HEARTLAND PAYMENT SYSTEMS INC
Form 10-K
February 28, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2013

OR

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

For the transition period from   to

Commission File No. 001-32594

HEARTLAND PAYMENT SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

Delaware	22-3755714
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

90 Nassau Street, Princeton, New Jersey 08542
(Address of principal executive offices) (Zip Code)
(609) 683-3831
(Registrant’s telephone number, including area code)

Securities registered pursuant to 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.001 par value	New York Stock Exchange

Securities registered pursuant to 12(g) of the Act:

(NONE)
(title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o YES x NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o YES x NO

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

Indicate by check mark if disclosure of delinquent filer pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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 definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o YES x NO

The aggregate market value of the voting and non-voting common stock held by non-affiliates computed by reference to the price at which the common stock was last sold on the New York Stock Exchange on June 30, 2013 was approximately $1.3 billion.
As of February 24, 2014, there were 36,701,106 shares of the registrant’s Common Stock, $0.001 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE
Specifically identified portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2014 annual meeting of shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K for fiscal year ended December 31, 2013.

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Heartland Payment Systems, Inc.
Annual Report on Form 10-K
For the Year Ended December 31, 2013

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FORWARD LOOKING STATEMENTS

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

Some of the information in this Annual Report on Form 10-K may contain forward looking statements that are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include the information concerning our possible or assumed future results of operations, financial condition and prospects, business strategies, financing plans, competitive position, industry environment, potential growth opportunities, the effects of future regulation and the effects of competition. Forward-looking statements include all statements that are not historical facts and can be identified by the use of forward-looking terminology such as the words “anticipate,” “believe,” "estimate," “expect,” “intend,” “plan,” "predict," "will be," "will continu or similar expressions.

Forward-looking statements involve risks, uncertainties and assumptions. Actual results may differ materially from those expressed in the forward-looking statements. You should understand that many important factors, in addition to those discussed elsewhere in this report, could cause our results to differ materially from those expressed in the forward-looking statements. Certain of these factors are described in Item 1A. Risk Factors and include, without limitation, unauthorized disclosure of user data through breaches of our computer systems or otherwise, our competitive environment, the business cycles and credit risks of our merchants, chargeback liability, merchant attrition, problems with our sponsor banks, our relationships with third-party bankcard payment processors, our inability to pass increased interchange fees, assessments, and transaction fees along to our merchants, economic conditions, systems failures and government regulation.

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PART I.
ITEM 1. BUSINESS

Overview of Our Company

Heartland Payment Systems, Inc.
90 Nassau Street, Princeton, NJ 08542
(609) 683-3831

Our primary business is to provide Card Payment Processing services to merchants throughout the United States. This involves providing end-to-end electronic payment processing services to merchants by facilitating the exchange of information and funds between them and cardholders' financial institutions. To accomplish this, we undertake merchant set-up and training, transaction authorization and electronic draft capture, clearing and settlement, merchant accounting, merchant assistance and support, and risk management. We also sell and rent point-of-sale devices. Our card-accepting customers primarily fall into two categories: small and mid-sized merchants (referred to as "Small and Midsized Enterprises," or “SME merchants”) and Network Services merchants, which are predominately petroleum industry merchants of all sizes (referred to as “Network Services merchants”).
We provide additional services in our other business segments such as:

- School nutrition, point-of-sale solutions, and associated payment solutions, including online prepayment solutions, to K-12 schools through Heartland School Solutions,
- Full-service Payroll Processing and related tax filing services, through Heartland Ovation Payroll,
- Payment processing, higher education loan services and open- and closed-loop payment solutions to colleges and universities through Campus Solutions,
- Prepaid and stored-value card solutions through Micropayments, and marketing solutions including loyalty and gift cards which we provide through Heartland Marketing Solutions.

We were incorporated in June 2000, in the state of Delaware. As of December 31, 2013, we employed 3,184 full- and part-time personnel, including 951 sales professionals, 722 customer service, risk management, financial and operations support and underwriting employees, 458 systems and technology employees, 328 Heartland Ovation Payroll employees, 204 Heartland School Solutions employees, 195 Campus Solutions employees, 250 accounting and administration employees, 31 Micropayments employees and 45 Leaf employees (which were part of our acquisition of Leaf Holdings, Inc, further discussed below). Our sales professionals include 844 Relationship Managers and Territory Managers and 58 Senior Product Advisors, primarily payroll specialists. None of our employees are represented by a labor union, and we have experienced no work stoppages. We consider our employee relations to be good.
General Business Developments
Acquisitions
On September 11, 2013, we purchased 66.67% of the outstanding capital stock of Leaf Holdings, Inc. (“Leaf”) for a $14.5 million cash payment. Leaf provides us with a cloud-based, software-as-a-service (SaaS), Point-of-Sale (POS) system to deliver an open-architecture platform supporting numerous vertical-specific business applications. Leaf products provide a mobile payment platform built for local commerce helping retail stores, restaurants, and other local merchants improve the speed and ease of checkout and offering easy-to-use business management, analytics, and customer engagement. Leaf is currently included in our core Card Payment Processing business.
On December 31, 2012, we purchased for a $44.2 million cash payment the stock of Ovation Payroll, Inc. (“Ovation”). The acquisition expanded our existing payroll processing business. Ovation provides payroll processing, payroll tax preparation, Internet payroll reporting, and direct deposit to over 10,000 clients in 48 states. With this acquisition the Company added scale to its HOP payroll platform (formerly PlusOne Payroll), leveraging operating costs, and also

added management, a new specialized payroll sales approach, an affinity partner referral network and enhanced product and servicing capabilities.

