

VeriFone Holdings, Inc.  
Form 10-Q  
September 09, 2008

**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 July 31, 2008**
- Or**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from to**

**Commission file number: 001-32465**

**VERIFONE HOLDINGS, INC.**

*(Exact name of registrant as specified in its charter)*

**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**04-3692546**  
*(I.R.S. Employer  
Identification No.)*

**2099 Gateway Place, Suite 600  
San Jose, CA 95110**  
*(Address of principal executive offices with zip code)*

**(408) 232-7800**  
*(Registrant's telephone number, including area code)*

**N/A**  
*(Former name, former address and former fiscal year, if changed since last report)*

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Edgar Filing: VeriFone Holdings, Inc. - Form 10-Q

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if a 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

At August 29, 2008 the number of shares outstanding of the registrant's common stock, \$0.01 par value was 84,325,800.

---

**VERIFONE HOLDINGS, INC.**

**TABLE OF CONTENTS**

**INDEX**

**PART I FINANCIAL INFORMATION**

<u>Item 1</u>	<u>Financial Statements (unaudited):</u>	
	<u>Condensed Consolidated Balance Sheets as of July 31, 2008 and October 31, 2007</u>	1
	<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended July 31, 2008 and 2007</u>	2
	<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended July 31, 2008 and 2007</u>	3
	<u>Notes to Condensed Consolidated Financial Statements</u>	4
<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
<u>Item 3</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	41
<u>Item 4</u>	<u>Controls and Procedures</u>	42

**PART II OTHER INFORMATION**

<u>Item 1</u>	<u>Legal Proceedings</u>	44
<u>Item 1A</u>	<u>Risk Factors</u>	44
<u>Item 2</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	44
<u>Item 3</u>	<u>Defaults Upon Senior Securities</u>	44
<u>Item 4</u>	<u>Submission of Matters to a Vote of Security Holders</u>	44
<u>Item 5</u>	<u>Other Information</u>	44
<u>Item 6</u>	<u>Exhibits</u>	44
<u>Signatures</u>		45
<u>Exhibit Index</u>		46
<u>EXHIBIT 31.1</u>		
<u>EXHIBIT 31.2</u>		
<u>EXHIBIT 32</u>		

---

**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>July 31, 2008</b>	<b>October 31, 2007(1)</b>
	<b>(Unaudited)</b>	
	<b>(In thousands, except par value)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 182,014	\$ 215,001
Accounts receivable, net of allowance of \$5,342 and \$4,270	176,852	194,146
Inventories	162,664	107,168
Deferred tax assets	20,997	23,854
Prepaid expenses and other current assets	69,727	63,413
Total current assets	612,254	603,582
Property, plant and equipment, net	53,263	48,293
Purchased intangible assets, net	126,356	170,073
Goodwill	634,928	611,977
Deferred tax assets	69,835	67,796
Debt issuance costs, net	12,406	12,855
Other assets	46,561	32,733
Total assets	\$ 1,555,603	\$ 1,547,309
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 105,796	\$ 105,215
Income taxes payable	16,463	19,530
Accrued compensation	22,887	21,201
Accrued warranty	7,330	11,012
Deferred revenue, net	54,312	43,049
Deferred tax liabilities	6,221	6,154
Accrued expenses	11,160	8,755
Other current liabilities	101,207	86,465
Current portion of long-term debt	5,034	5,386

Edgar Filing: VeriFone Holdings, Inc. - Form 10-Q

Total current liabilities	330,410	306,767
Accrued warranty	1,227	655
Deferred revenue, net	11,131	11,274
Long-term debt	544,713	547,766
Deferred tax liabilities	94,696	87,142
Other long-term liabilities	34,081	10,296
Total liabilities	1,016,258	963,900
Minority interest	2,119	2,487
Stockholders' equity:		
Preferred stock: \$0.01 par value; 10,000 shares authorized at July 31, 2008 and October 31, 2007; zero shares issued and outstanding as of July 31, 2008 and October 31, 2007		
Common stock: \$0.01 par value; 100,000 shares authorized at July 31, 2008 and October 31, 2007; 84,194 and 84,060 shares issued and outstanding as of July 31, 2008 and October 31, 2007	842	841
Additional paid-in capital	650,349	635,404
Accumulated deficit	(137,535)	(77,484)
Accumulated other comprehensive income	23,570	22,161
Total stockholders' equity	537,226	580,922
Total liabilities and stockholders' equity	\$ 1,555,603	\$ 1,547,309

(1) Amounts as of October 31, 2007 were derived from the October 31, 2007 audited consolidated financial statements.

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these financial statements.

**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<b>(Unaudited)</b>			
	<b>(In thousands, except per share data)</b>			
Net revenues:				
System Solutions	\$ 228,766	\$ 205,972	\$ 588,078	\$ 586,407
Services	29,932	25,729	89,142	78,540
Total net revenues	258,698	231,701	677,220	664,947
Cost of net revenues:				
System Solutions	151,698	132,268	403,208	391,510
Services	18,577	13,837	54,873	41,572
Total cost of net revenues	170,275	146,105	458,081	433,082
Gross profit	88,423	85,596	219,139	231,865
Operating expenses:				
Research and development	17,558	15,365	57,179	48,272
Sales and marketing	23,540	23,686	70,945	69,549
General and administrative	35,863	19,364	93,183	62,306
Amortization of purchased intangible assets	6,183	5,416	18,855	16,456
In-process research and development				6,650
Total operating expenses	83,144	63,831	240,162	203,233
Operating income (loss)	5,279	21,765	(21,023)	28,632
Interest expense	(6,447)	(9,468)	(21,877)	(28,731)
Interest income	1,194	2,226	4,677	4,751
Other income (expense), net	194	(4,156)	(6,240)	(4,419)
Income (loss) before income taxes	220	10,367	(44,463)	233
Provision for income taxes	7,419	52,753	14,221	53,116
Net loss	\$ (7,199)	\$ (42,386)	\$ (58,684)	\$ (52,883)
Net loss per share:				
Basic	\$ (0.09)	\$ (0.51)	\$ (0.70)	\$ (0.65)
Diluted	\$ (0.09)	\$ (0.51)	\$ (0.70)	\$ (0.65)

Weighted average shares used in computing net loss per share:

Edgar Filing: VeriFone Holdings, Inc. - Form 10-Q

Basic	84,194	82,407	84,181	81,699
Diluted	84,194	82,407	84,181	81,699

The accompanying Notes to Condensed Consolidated Financial Statements  
are an integral part of these financial statements.



**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Nine Months Ended</b>	
	<b>July 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
<b>Cash flows from operating activities:</b>		
Net loss	\$ (58,684)	\$ (52,883)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization of purchased intangible assets	43,155	44,930
Depreciation and amortization of property, plant and equipment	9,894	5,814
Amortization of capitalized software development costs	1,142	800
In-process research and development		6,650
Write-off of capitalized software development costs	2,700	
Loss on disposal of property, plant and equipment	375	
Amortization of debt issuance costs	1,994	1,129
Stock-based compensation	13,159	21,954
Non-cash portion of loss on debt extinguishment		4,764
Minority interest and equity in earnings of affiliates	(22)	(86)
Other	37	(81)
Net cash provided by operating activities before changes in working capital	13,750	32,991
Changes in operating assets and liabilities:		
Accounts receivable, net	18,306	(28,035)
Inventories	(54,875)	47,967
Deferred tax assets	1,327	(7,161)
Prepaid expenses and other current assets	(7,114)	(5,852)
Other assets	(15,361)	(3,709)
Accounts payable	386	19,487
Income taxes payable	15,583	39,475
Tax benefits from stock-based compensation	(939)	(6,882)
Accrued compensation	742	(5,147)
Accrued warranty	(3,110)	(2,640)
Accrued expenses and other liabilities	22,359	(15,432)
Deferred revenues	8,847	10,317
Deferred tax liabilities	7,747	9,434
Net cash provided by operating activities	7,648	84,813
<b>Cash flows from investing activities:</b>		
Software development costs capitalized	(3,170)	(4,532)
Purchase of property, plant and equipment	(14,368)	(20,366)
Purchase of other assets		(500)
Acquisition of businesses, net of cash acquired	(15,366)	(267,745)

Net cash used in investing activities	(32,904)	(293,143)
<b>Cash flows from financing activities:</b>		
Proceeds from long-term debt, net of costs	286	613,252
Purchase of convertible note hedge		(80,236)
Sale of warrants		31,188
Repayment of long-term debt	(3,750)	(262,554)
Proceeds from exercise of stock options	1,692	24,539
Payment of debt amendment fees	(1,751)	
Tax benefits from stock-based compensation	939	6,882
Investment in subsidiary by minority stockholder		1,050
Other	(63)	(17)
Net cash provided by (used in) financing activities	(2,647)	334,104
Effect of foreign exchange rate on cash and cash equivalents	(5,084)	608
Net increase (decrease) in cash and cash equivalents	(32,987)	126,382
Cash and cash equivalents at beginning of period	215,001	86,564
Cash and cash equivalents at end of period	\$ 182,014	\$ 212,946
<b>Supplemental disclosure for cash flow information:</b>		
Cash paid for interest	\$ 15,626	\$ 25,345
Cash paid (received) for income taxes	(\$ 1,002)	\$ 13,779
<b>Supplemental schedule of non-cash transactions:</b>		
Debt issuance costs withheld from proceeds	\$	\$ 8,333
Issuance of common stock and stock options for acquisition	\$	\$ 435,228

The accompanying Notes to the Condensed Consolidated Financial Statements  
are an integral part of these financial statements.

**Table of Contents**

**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1. Basis of Presentation**

***The Company***

VeriFone Holdings, Inc. ( VeriFone or the Company ) was incorporated in the state of Delaware on June 13, 2002. VeriFone designs, markets, and services electronic payment solutions that enable secure electronic payments among consumers, merchants, and financial institutions.

***Principles of Consolidation***

The accompanying condensed consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

***Unaudited Interim Financial Statements***

The accompanying condensed consolidated balance sheet as of July 31, 2008 and condensed consolidated statements of operations for the three and nine months ended July 31, 2008 and 2007 and condensed consolidated statements of cash flows for the nine months ended July 31, 2008 and 2007 are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information and the instructions to Rule 10-01 of Regulation S-X and the instructions for Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ) and, therefore, do not include all information and notes normally provided in audited financial statements prepared under GAAP. In the opinion of the Company's management, the unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and include all adjustments of a normal recurring nature necessary for the fair presentation of the Company's financial position as of July 31, 2008 and its results of operations for the three and nine months ended July 31, 2008 and 2007 and cash flows for the nine months ended July 31, 2008 and 2007. The condensed consolidated balance sheet at October 31, 2007 has been derived from audited consolidated financial statements, but does not include all disclosures required by GAAP. These unaudited interim condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2007 filed with the Securities and Exchange Commission.

***Summary of Significant Accounting Policies***

The Company adopted the Financial Accounting Standards Board ( FASB ) Interpretation 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*, effective November 1, 2007. FIN 48 clarifies the accounting for income taxes recognized in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position. FIN 48 indicates that an enterprise shall initially recognize the financial statement effects of a tax position when it is more likely than not of being sustained on examination, based on the technical merits of the position. In addition, FIN 48 indicates that the measurement of a tax position that meets the more likely than not threshold shall consider the amounts and probabilities of the outcomes that could be realized upon ultimate settlement. The impact on adoption of FIN 48 is described in Note 9, *Income Taxes* .

Other than this change, there have been no changes in the Company's significant accounting policies during the nine months ended July 31, 2008 as compared to the significant accounting policies described in the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2007.

**Table of Contents**

**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Use of Estimates***

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates, and such differences may be material to the condensed consolidated financial statements.

***Concentrations of Credit Risk***

As of July 31, 2008 and October 31, 2007, no customer accounted for 10% or more of the Company's accounts receivable. No customer accounted for 10% or more of net revenues for the three and nine months ended July 31, 2008 and 2007.

***Recent Accounting Pronouncements***

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. On February 12, 2008, the FASB issued FASB Staff Position ( FSP ) FAS 157-2, *Effective Date of FASB Statement No. 157*. FSP FAS 157-2 defers the implementation of SFAS No. 157 for certain nonfinancial assets and nonfinancial liabilities. The remainder of SFAS No. 157 is effective for the Company beginning in the first quarter of fiscal year 2009. The aspects that have been deferred by FSP FAS 157-2 will be effective for the Company beginning in the first quarter of fiscal year 2010. The implementation of SFAS No. 157 is not expected to have a material impact on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to elect to measure financial assets and liabilities at fair value. The objective of the guidance is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently, without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, provided the provisions of SFAS No. 157 are applied. The Company is evaluating SFAS No. 159 and has not yet determined the impact, if any, its adoption will have on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*. SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests ( NCI ) and classified as a component of equity. In conjunction with SFAS No. 141(R), discussed below, SFAS No. 160 will significantly change the accounting for partial and/or step acquisitions. SFAS No. 160 will be effective for the Company in the first quarter of fiscal year 2010. Early adoption is not permitted. The Company is currently evaluating SFAS No. 160 and has not yet determined the impact, if any, its adoption will have on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. SFAS No. 141(R) changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for pre-acquisition gain and loss contingencies, the recognition of capitalized in-process research and development as an indefinite-lived intangible asset until approved or discontinued rather than as an immediate expense, expensing restructuring costs in connection with an acquisition rather than considering them a liability assumed in the acquisition, the treatment of acquisition-related transaction costs, including the fair value of contingent consideration at the date of an acquisition, the recognition of

**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

changes in the acquirer's income tax valuation allowance, and accounting for partial and/or step acquisitions. SFAS No. 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies under SFAS No. 109, *Accounting for Income Taxes*. Early adoption is not permitted. When SFAS No. 141(R) becomes effective, which, for the Company, will be in the first quarter of fiscal year 2010, any adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of SFAS No. 141(R) will be recorded through income tax expense, whereas currently the accounting treatment would require any adjustment to be recognized through the purchase price. The Company is currently evaluating SFAS No. 141(R) and has not yet determined the impact, if any, its adoption will have on the Company's consolidated financial statements.

In May 2008, the FASB issued FASB Staff Position ( FSP ) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP APB 14-1 requires the issuer of a convertible debt instrument with cash settlement features to account separately for the liability and equity components of the instrument. The debt would be recognized at the present value of its cash flows discounted using an entity specific nonconvertible debt borrowing rate at the time of issuance. The equity component would be recognized as the difference between the proceeds from the issuance of the note and the fair value of the liability. The FSP also requires accretion of the resultant debt discount over the expected life of the debt. The FSP is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. Entities are required to apply the FSP retrospectively for all periods presented. The Company is currently evaluating FSP APB 14-1 and has not yet determined the impact its adoption will have on the Company's consolidated financial statements. However, the impact of this new accounting treatment will be significant and will result in a significant increase to non-cash interest expense beginning in fiscal year 2010 for financial statements covering past and future periods.

**Note 2. Balance Sheet and Statement of Operations Details*****Inventories***

Inventories consisted of the following (in thousands):

	<b>July 31, 2008</b>	<b>October 31, 2007</b>
Raw materials	\$ 47,681	\$ 29,548
Work-in-process	6,898	3,849
Finished goods	108,085	73,771
	<b>\$ 162,664</b>	<b>\$ 107,168</b>

***Prepaid Expenses and Other Current Assets***

Prepaid expenses and other current assets consisted of the following (in thousands):

	<b>July 31, 2008</b>	<b>October 31, 2007</b>
Prepaid taxes	\$ 47,273	\$ 38,390
Prepaid expenses	12,476	15,266
Other receivables	5,661	7,827
Other current assets	4,317	1,930
	<b>\$ 69,727</b>	<b>\$ 63,413</b>

The Company had \$2.0 million and \$1.3 million of restricted cash as of July 31, 2008 and October 31, 2007, respectively. The restricted cash balances were comprised mainly of pledged deposits for bank guarantees.



