segment includes CPOS, our Canadian payments processing subsidiary, since March 2008, and Network Services since May 2008. Goodwill and intangible assets resulting from the acquisitions of CPOS and Network Services are reported in the Card segment. At September 30, 2010, goodwill related to CPOS and Network Services was \$52.7 million. The Other segment includes Payroll, which provides payroll and related tax filing services, and PrepaidCard, which provides prepaid card, stored-value card and loyalty and gift card solutions. The PrepaidCard operating segment includes Debitek, General Meters and Chockstone since its November 2008 acquisition. Neither the Payroll operating segment nor the PrepaidCard operating segment meet the defined thresholds for determining individually reportable segments. Goodwill and intangible assets resulting from the acquisition of Debitek, General Meters and Chockstone are reported in the Other segment. At September 30, 2010, goodwill related to Debitek, General Meters and Chockstone was \$9.4 million.

The Company allocates revenues, expenses, assets and liabilities to segments only where directly attributable. The unallocated corporate administration amounts are costs attributed to finance, corporate administration, human resources and corporate services. At September 30, 2010 and 2009, 44% and 38% respectively, of the Other segment's total assets were funds that the Company holds as a fiduciary in its Payroll services activities for payment to taxing authorities. Reconciling items include eliminations of intercompany investments and receivables.

A summary of the Company's segments for the three and six periods ended September 30, 2010 and 2009 was as follows:

	Card Segment	Other Segment	Unallocated Corporate Administration Amounts (In thousands)	Reconciling Items	Total Amount
Three Months Ended September 30, 2010					
Total revenues	\$ 488,735	\$ 10,393	\$	\$ (54)	\$ 499,074
Depreciation and amortization	5,645	753	134		6,532
Interest income	43				43
Interest expense	1,290	4		(54)	1,240
Net income (loss) attributable to Heartland	12,354	22	(4,843)		7,533
Total assets	648,450	55,705		(158,228)	545,927
Three Months Ended September 30, 2009					
Total revenues	\$ 434,315	\$ 8,296	\$	\$ (43)	\$ 442,568
Depreciation and amortization	4,886	548	185		5,619
Interest income	29				29
Interest expense	812	9		(39)	782
Net income (loss) attributable to Heartland	(29,674)	269	(7,691)		(37,096)
Total assets	631,563	43,970		(150,746)	524,787

Table of Contents**Heartland Payment Systems, Inc. and Subsidiaries****Notes To Condensed Consolidated Financial Statements (Continued)**

(unaudited)

	Card Segment	Other Segment	Unallocated Corporate Administration Amounts	Reconciling Items	Total Amount
Nine Months Ended September 30, 2010					
Total revenues	\$ 1,356,170	\$ 30,096	\$	\$ (155)	\$ 1,386,111
Depreciation and amortization	16,493	2,219	429		19,141
Interest income	111				111
Interest expense	3,646	16		(151)	3,511
Net income (loss) attributable to Heartland	43,579	333	(16,008)		27,904
Total assets	648,450	55,705		(158,228)	545,927
Nine Months Ended September 30, 2009					
Total revenues	\$ 1,208,963	\$ 23,290	\$	\$ (140)	\$ 1,232,113
Depreciation and amortization	13,727	1,525	571		15,823
Interest income	86				86
Interest expense	1,964	32		(128)	1,868
Net income (loss) attributable to Heartland	(22,428)	(290)	(19,448)		(42,166)
Total assets	631,563	43,970		(150,746)	524,787

14. Earnings Per Share

The Company presents earnings per share data following the established standards for the computation and presentation of basic and diluted earnings per share data. Under these standards, the dilutive effect of stock options is excluded from the calculation of basic earnings per share but included in diluted earnings per share except in periods of net loss where inclusion would be anti-dilutive. The following is a reconciliation of the amounts used to calculate basic and diluted earnings per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands, except per share data)			
Basic:				
Net income (loss) attributable to Heartland	\$ 7,533	\$ (37,096)	\$ 27,904	\$ (42,166)
Weighted average common stock outstanding	38,130	37,461	37,899	37,484
Earnings (loss) per share	\$ 0.20	\$ (0.99)	\$ 0.74	\$ (1.12)
Diluted:				
Net income (loss) attributable to Heartland	\$ 7,533	\$ (37,096)	\$ 27,904	\$ (42,166)
Basic weighted average common stock outstanding	38,130	37,461	37,899	37,484
Effect of dilutive instruments:				
Stock options and restricted share units	1,314	668	1,364	412

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Diluted weighted average shares outstanding	39,444	38,129	39,263	37,896
Earnings (loss) per share (a)	\$ 0.19	\$ (0.99)	\$ 0.71	\$ (1.12)

- (a) Due to the net loss in the 2009 periods, calculating Diluted Earnings Per Share using diluted weighted average shares would be anti-dilutive. Therefore, weighted average common stock outstanding was used to calculate Diluted Earnings Per Share for the three and nine months ended September 30, 2009.

Table of Contents

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements (Continued)

(unaudited)

15. Fair Value of Financial Instruments

Management uses methods and assumptions to estimate the fair value of each class of financial instruments for which it is practicable to estimate fair value. Fair value equals quoted market price for securities held as available-for-sale investments. Other financial instruments include cash and cash equivalents, certificates of deposit, receivables, various accounts payable and accrued expenses. The fair value of such financial instruments approximates their carrying value due to their short maturity and pricing terms.