On December 14, 2012, we purchased for a $37.6 million cash payment the stock of Educational Computer Systems, Inc. (“ECSI”) and net assets of related entities. The acquisition expanded our Campus Solutions business. ECSI supports the

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entire life cycle of higher education and post-graduation school/student services, including student loan payment processing, electronic billing and payment, default solutions, refund services, tuition payment plans, tax document services, and business outsourcing to more than 1,800 colleges and universities nationwide. With this acquisition, our Campus Solutions business gained ECSI's client portfolio, boosting its number of higher education clients to more than 2,000 colleges and universities throughout North America.

On June 29, 2012, we purchased for a $26.0 million cash payment the net assets of Lunch Byte Systems, Inc. (a.k.a. "Nutrikids"). This acquisition added approximately 10,000 schools to our Heartland School Solutions business providing school nutrition, point-of-sale solutions, and associated payment solutions.

Divestiture

In the fourth quarter of 2012, we, along with the 30% non-controlling shareholders of Collective Point of Sale, Ltd. ("CPOS"), entered into an agreement to sell CPOS to a third party. CPOS, which operates as a provider of payment processing services in Canada, was not a significant subsidiary and we have no continuing involvement in its operations. After receiving regulatory approval, the buyer settled this sale on January 31, 2013. The total sales price was $30.3 million in cash including net working capital, of which we received $20.9 million for our 70% ownership position. During the first quarter of 2013, we recorded a gain on sale of $3.8 million, net of income taxes of $2.1 million. This gain and prior period earnings are reported as income from discontinued operations in our consolidated statements of income.

Business Segment Overview

Card Payment Processing

Performance Update

At December 31, 2013, we provided card payment processing services to 166,697 active SME merchants located across the United States. This compares to 169,994 active SME merchants at December 31, 2012. At December 31, 2013, we provided card payment processing services to 1,024 Network Services merchants with approximately 42,669 locations, compared to 396 Network Services merchants with approximately 47,064 locations at December 31, 2012. Our total card processing volume for the year ended December 31, 2013 was $102.3 billion, a 2.0% increase from the $100.4 billion processed during the year ended December 31, 2012. Our 2013 SME card processing volume was $74.6 billion, a 4.0% increase over $71.7 billion in 2012. Total card processing volume for 2013 includes $27.7 billion of settled volume for Network Services merchants, compared to $27.9 billion for 2012.

In addition to settling card transactions, Network Services processes a wide range of payment transactions for its predominantly petroleum customer base, including providing 2.3 billion transaction authorizations (primarily for Visa and MasterCard) through its front-end card processing systems in 2013.

According to The Nilson Report, in 2012 we were the 5th largest merchant acquirer in the United States ranked by transaction count and the 9th largest merchant acquirer by processed dollar volume, which consisted of Visa, MasterCard, and Discover signature debit cards, and Plus, Nyce, Pulse, STAR, ACCEL/Exchange and other PIN-based debit cards, in addition to Visa, American Express, MasterCard, Discover, Diners Club, Union Pay, and JCB credit cards. These rankings represented 3.3 billion transactions and 4.5% of the total U.S. bankcard processing market, respectively.

Business Structure

Our Card Payment Processing revenue from SME merchants and Network Services merchants is recurring in nature. We typically enter into three-year service contracts with our SME merchants and three-to-five-year agreements with Network Services merchants.

Most of our SME revenue is from fees for processing transactions, which are primarily a combination of a percentage of the dollar amount of each card transaction we process plus a flat fee per transaction. We make mandatory payments of interchange fees to card issuing banks through card networks and dues, assessments and transaction authorization fees to Visa, MasterCard and Discover, and we retain the remainder as net revenue. For example, in a transaction using a Visa or MasterCard credit card, the allocation of funds resulting from a $100 transaction follows.

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In contrast, our processing revenues from Network Services merchants generally consist of a flat fee per transaction and thus revenues are driven primarily by the number of transactions we process (whether settled, or only authorized), not card processing volume.

We also provide card processing services for DFS Services, LLC ("Discover") and American Express Travel Related Services Company, Inc. ("American Express").

Our Merchant Base

We have developed significant expertise in industries that we believe present relatively low risks as the customers are generally present and the products or services are generally delivered at the time the transaction is processed. These include:

- Restaurants
- Brick and mortar retailers
- Hotel and lodging
- Automotive sales and repair shops
- Convenience and liquor stores
- Professional service providers
- Gas stations

Generally, we define SME merchants as generating annual Visa and MasterCard card processing volume between $50,000 and $5,000,000. However, with the added functionality and cost benefits that our in-house processing platforms afford us, we also market to merchants with annual processing volume above $5,000,000.

The following table summarizes our SME processing volume by merchant category for the month of December 2013, compared to the months of December 2012 and December 2011.

	Month of December		
	2013	2012	2011
Restaurants	34.6%	36.0%	34.8%
Retail	17.5%	18.0%	18.2%
Convenience, Fast Food & Liquor	12.3%	11.2%	10.9%
Automotive	6.4%	6.5%	7.5%
Professional Services	7.1%	7.3%	7.1%
Lodging	4.8%	4.5%	4.3%
Petroleum	1.8%	1.9%	1.9%
Other	15.5%	14.6%	15.3%
Total SME processing volume	$5.9 billion	$5.7 billion	$5.6 billion

No single SME merchant accounted for more than 0.81% of our total SME Visa and MasterCard card processing volume in 2013, and during 2013, our top 25 SME merchants represented only 3.54% of our SME Visa and MasterCard card processing volume and 2.93% of our SME Visa and MasterCard gross processing revenue.

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In December 2013, SME merchants located in the following states represented the following percentages of our SME card processing volume: California represented 9.6%, Texas represented 6.6%, New York represented 4.8%, Florida represented 4.7%, and Pennsylvania represented 4.2%, respectively . No other state represented more than 4% of our total SME card processing volume. Our geographic concentration tends to reflect the states with the highest economic activity, as well as certain states where we have historically maintained a stronger sales force. This merchant and geographic diversification makes us less sensitive to changing economic conditions in any particular industry or region. We believe that the loss of any single SME merchant would not have a material adverse effect on our financial condition or results of operations.