Table of Contents**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Purchased Intangible Assets, net*

Purchased intangible assets subject to amortization consisted of the following (in thousands):

	July 31, 2008			October 31, 2007		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Developed technology	\$ 172,325	\$ (89,363)	\$ 82,962	\$ 172,564	\$ (64,981)	\$ 107,583
Core technology	14,442	(14,442)		14,442	(14,442)	
Trade name	22,225	(22,225)		22,225	(22,225)	
Internal use software	4,373	(1,461)	2,912	4,485	(853)	3,632
Customer relationships	90,821	(50,339)	40,482	91,023	(32,165)	58,858
	\$ 304,186	\$ (177,830)	\$ 126,356	\$ 304,739	\$ (134,666)	\$ 170,073

Amortization of purchased intangible assets for the three and nine months ended July 31, 2008 and 2007 was allocated as follows (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2008	2007	2008	2007
Included in cost of net revenues	\$ 8,001	\$ 9,278	\$ 24,300	\$ 28,474
Included in operating expenses	6,183	5,416	18,855	16,456
	\$ 14,184	\$ 14,694	\$ 43,155	\$ 44,930

Estimated future amortization expense of purchased intangible assets recorded as of July 31, 2008 is as follows (in thousands):

Fiscal Year	Cost of Net Revenues	Operating Expenses	Total
2008 (remaining 3 months)	\$ 7,770	\$ 6,573	\$ 14,343
2009	31,759	20,597	52,356
2010	24,796	12,137	36,933
2011	15,034	3,332	18,366

2012	2,614	462	3,076
Thereafter	988	294	1,282
Total	\$ 82,961	\$ 43,395	\$ 126,356

***Goodwill***

Activity related to goodwill consisted of the following (in thousands):

	<b>Nine Months Ended July 31, 2008</b>	<b>Year Ended October 31, 2007</b>
Balance at beginning of period	\$ 611,977	\$ 52,689
Additions related to acquisitions	16,158	540,043
Resolution of tax contingencies and adjustments to tax reserves and valuation allowance established in purchase accounting	1,504	(5,229)
Currency translation adjustments	5,289	24,474
Balance at end of period	\$ 634,928	\$ 611,977

**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Accrued Warranty***

Activity related to accrued warranty consisted of the following (in thousands):

	<b>Nine Months Ended July 31, 2008</b>	<b>Year Ended October 31, 2007</b>
Balance at beginning of period	\$ 11,667	\$ 5,432
Warranty charged to cost of net revenues	4,658	3,664
Utilization of warranty	(9,404)	(13,089)
Change in estimates	1,587	4,768
Warranty liabilities assumed in acquisitions	49	10,892
Balance at end of period	8,557	11,667
Less current portion	(7,330)	(11,012)
Long-term portion	\$ 1,227	\$ 655

***Deferred Revenue, net***

Deferred revenue, net consisted of the following (in thousands):

	<b>July 31, 2008</b>	<b>October 31, 2007</b>
Deferred revenue	\$ 75,909	\$ 58,992
Deferred cost of revenue	(10,466)	(4,669)
	65,443	54,323
Less current portion	(54,312)	(43,049)
Long-term portion	\$ 11,131	\$ 11,274

***Other Current Liabilities***

Other current liabilities consisted of the following (in thousands):

	<b>July 31, 2008</b>	<b>October 31, 2007</b>
Other tax liabilities(1)	\$ 46,899	\$ 39,310
Accrued interest	2,967	2,620
Accounts payable related accrual	18,841	16,246
Accrued legal and audit fees	9,562	4,693
Other	22,938	23,596
Total other current liabilities	\$ 101,207	\$ 86,465

(1) Two of the Company's Brazilian subsidiaries that were acquired as part of the Lipman acquisition have been notified of assessments regarding Brazilian customs penalties and interest that relate to alleged infractions in the importation of goods. The Company has accrued \$23.2 million as of July 31, 2008 and \$19.4 million as of October 31, 2007 related to these assessments. See Note 10, "Commitments and Contingencies", for additional information related to these tax assessments.

Table of Contents**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Other Income (Expense), net***

Other income (expense), net consisted of the following (in thousands):

	<b>Three Months Ended July 31,</b>		<b>Nine Months Ended July 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Foreign currency transaction gains (losses), net	\$ 428	\$ 1,213	\$ (5,430)	\$ 3,106
Foreign currency contract losses, net	(883)	(914)	(1,664)	(2,929)
Loss on debt extinguishment		(4,764)		(4,764)
Other, net	649	309	854	168
	\$ 194	\$ (4,156)	\$ (6,240)	\$ (4,419)

**Note 3. Financings**

The Company's financing consisted of the following (in thousands):

	<b>July 31, 2008</b>	<b>October 31, 2007</b>
Term B Loan	\$ 232,500	\$ 236,250
Senior convertible notes	316,250	316,250
Capital lease and other notes payable	997	652
Total	549,747	553,152
Less current portion	(5,034)	(5,386)
Long-term portion	\$ 544,713	\$ 547,766

***Secured Credit Facility***

On October 31, 2006, the Company's principal subsidiary, VeriFone, Inc. (the Borrower) entered into a Credit Agreement with a syndicate of financial institutions led by JP Morgan Chase Bank N.A. and Lehman Commercial Paper, Inc. (the Lender). The credit agreement consisted of a Term B Loan facility of \$500 million and a revolving loan permitting borrowings of up to \$40 million (the Credit Facility). At July 31, 2008 and October 31, 2007, \$232.5 million and \$236.3 million, respectively, were outstanding under the Term B Loan and there were no borrowings under the revolving loan.

The Credit Facility is guaranteed by the Company and certain of its subsidiaries and is secured by collateral including substantially all of the Company's assets and stock of the Company's subsidiaries. At July 31, 2008, the Term B Loan bore an interest rate of 5.55%, which was 2.75% over the three-month LIBOR. The effective interest rate was 7.11% as of October 31, 2007, which was prior to the amendments described below.

At July 31, 2008, at the Borrower's option, the revolving loan bears interest at a rate of 2.0% over the three-month LIBOR, or 1.0% over the lender's base rate. The effective interest rate was 4.80% as of July 31, 2008. The effective interest rate was 6.61% as of October 31, 2007, which was prior to the amendments described below.

The terms of the Credit Facility require the Company to comply with certain financial as well as non-financial covenants. As of July 31, 2008, the Company was in compliance with the covenants under the Credit Facility.

Effective January 25, 2008, the Borrower and VeriFone Intermediate Holdings, Inc. entered into a First Amendment to the Credit Agreement and Waiver (the "First Amendment") with the Lenders under its Credit Facility. The Amendment extended the time periods for delivery of certain required financial information for the three month periods ended January 31, April 30 and July 31, 2007, the year ended October 31, 2007 and the three

**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

month period ended January 31, 2008. In connection with the First Amendment, the Borrower paid to the consenting Lenders a fee of \$0.7 million, or 0.25% of the aggregate amount outstanding under Term B Loan and the amount of the revolving credit commitment made available by the consenting Lenders under the Credit Facility and agreed to an increase in the interest rate payable on the Term B Loan of 0.25% per annum.

On April 28, 2008, the Borrower and VeriFone Intermediate Holdings, Inc. entered into a Second Amendment to Credit Agreement (the Second Amendment) with the Lenders under its Credit Facility. The Second Amendment extended the time periods for delivery of certain required financial information for the three-month periods ended January 31, April 30 and July 31, 2007, the year ended October 31, 2007 and the three-month periods ended January 31 and April 30, 2008. In connection with the Second Amendment, the Borrower paid to consenting Lenders a fee of \$0.7 million, or 0.25% of the aggregate amount outstanding under the Term B loan and the amount of the revolving credit commitment made available by the consenting Lenders, agreed to an increase in the interest rate payable on the Term B loan and any revolving commitments of 0.75% per annum, agreed to an increase of 0.125% per annum to the commitment fee for unused revolving commitments and agreed to an increase of 0.75% per annum to the letter of credit fees, each of which are effective from the date of the Second Amendment.

On July 31, 2008, the Borrower and VeriFone Intermediate Holdings, Inc. entered into a Third Amendment to the Credit Agreement (the Third Amendment) with the Lenders under its Credit Facility. The Third Amendment extended the time periods for delivery of certain required financial information for the three-month periods ended January 31, April 30 and July 31, 2007, the year ended October 31, 2007 and the three-month periods ended January 31 and April 30, 2008 to August 31, 2008. In connection with the Third Amendment, the Borrower paid to consenting Lenders a fee of \$0.3 million, or 0.125% of the aggregate amount outstanding under the Term B loan and the amount of the revolving credit commitment made available by the consenting Lenders. Following the Third Amendment, the Borrower pays interest on the Term B loan at a rate of 2.75% over three-month LIBOR (the Borrower may elect at the end of an interest period to have the term loan bear interest at 1.75% over the lender's base rate) and any revolving loans would bear interest, at the Borrower's option, at either 2.0% over LIBOR or 1.0% over the lender's base rate, assuming the Borrower remains in the lowest rate tier based on its total consolidated leverage ratio.

***1.375% Senior Convertible Notes***

On June 22, 2007, the Company issued and sold \$316.2 million aggregate principal amount of its 1.375% Senior Convertible Notes due 2012 (the Notes) in an offering through Lehman Brothers Inc. and JP Morgan Securities Inc. (together the initial purchasers) to qualified institutional buyers pursuant to Section 4(2) of, and Rule 144A under the Securities Act. The net proceeds from the offering, after deducting transaction costs, were approximately \$307.9 million. The Company incurred approximately \$8.3 million of debt issuance costs. The transaction costs, consisting of the initial purchasers' discounts and offering expenses, were primarily recorded in debt issuance costs, net and are being amortized to interest expense using the effective interest method over five years. The Company will pay 1.375% interest per annum on the principal amount of the Notes, payable semi-annually in arrears in cash on June 15 and December 15 of each year, commencing on December 15, 2007, subject to increase in certain circumstances as described below. The fair value of the 1.375% Senior Convertible Notes was \$239.5 million as of July 31, 2008 based on the trading price at the end of the day.

The Notes were issued under an Indenture with U.S. Bank National Association, as trustee. Each \$1,000 of principal of the Notes will initially be convertible into 22.719 shares of VeriFone common stock, which is equivalent to a

conversion price of approximately \$44.02 per share, subject to adjustment upon the occurrence of specified events. Holders of the Notes may convert their Notes prior to maturity during specified periods as follows: (1) on any date during any fiscal quarter (and only during such fiscal quarter) if the closing sale price of the Company's common stock was more than 130% of the then current conversion price for at least 20 trading days in the period of the 30 consecutive trading days ending on the last trading day of the previous fiscal quarter; (2) at any time on or after March 15, 2012; (3) if the Company distributes to all holders of its common stock rights or warrants (other than pursuant to a rights plan) entitling them to purchase, for a period of 45 calendar days or less, shares of the Company's common stock at a price less than the average closing sale price for the ten trading days preceding the



**Table of Contents**

**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

declaration date for such distribution; (4) if the Company distributes to all holders of its common stock, cash or other assets, debt securities or rights to purchase the Company's securities (other than pursuant to a rights plan), which distribution has a per share value exceeding 10% of the closing sale price of the Company's common stock on the trading day preceding the declaration date for such distribution; (5) during a specified period if certain types of fundamental changes occur; or (6) during the five business-day period following any five consecutive trading-day period in which the trading price for the Notes was less than 98% of the average of the closing sale price of the Company's common stock for each day during such five trading-day period multiplied by the then current conversion rate. Upon conversion, the Company would pay the holder the cash value of the applicable number of shares of VeriFone common stock, up to the principal amount of the Note. Amounts in excess of the principal amount, if any, will be paid in stock. Unless and until the Company obtains stockholder approval to amend its certificate of incorporation to increase its authorized capital, the maximum number of shares available for issuance upon conversion of each \$1,000 principal amount of Notes will be the pro rata portion of an aggregate of 3,250,000 shares allocable to such Note, which equates to 10.2766 shares per \$1,000 principal amount of Notes. Because the Company did not increase its authorized capital to permit conversion of all of the Notes at the initial conversion rate by June 21, 2008, beginning on June 21, 2008 the Notes began to bear additional interest at a rate of 2.0% per annum (in addition to the additional interest described below) on the principal amount of the Notes, which will increase by 0.25% per annum on each anniversary thereafter if the authorized capital has not been increased. If stockholder approval to increase the Company's authorized capital is received, such additional interest will cease to accrue. As of July 31, 2008, the fair value of the derivative related to this interest penalty on the Notes was determined to be \$1.9 million and was included in Other Current Liabilities on the Condensed Consolidated Balance Sheets.

As of July 31, 2008, none of the conditions allowing holders of the Notes to convert had been met. If a fundamental change, as defined in the indenture pursuant to which the Notes were issued, occurs prior to the maturity date, holders of the Notes may require the Company to repurchase all or a portion of their Notes for cash at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest (including additional interest, if any) to, but excluding, the repurchase date.

The Notes are senior unsecured obligations and rank equal in right of payment with all of the Company's existing and future senior unsecured indebtedness. The Notes are effectively subordinated to any secured indebtedness to the extent of the value of the related collateral and structurally subordinated to indebtedness and other liabilities of the Company's subsidiaries including any secured indebtedness of such subsidiaries.

In connection with the sale of the Notes, the Company entered into a registration rights agreement, dated as of June 22, 2007, with the initial purchasers of the Notes (the "Registration Rights Agreement"). Under the Registration Rights Agreement, the Company has agreed (1) to use reasonable best efforts to cause a shelf registration statement covering resales of the Notes and the shares of common stock issuable upon conversion of the Notes to be declared effective by December 19, 2007 or to cause an existing shelf registration statement to be made available within 180 days after the original issuance of the Notes and (2) to use its reasonable best efforts to keep effective the shelf registration statement until the earliest of (i) the date when the holders of transfer-restricted Notes and shares of common stock issued upon conversion of the Notes are able to sell all such securities immediately without restriction under Rule 144(k) under the Securities Act of 1933, as amended (the "Securities Act"), (ii) the date when all transfer-restricted Notes and shares of common stock issued upon conversion of the Notes are registered under the registration statement and sold pursuant thereto and (iii) the date when all transfer-restricted Notes and shares of common stock issued upon conversion of the Notes have ceased to be outstanding. If the Company fails to meet these

terms, it will be required to pay additional interest on the Notes at a rate of 0.25% per annum for the first 90 days and at a rate of 0.50% per annum thereafter.

Due to the delay in the filing of the Company's Annual Report on Form 10-K for fiscal year 2007, the Company has not been able to register the Notes and the shares underlying the Notes. Accordingly, the interest rate on the Notes increased by 0.25% per annum on December 20, 2007 and by an additional 0.25% per annum on March 19, 2008

**Table of Contents**

**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

relating to the Company's obligations under the Registration Rights Agreement. Once a registration statement covering the Notes and shares underlying the Notes is declared effective, such additional interest will cease to accrue. As of July 31, 2008, the Company expensed \$0.9 million of which \$0.3 million was included in Other Current Liabilities on the Condensed Consolidated Balance Sheets.

In addition, the interest rate on the Notes increased an additional 0.25% per annum on May 1, 2008 (in addition to the additional interest described above) because the Company failed to file and deliver the 2007 Annual Report. Such additional 0.25% interest ceased to accrue following the filing of the 2007 Annual Report on August 19, 2008. As of July 31, 2008, the fair value of the derivative related to this interest penalty on the Notes was determined to be \$0.1 million and was included in Other Current Liabilities on the Condensed Consolidated Balance Sheets.

In connection with the offering of the Notes, the Company entered into note hedge transactions with affiliates of the initial purchasers (the counterparties) whereby the Company has the option to purchase up to 7,184,884 shares of its common stock at a price of approximately \$44.02 per share. The cost to the Company of the note hedge transactions was approximately \$80.2 million. The note hedge transactions are intended to mitigate the potential dilution upon conversion of the Notes in the event that the volume weighted average price of the Company's common stock on each trading day of the relevant conversion period or other relevant valuation period is greater than the applicable strike price of the convertible note hedge transactions, which initially corresponds to the conversion price of the Notes and is subject, with certain exceptions, to the adjustments applicable to the conversion price of the Notes.