Table of Contents

PART I FINANCIAL INFORMATION (continued)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the accompanying notes to condensed consolidated financial statements included elsewhere in this report, and the consolidated financial statements, notes to consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations and the risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2009 (the 2009 Form 10-K).

Forward Looking Statements

Unless the context requires otherwise, references in this report to the Company, we, us, and our refer to Heartland Payment Systems, Inc. and our subsidiaries.

Some of the information in this Quarterly Report on Form 10-Q may contain forward-looking statements that are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include the information concerning our possible or assumed future results of operations, the impact of the criminal breach of our payment system environment (the Processing System Intrusion), business strategies, financing plans, competitive position, industry environment, potential growth opportunities, the effects of future regulation and the effects of competition. Forward-looking statements include all statements that are not historical facts and can be identified by the use of forward-looking terminology such as the words believe, expect, anticipate, intend, plan, estimate or similar expressions.

Forward-looking statements involve risks, uncertainties and assumptions. Actual results may differ materially from those expressed in the forward-looking statements. You should understand that many important factors, in addition to those discussed elsewhere in this report, could cause our results to differ materially from those expressed in the forward-looking statements. Some of these factors are described in Item 1A. Risk Factors of the 2009 Form 10-K and include, without limitation, the significantly unfavorable economic conditions facing the United States, the results and effects of the Processing System Intrusion including the extent of cardholder information compromised and the consequences to our business, including the effects on sales and costs in connection with the Processing System Intrusion, our competitive environment, the business cycles and credit risks of our merchants, chargeback liability, merchant attrition, problems with our bank sponsor, our relationships with third-party bankcard payment processors, our inability to pass increased interchange fees along to our merchants, economic conditions, systems failures and government regulation.

Overview

General

Our primary business is to provide bankcard payment processing services to merchants in the United States and Canada. This involves facilitating the exchange of information and funds between merchants and cardholders' financial institutions, providing end-to-end electronic payment processing services to merchants, including merchant set-up and training, transaction authorization and electronic draft capture, clearing and settlement, merchant accounting, merchant assistance and support, and risk management. Our merchant customers primarily fall into two categories: our core small and mid-sized merchants (referred to as Small and Mid-sized Enterprises, or SME) and large national merchants, primarily in the petroleum industry. We also provide additional services to our merchants, such as payroll processing, gift and loyalty programs, paper check processing, and we sell and rent point-of-sale devices and supplies.

On January 20, 2009, we publicly announced the Processing System Intrusion, which apparently occurred during some portion of 2008. See Processing System Intrusion for more detail.

Table of Contents

At September 30, 2010, we provided our bankcard payment processing services to approximately 174,700 active SME merchants located across the United States. This compares to 173,400 active SME merchants at December 31, 2009, and 174,560 active SME merchants at September 30, 2009. At September 30, 2010, we provided bankcard payment processing services through Network services to 99 merchants with 53,253 locations. Additionally, at September 30, 2010, we provided bankcard payment processing services to over 7,800 merchants in Canada.

Our total bankcard processing volume for the three months ended September 30, 2010 was \$19.7 billion, a 6.4% increase from the \$18.6 billion processed during the three months ended September 30, 2009. Our total bank card processing volume for the nine months ended September 30, 2010 was \$56.1 billion, an 8.1% increase from the \$51.9 billion processed during the nine months ended September 30, 2009. Our SME bankcard processing volume for the three and nine months ended September 30, 2010 included increases for American Express and Discover processing. Our Discover processing volume for the 2010 nine-month period also benefited from our purchase of an existing merchant portfolio from Discover during the third quarter of 2009. Bankcard processing volume for the three and nine months ended September 30, 2010 and 2009 was as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2010	2009	September 30, 2010	2009
	(in millions)			
SME merchants	\$ 16,646	\$ 15,712	\$ 47,362	\$ 44,259
Large national merchants	2,953	2,726	8,325	7,306
Canada	150	123	411	333
Total bankcard processing volume (a)	\$ 19,749	\$ 18,561	\$ 56,098	\$ 51,898

(a) Bankcard processing volume includes volume for credit and signature debit transactions.

Merchant attrition is expected in the card payment processing industry in the ordinary course of business. We experience attrition in merchant bankcard processing volume resulting from several factors, including business closures, transfers of merchants' accounts to our competitors and account closures that we initiate due to heightened credit risks relating to, or contract breaches by, merchants, and (when applicable) same store sales contraction. We measure SME processing volume attrition against all SME merchants that were processing with us in the same month a year earlier. During the three months ended September 30, 2010, we experienced an improved 14.3% average annualized attrition in our SME bankcard processing volume and for the 2010 nine-month period we experienced average attrition of 16.2%. During 2009, 2008 and 2007, we experienced average annual attrition in our SME bankcard processing volume of 22.6%, 17.3% and 12.6%, respectively. Much of our attrition is related to business closures, which accelerated in 2009 and 2008 due to weak economic conditions, and in 2009 and 2008 our volume attrition was also significantly impacted by overall contraction in same stores sales.