Payment Processing Platforms

We have developed a number of proprietary payment processing systems to increase our operating efficiencies and customize our product offerings. These include:

- HPS Exchange, VAPS and NWS, our internal front-end authorization systems, provide authorization and data capture services that distribute processing and merchant data to card networks, merchants, and our sales force and customer service staff. These systems provide us greater control of the electronic transaction process, allow us to offer our merchants a differentiated product offering, and offer economies of scale that we expect will increase our long-term profitability.

HPS Exchange, VAPS and NWS enable us to provide more customized solutions to merchants that demand customized front-end solutions and take advantage of new terminal hardware platforms and technology like our End-to-End Encryption solution (known as "E3"), as well as near field communication ("NFC") and Europay, MasterCard and Visa (“EMV”) authentication standards. HPS Exchange, VAPS and NWS offer our merchants authorization and capture services in multiple industry verticals to a variety of point-of-sale systems including legacy terminals, petroleum pumps, middleware technologies, PC-integrated POS systems and a web-based virtual terminals. In addition, HPS Exchange, VAPS and NWS offer third-party point-of-sale developers multiple protocols to meet their needs for integration.

During 2013, approximately 96% of the transactions of our SME merchants were processed on HPS Exchange, and 96% of all merchant accounts established in 2013 were placed on the system. During 2013, 100% of the transactions for our Network Services merchants were processed on VAPS or NWS.

- Passport, our internally-developed back-end processing system, provides one settlement platform for SME merchants and Network Services merchants, providing value-added features such as Optimized Funding, multi-bank Next Day Funding, automated dispute resolution, advanced interchange management and single portal integration via InfoCentral. In addition, Passport generates significant cost savings and allows us greater economies of scale, by replacing third party processors' per-transaction charges with more of a fixed-cost structure. This structure allows per-transaction savings as increasing numbers of transactions are processed on Passport. In addition, Passport provides us the opportunity to offer our merchants significantly greater amounts of information regarding their processing characteristics, in more usable formats, and to offer our services to larger merchants. At December 31, 2013 and 2012, substantially all of our SME merchants were processing on Passport, and all of our Network Services settlement merchants were on Passport.

Security, Disaster Recovery and Back-up Systems

In the course of our operations, we compile and maintain a large database of information relating to our merchants and their transactions, and large amounts of card information cross our network as we authorize transactions. We have placed significant emphasis on maintaining a high level of security in order to attempt to protect the information of our merchants and their customers. We maintain current updates of network and operating system security releases and virus definitions, and have engaged a third party to regularly test our systems for vulnerability to unauthorized access. Further, we encrypt the cardholder numbers and merchant data that are stored in our databases using the strongest commercially available encryption methods.

Our internal network configuration provides multiple layers of security to isolate our databases from unauthorized access and implements detailed security rules to limit access to all critical systems.

Visa, STAR, NYCE and other debit card networks have established security guidelines for PIN-based debit transaction processing that is based upon ANSI standards that are published as the "ASC X9 TG-3 PIN Security Compliance Guideline." We have a regularly scheduled Security Review of our Key Management Procedures against this standard that is performed by an external auditor.

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We also have engaged external auditors to perform an annual Standards for Attestation Engagements No. 16 ("SSAE 16") review and publish our “Report on Controls Placed in Operation and Tests of Operating Effectiveness.”
We operate our front-end processing, back-end processing, and other product platforms in two geographically dispersed outsourced data centers located in Texas and California. We establish system service level operational thresholds based on our large national merchants' requirements, and regularly exceed those levels, with system availability of greater than 99.9%. To achieve this standard, transactions are mirrored between the two data centers, and each center has the capacity to handle our full merchant transaction load. This duplicate processing capability ensures uninterrupted transaction processing during maintenance windows and other times processing may not be available. We regularly process through both data centers.

Sponsor Banks

Because we are not a "member bank" as defined by Visa and MasterCard, in order to process and settle these bankcard transactions for our merchants, we have entered into sponsorship agreements with member banks. Visa and MasterCard rules restrict us from performing funds settlement or accessing merchant settlement funds and require that these funds be in the possession of the member bank until the merchant is funded.

A sponsorship agreement permits us to route Visa and MasterCard bankcard transactions under the member bank's control and identification numbers to clear credit and signature debit bankcard transactions through Visa and MasterCard. A sponsorship agreement also enables us to settle funds between cardholders and merchants by delivering funding files to the member bank, which in turn transfers settlement funds to the merchants' bank accounts. These restrictions place the settlement assets and liabilities under the control of the member bank.

The sponsorship agreements with the member banks require, among other things, that we abide by the bylaws and regulations of the Visa and MasterCard networks. If we were to breach a sponsorship agreement, the sponsor banks can terminate the agreement and, under the terms of the agreement, we would have 180 days to identify an alternative sponsor bank. As of December 31, 2013, we have not been notified of any such issues by our sponsor banks, Visa or MasterCard.

At December 31, 2013, we were party to three bank sponsorship agreements.

- Our primary sponsor bank for SME merchant processing is Wells Fargo Bank, N.A. (“Wells Fargo”). Either Wells Fargo or we can terminate the agreement if the other party materially breaches the agreement, including non-payment of fees due for processing our monthly settlement of transactions. The agreement may also be terminated if the other party files for or enters bankruptcy, if either party is required to discontinue performing its services under the agreement based upon a final order of a state or federal court or regulatory body or if there is a change in the majority ownership of the other party. Wells Fargo may terminate the agreement with us if we breach the by-laws and regulations of Visa or MasterCard, if either our registration or Wells Fargo's membership with Visa or MasterCard terminates, if any federal or state regulatory authority requests that the agreement be terminated or that Wells Fargo terminate its services or if applicable laws or regulations change to prevent Wells Fargo from performing its services under the agreement. Upon termination of the agreement for any reason, we will have 180 days to convert to another sponsor bank. The agreement, which we entered into with Wells Fargo on February 8, 2012, expires on February 8, 2016 and will automatically renew for successive three-year periods unless either party provides six months' prior written notice of non-renewal to the other party. The sponsorship agreements we have with our other two sponsor banks involve substantially the same terms as apply with Wells Fargo.