In addition, the Company sold warrants to the counterparties whereby they have the option to purchase up to approximately 7.2 million shares of VeriFone common stock at a price of \$62.356 per share. The Company received approximately \$31.2 million in cash proceeds from the sale of these warrants. If the volume weighted average price of the Company's common stock on each trading day of the measurement period at maturity of the warrants exceeds the applicable strike price of the warrants, there would be dilution to the extent that such volume weighted average price of the Company's common stock exceeds the applicable strike price of the warrants. Unless and until the Company obtains stockholder approval to amend its certificate of incorporation to increase its authorized capital, the maximum number of shares issuable upon exercise of the warrants will be 1,000,000 shares of the Company's common stock. If the Company does not obtain stockholder approval to amend its certificate of incorporation to increase its authorized capital by the date of the second annual meeting of the Company's stockholders after the date of the pricing of the Notes, the number of shares of the Company's common stock underlying the warrants will increase by 10%, and the warrants will be subject to early termination by the counterparties.

The cost incurred in connection with the note hedge transactions, net of the related tax benefit and the proceeds from the sale of the warrants, is included as a net reduction in additional paid-in capital in the accompanying condensed consolidated balance sheets as of July 31, 2008, in accordance with the guidance in Emerging Issues Task Force Issue No. 00-19 (EITF 00-19), *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*.

In accordance with SFAS No. 128, *Earnings per Share*, the Notes will have no impact on diluted earnings per share, or EPS, until the price of the Company's common stock exceeds the conversion price of \$44.02 per share because the principal amount of the Notes will be settled in cash upon conversion. Prior to conversion, the Company will include the effect of the additional shares that may be issued if its common stock price exceeds \$44.02 per share using the treasury stock method. If the price of the Company's common stock exceeds \$62.356 per share, it will also include the

effect of the additional potential shares that may be issued related to the warrants using the treasury stock method. Prior to conversion, the note hedge transactions are not considered for purposes of the EPS calculation as their effect would be anti-dilutive.

**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 4. Comprehensive Income (Loss)**

The components of comprehensive income (loss) were as follows (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net loss	\$ (7,199)	\$ (42,386)	\$ (58,684)	\$ (52,883)
Other comprehensive income (loss):				
Foreign currency translation adjustments	3,126	3,345	1,372	13,608
Unrealized gain (loss) on interest rate hedge, net of tax	18	4	37	(19)
Comprehensive income (loss)	\$ (4,055)	\$ (39,037)	\$ (57,275)	\$ (39,294)

The components of accumulated other comprehensive income consisted of the following (in thousands):

	<b>July 31,</b>	<b>October 31,</b>
	<b>2008</b>	<b>2007</b>
Foreign currency translation adjustments	\$ 23,596	\$ 22,224
Unrecorded loss on interest rate hedges	(26)	(63)
Accumulated other comprehensive income	\$ 23,570	\$ 22,161

**Note 5. Stockholders Equity**

The Company grants stock options and restricted stock units ( RSUs ) pursuant to stockholder approved stock option plans. The Company maintains certain equity incentive plans, as described in detail in Note 7 of Notes to Consolidated Financial Statements in its Annual Report on Form 10-K for the fiscal year ended October 31, 2007. All stock options and RSUs granted during the nine months ended July 31, 2008 were granted under the 2006 Equity Incentive Plan.

**Stock-Based Compensation**

The Company follows SFAS No. 123(R), *Share-Based Payment*, which requires the measurement of compensation cost for all outstanding unvested share-based awards at fair value and recognizes compensation over the requisite service period for awards expected to vest. The following table summarizes stock-based compensation expense by classification recorded under SFAS No. 123(R) for the three and nine months ended July 31, 2008 and 2007 (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Cost of net revenues	\$ 455	\$ 570	\$ 1,003	\$ 2,417
Sales and marketing	1,290	1,443	3,516	4,342
Research and development	1,536	1,974	4,856	5,486
General and administrative	1,378	1,872	3,784	9,709
Total stock-based compensation	\$ 4,659	\$ 5,859	\$ 13,159	\$ 21,954

**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Valuation Assumptions***

The Company estimates the grant-date fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of SFAS No. 123(R) and Staff Accounting Bulletin ( SAB ) No. 107, *Share-Based Payment*, using the weighted-average assumptions noted in the following table.

	<b>Three Months Ended July 31,</b>		<b>Nine Months Ended July 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Expected term of the options (in years)	N/A	2.0	3.0	2.1
Risk-free interest rate	N/A	4.8%	2.9%	4.8%
Expected stock price volatility	N/A	39.8%	40.6%	39.8%
Expected dividend rate	N/A	0.0%	0.0%	0.0%

There were no options or RSUs granted in the three months ended July 31, 2008. The weighted average fair value of options granted during the nine months ended July 31, 2008 and 2007 was \$6.07 and \$9.49, respectively. The weighted average fair value of RSUs granted during the nine months ended July 31, 2008 and 2007 was \$19.81 and \$35.46, respectively.

Expected volatility of the stock is based on a blend of the Company's peer group in the industry in which it does business and the Company's historical volatility for its own stock.

The expected term represents the period of time that options granted are expected to be outstanding. The expected term of options granted is derived from the historical actual term of option grants and an estimate of future exercises during the remaining contractual period of the option.

The average risk-free interest rate is based on the U.S. Treasury zero-coupon issues with a remaining term equal to the expected term of the options used in the Black-Scholes valuation model.

Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive equity awards, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by the Company under SFAS No. 123(R). The fair value of each RSU is equal to the market value of the Company's common stock on the date of grant.

The Company estimates forfeitures of options and RSUs based on historical experience and records compensation expense only for those awards that are expected to vest.

***Performance Restricted Stock Units for the Company's CEO***

In January 2007, the Company made an award of up to 900,000 RSUs to the Company's CEO. These RSUs may vest in three tranches of up to 300,000 RSUs each over a four-year period based upon annual growth in the Company's net

income, as adjusted, per share and its share price. Two-thirds of the RSUs are performance units that will vest based on achievement of net income, as adjusted, targets, and one-third of the RSUs are market units that will vest based on achievement of net income, as adjusted, targets and specified targets for the share price of the Company's stock.

As of October 31, 2007, the Company cancelled 200,000 performance units and 100,000 market units because the related fiscal year 2007 targets were not achieved.

The financial targets for the fiscal 2008 performance units were established upon filing of the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2007. Up to 200,000 performance units for 2008 will vest if the fiscal year 2008 performance target is achieved. Up to 100,000 market units for 2008 will vest if the fiscal year 2008 performance targets are achieved and the volume-weighted average price of the Company's stock exceeds \$51.84 per share during the 10 trading days beginning with the second full trading day following the Company's announcement of financial results for the fiscal year ending October 31, 2008.



Table of Contents**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The financial targets for the 2009 performance units have not yet been determined; therefore, no measurement date has occurred for that tranche. The Company will value the fiscal year 2009 performance units when all factors for measurement have been determined and a measurement date has occurred. Up to 200,000 performance units will vest if the fiscal year 2009 performance targets are achieved. Up to 100,000 stock units for the 2009 performance units will vest if the fiscal year 2009 targets are achieved and the volume-weighted average price of the Company's stock exceeds \$62.20 per share during the 10 trading days beginning with the second full trading day following the Company's announcement of financial results for the fiscal year ending October 31, 2010.

Because these shares are contingently issuable, they were excluded from the earnings per share calculation for the three and nine months ended July 31, 2008 and 2007.

***Equity Award Activity***

Stock option activity for the nine months ended July 31, 2008, was as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term  (In years)	Aggregate Intrinsic Value (In thousands)
Balance at November 1, 2007	8,331,637	\$ 27.10		
Granted	22,500	19.81		
Exercised	(104,575)	8.84		
Cancelled	(704,874)	29.51		
Balance at July 31, 2008	7,544,688	\$ 27.11	4.9	\$ 9,417
Vested or expected to vest at July 31, 2008	7,172,815	\$ 26.86	4.9	\$ 9,291
Exercisable at July 31, 2008	3,588,478	\$ 24.47	4.5	\$ 6,110

Restricted stock unit activity for the nine months ended July 31, 2008, was as follows:

Number of Shares	Aggregate Intrinsic Value (In thousands)
---------------------	---

Edgar Filing: VeriFone Holdings, Inc. - Form 10-Q

Balance at November 1, 2007	749,750		
Granted	7,500		
Vested	(7,500)		
Cancelled			
Balance at July 31, 2008	749,750	\$	2,240
Vested or expected to vest at July 31, 2008	642,174	\$	1,457

The total intrinsic value of options exercised was \$3.3 million and \$36.3 million during the nine months ended July 31, 2008 and 2007, respectively. The total fair value of RSUs vested during the nine months ended July 31, 2008 and 2007 was \$0.2 million and \$1.1 million, respectively.

Net cash proceeds from the exercise of stock options were \$0.9 million and \$25.1 million for the nine months ended July 31, 2008 and 2007, respectively.

**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of July 31, 2008, total compensation cost related to unvested options and RSUs expected to vest but not yet recognized was \$33.7 million and \$3.0 million, respectively, and was expected to be recognized over a weighted-average period of 2.2 years for options and 1.8 years for RSUs.

**Note 6. Net Income (Loss) Per Share**

Basic net loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding for the period, less the weighted average number of common shares subject to repurchase. Diluted net loss per common share is computed using the weighted average number of common shares outstanding plus the effect of common stock equivalents, unless the common stock equivalents are anti-dilutive. The potential dilutive shares of the Company's common stock resulting from the assumed exercise of outstanding stock options and equivalents, the assumed exercise of the warrants and the dilutive effect of the convertible senior notes are determined using the treasury stock method.

The following details the computation of the loss per common share (in thousands, except per share data):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Basic and diluted net loss per share:				
Numerator:				
Net loss	\$ (7,199)	\$ (42,386)	\$ (58,684)	\$ (52,883)
Denominator:				
Weighted-average common shares outstanding	84,194	83,078	84,181	82,589
Less: Weighted-average shares subject to repurchase		(671)		(890)
Weighted-average shares used in computing basic net loss per share	84,194	82,407	84,181	81,699
Add dilutive securities:				
Weighted-average shares subjects to repurchase				
Stock options and restricted stock units				
Weighted-average shares used in computing diluted net loss per share	84,194	82,407	84,181	81,699
Net loss per share:				
Basic	\$ (0.09)	\$ (0.51)	\$ (0.70)	\$ (0.65)
Diluted	\$ (0.09)	\$ (0.51)	\$ (0.70)	\$ (0.65)

As of July 31 2008 and 2007, options and restricted stock units to purchase 8.3 million and 10.4 million, respectively, of Common Stock were excluded from the calculation of weighted average shares for diluted net loss per share as they were anti-dilutive.

The senior convertible notes are considered to be Instrument C securities as defined by EITF No. 90-19, *Convertible Bonds with Issuer Option to Settle for Cash upon Conversion* ( EITF 90-19 ); therefore, only the conversion spread relating to the senior convertible notes is included in the Company's diluted earnings per share calculation, if dilutive. The potential dilutive shares of the Company's common stock resulting from the assumed settlement of the conversion spread of the senior convertible notes are determined under the method set forth in EITF 90-19. Under such method, the settlement of the conversion spread of the senior convertible notes has a

Table of Contents**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

dilutive effect when the average share price of the Company's common stock during the period exceeds \$44.02. The average share price of the Company's common stock during the three and nine months ended July 31, 2008 did not exceed \$44.02.

Warrants to purchase 7.2 million shares of the Company's common stock were outstanding at July 31, 2008, but were not included in the computation of diluted earnings per share because the warrants' exercise price was greater than the average market price of the Company's common stock during the three and nine months ended July 31, 2008; therefore, their effect was anti-dilutive.

**Note 7. Segment and Geographic Information*****Segment Information***

The Company is primarily structured in a geographic manner. The Company's Chief Executive Officer has been identified as the Chief Operating Decision Maker ( CODM ) as defined by SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. The CODM reviews consolidated financial information on revenues and gross profit percentage for System Solutions and Services. The CODM also reviews operating expenses, certain of which are allocated to the Company's two segments described below.

The Company operates in two business segments: North America and International. The Company defines North America as the United States and Canada, and International as the countries in which it makes sales outside the United States and Canada.

Net revenues and operating income (loss) of each business segment reflect net revenues generated within the segment, standard cost of System Solutions net revenues, actual cost of Services net revenues and expenses that directly benefit only that segment. Corporate net revenues and operating income (loss) reflect non-cash acquisition charges, including amortization of purchased core and developed technology assets, step-up of inventory and step-down in deferred revenue, and other corporate charges, including inventory obsolescence and scrap at corporate distribution centers, rework, specific warrant provisions, non-standard freight, over-and-under absorption of materials management, and supply chain engineering overhead. Corporate operating income (loss) also reflects the difference between the actual and standard cost of System Solutions net revenues and shared operating costs that benefit both segments, predominately research and development expenses and centralized supply chain management.

The following table sets forth net revenues and operating income (loss) for the Company's segments (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net revenues:				
International	\$ 161,197	\$ 128,391	\$ 412,303	\$ 379,136
North America	97,783	103,961	265,790	288,899
Corporate	(282)	(651)	(873)	(3,088)

Edgar Filing: VeriFone Holdings, Inc. - Form 10-Q

Total net revenues	\$ 258,698	\$ 231,701	\$ 677,220	\$ 664,947
Operating income (loss):				
International	\$ 31,745	\$ 28,789	\$ 67,472	\$ 90,615
North America	36,755	43,148	95,688	113,974
Corporate	(63,221)	(50,172)	(184,183)	(175,957)
Total operating income (loss)	\$ 5,279	\$ 21,765	\$ (21,023)	\$ 28,632

**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company's long-lived assets which consist primarily of property, plant, and equipment, net by segment were as follows (in thousands):

	<b>July 31, 2008</b>	<b>October 31, 2007</b>
International	\$ 25,262	\$ 24,271
North America	30,253	26,549
Total	\$ 55,515	\$ 50,820

The Company's goodwill by segment was as follows (in thousands):

	<b>July 31, 2008</b>	<b>October 31, 2007</b>
International	\$ 565,122	\$ 542,186
North America	69,806	69,791
Total	\$ 634,928	\$ 611,977

The Company's total assets by segment were as follows (in thousands):

	<b>July 31, 2008</b>	<b>October 31, 2007</b>
International	\$ 1,126,865	\$ 1,122,411
North America	428,738	424,898
Total	\$ 1,555,603	\$ 1,547,309

The Company's depreciation and amortization by segment was as follows (in thousands):

<b>Three Months Ended July 31,</b>		<b>Nine Months Ended July 31,</b>	
<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>

Edgar Filing: VeriFone Holdings, Inc. - Form 10-Q

International	\$ 1,603	\$ 1,258	\$ 4,824	\$ 3,639
North America	1,924	792	5,070	2,175
Total	\$ 3,527	\$ 2,050	\$ 9,894	\$ 5,814

***Geographic Information***

The net revenues by geographic area were as follows (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Europe	\$ 80,930	\$ 69,912	\$ 214,482	\$ 209,875
Latin America	60,401	42,673	145,668	124,841
Asia	19,866	15,806	52,153	44,420
United States	84,163	92,513	236,098	257,569
Canada	13,338	10,797	28,819	28,242
Total revenues	\$ 258,698	\$ 231,701	\$ 677,220	\$ 664,947

Revenues are allocated to the geographic areas based on the shipping destination of customer orders. Corporate revenues are included in the United States geographic area revenues.