In our SME business, we measure same store sales growth, or contraction, as the change in bankcard processing volume for all bankcard merchants that were processing with us in the same month a year earlier. During the three months ended September 30, 2010, same store sales grew 2.0% on average, our second consecutive quarter of same store sales growth. For the 2009 full year, we experienced 7.8% contraction. Same store sales growth or contraction results from the combination of the increasing or decreasing use by consumers of bankcards for the purchase of goods and services at the point of sale, and sales growth or contraction experienced by our retained SME bankcard merchants. The following table compares our same store sales growth or contraction during 2010, 2009, 2008 and 2007:

Same Store Sales Growth (Contraction)	2010	2009	2008	2007
First Quarter	(1.5)%	(7.6)%	0.6%	3.4%
Second Quarter	1.1%	(9.7)%	(0.1)%	3.3%
Third Quarter	2.0%	(8.6)%	(2.0)%	3.6%
Fourth Quarter		(5.2)%	(6.8)%	2.1%
Full Year		(7.8)%	(2.1)%	3.0%

Table of Contents

We attribute the deterioration in same store sales percentages that we experienced in our SME business from the third quarter of 2008 through the fourth quarter of 2009 to declining economic conditions including impacts from severely contracted credit markets, a weak housing market, historically low consumer and investor confidence and high unemployment rates. Our same store sales contraction experience tracked the overall economic downturn. The improvement we experienced in same store sales percentages in 2010 also tracks the general economy, as well as benefitting from year-over-year comparison to weaker processing volumes. Management believes that the challenging economic conditions may continue to result in modest, if any, improvements in our existing SME merchants' businesses.

In September 2010, we refocused the efforts of our sales force by applying historically productive sales and motivation techniques and relying less on the Industry Specialization Model (ISM) we developed and had attempted to implement earlier in the year. The ISM model had focused the sales force on specific industry verticals, whereby Relationship Managers were assigned protected merchant verticals (e.g., restaurants, healthcare and lodging) within their territories. In order to retain their protected merchant lists, a Relationship Manager was required to meet a minimum level of documented daily merchant visits within the protected vertical, and to report on their progress. During the summer, management determined that the daily reporting and weekly tracking processes required under the ISM model slowed down the Relationship Managers and their sales managers, distracted them from their overall selling efforts and adversely affected sales results.

We measure the overall production of our sales force by gross margin installed, which reflects the expected annual gross profit from a merchant contract after deducting processing and servicing costs associated with that revenue. Our newly installed gross margin for the nine months ended September 30, 2010 decreased 20.4% from the gross margin we installed during the nine months ended September 30, 2009. We attribute this decline in newly installed gross margin to the weak economy, the disruption caused by our attempt to transition to the ISM model, and the related focus on increasing the size and training of our sales force during the first nine months of 2010.

We compensate our sales managers based on their success in growing the sales force and increasing the total SME merchant base in their regions. Historically, increases in our direct sales force, including our Relationship Managers, had led to significant growth in the total SME merchants for which we process and the gross margin generated by those merchants. For the first half of 2010, our sales managers were focused on increasing our number of Relationship Managers. During the six months ended June 30, 2010, we grew the number of Relationship Managers by 30.0% to 1,393, from 1,069 at December 31, 2009. However, during the third quarter of 2010, we refocused our sales efforts toward enhancing individual Relationship Manager productivity and, as a result of that new focus, our Relationship Manager count declined by 249 to 1,144 Relationship Managers at September 30, 2010.

The bankcard revenue we earn in our SME business is recurring in nature, as we typically enter into three-year service contracts with our card processing merchants that, in order to qualify for the agreed-upon pricing, require the merchant to achieve bankcard processing volume minimums. Most of our SME revenue is from payment processing fees, which are a combination of a fee equal to a percentage of the dollar amount of each Visa or MasterCard transaction we process plus a flat fee per transaction. We make mandatory payments of interchange fees to card-issuing banks through Visa and MasterCard and dues, assessments and other network fees to Visa and MasterCard. Our SME gross bankcard processing revenue is largely driven by Visa and MasterCard volume processed by our merchants. More recently, we have experienced growth in card processing revenues by processing transaction for SME merchants new to accepting American Express and from processing Discover transactions.

Table of Contents

In contrast to SME card processing revenues, Network Services revenues from our large national merchants are largely driven by the number of transactions we process (whether settled, or only authorized), not our processing volume, as the larger merchants which comprise Network Services' customer base pay on a per transaction basis for processing services. Additionally, we acquire and settle transactions on our front and back end systems for American Express transactions for which we receive compensation from American Express on a per transaction basis. The number of transactions we processed for large national merchants and American Express for the three and nine months ended September 30, 2010 and 2009 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Large national merchants:				
Settled	129,947	123,014	361,871	350,059
Authorized	695,155	634,187	1,947,889	1,776,669
American Express	8,069		12,725	
Total	833,171	757,201	2,322,485	2,126,728

We have developed a number of proprietary payment processing systems to increase our operating efficiencies and distribute our processing and merchant data to our three main constituencies: our merchant base, our sales force and our customer service staff. We provide authorization and data capture services to our SME merchants through our own front-end processing system, which we call HPS Exchange. We provide clearing, settlement and merchant accounting services through our own internally developed back-end processing system, which we call Passport. Passport enables us to more effectively customize these services to the needs of our Relationship Managers and merchants.