- In November 2009, we entered into a sponsorship agreement with The Bancorp Bank ("TBB") to sponsor processing for our Network Services merchants. The agreement with TBB expires in February 2015 and will automatically renew for successive one-year periods unless either party provides six months written notice of non-renewal to the other party.

On October 1, 2013, we transfered sponsorship and processing for a portfolio of SME merchants from Heartland Bank to TBB. We were party to a prior sponsorship agreement with Heartland Bank, an unrelated third party, to sponsor SME merchant processing. In March 2013, we notified Heartland Bank of our intention to terminate the sponsorship agreement and made arrangements for continuing sponsorship with TBB under the terms of the November 2009 sponsorship agreement.

- On March 24, 2011, we entered into a sponsorship agreement with Barclays Bank Delaware to sponsor processing for certain of our Network Services merchants. The agreement with Barclays Bank Delaware expires in March 2016 and will automatically renew for successive one-year periods unless either party provides six months written notice of non-renewal to the other.

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Following is a breakout of our total Visa and MasterCard settled card processing volume for the month of December 2013 by percentage processed under our individual bank sponsorship agreements:

Sponsor Bank	% of December 2013 Card Processing Volume
Wells Fargo Bank, N.A.	67%
The Bancorp Bank	22%
Barclays Bank Delaware	11%

Customer Acquisition

Unlike many of our competitors who rely on Independent Sales Organizations or salaried salespeople and telemarketers, we have built a direct, commission-based sales force. Our sales model divides the United States into six primary markets overseen by Executive Directors of Business Development. These Executive Directors are responsible for hiring Relationship Managers and increasing the sales of our products in their markets.

As of December 31, 2013, we employed 844 Relationship Managers and Territory Managers in 50 states plus the District of Columbia. This compares to a Relationship Manager and Territory Manager count of 739 at December 31, 2012. In addition, as of December 31, 2013, we employed an additional 58 Senior Product Advisors ("SPAs"), primarily payroll specialists, who have augmented our generalist sales force.

We designed our sales force compensation structure to motivate our Relationship Managers to establish profitable long-term relationships with low-risk merchants and create a predictable and recurring revenue stream. Compensation for Relationship Managers is entirely commission-based, with commissions paid as a percentage of the financial value of new merchant accounts installed, which is measured in terms of the annual gross margin we estimate we will receive from the merchant accounts installed. This is calculated by deducting the cost of processing (on a per-transaction basis) and servicing (measured in dollars per month) from the expected first-year net revenue the account is expected to generate.

The Relationship Manager will be paid a signing bonus equal to 50% of the first 12 months' estimated gross margin. The Relationship Manager will also receive, beginning the month installed, 15% of the gross margin generated from the merchant each month as residual commissions for as long as the merchant remains our customer.

In addition, the Division Manager will receive an amount equal to 25% of the amount paid to the Relationship Manager (split with a Territory Manager, if one exists for the account). The Executive Director will receive an amount equal to 25% of the amount paid to the Division Manager. For example, if a merchant account has $1,000 of estimated annual gross margin for the first twelve months and estimated monthly gross margin of $83.33, our sales force would be compensated as follows:

Signing Bonus:			
Estimated gross margin for first 12 months	$1,000		
Signing bonus paid to:			
Relationship Manager	$500	50.0	%
Division Manager (plus Territory Manager)	$125	12.5	%
Executive Director	$31	3.13	%
Residual Commission:			
Estimated monthly gross margin	$83.33		
Monthly residual commission paid to:			
Relationship Manager	$12.50	15.0	%
Division Manager (plus Territory Manager)	$3.12	3.75	%
Executive Director	$0.78	0.94	%

Marketing

Our marketing efforts have historically focused on industry verticals and marketing partnerships. We focus our marketing efforts on industries in which we believe our direct sales model is most effective and on merchants with certain key attributes. These attributes include owners who are typically on location, interact with customers, value a local sales presence, and consult with trade associations and other civic groups to make purchasing decisions. We also determine which additional

markets to enter into based on the following criteria:
•Average potential customer revenue;
•Number of locations to be serviced;
•Underwriting risk; and
•Required technological upgrades.
We have focused significantly on the hospitality industry and, in particular, independent restaurants. The number of independent restaurants to which we provide our products and services was 42,069 as of December 31, 2013.
We have also historically had success in marketing our products and services through relationships with key trade associations, agent banks and value-added resellers.
As of December 31, 2013, we had preferred partner agreements with more than 250 trade associations, approximately 42 percent of which are in the hospitality industry. Of these partnerships, 46 are state restaurant associations and another 44 are state lodging associations. In addition, we are the American Hotel & Lodging Association's and National Restaurant Association's endorsed provider for credit card processing, gift card marketing and payroll services.
In exchange for an association's endorsements and recommendation of our products and services to their members, and upon the installation of a new merchant that is a member of the association, we pay to the trade association a signing bonus and residual commission.
We offer programs to banks across the United States that allow them access to leverage our extensive sales and support teams and other resources. The program provides our partner banks a source to refer their customers for merchant services as well as payroll processing and other electronic payments processing services. We offer on-site sales, training, installation, and on-going service and support to the referred merchants. In exchange for a bank's endorsement of our products and services, we typically pay the bank a monthly residual fee based on the referred merchant's processing volumes or margin. As of December 31, 2013, we provide these services to more than 1,587 banking locations in the United States.
In order to further market our products and services, we enter into arrangements with value-added resellers and third-party software developers. Value-added resellers typically sell complementary products and services such as hardware and software applications and point-of-sale hardware, software and communication network services to merchants in markets similar to ours. Our agreements with value-added resellers provide that, in exchange for their endorsement of our products and services and upon the installation of a new merchant referred by them, we will pay the value-added reseller a portion of the sales commission from the Relationship Manager responsible for that merchant and/or a transaction fee.