**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company's long-lived assets exclusive of intercompany accounts were as follows (in thousands):

	<b>July 31, 2008</b>	<b>October 31, 2007</b>
North America	\$ 30,254	\$ 26,549
Europe	20,029	20,694
Latin America	2,144	2,160
Asia	3,088	1,417
Total	\$ 55,515	\$ 50,820

**Note 8. Business Combinations*****A.C. Application Limited***

On July 1, 2008, the Company's wholly-owned subsidiary, VeriFone Israel Ltd., acquired the business of A.C. Application Ltd., in accordance with an asset purchase agreement, between VeriFone Israel Ltd and A.C. Application Ltd. The acquisition was an all-cash transaction of approximately \$12.4 million including acquisition costs. The assets acquired as a result of the A.C. Application Ltd. acquisition consisted primarily of intangible assets related to technology and customer relationships. The agreement also provides for additional consideration to be paid in the form of an earn-out amount of up to \$2.3 million, if certain target revenues and gross margins are achieved at April 30, 2009 and 2010. The earn-out payment to be made, if any, is not included in the \$12.4 million approximate total purchase price mentioned above. The earn-out payments to be made under the agreement, if any, will be recorded as an expense when it is probable that the earn-out payments will be payable. The results of operations were included in the condensed consolidated financial statements from the acquisition date. The Company is still in the process of finalizing the closing balance sheet and valuation of intangibles. Pro forma results of operations have not been presented because the effect of the acquisition was not material.

***Peripheral Computer Industries Pty Limited***

On December 13, 2007, the Company's wholly-owned subsidiary, VeriFone Systems Australia Pty Ltd., acquired the business of Peripheral Computer Industries Pty Limited ( PCI ) in accordance with an asset purchase agreement, between Peripheral Computer Industries Pty Limited and VeriFone Systems Australia Pty Ltd. The acquisition was an all-cash transaction of approximately \$3.0 million including acquisition costs. The assets acquired as a result of the PCI acquisition consisted primarily of intangible assets related to technology and customer relationships. The agreement also provides for additional consideration to be paid in the form of an earn-out amount of up to \$6.8 million, if certain target revenues are achieved at the end of the 36 month earn-out period. The earn-out payment to be made, if any, is not included in the \$3.0 million approximate total purchase price mentioned above. The earn-out payments to be made under the agreement, if any, will be recorded as an additional cost of the acquisition at such time as they are earned. The results of operations were included in the condensed consolidated financial statements from the acquisition date. The Company is still in the process of finalizing the closing balance sheet and valuation of

intangibles. Pro forma results of operations have not been presented because the effect of the acquisition was not material.

**Note 9. Income Taxes**

Effective November 1, 2007, the Company adopted the provisions of FIN 48. FIN 48 establishes a single model to address accounting for uncertain tax positions by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. In addition, FIN 48 provides guidance on derecognition, measurement classification, interest and penalties, accounting in interim periods, disclosure, and transition.

**Table of Contents**

**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As a result of the implementation of FIN 48, the Company recognized a \$3.3 million increase in its existing liabilities for uncertain tax positions which has been recorded as a decrease of \$1.4 million to the opening balance of retained earnings, an increase of \$0.5 million to non-current deferred tax assets and an increase of \$1.4 million to goodwill. At the adoption date, the Company had \$18.8 million of gross unrecognized tax benefits and accrued interest and penalties of \$3.7 million. If all of the Company's unrecognized tax benefits were recognized, approximately \$5.7 million would impact the Company's effective tax rate. At November 1, 2007, the Company also reclassified \$17.7 million from current to non-current taxes payable.

The Company has recorded the FIN 48 liability as a long-term liability as it does not expect significant payments to occur over the next 12 months. The Company's existing positions will continue to generate an increase in liabilities for uncertain tax benefits. The Company will continue to recognize interest and penalties related to income tax matters in income tax expense. During the three and nine months ended July 31, 2008, the Company accrued \$0.5 million and \$1.1 million, respectively, for FIN 48 related interest expense.

The Company expects to provide taxes in fiscal year 2008 notwithstanding an expected loss on its income statement for the full fiscal year. This is because, in significant part, it has net profits in its international operations and a loss in the United States. The tax benefit of the U.S. financial reporting loss is also offset by an expected increase in the valuation allowance on U.S. deferred tax assets. The effect of these circumstances is to create a negative tax rate in the nine months ended July 31, 2008 despite a positive tax rate in the three months ended July 31, 2008. The application of the intraperiod tax accounting rules of FIN 18 and expected losses with no tax benefit at certain entities results in a computed charge for tax expense of \$7.4 million in the quarter. For the three months ended July 31, 2007, the tax expense was \$52.8 million. The decrease in taxes from the three months ended July 31, 2008 as compared to the three months ended July 31, 2007 is primarily attributable to the application of the intraperiod tax accounting rules of FIN 18 as applied to discrete items, primarily certain non-deductible in-process research and development charges. There were discrete items in the three and nine months ended July 31, 2007 that resulted in an unusually large tax expense relative to pre-tax income. There were no comparable discrete items in the effective tax rate calculations for the three and nine months ended July 31, 2008.

As of July 31, 2008, the Company has recorded deferred tax assets on its balance sheet net of valuation allowance the realization of which is dependent upon the Company's ability to generate sufficient U.S. and certain foreign taxable income. Although realization is not assured, Management believes that it is more likely than not that these deferred tax assets will be realized. The amount of deferred tax assets considered realizable may increase or decrease in subsequent quarters when the Company reevaluates the underlying basis for its estimates of future domestic and certain foreign taxable income.

The Company is currently under audit by the Internal Revenue Service ( IRS ) for its fiscal years 2003 to 2004. Although the Company believes it has correctly provided income taxes for the years subject to audit, the IRS may adopt different interpretations. The Company has not yet received any final determinations with respect to this audit although certain adjustments have been agreed with the IRS. The liability associated with the agreed adjustments had been accrued in previous periods. Subsidiaries of the Company are also under audit by the Israeli tax authorities for calendar years 2004 to 2006 and the Brazilian federal government for the periods between January 1, 2003 through the current date. With few exceptions, the Company is no longer subjected to tax examination outside of the U.S. for periods prior to 2000.



Table of Contents**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 10. Commitments and Contingencies***Commitments*

The Company leases certain real and personal property under noncancelable operating leases. Additionally, the Company subleases certain real property to third parties. Future minimum lease payments and sublease rental income under these leases as of July 31, 2008 were as follows (in thousands):

<b>Fiscal Year</b>	<b>Minimum Lease Payments</b>	<b>Sublease Rental Income</b>	<b>Net Minimum Lease Payments</b>
2008 (remaining 3 months)	\$ 2,638	\$ 34	\$ 2,604
2009	9,016	86	8,930
2010	7,726	4	7,722
2011	6,093		6,093
2012	5,518		5,518
Thereafter	12,226		12,226
<b>Total</b>	<b>\$ 43,217</b>	<b>\$ 124</b>	<b>\$ 43,093</b>

*FASB Interpretation No. 48 ( FIN 48 ) Liabilities*

As of November 1, 2007, the amount of the unrecognized tax benefits was \$22.4 million, including accrued interest and penalties, none of which is expected to be paid within one year. The Company is unable to make a reasonably reliable estimate as to when cash settlement with a taxing authority may occur. However, it is reasonably possible that the total amount of unrecognized tax benefits will increase or decrease in the next 12 months. Such changes could occur based on the normal expiration of various statutes of limitations or the possible conclusion of ongoing tax audits in various jurisdictions around the world.

*Contingencies**Manufacturing Agreements*

The Company works on a purchase order basis with third-party contract manufacturers and component suppliers with facilities in China, Singapore, Israel and Brazil to supply a majority of the Company's finished goods inventories. The Company provides each contract manufacturer with a purchase order to cover the manufacturing requirements, which constitutes a binding commitment by the Company to purchase materials produced by the manufacturer as specified in the purchase order. The total amount of purchase commitments as of July 31, 2008 was approximately \$89.1 million, and are generally paid within one year. Of this amount, \$4.1 million has been recorded in other current liabilities in the accompanying Condensed Consolidated Balance Sheet as of July 31, 2008 because these commitments are not expected to have future value to the Company.

***Litigation***

***Brazilian State Tax Assessments***

***State Value Added Tax***

One of the Company's Brazilian subsidiaries has been notified of a tax assessment regarding Brazilian state value added tax ( VAT ), for the periods from January 2000 to December 2001 that relates to products supplied to the Company by a contract manufacturer. The assessment relates to an asserted deficiency of 8.6 million Brazilian reais (approximately \$5.5 million) including interest and penalties. The tax assessment was based on a clerical error in which the Company's Brazilian subsidiary omitted the required tax exemption number on its invoices. Management does not expect that the Company will ultimately incur a material liability in respect of this

**Table of Contents**

**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

assessment, because they believe, based in part on advice of the Company's Brazilian tax counsel, that the Company is likely to prevail in the proceedings relating to this assessment. On May 25, 2005, the Company had an administrative hearing with respect to this audit. Management expects to receive the decision of the administrative body sometime in 2008. In the event the Company receives an adverse ruling from the administrative body, the Company will decide whether or not to appeal and would reexamine the determination as to whether an accrual is necessary. It is currently uncertain what impact this state tax examination may have with respect to the Company's use of a corresponding exemption to reduce the Brazilian federal VAT.

***Importation of Goods Assessments***

Two of the Company's Brazilian subsidiaries that were acquired as a part of the Lipman acquisition have been notified of assessments regarding Brazilian customs penalties that relate to alleged infractions in the importation of goods. The assessments were issued by the Federal Revenue Department in the City of Vitória, the City of São Paulo, and the City of Itajai. The assessments relate to asserted deficiencies totaling 26.9 million Brazilian reais (approximately \$17.2 million) excluding interest. The tax authorities allege that the structure used for the importation of goods was simulated with the objective of evading taxes levied on the importation by under-invoicing the imported goods; the tax authorities allege that the simulation was created through a fraudulent interposition of parties, where the real sellers and buyers of the imported goods were hidden.

In the Vitória tax assessment, the fines were reduced from 4.7 million Brazilian reais (approximately \$3.0 million) to 1.5 million Brazilian reais (approximately \$0.9 million) on a first level administrative decision on January 26, 2007. The proceeding has been remitted to the Taxpayers Council to adjudicate the appeal of the first level administrative decision filed by the tax authorities. The Company also appealed the first level administrative decision on February 26, 2007. In this appeal, the Company argued that the tax authorities did not have enough evidence to determine that the import transactions were indeed fraudulent and that, even if there were some irregularities in such importations, they could not be deemed to be the Company's responsibility since all the transactions were performed by the third-party importer of the goods. Management expects to receive the decision of the Taxpayers Council sometime in 2008. In the event the Company receives an adverse ruling from the administrative body, the Company will decide whether or not to appeal to the judicial level. Based on the Company's current understanding of the underlying facts, the Company believes that it is probable that its Brazilian subsidiary will be required to pay some amount of fines. At July 31, 2008, the Company has accrued 4.7 million Brazilian reais (approximately \$3.0 million), excluding interest, which it believes is the probable payment.

On July 12, 2007, the Company was notified of a first administrative level decision rendered in the São Paulo tax assessment, which maintained the total fine of 20.2 million Brazilian reais (approximately \$13.0 million) imposed. On August 10, 2007, the Company appealed the first administrative level decision to the Taxpayers Council. A hearing was held on August 12, 2008 before the Taxpayers Council, but the Taxpayers Council did not render a decision pending its further review of the records. Management expects to receive the decision of the Taxpayers Council sometime in 2008. In the event the Company receives an adverse ruling from the Taxpayers Council, the Company will decide whether or not to appeal to the judicial level. Based on the Company's current understanding of the underlying facts, the Company believes that it is probable that its Brazilian subsidiary will be required to pay some amount of fines. Accordingly, at July 31, 2008, the Company has accrued 20.2 million Brazilian reais (approximately \$13.0 million), excluding interest.

On May 22, 2008, the Company was notified of a first administrative level decision rendered in the Itajai assessment, which maintained the total fine of 2.0 million Brazilian reais (approximately \$1.3 million) imposed, excluding interest. On May 27, 2008, the Company appealed the first level administrative level decision to the Taxpayers Council. Based on the Company's current understanding of the underlying facts, the Company believes that it is probable that its Brazilian subsidiary will be required to pay some amount of fines. Accordingly, at July 31, 2008, the Company has accrued 2.0 million Brazilian reais (approximately \$1.3 million), excluding interest.



**Table of Contents**

**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Patent Infringement Lawsuits***

*SPA Syspatronic AG v. VeriFone Holdings, Inc., VeriFone, Inc., et al.*

On September 18, 2007, SPA Syspatronic AG ( SPA ) commenced this action in the United States District Court for the Eastern District of Texas, Marshall Division, against the Company and others, alleging infringement of U.S. Patent No. 5,093,862 purportedly owned by SPA. The plaintiff is seeking a judgment of infringement, an injunction against further infringement, damages, interest and attorneys' fees. The Company filed an answer and counterclaims on November 8, 2007, and intends to vigorously defend this litigation. On January 28, 2008, the Company requested that the U.S. Patent and Trademark Office (the PTO ) perform a re-examination of the patent. The PTO granted the request on April 4, 2008. The Company then filed a motion to stay the proceedings with the Court and on April 25, 2008, the Court agreed to stay the proceedings pending the re-examination. The case is still in the preliminary stages, and it is not possible to quantify the extent of the Company's potential liability, if any. An unfavorable outcome could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flow.

*Cardsoft, Inc. et al v. VeriFone Holdings, Inc., VeriFone, Inc., et al.*

On March 6, 2008, Cardsoft, Inc. and Cardsoft (Assignment for the Benefit of Creditors), LLC ( Cardsoft ) commenced this action in the United States District Court for the Eastern District of Texas, Marshall Division, against the Company and others, alleging infringement of U.S. Patents No. 6,934,945 and No. 7,302,683 purportedly owned by Cardsoft. The plaintiff is seeking a judgment of infringement, an injunction against further infringement, damages, interest and attorneys' fees. The Company intends to vigorously defend this litigation. The case is still in the preliminary stages, and it is not possible to quantify the extent of the Company's potential liability, if any. An unfavorable outcome could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flow.

*Communication Transaction Solutions, Inc. v. VeriFone Holdings, Inc., VeriFone, Inc., et al.*

The Company is a defendant in this action initiated in the California Superior Court in Santa Clara County on August 30, 2006, in which the plaintiff alleges among other things misappropriation of trade secrets in connection with the Company's development of its wireless pay-at-the-table system. These allegations followed the Company's decision in October 2005 to terminate discussions regarding a possible acquisition of the plaintiff's business. The plaintiff is seeking damages, interest and attorneys' fees. The parties argued summary judgment motions on September 4, 2008 and the Court is expected to rule on those motions during September. If the actions are not dismissed on summary judgment, the case is scheduled to go to trial later this year. Although an unfavorable outcome could have a material adverse effect on the Company, the Company believes the plaintiff's claims are entirely without merit and intends to vigorously defend this litigation and pursue its counterclaims.