During the three months ended September 30, 2010 and 2009, we processed approximately 90% and 88%, respectively, of our SME bankcard merchant transactions through HPS Exchange. At September 30, 2010 and 2009, we were processing approximately 99% of our active SME bankcard merchants on Passport. Our internally developed systems are providing substantially all aspects of most of our merchants' bankcard processing needs, excluding Network Services. However, in the fourth quarter of 2010, the processing of Network Services' settled transactions will be fully converted to Passport. Previously, we relied on third party vendors for many of these services including bankcard authorization and data capture services, settlement and merchant accounting services. We will continue to process a portion of our Network Services back end settlement transactions and a minority of our SME transactions through systems developed by third parties.

We also provide payroll processing services throughout the United States. At September 30, 2010, we processed payroll for 10,968 customers, an increase of 18.8% from 9,232 payroll customers at September 30, 2009. At December 31, 2009, we processed payroll for 9,382 payroll customers. During 2008 and 2009, we developed a new comprehensive payroll management system, which we refer to as PlusOne Payroll, that streamlines all aspects of the payroll process to enable time and cost savings. PlusOne Payroll currently is being rolled out to both new and existing payroll customers. The PlusOne Payroll platform enables us to process payroll on a large scale and provide customizable solutions for businesses of all sizes.

Processing System Intrusion

On January 20, 2009, we publicly announced the discovery of the Processing System Intrusion. The Processing System Intrusion involved malicious software that appears to have been used to collect in-transit, unencrypted payment card data while it was being processed by us during the transaction authorization process. Such data is not required to be encrypted while in transit under current payment card industry guidelines. We had received confirmation of our compliance with the Payment Card Industry Data Security Standard (PCI-DSS) from a third-party assessor each year since the standard was announced, including in April 2008, before the discovery of the Processing System Intrusion. Subsequent to the discovery of the Processing System Intrusion, we were advised by Visa that based on Visa's investigation of the Processing System Intrusion, Visa had removed us from Visa's published list of PCI-DSS compliant service providers. We were similarly advised by MasterCard that, based on MasterCard's investigation of the Processing System Intrusion, MasterCard believed we were in violation of the MasterCard Standards and, based on that belief, MasterCard removed us from MasterCard's published list of Compliant Service Providers. In April 2009, we were re-certified as PCI-DSS compliant and the assessor's report attesting to such re-certification has been reviewed and approved by Visa. As such, we were returned to MasterCard's published list of Compliant Service Providers and Visa's Global List of PCI-DSS Validated Service Providers.

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Card data that could have been exposed by the Processing System Intrusion included card numbers, expiration dates, and certain other information from the magnetic stripe on the back of the payment card (including, for a small percentage of cards, the cardholder's name). However, the cardholder information that we process does not include addresses or Social Security numbers. Also, we believe that no unencrypted PIN data was captured and that the breach has been contained and did not extend beyond 2008.

Table of Contents

Since its announcement of the Processing System Intrusion on January 20, 2009 and through September 30, 2010, we had expensed a total of \$145.0 million, before reducing those charges by \$30.7 million of total insurance recoveries. The majority of the total charges, or approximately \$114.7 million, related to settlements of claims. Approximately \$30.3 million of the total charges were for legal fees and costs we incurred for investigations, defending various claims and actions, remedial actions and crisis management services.

During the nine months ended September 30, 2010, we recovered from our insurance providers approximately \$26.8 million of the costs we incurred for the Processing System Intrusion and expensed approximately \$12.0 million for accruals, legal fees and costs we incurred for defending various claims and actions, resulting in a net recovery of \$14.8 million, or \$0.23 per share. For the three months ended September 30, 2010, we expensed a total of \$0.7 million, or about \$0.01 per share, respectively, associated with the Processing System Intrusion.

For the three and nine months ended September 30, 2009, we expensed a total of \$73.3 million and \$105.3 million, respectively, or about \$1.22 and \$1.74 per share, respectively, for settlement accruals, legal fees and costs we incurred for defending various claims and actions associated with the Processing System Intrusion.

At September 30, 2010, the Company carried a \$1.6 million Reserve for Processing System Intrusion on our Consolidated Balance Sheet. The majority of this Reserve related to settlements which have been agreed upon but are unpaid as of the date of the Balance Sheet. During the three months ended September 30, 2010, we settled claims and disputes with DFS Services, LLC (Discover) and MasterCard Worldwide (MasterCard) from our cash reserves as follows:

On August 31, 2010, we entered into an agreement of settlement and release with Discover (the Discover Settlement Agreement) to resolve potential claims and other disputes among us and Discover (and its affiliates and certain of its issuers) with respect to the Processing System Intrusion. On September 2, 2010, we paid Discover \$5.0 million in full and final satisfaction of any and all claims of Discover, its affiliates and certain of its issuers arising from or relating to the Processing System Intrusion. The Discover Settlement Agreement contains mutual releases by and between us and Discover (on behalf of itself and its affiliates) relating to the Processing System Intrusion.

On May 19, 2010, we entered into a settlement agreement with MasterCard (the MasterCard Settlement Agreement) to resolve potential claims and other disputes among us, Heartland Bank, Key Bank National Association (Key Bank, and, together with Heartland Bank, the Sponsor Banks) and MasterCard related to the Processing System Intrusion. Under the MasterCard Settlement Agreement, alternative recovery offers totaling \$41.4 million were made to eligible MasterCard issuers with respect to losses alleged to have been incurred by them as a result of the Processing System Intrusion. The \$41.4 million included a \$6.6 million credit for fines previously collected by MasterCard during 2009, so the maximum amount payable under the settlement was \$34.8 million if all MasterCard issuers had accepted the settlement. The Company paid approximately \$34.4 million because certain issuers did not accept settlement. Those issuers, who represent less than 1% of the accounts eligible for the settlement, have been preliminarily awarded \$367,172 by MasterCard, and the Company is contesting that award. On September 3, 2010 and September 14, 2010, we paid the remaining settlement amounts.