As we continue to expand our product offerings, we intend to introduce capabilities that will allow our systems to be compatible with third-party software developers while working to reduce merchants' third-party up-front costs for processing with us. We are committed to passing along our cost efficiencies to our merchants and their point-of-sale providers to encourage joint technology partnerships.
Merchant and Transaction Risk Management

We focus our sales efforts on low-risk bankcard merchants and have developed systems and procedures designed to minimize our exposure to potential merchant losses.
We have developed significant expertise in industries that we believe present relatively low risks as the customers are generally present and the products or services are generally delivered at the time the transaction is processed. These industries include restaurants, brick and mortar retailers, convenience and liquor stores, automotive sales and repair shops, gas stations, professional service providers, lodging establishments and others. As of December 31, 2013, approximately 25.2% of our SME merchants were restaurants, approximately 18.7% were brick and mortar retailers, approximately 12.7% were professional service providers, approximately 11.3% were convenience and liquor stores, approximately 7.6% were automotive sales and repair shops, approximately 3.2% were hotel and lodging establishments, and approximately 1.6% were gas stations.

Effective risk management helps us minimize merchant losses for the mutual benefit of our merchants and ourselves. Our risk management procedures also help protect us from fraud perpetrated by our merchants. We believe our knowledge and experience in dealing with attempted fraud has resulted in our development and implementation of effective risk management and fraud prevention systems and procedures for the types of fraud discussed in this section. In 2013, 2012 and 2011, we

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experienced losses of 0.41 basis points, 0.28 basis points and 0.76 basis points, respectively, of our SME card processing volume.

We employ the following systems and procedures to minimize our exposure to merchant and transaction fraud:

Underwriting. Our sales force sends new applications to their regional service team for scoring and account set up. Higher-risk applications are routed to our credit underwriting department for review and screening. Our underwriting department's review of these applications serves as the basis for our decision whether to accept or reject a merchant account. The review also provides the criteria for establishing cash deposit or letter of credit requirements, processing limits, average transaction amounts and pricing, which assists us in monitoring merchant transactions for those accounts that exceed those pre-determined thresholds. The criteria set by our underwriting department also assist our risk management staff in advising merchants with respect to identifying and avoiding fraudulent transactions. Depending upon their experience level, our underwriting staff has the authority to render judgment on new applications or to take additional actions such as adjusting processing limits supported by prior processing history, analyzing average charge per transaction information or establishing cash deposits/letters of credit, reserves, and delayed funding requirements for new and existing merchants. Our underwriting department prepares accounts that are risk sensitive for our Credit Committee review. The Credit Committee consists of a Manager of Underwriting, Manager of Risk Review, Director of Underwriting and Executive Director of HSC Operations. Merchant accounts that exceed certain committee thresholds are reviewed by either our CEO, Vice Chairman or Chief of Operations. Our sponsor banks also review and approve our merchant underwriting policies and procedures to ensure compliance with Visa and MasterCard operating rules and regulations.

Merchant Monitoring. We employ several levels of merchant account monitoring to help us identify suspicious transactions and trends. Daily merchant activity is sorted into a number of customized reports by our systems. Our risk management team reviews any unusual activity highlighted by these reports, such as larger than normal transactions or credits, and monitors other parameters that are helpful in identifying suspicious activity. We have daily windows to decide if any transactions should be held for further review, which provides us time to interview a merchant or issuing bank to determine the validity of suspicious transactions. We have also developed a fraud management system for HPS Exchange that is fully integrated with our internal customer relationship management software and has detailed review capabilities to further streamline our monitoring of those transactions. We also place merchants who require special monitoring on alert status and have engaged a web crawling solution that scans all merchant websites for content and integrity.

Investigation and Loss Prevention. If a merchant exceeds any parameters established by our underwriting and/or risk management staff or violates regulations established by the applicable bankcard network or the terms of our merchant agreement, one of our investigators will identify the incident and take appropriate action to reduce our exposure to loss and the exposure of our merchant. This action may include requesting additional transaction information, withholding or diverting funds, verifying delivery of merchandise or even deactivating the merchant account. Additionally, Relationship Managers may be instructed to retrieve equipment owned by us.

Collateral. We require some of our merchants to establish cash deposits or letters of credit that we use to offset against liabilities we may incur. We hold such cash deposits or letters of credit for as long as we are exposed to a loss resulting from a merchant's payment processing activity. In addition, we maintain a 5-day delayed deposit policy on transactions processed by our Internet merchants and newly established merchants who have not previously processed bankcards to allow for additional risk monitoring. We also place a “hold” on batches containing questionable transactions, diverting the funds to a separate account pending review. As of December 31, 2013, these cash deposits and delayed and “held” batches totaled approximately $7.7 million.

Industry Overview

The payment processing industry provides merchants with credit, debit, gift and loyalty card and other payment processing services, along with related information services. The industry continues to grow as a result of wider merchant acceptance, increased consumer use of bankcards and advances in payment processing and telecommunications technology. According to The Nilson Report, total expenditures for all card type transactions by U.S. consumers are expected to grow to $6.0 trillion by 2017, representing a compound annual growth rate of 9.8%. The proliferation of bankcards has made the acceptance of bankcard payments a virtual necessity for many businesses,

regardless of size, in order to remain competitive. This increased use of bankcards and prepaid cards, enhanced technology initiatives, efficiencies derived from economies of scale and the availability of more sophisticated products and services to all market segments has resulted in a highly competitive and specialized industry.
The payment processing industry is dominated by a small number of large, fully-integrated payment processors that sell directly to, and handle the processing needs of, the nation's largest merchants. These processors include:

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- First Data Corporation
- Global Payments Inc.
- Vantiv, Inc.
- Chase Paymentech Solutions
- Bank of America Merchant Services
- Elavon, Inc.
- Total Systems Services, Inc.