***Class Action and Derivative Lawsuits***

On or after December 4, 2007, several securities class action claims were filed against the Company and certain of the Company's officers. The various complaints specify different class periods, with the longest proposed class period being August 31, 2006 through December 3, 2007. These lawsuits have been consolidated in the U.S. District Court for the Northern District of California as *In re VeriFone Holdings, Inc. Securities Litigation*, C 07-6140 MHP. The

original actions were: *Eichenholtz v. VeriFone Holdings, Inc. et al.*, C 07-6140 MHP; *Lien v. VeriFone Holdings, Inc. et al.*, C 07-6195 JSW; *Vaughn et al. v. VeriFone Holdings, Inc. et al.*, C 07-6197 VRW (Plaintiffs voluntarily dismissed this complaint on March 7, 2008); *Feldman et al. v. VeriFone Holdings, Inc. et al.*, C 07-6218 MMC; *Cerini v. VeriFone Holdings, Inc. et al.*, C 07-6228 SC; *Westend Capital Management LLC v. VeriFone Holdings, Inc. et al.*, C 07-6237 MMC; *Hill v. VeriFone Holdings, Inc. et al.*, C 07-6238 MHP; *Offutt v. VeriFone Holdings, Inc. et al.*, C 07-6241 JSW; *Feitel v. VeriFone Holdings, Inc., et al.*, C 08-0118 CW. On March 17, 2008 the Court held a hearing on Plaintiffs' motions for Lead Plaintiff and Lead Counsel and in May

**Table of Contents**

**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

2008, the Court requested additional briefing on these matters, which was submitted in June 2008. The Company currently expects that following the Court's order appointing Lead Plaintiff and Lead Counsel, a Consolidated Complaint will be filed. Each of the consolidated actions allege, among other things, violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, based on allegations that the Company and the individual defendants made false or misleading public statements regarding the Company's business and operations during the putative class periods, and seeks unspecified monetary damages and other relief. At this time, the Company has not recorded any liabilities as the Company is unable to estimate any potential liability.

Beginning on December 13, 2007, several derivative actions were also filed against certain current and former directors and officers. These derivative lawsuits were filed in: (1) the U.S. District Court for the Northern District of California, as *In re VeriFone Holdings, Inc. Shareholder Derivative Litigation*, Lead Case No. C 07-6347, which consolidates *King v. Bergeron, et al.* (Case No. 07-CV-6347), *Hilborn v. VeriFone Holdings, Inc., et al.* (Case No. 08-CV-1132), *Patel v. Bergeron, et al.* (Case No. 08-CV-1133), and *Lemmond, et al. v. VeriFone Holdings, Inc., et al.* (Case No. 08-CV-1301); and (2) California Superior Court, Santa Clara County, as *In re VeriFone Holdings, Inc. Derivative Litigation*, Lead Case No. 1-07-CV-100980, which consolidates *Catholic Medical Mission Board v. Bergeron, et al.* (Case No. 1-07-CV-100980), and *Carpel v. Bergeron, et al.* (Case No. 1-07-CV-101449). The complaints allege, among other things, that certain of the Company's current and former directors and officers breached their fiduciary duties to the Company and violated provisions of the California Corporations Code and certain common law doctrines by engaging in alleged wrongful conduct complained of in the securities class action litigation described above. The Company is named solely as a nominal defendant against whom the plaintiffs seek no recovery. Amended consolidated complaints are expected to be filed in September 2008 in each set of consolidated cases.

On January 27, 2008, a class action complaint was filed against the Company in the Central District Court in Tel Aviv, Israel on behalf of purchasers of the Company's stock on the Tel Aviv Stock Exchange. The complaint seeks compensation for damages allegedly incurred by the class of plaintiffs due to the publication of erroneous financial reports. On May 25, 2008, the Court held a hearing on the Company's motion to dismiss or stay the proceedings, after which the Court requested that the plaintiff and the Company submit additional information to the Court with respect to the applicability of Israeli law to dually registered companies. This additional information was submitted to the Court in June 2008 and the parties are currently awaiting the Court's ruling on this issue. At this time, the Company has not recorded any liabilities as it is unable to estimate the potential liabilities.

The foregoing cases are still in the preliminary stages, and the Company is not able to quantify the extent of its potential liability, if any. An unfavorable outcome in any of these matters could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flow. In addition, defending this litigation is likely to be costly and may divert management's attention from the day-to-day operations of the Company's business.

***Regulatory Actions***

The Company has responded to inquiries and provided information and documents related to the restatement of its fiscal year 2007 interim financial statements to the Securities and Exchange Commission, the Department of Justice, the New York Stock Exchange and the Chicago Board Options Exchange. The SEC has also expressed an interest in interviewing several current and former officers and employees of the Company, and the Company is continuing to cooperate with the SEC in responding to the SEC's requests for information. The Company is unable to predict what

consequences, if any, any investigation by any regulatory agency may have on the Company. There is no assurance that other regulatory inquiries will not be commenced by other U.S. federal, state or foreign regulatory agencies.

Table of Contents**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Other Litigation*

The Company is subject to various other legal proceedings related to commercial, customer, and employment matters that have arisen during the ordinary course of business. Although there can be no assurance as to the ultimate disposition of these matters, the Company's management has determined, based upon the information available at the date of these financial statements, that the expected outcome of these matters, individually or in aggregate, will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

**Note 11. Restructuring Charges**

In January 2008, management approved and committed the Company to a plan to reduce the Company's cost structure. The restructuring plan applied to employees worldwide. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the Company accrued and expensed \$4.5 million of one-time termination benefits related to employee severance and other related benefits in the nine months ended July 31, 2008, of which \$0.3 million is in the North America segment and the balance in the International segment. As of July 31, 2008 \$0.3 million has been paid in the North America segment and \$3.9 million in the International segment.

In July 2008, management approved and committed the Company to a plan to reduce the Company's cost structure further. The restructuring plan applied to employees and operating leases for offices in Europe and the United States. The plan was accounted for in accordance with SFAS No. 112, *Employers' Accounting for Postemployment Benefits* and the operating leases for the offices were accounted for in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. The Company accrued and expensed \$2.2 million in the three months ended July 31, 2008, of which \$0.9 million was in the North America segment and the balance in International segment. No amounts have been paid as of July 31, 2008.

The following table summarizes restructuring expenses by classification recorded for the 2008 restructuring activities (in thousands):

	<b>Three Months Ended July 31, 2008</b>	<b>Nine Months Ended July 31, 2008</b>
Cost of net revenues	\$ 307	\$ 470
Sales and marketing	651	2,987
Research and development	262	1,341
General and administrative	1,018	1,866
	<b>\$ 2,238</b>	<b>\$ 6,664</b>

Other restructuring plans from prior periods have not changed materially during the three and nine months ended July 31, 2008 as compared to Note 8. Restructuring Charges in the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2007.

**Note 12. Related-Party Transactions**

For the three and nine months ended July 31, 2008, the Company recorded \$6.0 million and \$8.4 million, respectively, of sales to affiliates of one of the members of the Company's Board of Directors which were included in System Solutions net revenues in the accompanying Condensed Consolidated Statements of Operations. For the comparable periods in fiscal year 2007, the Company recorded sales to affiliates of related parties of \$3.6 million and \$6.9 million, respectively.

**Table of Contents**

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

*This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. In some cases, forward-looking statements can be identified by words such as anticipates, expects, believes, plans, predicts, and similar terms. Such forward-looking statements are based on current expectations, estimates, and projections about our industry, management's beliefs, and assumptions made by management. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A Risk Factors below and in Item 1A of our Annual Report on Form 10-K for the year ended October 31, 2007 filed with the SEC. The following discussion should be read in conjunction with our consolidated financial statements and related notes included in our 2007 Annual Report on Form 10-K and the condensed Consolidated Financial Statements and Notes thereto included elsewhere in this Quarterly Report on Form 10-Q. Unless required by law, we expressly disclaim any obligation to update publicly any forward-looking statements, whether as result of new information, future events, or otherwise.*

When we use the terms VeriFone, we, us, and our in this item, we mean VeriFone Holdings, Inc., a Delaware corporation, and its consolidated subsidiaries.

**Overview**

We are a global leader in secure electronic payment solutions. We provide expertise, solutions, and services that add value to the point of sale with merchant-operated, consumer-facing, and self-service payment systems for the financial, retail, hospitality, petroleum, government, and healthcare vertical markets. We have one of the leading electronic payment solutions brands and are one of the largest providers of electronic payment systems worldwide. We believe that we benefit from a number of competitive advantages gained through our 26-year history and success in our industry. These advantages include our globally trusted brand name, large installed base, history of significant involvement in the development of industry standards, global operating scale, customizable platform, and investment in research and development. We believe that these advantages position us well to capitalize on the continuing global shift toward electronic payment transactions as well as other long-term industry trends.

Our industry's growth continues to be driven by the long-term shift towards electronic payment transactions and away from cash and checks in addition to the need for improved security standards. Internationally, growth rates have been higher because of the relatively low penetration rates of electronic payment transactions in many countries and interest by governments in modernizing their economies and using electronic payments as a means of improving value-added tax or VAT, and sales tax collection. Recently, additional factors have driven growth, including the shift from dial up to internet protocol, or IP, based and wireless communications, personal identification number, or PIN, based debit transactions, and advances in computing technology which enable vertical solutions and non-payment applications to reside at the point of sale.

Revenues recognized in our fiscal quarters tend to be back-end loaded as we receive sales orders and deliver our System Solutions increasingly towards the end of each fiscal quarter including the fourth quarter. This back-end loading may adversely affect our results of operations in a number of ways. First, if we expect to receive sales orders that do not materialize at the end of the fiscal quarter or if we do not receive them with sufficient time to deliver our Systems Solutions and recognize revenue in that fiscal quarter, our revenues and profitability may be adversely affected. In addition, the manufacturing processes at our internal manufacturing facility could become concentrated in a shorter time period which could increase labor and other manufacturing costs and negatively impact gross margins. If, on the other hand, we were to hold higher inventory levels to counteract this we would be subject to an enhanced risk of inventory obsolescence. The concentration of orders may also make it difficult to accurately forecast

component requirements and, as a result, we could experience a shortage of the components needed for production, possibly delaying shipments and causing lost orders. This could cause us to fail to meet our revenue and operating profit expectations for a particular quarter and could increase the fluctuation of our quarterly results if shipments are delayed from one fiscal quarter to the next or orders are cancelled by customers.



**Table of Contents**

Security has become a driving factor in our business as our customers endeavor to meet ever escalating governmental statutory requirements related to the prevention of identity theft as well as operating regulation safeguards from the credit and debit card associations, including Visa International, or Visa, MasterCard Worldwide, or MasterCard, American Express, Discover Financial Services and JCB Co., Ltd., or JCB. In 2006, these card associations established the Payment Card Industry Council, or PCI Council, to oversee and unify industry standards in the areas of credit card data security, referred to as the PCI-PED standard which consists of PIN-entry device security, or PED, and the PCI Data Security Standard, or PCI-DSS, standard.

We operate in two business segments: North America and International. We define North America as the United States and Canada, and International as all other countries from which we derive revenues.

We believe that demand for wireless, IP enabled, PIN based debit and more secure systems will continue worldwide. In addition, demand in emerging economies will continue to grow as these economies develop and seek to collect more VAT. We continue to devote R&D resources to address these market needs.

**Restatement**

On December 3, 2007, we announced that our management had identified errors in accounting related to the valuation of in-transit inventory and allocation of manufacturing and distribution overhead to inventory and that as a result of these errors, we anticipated that a restatement of our unaudited condensed consolidated financial statements for the interim periods during our fiscal year ended October 31, 2007 would be required. Our Audit Committee conducted an independent investigation into the errors in accounting that led to the anticipated restatement. The Audit Committee engaged independent counsel, Simpson Thacher & Bartlett LLP ( Simpson Thacher ), to conduct the independent investigation under the Audit Committee's supervision. Simpson Thacher engaged Navigant Consulting, Inc. ( Navigant ) to serve as independent forensic accountants. The scope of the investigation was proposed by Simpson Thacher in consultation with Navigant and approved by the Audit Committee. The investigation covered among other things (1) the circumstances surrounding the errors identified by management and described in our December 3, 2007 announcement; (2) whether additional errors existed requiring further restatement in the interim periods of fiscal year 2007 and the determinations of the adjustments required to correct and restate our interim financial statements; and (3) whether evidence existed indicating that periods prior to fiscal year 2007 may also be required to be restated.

We announced on April 2, 2008 that the Audit Committee investigation was complete and had confirmed the existence of the errors in accounting identified in our December 3, 2007 announcement. In particular, the investigation confirmed that incorrect manual journal and elimination entries had been made primarily by our Sacramento, California supply chain accounting team with respect to several inventory-related matters and identified certain additional errors. Management also made additional adjustments to reduce certain accruals which had been recorded, such as bonuses, which were accrued based upon information which, following the restatement, was no longer accurate. The Audit Committee investigation also concluded that existing policies with respect to manual journal entries were not followed and that the review processes and controls in place were not sufficient to identify and correct the errors in a timely manner. The Audit Committee investigation found no evidence that any period prior to fiscal year 2007 required restatement.

The Audit Committee investigation and restatement process resulted in delays to the completion of our fiscal year 2007 annual financial statements and first and second quarter of fiscal year 2008 interim financial statements and we have incurred and will continue to incur significant costs related to this process. In addition, a number of securities class action complaints were filed against us and certain of our officers, and a number of derivative actions were filed against certain of our current and former directors and officers. The costs of the investigation, the restatement and defense of the related litigation, as well as the time and energy required to be devoted to these matters by our management, has had a significant impact on our results of operations and may continue to do so for the foreseeable

future.

In connection with the Audit Committee investigation and restatement process, we identified material weaknesses in our internal control over financial reporting, as a result of which our senior management concluded that our disclosure controls and procedures were not effective. These material weaknesses and management's remediation efforts are summarized under **Item 4 Controls and Procedures** in this Quarterly Report.

**Table of Contents****Results of Operations*****Net Revenues***

We generate net revenues through the sale of our electronic payment systems and solutions that enable electronic payments, which we identify as System Solutions, and to a lesser extent, warranty and support services, field deployment, installation and upgrade services, and customer specific application development, which we identify as Services.

Net revenues, which include System Solutions and Services, are summarized in the following table (in thousands, except percentages):

	<b>Three Months Ended July 31,</b>				<b>Nine Months Ended July 31,</b>			
	<b>2008</b>	<b>2007</b>	<b>Net Change</b>	<b>Percentage Change</b>	<b>2008</b>	<b>2007</b>	<b>Net Change</b>	<b>Percentage Change</b>
Systems Solutions	\$ 228,766	\$ 205,972	\$ 22,794	11.1%	\$ 588,078	\$ 586,407	\$ 1,671	0.3%
Services	29,932	25,729	4,203	16.3%	89,142	78,540	10,602	13.5%
<b>Total</b>	<b>\$ 258,698</b>	<b>\$ 231,701</b>	<b>\$ 26,997</b>	<b>11.6%</b>	<b>\$ 677,220</b>	<b>\$ 664,947</b>	<b>\$ 12,273</b>	<b>1.8%</b>

***System Solutions***

System Solutions net revenues increased \$22.8 million, or 11.1%, to \$228.8 million for the three months ended July 31, 2008 from \$206.0 million for the three months ended July 31, 2007. System Solutions net revenues comprised 88.4% of total net revenues for the three months ended July 31, 2008 as compared to 88.9% for the three months ended July 31, 2007.

International System Solutions net revenues for the three months ended July 31, 2008 increased \$32.1 million, or 27.9%, to \$147.1 million compared to the three months ended July 31, 2007. The increase was primarily attributable to a \$16.5 million or 43.4% increase in our Latin America's System Solutions revenues due primarily to high Brazil sales. Brazilian customer decisions to expand and upgrade point of sale solutions have been favorably impacted by the public offerings of our two largest customers in Brazil, Redcard and Visanet, and an improving macroeconomic environment. Mexico revenues declined due to a less favorable tax regime from the government sponsored terminalization program. In addition, Europe's System Solutions revenues grew \$12.9 million or 21.0% compared to the same period in the prior year, when results were unfavorably impacted by poor sales and supply chain execution. Asia's Systems Solutions revenues grew \$2.6 million or 16.9% to \$18.1 million compared to three months ended July 31, 2007. This increase was primarily in China, due to improved demand in major cities and the establishment of after-market channel partners which deploys in smaller cities. Revenues were adversely impacted by increased pricing competition from our principal competitors in Europe and Latin America and local competitors in Asia.