Claims and disputes with other Card Brands, which were settled and paid prior to the three months ended September 30, 2010, were as follows:

On December 17, 2009, we entered into a settlement agreement and release with American Express to resolve potential claims and other disputes among us and American Express (and its issuers) with respect to the Processing System Intrusion, and subsequently we paid approximately \$3.5 million in full and final satisfaction of any and all claims of American Express and its issuers arising from or relating to the Processing System Intrusion. Such settlement agreement and release contains mutual releases by and between us and American Express (on behalf of itself and its issuers) relating to the Processing System Intrusion.

Table of Contents

On January 7, 2010, the Company, the Sponsor Banks, and Visa U.S.A. Inc., Visa International Service Association and Visa Inc. (collectively, "Visa") entered into a settlement agreement (the "Visa Settlement Agreement") to resolve potential claims and other disputes among us, the Sponsor Banks and Visa with respect to the potential rights and claims of Visa and certain issuers of Visa-branded credit and debit cards related to the Processing System Intrusion. After including a \$780,000 credit for fines previously collected by Visa during 2009, the amount paid by us under the Visa Settlement Agreement was \$59.3 million. The costs of this settlement were included in our Provision for Processing System Intrusion on our Consolidated Statement of Operations for the year ended December 31, 2009 and in our Reserve for Processing System Intrusion on our Consolidated Balance Sheet as of December 31, 2009.

On February 18, 2010, we entered into a bridge loan agreement (the "Bridge Loan Agreement") with KeyBank, as administrative agent, and KeyBank and Heartland Bank as bridge lenders. On that date, KeyBank made a bridge loan to us in the amount of \$20.0 million and Heartland Bank made a bridge loan to us in the amount of \$8.0 million (collectively, the "Bridge Loan"), which are the maximum amounts that we may borrow under the Bridge Loan Agreement. We must repay the Bridge Loan by February 17, 2011.

On February 18, 2010, we also entered into a Commitment Increase Agreement (the "Commitment Increase Agreement") pursuant to the Amended and Restated Credit Agreement dated as of May 30, 2008 whereby KeyBank, as one of the lenders under the Amended and Restated Credit Agreement, agreed to increase its revolving credit commitment to us under the Amended and Restated Credit Agreement by \$25.0 million (the "Increased Credit Commitment"). The terms of the Increased Credit Commitment are similar to the terms of the Revolving Credit Facility under the Amended and Restated Credit Agreement.

The proceeds of the Bridge Loan and the Increased Credit Commitment, together with a portion of our cash reserves, were used to fund the settlement with Visa. The Visa Settlement Agreement was consummated on February 18, 2010, with a payment of \$58.6 million.

These settlement amounts were previously provided for in our Provision for Processing System Intrusion and carried in our Reserve for Processing System Intrusion. We are prepared to vigorously defend itself against any unsettled claims relating to the Processing System Intrusion that have been asserted against it and its sponsor banks to date. We feel we have strong defenses to all the claims that have been asserted against us and our sponsor banks relating to the Processing System Intrusion.

Additional costs we expect to incur for legal fees and costs for defending various claims and actions associated with the Processing System Intrusion will be recognized as incurred. Such costs could be material and could adversely impact our results of operations, financial condition and cash flow.

Third Quarter of 2010 Financial Results

Our financial results for the three months ended September 30, 2010 continue to reflect the impact of a slow economic recovery for our SME merchant base, and the costs of the Processing System Intrusion. Both the levels of new SME merchant installs and processing volume at existing SME merchants continue to be unfavorably impacted by the uncertain economy. For the three months ended September 30, 2010, we recorded net income of \$7.5 million, or \$0.19 per share, compared to a net loss of \$37.1 million, or \$0.99 per share, in the three months ended September 30, 2009.

In the three months ended September 30, 2010, we recorded total expenses of \$0.7 million, or \$0.01 per share, and for the three months ended September 30, 2009, we recorded total expenses of \$73.3 million, or \$1.22 per share, associated with the Processing System Intrusion (see "Processing System Intrusion" for more detail). The following is a summary of our financial results for the three months ended September 30, 2010:

During the three months ended September 30, 2010, our SME processing volume increased 5.9% to \$16.6 billion from \$15.7 billion during the three months ended September 30, 2009. We earn percentage-based revenues on our SME processing volume. Our SME bankcard processing volume for the three months ended September 30, 2010 included increases for American Express and Discover processing as well as increases in Visa and MasterCard processing.

Table of Contents

During the three months ended September 30, 2010, we generated revenues on the 130 million large national merchant transactions that we settled and on the 695 million large national merchant transactions that we authorized. These compare to 123 million transactions settled and 634 million transactions authorized during the three months ended September 30, 2009. We earn transaction-based revenues on our large national merchant card processing volume.