These integrated processors serve a broad market spectrum from large to small merchants and some provide banking, ATM and other payment-related services and systems in addition to card payment processing. Large national merchants with multiple locations and high volumes of bankcard transactions typically demand and receive the full range of payment processing services at low per-transaction costs.

SME merchants' payment processing needs generally are served by a large number of smaller payment processors, including banks and Independent Sales Organizations, that generally procure most of the payment processing services they offer from large payment processors. It is difficult, however, for banks and Independent Sales Organizations to customize payment processing services for the SME merchant on a cost-effective basis or to provide sophisticated value-added services.

Accordingly, services to the SME merchant market segment historically have been characterized by basic payment processing without the availability of the more customized and sophisticated processing, information-based services or customer service that is offered to large merchants. The continued growth in bankcard transactions is expected to cause SME merchants to increasingly value sophisticated payment processing and information services similar to those provided to large merchants.

We compete with other providers of payment processing services on the basis of the following factors:

- Sales force effectiveness
- Range of product offering
- Quality of service
- Reliability of service
- Professional association endorsements
- Ability to evaluate, undertake and manage risk
- Speed in approving merchant applications
- Price
- Brand name

Some of our large competitors have substantially greater capital resources than we have and operate as subsidiaries of financial institutions or bank holding companies, which may allow them on a consolidated basis to own and conduct depository and other banking activities that we do not have the regulatory authority to own or conduct.

Since they are affiliated with financial institutions or banks, these competitors may not incur the costs associated with being sponsored by a bank for registration with card networks and they can settle transactions quickly for the merchants with a deposit account at the bank.

Competitive Advantage

We believe our competitive strengths related to card payment processing, particularly SME, include the following:

- Large, Experienced, Efficient, Direct Sales Force

We sell and market our SME card payment processing services through a nationwide direct sales force of 844 Relationship Managers and Territory Managers, and 58 Senior Product Advisors who work exclusively for us. Many of our competitors rely on Independent Sales Organizations that often generate merchant accounts for multiple payment processing companies simultaneously. Our sales professionals have local merchant relationships and industry-specific knowledge that allow them to effectively compete for merchants. These relationships are also supported by our customer service and support teams located in our service center.

• Recurring and Predictable Revenue

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We generate recurring revenue in most of our businesses and products. This recurring revenue grows as the number of transactions or dollar volume processed for an SME merchant increases or as we add new SME merchants and as we add transactions or merchants in Network Services. In 2013, approximately 91% of our SME card processing volume came from merchants we installed in 2012 and earlier.

- Internal Growth

We grow our SME payment processing business exclusively through internal expansion by generating new SME merchant contracts submitted by our own direct sales force. We believe our control of sales, underwriting and servicing both enhances our SME merchant retention and reduces our risks. We also believe that internally generated SME merchant contracts generally are of a higher quality and are more predictable than contracts acquired from third parties, and the costs associated with such contracts generally are lower than the costs associated with contracts acquired from third parties.

- Strong Position and Substantial Experience in Our Target Markets

As of December 31, 2013, we were providing card payment processing services to 166,697 active SME merchants located across the United States. We believe our understanding of the needs of SME merchants and the risks inherent in doing business with them, combined with our efficient direct sales force, provides us with a competitive advantage over larger service providers that access this market segment indirectly. We also believe that we have a competitive advantage over service providers of a similar or smaller size that may lack our extensive experience and resources, and so do not benefit from the economies of scale that we have achieved.

At December 31, 2013, we also provided card payment processing services to approximately 1,024 Network Services merchants with approximately 42,669 locations. These Network Services merchants are predominately in the petroleum industry. We believe that our understanding of the processing needs of petroleum merchants and the products we offer them provides us with a competitive advantage.

- Expertise and Focus

Historically, we have focused our sales efforts on SME merchants who have certain key attributes and on industries in which we believe our direct sales model is most effective and the risks associated with card processing are relatively low. These attributes include owners who are typically on location, interact with customers in person, value a local sales and servicing presence and often consult with trade associations and other civic groups to help make purchasing decisions.

To further promote our products and services, we have entered into referral arrangements with various trade associations, with an emphasis on state restaurant and hospitality groups. We believe that these partnerships have enabled us to gain exposure and credibility within the restaurant industry and have provided us with opportunities to market our products to new merchants.

Our historical focus on SME merchants has diversified our merchant portfolio and we believe has reduced the risks associated with revenue concentration. In 2013, no single SME merchant represented more than 0.81% of our total SME Visa and Mastercard processing volume, consistent with prior years.

Our Network Services business has further diversified our total merchant portfolio adding a substantial base of large national merchants, predominately in the petroleum industry.

- Merchant-centric Culture

We have built a corporate culture and established practices that we believe improve the quality of services and products we provide to our merchants. We developed and endorsed The Merchant Bill of Rights, an advocacy initiative that details ten principles we believe should characterize all merchants' processing relationships. The Merchant Bill of Rights allows our sales team to differentiate our approach to bankcard processing and we believe that a focus on these principles will enhance our merchant relationships. We believe that our culture and practices allow us to maintain strong merchant relationships and differentiate ourselves from our competitors in obtaining new merchants.

Our merchant-centric culture spans from our sales force, which maintains a local market presence to provide rapid, personalized customer service, through our service center, which is segmented into regional teams to optimize

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responsiveness, and to our technology organization, which has developed a customer management interface and information system that alerts our Relationship Managers to any problems a merchant has reported and provides them with detailed information on the merchants in their portfolio. Additionally, we believe that we are one of the few companies that fully discloses our pricing to merchants. We think this approach contributes substantially to building long-term merchant relationships.