North America System Solutions net revenues for the three months ended July 31, 2008 decreased \$9.3 million or 10.2% to \$81.6 million compared to the three months ended July 31, 2007. The biggest driver for this decrease was our U.S. Financial business, which sells payment systems to small and medium sized businesses through independent selling organizations, or ISO and payment processors. This business continued to be constrained by adverse economic conditions which slowed retail store openings. Petroleum Solutions sales continued to decline due to an unfavorable economic climate and high petroleum prices which affected the retail petroleum market. Partially offsetting this

decline was growth in Canada and the Multilane Retail business. Canadian revenue grew as our customers transitioned to solutions in compliance with the EMV standard. EMV is a standard developed by EMVCo LLC, which was formed by EuroPay International, MasterCard International, and Visa International to manage, maintain, and enhance a set of EMV integrated circuit card, or smart card, specifications and a corresponding compliance testing and certification approval process. Multilane Retail growth was a result of customer requirements to upgrade their infrastructure to comply with Payment Card Industry Data Security Standards ( PCI-DSS ). PCI-DSS is a standard from the Payment Card Industry Security Standards Council, developed by the major credit card companies as a guideline to help organizations that process card payments to prevent credit card fraud, hacking and various other security vulnerabilities and threats.

**Table of Contents**

System Solutions net revenues increased \$1.7 million, or 0.3%, to \$588.1 million for the nine months ended July 31, 2008 from \$586.4 million for the nine months ended July 31, 2007. System Solutions net revenues comprised 86.8% of total net revenues for the nine months ended July 31, 2008 as compared to 88.2% for the nine months ended July 31, 2007

International System Solutions net revenues for the nine months ended July 31, 2008 increased \$32.9 million, or 9.8%, to \$370.1 million compared to the nine months ended July 31, 2007. Latin American net revenues increased \$16.0 million, or 14.2% to \$128.0 million, European net revenues increased \$13.2 million, or 7.3%, to \$194.3 million, and net revenues in Asia increased \$4.2 million, or 9.7%, to \$47.7 million, compared to the nine months ended July 31, 2007. In Latin America, Brazil financial system solutions markets were favorably impacted by the public offerings of our two largest Brazilian customers and Brazil demand for prepaid top-ups, medical and healthcare system solutions increased due to a favorable macroeconomic climate. Mexico revenues declined due to a less favorable tax regime from the government sponsored terminalization program. European net revenues increased due to improved supply chain and sales execution compared to the nine months ended July 31, 2007. In addition, revenues were adversely impacted by increased pricing competition from our principal competitors in Europe and Latin America and local competitors in Asia.

North America System Solutions net revenues for the nine months ended July 31, 2008 decreased \$31.8 million or 12.7% to \$218.0 million compared to the nine months ended July 31, 2007. The largest declines were in the U.S. Financial business and Petroleum Solutions business. Our U.S. Financial business was constrained overall due to adverse economic conditions which slowed retail store openings. Petroleum Solutions sales continued to decline due to an unfavorable economic climate and high petroleum prices which affected the retail petroleum market. The decline in revenue was partially offset by strong sales in Multi-lane, reflecting deployments which address enhanced PCI-DSS. Furthermore, Canadian sales increased in the second half of fiscal year 2008 as our customers transitioned to solutions in compliance with the EMV standard.

*Services*

Services net revenues increased \$4.2 million, or 16.3%, to \$29.9 million for the three months ended July 31, 2008 from \$25.7 million for the three months ended July 31, 2007. Services net revenues increased \$10.6 million, or 13.5%, to \$89.1 million for the nine months ended July 31, 2008 from \$78.5 million for the nine months ended July 31, 2007. The majority of the growth was associated with North America services related to our taxicab payment solutions business. International service revenue growth in Brazil and Asia was offset by a decline in European refurbishment contracts.

*Gross Profit*

The following table shows the gross profit for System Solutions and Services (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	Amount		Gross Profit Percentage		Amount		Gross Profit Percentage	
	2008	2007	2008	2007	2008	2007	2008	2007
Systems Solutions	\$ 77,068	\$ 73,704	33.7%	35.8%	\$ 184,870	\$ 194,897	31.4%	33.2%
Services	11,355	11,892	37.9%	46.2%	34,269	36,968	38.4%	47.1%
Total	\$ 88,423	\$ 85,596	34.2%	36.9%	\$ 219,139	\$ 231,865	32.4%	34.9%

Gross profit on System Solutions increased \$3.4 million, or 4.6%, to \$77.1 million for the three months ended July 31, 2008 from \$73.7 million for the three months ended July 31, 2007. Gross profit on System Solutions represented 33.7% of System Solutions net revenues for the three months ended July 31, 2008 down from 35.8% for the three months ended July 31, 2007.

North America gross profit percentage declined primarily due to the growth in Multi-lane system solutions, which carry lower than average gross margins, and the lower proportion of Petroleum system solution sales, which carry higher than average gross margins. In addition, we experienced pricing pressure in landline and to a lesser

**Table of Contents**

degree wireless solutions. Increase sales of wireless solutions, which carry above average gross margins, partially offset these declines.

International gross profit percentage was approximately flat. The effect of improved supply chain cost management and pricing in Europe was partially offset by a higher mix of sales to Latin America, which generally carries a lower gross profit percentage than sales to Europe.

Corporate costs decreased as a percentage of System Solutions net revenues primarily due to \$3.8 million of lower excess and obsolescence charges, reflecting a period of lower than typical product transitions for the three months ended July 31, 2008. In the three months ended July 31, 2007, there were writeoffs associated with product transitions and a closure of an acquired distribution center. Amortization of purchased core and developed technology assets as a result of the Lipman acquisition declined by \$1.3 million. Partially offsetting these declines were increases of \$1.2 million in warranty expenses, primarily due to an increase in sales of certain products with longer standard warranty terms, and \$0.8 million of increased freight primarily due to rising fuel costs. Corporate costs are comprised of non-cash acquisition charges, including amortization of purchased core and developed technology assets, step-up of inventory and step-down in deferred revenue, and other Corporate charges, including inventory obsolescence and scrap at corporate distribution centers, rework, specific warranty provisions, non-standard freight, over-and-under absorption of materials management, and supply chain engineering overhead. Since these costs are generally incurred on a company-wide basis, it is impractical to allocate them to either the North America or International segment.

Gross profit on Services decreased \$0.5 million, or 4.5%, to \$11.4 million for the three months ended July 31, 2008 from \$11.9 million for the three months ended July 31, 2007. Gross profit on Services represented 37.9% of Services net revenues for the three months ended July 31, 2008 as compared to 46.2% for the three months ended July 31, 2007. This decrease was primarily due to the diseconomies of scale in our European services operations as a result of lower revenues. Partially offsetting this reduction was a slight increase in gross profit percentage in North America, primarily due to growth in services associated with our taxicab payment solutions.

Gross profit on System Solutions decreased \$10.0 million, or 5.1%, to \$184.9 million for the nine months ended July 31, 2008 from \$194.9 million for the nine months ended July 31, 2007. Gross profit on System Solutions represented 31.4% of System Solutions net revenues for the nine months ended July 31, 2008 down from 33.2% for the nine months ended July 31, 2007.

North America gross profit percentage declined primarily due to the growth in Multi-lane system solutions, which carry lower than average gross margins, and the lower proportion of Petroleum system solution sales, which carry higher than average gross margins. In addition, we experienced pricing pressure in both landline and wireless financial solutions. Partially offsetting this was the reduction of sales of a low margin legacy check processing solution for which sales effectively terminated in the three months ended January 31, 2007.

International gross profit percentage declined due to the combination of increased price competition in emerging markets countries, including Russia, China, Turkey and Brazil, and unfavorable local freight costs and distribution center inventory provisions. In addition, certain customers purchased non-PCI compliant inventory at significant discounts. This was partially offset by revenues in Latin America, which have historically carried gross margins below international averages, increased proportionally in the nine months ended July 31, 2008.

The overall gross profit percentage also declined due to the higher proportion of international net revenues, which typically carry a lower margin than North American net revenues.

Corporate costs decreased as a percentage of System Solutions net revenues primarily due to a \$14.0 million decrease in amortization of inventory step-up and a \$4.2 million decrease in amortization of purchased core and developed

technology assets as a result of the Lipman acquisition. These amortization expenses amounted to 4.1% of System Solutions net revenues for the nine months ended July 31, 2008 compared to 7.2% for the nine months ended July 31, 2007. In addition, there were \$4.4 million of lower excess and obsolescence charges, reflecting a period of lower than typical product transitions and the non-recurrence of write-offs associated with closures of an acquired distribution center for the nine months ended July 31, 2007. These decreases were partially offset by a \$3.9 million increase in freight primarily due to rising fuel costs, a \$2.3 million increase in warranty expenses primarily due to an increase in sales of certain products with longer standard warranty terms, and a \$1.3 million



**Table of Contents**

increase in Tel Aviv factory costs due to a doubling of unit volume production driven by increases in actual and forecasted demand of Nurit products.

**Research and Development Expenses**

Research and development ( R&D ) expenses are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2008	2007	Net Change	Percentage Change	2008	2007	Net Change	Percentage Change
Research and development	\$ 17,558	\$ 15,365	\$ 2,193	14.3%	\$ 57,179	\$ 48,272	\$ 8,907	18.5%
Percentage of net revenues	6.8%	6.6%			8.4%	7.3%		

R&D expenses in the three months ended July 31, 2008, increased \$2.2 million, or 14.3%, compared to the three months ended July 31, 2007 primarily due to a \$2.5 million increase in personnel costs as a result of higher headcount and unfavorable currency exchange rates partially offset by a \$0.2 million decrease in stock-based compensation expense.

R&D expenses in the nine months ended July 31, 2008, increased \$8.9 million, or 18.5%, compared to the nine months ended July 31, 2007 primarily due to a \$6.3 million increase in personnel costs resulting from higher headcount and unfavorable currency exchange rates, \$1.3 million in restructuring costs and \$2.7 million write-off of capitalized software development costs. The write-off was due to our restructuring activities and a change in our approach to the French market. These increases were partially offset by a \$0.8 million decrease in stock-based compensation expense.

We expect R&D expenses over the next several quarters to decline as a percentage of net revenues, primarily as a result of increased net revenues.

**Sales and Marketing Expenses**

Sales and marketing expenses are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2008	2007	Net Change	Percentage Change	2008	2007	Net Change	Percentage Change
Sales and marketing	\$ 23,540	\$ 23,686	(\$ 146)	(0.6)%	\$ 70,945	\$ 69,549	\$ 1,396	2.0%
Percentage of net revenues	9.1%	10.2%			10.5%	10.5%		

Sales and marketing expenses decreased \$0.1 million for the three months ended July 31, 2008, compared to the three months ended July 31, 2007 primarily due to \$1.6 million in lower sales and marketing activities and a \$0.4 million decrease in stock-based compensation expense. These decreases were partially offset by a \$1.2 million increase in

personnel costs resulting from wage increases and unfavorable currency exchange rates and a \$0.7 million increase in restructuring costs.

Sales and marketing expenses increased \$1.4 million for the nine months ended July 31, 2008, compared to the nine months ended July 31, 2007 mainly as a result of \$3.0 million of restructuring costs and a \$1.0 million increase in personnel costs resulting from wage increases and unfavorable currency exchange rates partially offset by \$2.4 million in lower sales and marketing activities and a \$0.6 million decrease in stock-based compensation expense.

We expect sales and marketing expenses to decline as a percentage of net revenues for the foreseeable future, primarily as a result of increased net revenues.

**Table of Contents****General and Administrative Expenses**

General and administrative expenses are summarized in the following table (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2008	2007	Net Change	Percentage Change	2008	2007	Net Change	Percentage Change
General and administrative	\$ 35,863	\$ 19,364	\$ 16,499	85.2%	\$ 93,183	\$ 62,306	\$ 30,877	49.6%
Percentage of net revenues	13.9%	8.4%			13.8%	9.4%		

General and administrative expenses in the three months ended July 31, 2008 increased \$16.5 million compared to the three months ended July 31, 2007. The increase was primarily due to \$15.4 million in costs related to the independent investigation and 2007 quarterly restatement, a \$1.8 million increase in professional services fees, a \$1.3 million increase in personnel costs resulting from higher headcount and unfavorable currency exchange rates, a \$1.0 million increase in restructuring, and a \$0.7 million increase in travel costs. These increases were partially offset by the non-recurrence of \$2.3 million of integration expenses incurred in the three months ended July 31, 2007 for the preparation of the response to the U.S. Department of Justice investigation of the Lipman acquisition, the establishment of business controls in former Lipman entities, and a Lipman distributor agreement restructuring charge. Furthermore, we also experienced a \$1.2 million decrease in bad debt expense and a \$0.5 million decrease in stock based compensation.

General and administrative expenses in the nine months ended July 31, 2008 increased \$30.9 million compared to the nine months ended July 31, 2007. The increase was primarily due to \$33.5 million in costs related to the independent investigation and 2007 quarterly restatement, a \$4.8 million increase in professional services fees, a \$3.7 million increase in personnel cost largely attributable to higher employee compensation and the impact of unfavorable foreign currency exchange rates, a \$1.8 million increase in restructuring costs, a \$1.9 million increase in travel costs, and a \$0.7 million increase in contract services. These increases were partially offset by the non-recurrence of \$9.7 million of integration expenses incurred during the nine months ended July 31, 2007 relating to the acquisition of Lipman and restructuring charges in VeriFone entities, a \$5.9 million decrease in stock-based compensation, and a \$1.8 million decrease in bad debt expenses.

We expect general and administrative expenses to decline as a percentage of net revenues over the next several quarters as a result of increased net revenues and the finalization of the investigation and restatement related costs.

**Amortization of Purchased Intangible Assets**

Amortization of purchased intangible assets increased \$0.8 million to \$6.2 million for the three months ended July 31, 2008 compared with \$5.4 million for the three months ended July 31, 2007 primarily due to the fluctuation of foreign currency exchange rates.

Amortization of purchased intangible assets increased \$2.4 million to \$18.9 million for the nine months ended July 31, 2008 compared with \$16.5 million for the nine months ended July 31, 2007 primarily due to the fluctuation of foreign currency exchange rates.

**Interest Expense**

Interest expense decreased \$3.0 million in the three months ended July 31, 2008 compared to the three months ended July 31, 2007. Interest expense decreased \$6.9 million in the nine months ended July 31, 2008 compared to the nine months ended July 31, 2007. These decreases in interest expense for the three and nine months ended July 31, 2008 were mostly attributable to the lower effective interest rate in the second and third quarter of fiscal 2008. In June 2007, we repaid an aggregate of \$263.0 million of our Term B Loan which had an interest rate of 7.11% with a portion of the proceeds from the issuance of the Senior Convertible Notes which bear interest at a rate of 1.375% subject to adjustments as described in Note 3 of our Condensed Consolidated Financial Statements.

In May 2008, the FASB issued FASB Staff Position ( FSP ) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP APB14-1 will require us to account separately for the liability and equity components of our convertible debt. The debt would be

**Table of Contents**

recognized at the present value of its cash flows discounted using our nonconvertible debt borrowing rate at the time of issuance. The equity component would be recognized as the difference between the proceeds from the issuance of the note and the fair value of the liability. The FSP also requires accretion of the resultant debt discount over the expected life of the debt. The FSP is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. Entities are required to apply the FSP retrospectively for all periods presented. We are currently evaluating FSP APB 14-1 and have not yet determined the impact its adoption will have on our consolidated financial statements. However, the impact of this new accounting treatment may be significant and may result in a significant increase to non-cash interest expense beginning in fiscal year 2010 for financial statements covering past and future periods.

***Interest Income***

Interest income decreased \$1.0 million in the three months ended July 31, 2008 compared to the three months ended July 31, 2007. This increase was attributable to the lower effective interest rates during the three months ended July 31, 2008.

Interest income decreased \$0.1 million in the nine months ended July 31, 2008 compared to the nine months ended July 31, 2007. This decrease was attributable to the impact of lower effective interest rates partially offset by the higher average cash and cash equivalents balances during fiscal year 2008 compared to fiscal year 2007.