Net revenue, which we define as total revenues less interchange fees and dues, assessments and fees, increased \$5.4 million, or 4.9%, from \$110.0 million in the three months ended September 30, 2009 to \$115.4 million in the three months ended September 30, 2010. The increase in net revenue was driven by the increases in net revenue from our SME merchants and increases in equipment-related income, primarily from prepaid card and stored-value card systems at our Debitex, Inc. subsidiary.

Our processing and servicing expenses increased 17.7%, from \$50.4 million in the three months ended September 30, 2009, to \$59.3 million in the three months ended September 30, 2010 due to increased costs of sales related to higher equipment-related revenues, costs associated with higher SME bankcard processing volume, an increase in the costs of support personnel and costs of investments we have made in enhancing our processing systems.

Our general and administrative expenses decreased 8.3% from \$27.8 million in the three months ended September 30, 2009 to \$25.5 million in the three months ended September 30, 2010 primarily due to a decrease in staff expense, including bonus and fringe benefits, as well as an increase in the amount of personnel expense capitalized for work on system development. General and administrative expenses as a percentage of total revenue for the three months ended September 30, 2010 was 5.1%, a decrease from 6.3% for the three months ended September 30, 2009.

Our income from operations, which we also refer to as operating income, declined 3.3% to \$14.2 million for the three months ended September 30, 2010, from \$14.7 million for the three months ended September 30, 2009. This decline was primarily due to the continuing limiting effect which economic conditions had on growth of our net revenues, and to increases in processing and servicing expense. Our operating margin, which we measure as operating income divided by net revenue, was 12.3% for the three months ended September 30, 2010, compared to 13.4% for the three months ended September 30, 2009.

See **Results of Operations – Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2009** for a more detailed discussion of our third quarter financial results.

Critical Accounting Estimates

The discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. These condensed consolidated financial statements are unaudited. In our opinion, the unaudited condensed consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of our financial position at September 30, 2010, our results of operations, our changes in stockholders' equity and our cash flows for the nine months ended September 30, 2010 and 2009. Results of operations reported for interim periods are not necessarily indicative of the results to be expected for the year ended December 31, 2010. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates. Our significant accounting policies are more fully described in Note 2 to our consolidated financial statements included elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2009. The critical accounting estimates described here are those that are most important to the depiction of our financial condition and results of operations, including those whose application requires management's most subjective judgment in making estimates about the effect of matters that are inherently uncertain. The line items on our income statement and balance sheet, which are impacted by management's estimates, are described below.

Table of Contents*Revenue*

Our bankcard processing revenue is derived from processing and settling Visa and MasterCard bankcard transactions for our merchant customers. Our most significant expense related to the generation of those revenues is interchange fees, which are set by the Visa and MasterCard card networks, and paid to the card issuing banks. For our SME merchants bankcard processing, we do not offset bankcard processing revenues and interchange fees because our business practice is to advance the interchange fees to most of our merchants when settling their daily transactions (thus paying the full amount of the transaction to the merchant), and then to collect our full discount fees from our merchants on the first business day of the next month. We believe this policy aids in new business generation, as our merchants benefit from bookkeeping simplicity. However, this results in our carrying a large receivable from our merchants at each period-end, and a corresponding but smaller payable to our sponsor banks, which are settled on the first business day after the period-end. As we are at risk for the receivables, we record the associated revenues on a gross processing revenue basis in our Consolidated Statements of Operations. Certain of our competitors report their processing revenue net of interchange fees. This is because the card issuing banks make their payments to these competitors net of those interchange fees, and these acquirers pay this reduced amount to their merchants. Since the acquisition of Network Services, we also record a portion of our processing revenues net of interchange fees because the daily cash settlement with Network Services merchants is net of interchange fees.

Capitalized Customer Acquisition Costs

Capitalized customer acquisition costs consist of (1) up-front signing bonuses paid to Relationship Managers and sales managers, referred to as the salesperson or salespersons, for the establishment of new merchant relationships, and (2) deferred acquisition cost representing the estimated cost of buying out the commissions of vested salespersons at some point in the future. Capitalized customer acquisition costs represent incremental, direct customer acquisition costs that are recoverable through gross margins associated with SME merchant contracts. The capitalized customer acquisition costs are amortized using a method which approximates a proportional revenue approach over the initial three-year term of the merchant contract.

The amount of the up-front signing bonus paid for new SME bankcard, payroll and check processing accounts is based on the estimated gross margin for the first year of the merchant contract. The gross signing bonuses paid during the nine months ended September 30, 2010 and 2009 were \$19.9 million and \$26.4 million respectively and for the full year ended December 31, 2009 were \$34.7 million. The signing bonus paid, amount capitalized, and related amortization are adjusted at the end of the first year to reflect the actual gross margin generated by the merchant contract during that year. The net signing bonus adjustments made during the nine months ended September 30, 2010 and 2009 were \$(2.0) million and \$(0.9) million, respectively. Positive signing bonus adjustments occur when the actual gross margin generated by the merchant contract during the first year exceeds the estimated gross margin for that year, resulting in the underpayment of the up-front signing bonus and would be paid to the relevant sales person. Negative signing bonus adjustments result from prior overpayments of up-front signing bonuses, and would be recovered from the relevant salesperson. The amount of signing bonuses paid which remained subject to adjustment at September 30, 2010 was \$26.2 million.

The deferred acquisition cost component is accrued for vested salespersons over the first year of SME bankcard merchant processing, consistent with the build-up in the accrued buyout liability, which is described below.