• Scalable Operating Structure

Our scalable operating structure generally allows us to expand our operations without proportionally increasing our fixed and semi-fixed support costs. In addition, our front-end and back-end card processing technology platforms were designed with the flexibility to support significant growth and drive economies of scale with relatively low incremental costs. Most of our operating costs are related to the number of individuals we employ. We have in the past used, and expect in the future to use, technology to leverage our personnel, which should cause our personnel costs to increase at a lower rate than our card processing volume.

• Advanced Technology

We employ information technology systems which use the Internet to improve management reporting, enrollment processes, customer service, sales management, productivity, merchant reporting and problem resolution. We believe that these systems help attract both new merchants and Relationship Managers and provide us with a competitive advantage over many of our competitors who rely on less flexible legacy systems.

We actively leverage the latest advances in technology to provide the best payments experience for merchants within liability levels that we believe exceed industry norms.

Heartland School Solutions

Heartland School Solutions provides cafeteria point of sale solutions to more than 29,000 schools, making us the largest provider of kindergarten through 12th grade ("K to 12") food-service technology in the nation. In conjunction with this core POS business, approximately 80% of our customer schools actively use Heartland's online prepayment solutions to allow parents to fund accounts for school lunches or other on-campus activities. Parents can opt to establish recurring payments with customized low balance thresholds, make one-time payments, or simply see what their students ate for lunch that day. With a consistently high annual renewal rate for its POS customers, those platforms serve as a reliable base on which to offer additional value-added products and services. We offer back office management software, hardware, annual technical support, and training to our customer school districts.

Heartland School Solutions has been built through a series of five acquisitions in 2010, 2011 and 2012. On June 29, 2012, Heartland completed its latest K to 12 acquisition of Rochester, NY based Nutrikids, Inc. Following the acquisitions, we focused on merging the management and operational structures of the five acquired businesses that make up the School Solutions group. The more than 200 combined School Solutions professionals now operate under a single management structure and go-to-market strategy. While continuing to maintain certain legacy POS platforms for the foreseeable future, we combined all online prepayment activity into two platforms: MySchoolBucks and MyLunchMoney. Together these two systems have more than 4 million registered users. During 2013, we made a significant investment in our consumer-focused marketing strategy in order to encourage more widespread adoption of our online payments products, which resulted in organic growth of total volume by 16% between 2012 and 2013. Revenues for Heartland School Solutions were $50.5 million, $36.6 million, and $11.2 million, respectively, in 2013, 2012, and 2011.

The K to 12 food service technology industry is competitive, with our largest competitor being Horizon Software International and others being much smaller, privately-held companies. Competition in the K to 12 food-service technology industry is primarily based on the products and services offered, innovation, customer service, reputation and price. Products must keep pace with government regulations for schools. Payment processing is becoming an increasingly important element of the overall offering for schools, which provides us with a competitive advantage. We believe we are well positioned to gain new school customers and generate additional revenue with our existing customers primarily through greater adoption of payment processing services.

Heartland Ovation Payroll

We operate a full-service nationwide payroll processing service. Payroll processing revenues were $44.6 million, $21.4 million and $19.5 million, respectively, in 2013, 2012 and 2011. Our payroll services include check printing, direct deposit, related federal, state and local tax deposits, accounting documentation and human resources information. In order to improve operating efficiencies and ease-of-use for our customers and to decrease our own processing costs, we offer electronic and paperless payroll processing that allows an employer to submit its periodic payroll information to us via the Internet. If a customer chooses the online option, all reports and interactions between the employer and Heartland Ovation Payroll can be managed electronically, eliminating the need for cumbersome paperwork. Approximately 65% of our payroll customers currently submit their information electronically. However, if a customer chooses not to submit their payroll data online, they may submit such information via phone or facsimile. Regardless of input method, clients can choose to have Heartland Ovation Payroll print and ship their payroll package or to receive this information electronically.

On December 31, 2012, we acquired Ovation, adding over 10,000 customers to our payroll business. As of December 31, 2013, 2012 and 2011, we provided payroll processing services to 24,088, 22,553 and 11,841 customers, respectively. In 2013, 2012 and 2011, we installed 5,797, 3,399 and 3,723 new payroll processing customers, respectively.

We operate a comprehensive payroll management platform, which we refer to as HOP (formerly PlusOne Payroll), which streamlines all aspects of the payroll process to enable time and cost savings. We consider our HOP payroll platform to be state-of-the art, enabling us to process payroll on a large scale and provide customizable, cost-effective solutions for businesses of all sizes. HOP enables faster processing and continuous updates to help businesses remain compliant with payroll, tax and human resources regulations. The HOP platform features web-hosted access, enabling businesses and their accountants to securely access all payroll data from virtually anywhere with SSL-encryption protection. It also provides robust, easy-to-use reporting for better business analysis. HOP is equipped to interface with certain leading providers of accounting services and time and attendance applications, as well as restaurant and retail point-of-sale systems. Our platform also includes an Employee Self-Serve web portal that allows employees to review copies of their paychecks, vouchers, payroll detail and maintain their individual demographic information. The acquisition of Ovation added scale to our HOP payroll platform, leveraging operating costs, and also added experienced payroll management, a new specialized payroll sales approach, an affinity partner referral network, and enhanced product and servicing capabilities.

The payroll processing services industry is highly competitive, with services provided by outsourced providers like Heartland Ovation Payroll, but also accounting firms and self-service options. Overall the industry is comprised of two major segments: large national full-service payroll providers, and numerous much smaller national, regional, local and on-line providers. While large national payroll service firms such as ADP, Paychex, Ceridian, and Intuit are highly recognized, their combined market share in the industry approximates only 15%. We compete with both segments.