***Other Income (Expense), Net***

Other income (expense), net increased \$4.4 million during the three months ended July 31, 2008 compared to the three months ended July 31, 2007 primarily due to the non-recurrence of a \$4.7 million write-off of debt issuance expense as a result of the extinguishment of debt in the three months ended July 31, 2007. Other income (expense), net decreased \$1.8 million in the nine months ended July 31, 2008 compared to the nine months ended July 31, 2007 predominately resulting from a \$7.3 million increase in foreign currency exchange losses in the nine months ended July 31, 2008 partially offset by the non-recurrence of a \$4.7 million write-off of debt issuance expense as a result of the extinguishment of debt in the nine months ended July 31, 2007.

Components of other income (expense) include net foreign exchange losses on transactions and settlements of currency derivative transactions. For the three and nine months ended July 31, 2008, we recorded \$0.4 million foreign currency transaction gains and \$6.4 million foreign currency transaction losses, respectively, due to a deferred tax liability in Israel which is denominated in Israeli Shekels. This is a non-cash charge and is not expected to be settled in the foreseeable future.

***Provision for Income Tax***

We expect to provide taxes in fiscal year 2008 notwithstanding an expected loss on our income statement for the full fiscal year. This is because, in significant part, we have net profits in our international operations and a loss in the United States. The tax benefit of the U.S. financial reporting loss is also offset by an expected increase in the valuation allowance on U.S. deferred tax assets. The effect of these circumstances is to create a negative tax rate both in the three and nine months ended July 31, 2008. The application of the intraperiod tax accounting rules of FIN 18 and expected losses at certain entities results in a computed charge for tax expense of \$7.4 million in the three months ended July 31, 2008. For the three months ended July 31, 2007, the tax expense was \$52.7 million. The decrease in taxes from the three months ended July 31, 2008 as compared to the three months ended July 31, 2007 is primarily attributable to the application of the intraperiod tax accounting rules of FIN 18 as applied to discrete items, primarily certain non-deductible in-process research and development charges. There were discrete items in the three and nine months ended July 31, 2007 that resulted in an unusually large tax expense relative to pre-tax income. There were no

comparable discrete items in the effective tax rate calculations for the three and nine months ended July 31, 2008.

As of July 31, 2008, we have recorded deferred tax assets, net of valuation allowance on our balance sheet, the realization of which is dependent on us generating sufficient U.S. and certain foreign taxable income. Although realization is not assured, our management believes that it is more likely than not that these deferred tax assets will be realized. The amount of deferred tax assets considered realizable may increase or decrease in subsequent

**Table of Contents**

quarters when we reevaluate the underlying basis for our estimates of future domestic and certain foreign taxable income.

We are currently under audit by the Internal Revenue Service ( IRS ) for our fiscal years 2003 to 2004. Although we believe we have correctly provided income taxes for the years subject to audit, the IRS may adopt different interpretations. We have not yet received any final determinations with respect to this audit although certain adjustments have been agreed with the IRS. The liability associated with the agreed adjustments had been accrued in previous periods. Subsidiaries of the company are also under audit by the Israeli tax authorities for 2004 to 2006 and the Brazilian federal government for the periods between January 31, 2003 through the current date. With few exceptions, we are no longer subjected to tax examination outside of the U.S. for periods prior to 2000.

**Segment Information**

The following table reconciles segmented net revenues and operating income to totals for the three and nine months ended July 31, 2008 and 2007. Corporate net revenues and operating income (loss) reflect non-cash acquisition charges, including amortization of purchased core and developed technology assets, step-up of inventory and step-down in deferred revenue and other corporate charges, including inventory obsolescence and scrap at corporate distribution centers, rework, specific warrant provisions, non-standard freight, over-and-under absorption of materials management, and supply chain engineering overhead. Corporate operating income (loss) also reflects the difference between the actual and standard cost of System Solutions net revenues and shared operating costs that benefit both segments, predominately research and development expenses and centralized supply chain management.

The following table sets forth net revenues and operating income (loss) by segments (in thousands, except percentages):

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2008	2007	Net Change	Percentage Change	2008	2007	Net Change	Percentage Change
Net revenues								
International	\$ 161,197	\$ 128,391	\$ 32,806	25.6%	\$ 412,303	\$ 379,136	\$ 33,167	8.7%
North America	97,783	103,961	(6,178)	(5.9)%	265,790	288,899	(23,109)	(8.0)%
Corporate	(282)	(651)	369	56.7%	(873)	(3,088)	2,215	71.7%
Total net revenues	\$ 258,698	\$ 231,701	\$ 26,997	11.7%	\$ 677,220	\$ 664,947	\$ 12,273	1.8%
Operating income (loss)								
International	\$ 31,745	\$ 28,789	\$ 2,956	10.3%	\$ 67,472	\$ 90,615	\$ (23,143)	(25.5)%
North American	36,755	43,148	(6,393)	(14.8)%	95,688	113,974	(18,286)	(16.0)%
Corporate	(63,221)	(50,172)	(13,049)	(26.0)%	(184,183)	(175,957)	(8,226)	(4.7)%
Total operating income (loss)	\$ 5,279	\$ 21,765	\$ (16,486)	(75.7)%	\$ (21,023)	\$ 28,632	\$ (49,655)	(173.4)%

The net revenues increased \$32.8 million in International for the three months ended July 31, 2008 as compared to the same period in 2007 primarily driven by an increase of approximately \$32.1 million in System Solutions net revenues and \$0.7 million in Services net revenues. Net revenues increased \$33.2 million in International for the nine months ended July 31, 2008 as compared to the nine months ended July 31, 2007 primarily driven by a \$32.9 million increase in System Solutions net revenues. See Results of Operations Net Revenues.

Net revenues decreased \$6.2 million in North America for the three months ended July 31, 2008 as compared to the three months ended July 31, 2007 primarily due to a \$9.3 million decrease in Systems Solutions net revenues partially offset by a \$3.1 million increase in Services net revenues. Net revenues decreased \$23.1 million in North America for the nine months ended July 31, 2008 as compared to the nine months ended July 31, 2007 primarily driven by a \$31.8 million decrease in Systems Solutions net revenues partially offset by an \$8.7 million increase in Services net revenues. See Results of Operations Net Revenues.



**Table of Contents**

The increase in International operating income for the three months ended July 31, 2008 compared to the three months ended July 31, 2007 was mainly due to higher revenues partially offset by an increase in operating expenses. The decrease in International operating income for the nine months ended July 31, 2008 compared to the nine months ended July 31, 2007 was mainly due to lower gross profit percentage, and higher operating expenses. See Results of Operations Gross Profit.

The decrease in operating income for North America for the three and nine months ended July 31, 2008 compared to the three and nine months ended July 31, 2007 was mainly due to lower revenues, lower gross profit percentage and higher operating expenses. See Results of Operations Gross Profit.

The increase in Corporate operating loss for the three months ended July 31, 2008 was primarily due to \$15.4 million in costs related to the independent investigation and restatement. The increase was partially offset by the non-recurrence of \$2.3 million of integration expenses incurred in the three months ended July 31, 2007 for the preparation of the response to the U.S. Department of Justice investigation of the Lipman acquisition, the establishment of business controls in former Lipman entities, and a Lipman distributor agreement restructuring charge, and a \$1.2 million decrease in stock-based compensation.

The increase in Corporate operating loss for the nine months ended July 31, 2008 was primarily due to \$33.5 million in costs related to the independent investigation and restatement and a \$4.0 million increase in personnel expenses partially the result of unfavorable foreign currency trends. The increase was partially offset by a decrease of \$20.6 million in amortization of step-up in inventory and in-process research and development charges in relation to the Lipman acquisition and the non-recurrence of \$9.7 million of integration expenses relating to the acquisition of Lipman and restructuring charges incurred during the nine months ended July 31, 2007. In addition, stock-based compensation decreased \$8.8 million during the nine months ended July 31, 2008 compared to the nine months ended July 31, 2007.

**Liquidity and Capital Resources**

	<b>Nine Months Ended July 31,</b>	
	<b>2008</b>	<b>2007</b>
Net cash provided by (used for):		
Operating activities	\$ 7,648	\$ 84,813
Investing activities	(32,904)	(293,143)
Financing activities	(2,647)	334,104
Effect of exchange rate fluctuation on cash and cash equivalents	(5,084)	608
Net increase (decrease) in cash and cash equivalents	\$ (32,987)	\$ 126,382

Our primary liquidity and capital resource needs are to service our debt, finance working capital, and to make capital expenditures and investments. At July 31, 2008, our primary sources of liquidity were cash and cash equivalents of \$182.0 million and our \$40 million unused revolving credit facility. Our cash and cash equivalents balance decreased \$33.0 million primarily due to \$15.4 million used in business acquisitions, net of cash acquired, \$14.4 million used to purchase property, plant and equipment and \$3.8 million used to repay long-term debt.

**Operating Activities**

Cash flow from operating activities was \$7.6 million for the nine months ended July 31, 2008.

Cash provided by operations before changes in working capital amounted to \$13.7 million for the nine months ended July 31, 2008 and consisted of \$58.7 million net loss adjusted for \$72.4 million of non-cash items such as amortization of purchased intangible assets, stock-based compensation expense, depreciation and amortization of property, plant, and equipment, amortization debt issuance and loss on write-off of capitalized software.

**Table of Contents**

Cash used in operations due to changes in working capital netted to \$6.1 million during the nine months ended July 31, 2008. The main drivers were as follows:

The \$54.9 million increase in inventories is due to several factors, including sales for certain products, particularly in North America that fell short of expectations, strategic decisions to increase inventory for certain products to reduce the incidence of missed sales opportunities due to insufficient quantities on hand, increased inventory of MX Multilane Retail products ahead of projected sales potential, and increased use of ocean rather than air freight to ship inventory.

A \$15.4 million increase in other assets primarily due to the deferral of costs of goods for inventory delivered to customers for which net revenues and associated cost of net revenues is recognized as the customers are billed.

A \$7.1 million increase in prepaid expenses and other current assets due mainly to an increase in prepaid income taxes.

Offset by:

A \$22.4 million increase in accrued expenses and other liabilities due to the investigation and 2007 quarterly restatement related costs, professional fees and long-term tax reserves on adoption of FIN 48;

A \$18.3 million decrease in accounts receivable due to better collections;

A \$15.6 million increase in income taxes payable;

A \$9.1 million decrease in deferred tax balances; and

A \$8.8 million increase in deferred revenue due mainly to the deferral of revenue for certain transactions because all revenue recognition criteria have not been met.

**Investing Activities**

Cash used in investing activities was \$32.9 million in the nine months ended July 31, 2008, and primarily consisted of \$14.4 million in purchases of property, plant and equipment, \$15.4 million used in business acquisitions, net of cash acquired and a \$3.2 million capitalization of software development costs.

**Financing Activities**

The \$2.6 million of cash used in financing activities in the nine months ended July 31, 2008 primarily consist of \$3.8 million repayment of long-term debt and a \$1.8 million debt amendment fee which were partially offset by \$1.7 million of receipts from the exercise of stock options and \$0.9 million from the tax benefit derived from stock-based compensation.

We believe that we have the financial resources to meet our business requirements for the next twelve months, including capital expenditures, working capital requirements, and future strategic investments, and to comply with our financial covenants.

**Contractual Obligations**

The following table summarizes our contractual obligations as of July 31, 2008 (in thousands):

	<b>Total</b>	<b>Less Than 1 Year</b>	<b>1 to 3 Years</b>	<b>3 to 5 Years</b>	<b>More Than 5 Years</b>
Term B Loan (including interest)(1)	\$ 297,427	\$ 17,954	\$ 35,064	\$ 33,972	\$ 210,437
Senior convertible notes (including interest)	334,670	5,375	8,697	320,598	
Capital lease obligations	121	22	99		
Operating leases	43,217	2,638	16,742	11,611	12,226
Minimum purchase obligations	89,546	89,546			
	\$ 764,981	\$ 115,535	\$ 60,602	\$ 366,181	\$ 222,663

(1) Interest in the above table has been calculated using the rate in effect at July 31, 2008.

**Table of Contents*****FASB Interpretation No. 48 ( FIN 48 ) Liabilities***

As of November 1, 2007, the amount of the unrecognized tax benefits was \$22.4 million, including accrued interest and penalties, none of which is expected to be paid within one year. We are unable to make a reasonably reliable estimate as to when cash settlement with a taxing authority may occur. However, it is reasonably possible that the total amount of unrecognized tax benefits will increase or decrease in the next 12 months. Such changes could occur based on the normal expiration of various statutes of limitations or the possible conclusion of ongoing tax audits in various jurisdictions around the world.

**Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA), as adjusted**

We define earnings before interest, taxes, depreciation, and amortization, or EBITDA, as adjusted, as the sum of (1) net income (excluding extraordinary items of gain or loss and any gain or loss from discontinued operations), (2) interest expense, (3) income taxes, (4) depreciation, amortization, goodwill impairment, and other non-recurring charges, (5) non-cash charges, including non-cash stock-based compensation expense and purchase accounting items, and (6) acquisition related charges and restructuring costs. EBITDA, as adjusted, is a primary component of the financial covenants to which we are subject under our credit agreement. If we fail to maintain required levels of EBITDA, as adjusted, we could have a default under our credit agreement, potentially resulting in an acceleration of all of our outstanding indebtedness. Management uses EBITDA, as adjusted, only in addition to and in conjunction with results presented in accordance with GAAP. Management believes that the use of this non-GAAP financial measure, in conjunction with results presented in accordance with GAAP, helps it to evaluate our performance and to compare our current results with those for prior periods as well as with the results of other companies in our industry. Our competitors may, due to differences in capital structure and investment history, have interest, tax, depreciation, amortization, and other non-cash expenses that differ significantly from ours. Management also uses this non-GAAP financial measure in our budget and planning process. Management believes that the presentation of this non-GAAP financial measure may be useful to investors for many of the same reasons that management finds these measures useful.

Our EBITDA, as adjusted, contains limitations and should be considered as a supplement to, and not as a substitute for, or superior to, disclosures made in accordance with GAAP. EBITDA, as adjusted, may be different from EBITDA or EBITDA, as adjusted, calculated by other companies and is not based on any comprehensive set of accounting rules or principles. In addition, EBITDA, as adjusted, does not reflect all amounts and costs, such as employee stock-based compensation costs, periodic costs of assets used to generate net revenues and costs to replace those assets, cash expenditures or future requirements for capital expenditures or contractual commitments, cash requirements for working capital needs, interest expense or the cash requirements necessary to service interest or principal payments on our debt, income taxes and the related cash requirements, restructuring and impairment charges and losses from discontinued operations, associated with our results of operations as determined in accordance with GAAP. Furthermore, we expect to continue to incur expenses similar to those amounts excluded from EBITDA, as adjusted. Management compensates for these limitations by also relying on the comparable GAAP financial measure.

As noted above, management excludes the following items from EBITDA, as adjusted:

*Provision for (benefit from) income taxes.* While income taxes are directly related to the amount of pre-tax income, they are also impacted by tax laws and the company's tax structure. As the tax laws and our tax structure are not under the control of our operational managers, management believes that the provision for (benefit from) income taxes should be excluded when evaluating our operational performance.

*Interest expense and interest income.* While working capital supports the business, management does not believe that related interest expense or interest income is directly attributable to the operating performance of our business.

*Depreciation of property, plant and equipment.* Management excludes depreciation because while tangible assets support the business, management does not believe the related depreciation costs are directly attributable to the operating performance of our business. In addition, depreciation may not be indicative of current or future capital expenditures.

**Table of Contents**

*Amortization of capitalized software.* Management excludes amortization of capitalized software because while capitalized software supports the business, management does not believe the related amortization costs are directly attributable to the operating performance of our business. In addition, amortization of capitalized software may not be indicative of current or future expenditures to develop software.