Management evaluates the capitalized customer acquisition costs for impairment at each balance sheet date by comparing, on a pooled basis by vintage month of origination, the expected future net cash flows from underlying merchant relationships to the carrying amount of the capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the value of the capitalized customer acquisition costs, the impairment loss will be charged to operations. We have not recognized an impairment loss for the nine months ended September 30, 2010 or the year ended December 31, 2009.

Accrued Buyout Liability

We pay our salespersons residual commissions based on the gross margin generated from the monthly processing activity of SME merchants signed by them. We refer to these residual commissions as the owned portion of such commissions, or portfolio equity. The salesperson has no obligation to perform

Table of Contents

additional services for the merchant for so long as the merchant continues processing with us. We accrue the buyout liability, which represents the estimated current settlement cost of buying out all vested and expected-to-vest salespersons for the owned portion of such commissions. We also record a deferred acquisition cost asset related to those buyouts, and amortize that asset as an expense over the initial 3-year contract term.

We consider a salesperson to be vested once they have established merchant relationships that generate the equivalent of \$10,000 of monthly gross margin. Vested status entitles the salesperson to his or her residual commissions for as long as the merchant processes with us, even if the salesperson is no longer employed by us.

The accrued buyout liability is based on the SME merchants we have under contract at the balance sheet date, the gross margin we generated from those accounts in the prior twelve months, the owned commission rate, and the fixed buyout multiple of 2.5 times the commissions. The liability related to a new merchant is therefore zero when the merchant is installed, and increases over the twelve months following the installation date.

For unvested salespersons, the accrued buyout liability is accrued over the expected vesting period; however, no deferred acquisition cost is capitalized as future services are required in order to vest. In calculating the accrued buyout liability for unvested salespersons, we have assumed that 31% of unvested salespersons will vest in the future, which represents our historical vesting rate. A 5% increase to 36% in the expected vesting rate would have increased the accrued buyout liability for unvested salespersons by \$0.3 million at September 30, 2010 and December 31, 2009.

Buyout payments made to salespersons reduce the outstanding accrued buyout liability. Given our view of the duration of the cash flows associated with a pool of merchant contracts, we believe that the benefits of such buyouts significantly exceed the cost, which typically represents 2 to 2 1/2 years of commissions. If the cash flows associated with a pool of bought out contracts does not exceed this cost, we will incur an economic loss on our decision to buyout the contracts. During the nine months ended September 30, 2010 and 2009 we made buyout payments of approximately \$22.8 million and \$6.3 million, respectively, and during the 2009 full year, we made buyout payments of approximately \$8.1 million.

Buyout payments we made during the nine months ended September 30, 2010 included approximately \$17.7 million of cash payments made in the third quarter to buy out a substantial portion of residual commissions owned by our Relationship Managers and sales managers. We expect to realize a reduction of approximately \$0.6 million in monthly residual commission expense beginning in the fourth quarter of 2010, and lesser reductions in ensuing years. The amount of future reductions in residual commission expense will be impacted by merchant attrition. Management believes that these buyouts will generate an attractive return for the Company in the years ahead.

We expect to make buyout payments in the future, subject to available cash, as such buyouts reduce the monthly payments we will have to make to our salespersons for such merchants in the future.

Reserve for Processing System Intrusion

The Processing System Intrusion requires us to make assumptions and estimates concerning the outcomes and related costs and losses in connection with various lawsuits, claims, and investigations. We make our estimates of costs based on our best judgments and anticipated outcomes of these lawsuits, claims, and investigations. See [Overview Processing System Intrusion](#) for a discussion of the Processing System Intrusion.

Since our announcement of the Processing System Intrusion on January 20, 2009 and through September 30, 2010, we have expensed a total of \$145.0 million, before reducing those charges by \$30.7 million of total insurance recoveries. The majority of the total charges, or approximately \$114.7 million, related to settlements of claims. Approximately \$30.3 million of the total charges were for legal fees and costs we incurred for investigations, defending various claims and actions, remedial actions and crisis management services.

Table of Contents

During the nine months ended September 30, 2010, we recovered from our insurance providers approximately \$26.8 million of the costs it incurred for the Processing System Intrusion and expensed approximately \$12.0 million for accruals, legal fees and costs it incurred for defending various claims and actions, resulting in a net recovery of \$14.8 million, or \$0.23 per share. For the three months ended September 30, 2010, we expensed a total of \$0.7 million, or about \$0.01 per share, respectively, associated with the Processing System Intrusion.

For the three and nine months ended September 30, 2009, we expensed a total of \$73.3 million and \$105.3 million, respectively, or about \$1.22 and \$1.74 per share, respectively, for settlement accruals, legal fees and costs we incurred for defending various claims and actions associated with the Processing System Intrusion.

At September 30, 2010, we carried a \$1.6 million Reserve for Processing System Intrusion on its Consolidated Balance Sheet. The majority of this Reserve related to settlements which have been agreed upon but are unpaid as of the date of the Balance Sheet. We are prepared to vigorously defend ourselves against any unsettled claims relating to the Processing System Intrusion that have been asserted against us and our sponsor banks to date. We feel we have strong defenses to all the claims that have been asserted against us and our sponsor banks relating to the Processing System Intrusion.

Additional costs we expect to incur for legal fees and settlements related to the Processing System Intrusion will be recognized as incurred. Such costs could be material and could adversely impact our results of operations, financial condition and cash flow.

Merchant Deposits and Loss Reserves

Disputes between a cardholder and a merchant periodically arise as a result of, among other things, the cardholder's dissatisfaction with merchandise quality or merchant services. Such disputes may not be resolved in the merchant's favor. In these cases, the transaction is charged back to the merchant, which means the purchase price is refunded to the customer by the card-issuing bank and charged to the merchant. If the merchant is unable to fund the refund, we must do so. We also bear the risk of reject losses arising from the fact that we collect our fees from our merchants on the first day after the monthly billing period. If the merchant has gone out of business during such period, we may be unable to collect such fees. We maintain cash deposits or require the pledge of a letter of credit from certain merchants, generally those with higher average transaction size where the card is not present when the charge is made or the product or service is delivered after the charge is made, in order to offset potential contingent liabilities such as chargebacks and reject losses that would arise if the merchant went out of business. The majority of merchant deposits held by the Company include funds in transit associated with debit processing and check processing in addition to merchant funds held that are associated with bankcard processing. At September 30, 2010 and December 31, 2009, we held SME bankcard processing merchant deposits totaling \$8.1 million and \$8.8 million, respectively. Most chargeback and reject losses are charged to processing and servicing as they are incurred. However, we also maintain a loss reserve against losses including major fraud losses, which are both less predictable and involve larger amounts. The loss reserve was established using historical loss rates, applied to recent bankcard processing volume. At September 30, 2010 and December 31, 2009, our loss reserve totaled \$1.5 million and \$1.3 million, respectively. Aggregate bankcard merchant losses, including losses charged to operations and the loss reserve, were \$7.3 million and \$4.1 million for the nine months ended September 30, 2010 and 2009, respectively, and were \$5.9 million for the year ended December 31, 2009.

Chargebacks originating from large national merchant bankcard processing are processed and carried by Fifth Third Processing Solutions, which is our third-party outsourced processor for settling large national merchant accounts.

Stock Options

We expense employee share-based payments under the fair value method. Share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the requisite service period. Under the modified-prospective-transition method, we are required to record compensation expense for all awards granted after the date of adoption using grant-date fair value estimate and for the unvested portion of previously granted awards using the grant-date fair value estimate.

Table of Contents

We estimate the grant date fair value of the stock options we issue using a Black-Scholes valuation model for plain-vanilla stock options and performance-based stock options, and we use a Lattice valuation model to measure grant date fair value for stock options containing market vesting conditions. Our assumption for expected volatility is based on our historical volatility for those option grants whose expected life fall within a period we have sufficient historical volatility data related to market trading of our own Common Stock. For those option grants whose expected life is longer than we had sufficient historical volatility data related to market trading of our own Common Stock, we determined an expected volatility assumption by referencing the average volatility experienced by a group of our public company peers. For plain-vanilla stock options, we estimate the expected life of a stock option based on the simplified method as provided by the staff of the SEC. The simplified method is used because, at this point, we do not have sufficient historical information to develop reasonable expectations about future exercise patterns. For the performance-based options, the expected life is estimated based on the average of three possible performance condition outcomes. Our dividend yield assumption is based on dividends expected to be paid over the expected life of the stock option. Our risk-free interest rate assumption for stock options granted is determined by using U.S. treasury rates of the same period as the expected option term of each stock option.

The weighted-average fair value of options we granted during 2010, 2009 and 2008 were \$6.12, \$3.12 and \$6.11, respectively. The fair value of options granted during 2010, 2009 and 2008 was estimated at the grant date using the following weighted average assumptions:

	Year Ended December 31,		
	2010	2009	2008
Expected volatility	54%	48%	35%
Expected life	3.75 years	3.75 to 4.0 years	2.5 to 4.0 years
Expected Dividends	0.40%	0.47%	1.36%
Risk-free interest rate	1.21%	1.76%	2.98%

In the second quarter of 2009, our Board of Directors approved grants of 930,000 stock options subject to multiple vesting conditions. Under these stock options, the employee must provide continuous service over four years and a market price condition must be satisfied within those four years. These stock options have a five-year term and could vest in equal amounts in 2010, 2011, 2012 and 2013 only if during the four-year service period, the price of our common stock as reported by the New York Stock Exchange exceeds two or three times the exercise price for 30 consecutive trading days. The grant date fair values of these multiple vesting condition options are recognized as compensation expense over their four-year service periods.

Also in 2009, our Board of Directors approved grants of 362,600 Restricted Share Units. These Restricted Share Units are nonvested share awards which vest over a four-year service period. The closing price of our common stock on the grant date equals the grant date fair value of these nonvested share awards and will be recognized as compensation expense over their four-year service periods.

Goodwill

Goodwill represents the excess of acquisition costs over the fair values of net assets acquired in business combinations. We recorded goodwill in connection with our acquisitions of Debittek, Inc., E-Secure Peripherals, Inc., General Meters Corp., Collective Point of Sales Solutions Ltd., Network Services and Chockstone, Inc. Goodwill is tested for impairment at least annually and between annual tests if an event occurs or changes in circumstances suggest a potential decline in the fair value of the reporting unit. A significant amount of judgment is involved in determining if an indicator or change in circumstances relating to impairment has occurred. Such changes may include, among others: a significant decline in expected future cash flows; a sustained decline in market capitalization; a significant adverse change in legal factors or in the business