*Amortization of certain acquisition related items.* We incur amortization of purchased core and developed technology assets, amortization of purchased intangible assets, amortization of step-down in deferred revenue on acquisition, and amortization of step-up in inventory on acquisition in connection with acquisitions. Management excludes these items because it does not believe these expenses are reflective of ongoing operating results in the period incurred. These amounts arise from prior acquisitions and management does not believe that they have a direct correlation to the operation of our business.

*In-process research and development.* We incur IPR&D expenses when technological feasibility for acquired technology has not been established at the date of acquisition and no future alternative use for such technology exists. These amounts arise from prior acquisitions and management does not believe they have a direct correlation to the operation of VeriFone's business.

*Stock-based compensation.* These expenses consist primarily of expenses for employee stock options and restricted stock units under SFAS No. 123(R). Management excludes stock-based compensation expenses from non-GAAP financial measures primarily because they are non-cash expenses which management believes are not reflective of ongoing operating results.

*Acquisition related charges and restructuring costs.* This represents charges incurred for consulting services and other professional fees associated with acquisition related activities. These expenses also include charges related to restructuring activities, including costs associated with severance, benefits, and excess facilities. As management does not believe that these charges directly relate to the operation of our business, management believes they should be excluded when evaluating our operating performance.

*Non-cash portion of loss on debt extinguishment.* This represents the non-cash portion of loss incurred on the extinguishment of our credit facility. While this credit facility supported our business, management does not believe the related loss on extinguishment is a cost directly attributable to the operating performance of our business.

*Capitalized software write-off.* This represents charges related to the write-off of previously incurred and capitalized software development costs due to restructuring activities and changes in our market approach in certain areas. As management does not believe that these charges directly relate to the operation of our business, management believes they should be excluded when evaluating our operating performance.

**Table of Contents**

A reconciliation of net loss, the most directly comparable U.S. GAAP measure, to EBITDA, as adjusted, for the three and nine months ended July 31, 2008 and 2007 is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	July 31,		July 31,	
	2008(1)	2007	2008(1)	2007
U.S. GAAP net loss	\$ (7,199)	\$ (42,386)	\$ (58,684)	\$ (52,883)
Provision for income taxes	7,419	52,753	14,221	53,116
Interest expense	6,447	9,468	21,877	28,731
Interest income	(1,194)	(2,226)	(4,677)	(4,751)
Depreciation and amortization of property, plant and equipment	3,527	2,049	9,894	5,814
Amortization of capitalized software	421	230	1,142	800
Amortization of purchased intangible assets	14,184	14,694	43,155	44,930
Amortization of step-down in deferred revenue on acquisition	282	652	873	3,088
Amortization of step-up in inventory on acquisition				13,961
In-process research and development				6,650
Stock-based compensation	4,659	5,859	13,159	21,954
Acquisition related charges and restructuring costs		2,297		9,714
Extinguishment of debt issuance costs		4,764		4,764
Capitalized software write-off			2,700	
EBITDA as adjusted	\$ 28,546	\$ 48,154	\$ 43,660	\$ 135,888

- (1) Net loss for the three months ended July 31, 2008 was negatively impacted by \$15.4 million of costs related to the restatement and \$2.2 million in restructuring costs. None of the \$17.6 million has been added back in calculating EBITDA. Net loss for the nine months ended July 31, 2008 was negatively impacted by \$33.5 million of costs related to the restatement and \$6.7 million in restructuring costs. None of the \$40.2 million has been added back in calculating EBITDA.

Our operating cash flow and EBITDA, as adjusted, have each declined in the nine months ended July 31, 2008 as compared to the comparable period of 2007. As a result, our cash liquidity has declined since October 31, 2007 and, although we remain in compliance with the financial covenants in our bank agreement by significant margins, the relevant financial ratios have also weakened. The declines in operating cash flow and EBITDA, as adjusted, were attributable largely to lower net income recorded during the period, which has in turn been impacted by the significant expenses attributable to the restatement and related internal and governmental investigations and litigation activities. Through July 31, 2008, we had incurred approximately \$33.5 million in such expenses.

**Off-Balance Sheet Arrangements**

Our only off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of the SEC's Regulation S-K, consist of interest rate cap agreements and forward foreign currency exchange agreements described under Quantitative and Qualitative Disclosures about Market Risk. See Item 3.



### **Recent Accounting Pronouncements**

Information with respect to our recent accounting pronouncements may be found in Note 1 *Recent Accounting Pronouncements* in the Notes to Condensed Consolidated Financial Statements included in this Form 10-Q, which section is incorporated herein by reference.

### **Critical Accounting Policies and Estimates**

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for

## **Table of Contents**

making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

On an on-going basis, we evaluate our critical accounting policies and estimates, including those related to revenue recognition, inventory valuation, product returns reserve and allowance for doubtful account, contingencies and litigation, income taxes, and intangible assets. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

In the first quarter of 2008, we adopted Financial Accounting Standards Board Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position. FIN 48 indicates that an enterprise shall initially recognize the financial statement effects of a tax position when it is more likely than not to be sustained on examination, based on the technical merits of the position. In addition, FIN 48 indicates that the measurement of a tax position that meets the more likely than not threshold shall consider the amounts and probabilities of the outcomes that could be realized upon ultimate settlement. The impact on adoption of FIN 48 is described in Note 9, *Income Taxes* . The following is a revision of our income tax critical accounting policy.

### **Income Taxes**

Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts using enacted tax rates in effect for the year the differences are expected to reverse. In evaluating our ability to recover our deferred tax assets we consider all available positive and negative evidence including our past operating results, the existence of cumulative losses in past fiscal years and our forecast of future taxable income in the jurisdictions in which we have operations.

We have placed a valuation allowance on certain U.S. deferred tax assets and our non-U.S. net operating loss carry forwards because realization of these tax benefits through future taxable income cannot be reasonably assured. We intend to maintain the valuation allowances until sufficient positive evidence exists to support the reversal of the valuation allowances. An increase in the valuation allowance would result in additional expense in such period. We make estimates and judgments about our future taxable income that are based on assumptions that are consistent with our plans and estimates. Should the actual amounts differ from our estimates, the amount of our valuation allowance could be materially impacted.

We must make certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of tax credits and deductions, and in the calculation of certain tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes, as well as the interest and penalties relating to these uncertain tax positions. Significant changes to these estimates may result in an increase or decrease to our tax provision in a subsequent period.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. As a result of the implementation of FIN 48, we recognize liabilities for uncertain tax positions based on the two-step process prescribed within the interpretation. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as this requires us to determine

the probability of various possible outcomes. We reevaluate these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in the period.

**Table of Contents**

For further information on our critical accounting policies, see the discussion of critical accounting policies in our Annual Report on Form 10-K for the fiscal year ended October 31, 2007.

**ITEM 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. To mitigate some of these risks, we utilize derivative financial instruments to hedge these exposures. We do not use derivative financial instruments for speculative or trading purposes nor do we issue or hold leveraged derivative financial instruments.

**Interest Rates**

We are exposed to interest rate risk related to our debt, some of which bears interest based upon the three-month LIBOR rate. We have reduced our exposure to interest rate fluctuations through the purchase of interest rate caps covering a portion of our variable rate debt. In 2006, we purchased two-year interest rate caps for \$118,000 with an initial notional amount of \$200 million declining to \$150 million after one year with an effective date of November 1, 2006 under which we will receive interest payments if the three-month LIBOR rate exceeds 6.5%. Based on effective interest rates at July 31, 2008, a 50 basis point increase in interest rates on our borrowings subject to variable interest rate fluctuations would increase our interest expense by approximately \$1.2 million annually.

**Foreign Currency Risk**

A majority of our business consists of sales made to customers outside the United States. A substantial portion of the net revenues we receive from such sales is denominated in currencies other than the U.S. dollar. Additionally, portions of our costs of net revenues and our other operating expenses are incurred by our International operations and denominated in local currencies. While fluctuations in the value of these net revenues, costs and expenses as measured in U.S. dollars have not materially affected our results of operations historically, we cannot assure you that adverse currency exchange rate fluctuations will not have a material impact in the future. In addition, our balance sheet reflects non-U.S. dollar denominated assets and liabilities which can be adversely affected by fluctuations in currency exchange rates. In certain periods, we have not hedged our exposure to these fluctuations.

We have entered into foreign currency forward contracts and other arrangements intended to hedge our exposure to adverse fluctuations in exchange rates. As of July 31, 2008, we had no foreign currency forward contracts outstanding. During the first week of August 2008, we entered into foreign currency forward contracts with aggregate notional amounts of \$31.6 million to hedge exposures to non-functional currencies. If we had chosen not to enter into foreign currency forward contracts to hedge against these exposures and if the hedge currencies were to devalue 5% to 10% against the U.S. dollar, results of operations would include a foreign exchange loss of approximately \$1.6 million to \$3.2 million for the three and nine months ended July 31, 2008.

Hedging arrangements of this sort may not always be effective to protect our results of operations against currency exchange rate fluctuations, particularly in the event of imprecise forecasts of non-U.S. denominated assets and liabilities. Accordingly, if there are adverse movements in exchange rates, we might suffer significant losses.

**Equity Price Risk**

In June 2007, we sold \$316.2 million aggregate principal amount of 1.375% Senior Convertible Notes due 2012 (the Notes ). Holders may convert their Notes prior to maturity upon the occurrence of certain circumstances. Upon conversion, we would pay the holder the cash value of the applicable number of shares of VeriFone common stock, up to the principal amount of the Notes. Amounts in excess of the principal amount, if any may be paid in cash or in

stock at our option. Concurrent with the issuance of the Notes, we entered into note hedge transactions and separately, warrant transactions, to reduce the potential dilution from the conversion of the Notes and to mitigate any negative effect such conversion may have on the price of our common stock.

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

VeriFone maintains disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management is responsible for establishing and maintaining our disclosure controls and procedures. Our Chief Executive Officer and Interim Chief Financial Officer participated with our management in evaluating the effectiveness of our disclosure controls and procedures as of July 31, 2008.

Based on our management's evaluation (with the participation of our Chief Executive Officer and Interim Chief Financial Officer), our Chief Executive Officer and Interim Chief Financial Officer have concluded that, as of July 31, 2008, in light of the material weaknesses described below, our disclosure controls and procedures were not effective to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Interim Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Notwithstanding the material weaknesses described below, we have performed additional analyses and other procedures to enable management to conclude that our condensed consolidated financial statements included in this report were prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). Based in part on these additional efforts, our Chief Executive Officer and Interim Chief Financial Officer have included their certifications as exhibits to this Form 10-Q.

A material weakness is a control deficiency, or combination of control deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. Management's assessment identified the following material weaknesses in our internal control over financial reporting as of July 31, 2008. As set forth below, management has taken or will take steps to remediate each of these material weaknesses.

A transaction-level material weakness in the design and operation of control activities, relating to the preparation, review, approval and entry of manual, non-standard, journal entries. This material weakness contributed to adjustments in several accounts and the restatement of the interim condensed consolidated financial statements for the quarterly periods during the fiscal year ended October 31, 2007. The accounts most affected in the restatement included inventory and cost of net revenues; however, this material weakness could impact all financial statement accounts.

An entity-level material weakness in the control environment related to our period-end financial reporting process due to an insufficient number of qualified personnel with the required proficiency to apply our accounting policies in accordance with U.S. GAAP, following the November 1, 2006 acquisition of Lipman Electronic Engineering Ltd. This material weakness contributed to adjustments in several accounts and the restatement of the interim condensed consolidated financial statements for the quarterly periods during the fiscal year ended October 31, 2007. The accounts most affected in the restatement include inventories and cost

of net revenues; however, this material weakness could impact all financial statement accounts, with a higher likelihood for accounts subject to non-routine or estimation processes, such as inventory reserves and income taxes.

An entity-level material weakness in control activities related to the design and operation of our supervision, monitoring and monthly financial statement review processes. This material weakness contributed to adjustments in several accounts and the restatement of interim condensed consolidated financial statements for the quarterly periods during the fiscal year ended October 31, 2007. The accounts most affected in the restatement include inventory and cost of net revenues; however, this material weakness could impact all financial statement accounts.

## **Table of Contents**

A transaction-level material weakness in the design and operating effectiveness of controls related to income taxes. Specifically, our processes and procedures were not designed to provide for adequate and timely identification, documentation and review of various income tax calculations, reconciliations and related supporting documentation required to apply our accounting policy for income taxes in accordance with U.S. GAAP, particularly following the November 1, 2006 acquisition of Lipman Electronic Engineering Ltd. This material weakness impacted our ability to report financial information related to income tax accounts and resulted in adjustments to income tax expense, income taxes payable, deferred tax assets and liabilities, and goodwill accounts during the fiscal year ended October 31, 2007.

## **Management's Remediation Initiatives**

In response to the material weaknesses discussed above, we plan to continue the efforts already underway to review and make necessary changes to improve our internal control over financial reporting, including:

We have enhanced and expect to continue to enhance our manual journal entry policy, including a more stringent manual journal entry review and approval process that requires tiered approval levels in which escalating dollar amounts require additional approval by increasingly more senior personnel;

We migrated to a new worldwide, integrated, enterprise resource planning (ERP) system. The new ERP system is our principal computing platform and provides for a single unified chart of accounts worldwide. This system was activated for the majority of our worldwide operations in the first fiscal quarter of 2008 and by the end of the second fiscal quarter of 2008 over 90% of our consolidated net revenues and cost of net revenues were processed on this system;

We have added and expect to continue to add qualified accounting and finance personnel having sufficient knowledge and experience in general accepted accounting principles, cost accounting, tax, and management of financial systems;

We intend to enhance our review process over the monthly financial results by requiring additional documentation and analysis to be provided that will then be reviewed by appropriate key senior personnel from both finance and non-finance areas;

We expect to enhance the segregation of duties between the financial planning and the accounting and control functions; and

We intend to enhance our governance and compliance functions to improve control consciousness and prevention of errors in financial reporting, as well as to improve tone, communication, education, and training for employees involved in the financial reporting process, including the appointment of a chief legal and compliance officer.

## **Changes in Internal Control over Financial Reporting**

During the third quarter of our fiscal year ending October 31, 2008, we implemented the following changes to internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934):

We have enhanced our manual journal entry review and approval process so that the required approval levels (in which escalating dollar amounts require additional approval by increasingly more senior personnel) are performed in the enterprise resource planning (ERP) system and thus entries cannot be recorded unless the



approval is obtained electronically by the appropriate level of personnel. This control also provides a clear audit trail of the entry.

We have added additional qualified accounting and finance personnel having sufficient knowledge and experience in general accepted accounting principles to the cost accounting and corporate accounting group.

There have been no other changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting for the quarter ended July 31, 2008.

**Table of Contents**

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Information with respect to this Item may be found in Note 10 of Notes to Condensed Consolidated Financial Statements in this Form 10-Q, which is incorporated into this Item 1 by reference.

**ITEM 1A. RISK FACTORS**

A description of risks associated with our business, financial condition, and results of operations is set forth in Part 1, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended October 31, 2007. There have been no material changes in our risks from such description.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

The following documents are filed as Exhibits to this report:

<b>Exhibit Number</b>	<b>Description</b>
10.1	Third Amendment to Credit Agreement, dated as of July 31, 2008 (incorporated by reference to the Current Report on Form 8-K filed by VeriFone Holdings, Inc. on July 31, 2008).
31.1	Certification of the Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Interim Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer and the Interim Chief Financial Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002.



**Table of Contents**

**SIGNATURES**

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

VERIFONE HOLDINGS, INC

Douglas G. Bergeron  
Chief Executive Officer

By: /s/ Douglas G. Bergeron

Clinton Knowles  
Interim Chief Financial Officer

By: /s/ Clinton Knowles

Date: September 9, 2008

45

---

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
10.1	Third Amendment to Credit Agreement, dated as of July 31, 2008 (incorporated by reference to the Current Report on Form 8-K filed by VeriFone Holdings, Inc. on July 31, 2008).
31.1	Certification of the Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Interim Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer and the Interim Chief Financial Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002.