Competition in the payroll processing industry is primarily based on service responsiveness, payroll accuracy, quality, reputation, range of product offering and price. The payroll industry faces continually evolving tax, regulatory and technology environments, which for smaller competitors create increasingly complex tax and in the future Affordable Care Act compliance, technology, service, and platform development challenges that they may lack the technical and financial resources to overcome. We believe Heartland Ovation Payroll is well-positioned to continue to gain payroll customers from those challenged providers. Additionally, we believe our competitive position is enhanced through our ability to offer payment processing services to payroll customers and thus offer an integrated services suite which will provide our customers with efficient and convenient options.

Campus Solutions

In December 2012, we added to our Campus Solutions segment by acquiring ECSI, which provides a suite of solutions to support administrative services for higher education including student loan payment processing, delinquency and default services, refund management, tuition payment plans, electronic billing and payment, tax document services, and business outsourcing. ECSI's core services support the management, payment and collection of student loans including Perkins and institutional financing. Since its founding in 1972, ECSI has printed and mailed 500 million billing statements, processed over 400 million tuition and loan payments and managed accounts for approximately 7 million students and borrowers. ECSI also processes nearly 5 million tax documents every year. With ECSI, our Campus Solutions currently serves over 2,000 colleges and universities across multiple higher education sectors including Non-Profit, For-Profit, Private, and Community Colleges.

Campus Solutions also provides open- and closed-loop payment solutions for college or university campuses to efficiently process small value electronic transactions. Besides payment processing, our One-Card product enables personal identification, door access, cashless vending transactions, cashless laundry, meal plans and cashless printing at campus facilities. Our innovative Give Something Back Network adds Internet and phone accessible closed-loop debit card based financial services to the students, faculty, staff and local community merchants of an educational institution. In addition, our Refund Select program, which we introduced in 2010, addresses the major operational needs of campuses by providing an open-loop debit card platform onto which schools will load financial aid refunds. At December 31, 2013, we had thirty colleges enrolled, representing 150,000 students and over $280 million in annual reimbursement, under the Refund Select

program. We currently have 208 OneCard and Refund Select college and university accounts. Revenues for Campus Solutions were $36.2 million, $8.1 million and $6.5 million, respectively, in 2013, 2012 and 2011.
The Campus Solutions industry is competitive with no single competitor providing the complete set of solutions that we provide. However, companies such as Higher One, NelNet and Tuition Management Systems are larger competitors that compete with some of the solutions provided by us. Competition is primarily based on the products and services offered, innovation, customer service, reputation and price. Products must be compliant with various government regulations which impedes new, smaller entrants. We believe we're well positioned to gain customers and generate additional revenue by selling additional products to our existing base of customers.

Micropayments
We began addressing the small value transaction market in 2006. Revenues for Micropayments were $12.6 million, $8.2 million and $7.2 million, respectively, in 2013, 2012 and 2011. We manufacture and sell solutions comprising unattended online wireless credit card based payment systems, and unattended value top-up systems for off-line closed-loop smart (chip) card based payment systems. Our electronic cash systems provide small value transaction processing for laundromat machines, vending machines, and cash registers, which are located in apartment laundries, cruise ships, corporate and university campuses, and penitentiaries. These systems offer consumers convenient ways to use their debit and credit cards in laundromats with our new Waverider system, to purchase and reload electronic cash cards, and to spend the value on the card for small value purchases in both attended and unattended point of sale locations. In addition, we provide merchants financial settlement between the value (electronic cash card) issuer and the vendor/merchant who accepts the card as payment. We believe that there is increasing consumer demand for, and merchant interest in, card-based solutions for small denomination transactions, and expect to make additional investments in the future in developing solutions in this area.
The unattended payments industry is competitive with the largest competitor being USA Technologies. Other competitors include vending machine manufacturers and privately-held companies focusing on specific vertical markets. Competition is primarily based on the products and services offered, ease of installation and setup, innovation and price. As payment processing is a core component of the services offered, we believe that we have a distinct advantage over many of our competitors. As unattended payments are becoming more commonplace and expected, we believe that we will continue to add new customers.

Heartland Marketing Solutions
We continue to leverage our November 2008 acquisition of Chockstone, Inc. to provide a suite of marketing solutions including gift and rewards. Revenues for Heartland Marketing Solutions were $9.6 million, $13.4 million and $12.0 million, respectively, in 2013, 2012 and 2011. Through our Marketing Solutions group, we deliver a full suite of mobile and card-based marketing services to merchant locations through real-time communications with the merchant point-of-sale, enabling us to leverage existing installations across our merchant base and enhancing our overall value proposition to the merchant community. In addition to servicing the SME merchant market, the Marketing Solutions group also provides gift and rewards services to regional and national brands.
The Marketing Solutions space continues to evolve and become even more relevant as merchants are looking for deeper engagement with their customers. Heartland Marketing Solutions has spent 2013 laying the groundwork to support enhancements such as mobile presentment, data & analytics and integration into third party mobile applications. As of December 31, 2013, Heartland Marketing Solutions has signed over 10,840 merchant locations and loaded $83 million on approximately 2.3 million consumer gift cards, compared to 10,239 merchant locations and $68 million loaded on approximately 2.0 million cards as of December 31, 2012.
Virtualization of the gift card space continues to grow as a means of increasing revenue generated from gift sales. The cash value on virtual cards is expected to reach $10 billion in the U.S. in 2015, up from less than $500 million in 2011, says consulting firm Aite Group. A survey of broad sector retailers by Aberdeen Group in late 2012 found that 21% of those retailers offer a digital gift card that can be sent via email, and 55% plan to implement such a digital gift card program in the next 12 to 18 months. In addition, there has been prolific emergence of mobile application providers to enable merchants to create a branded mobile application to compete with a "Starbuck's-like" solution, which

is considered the gold standard in mobile payment applications. Heartland Marketing Solutions has reacted by developing a robust set of Application Programming Interfaces ("APIs") to enable integration in the fast moving market to allow for quick integration into multiple partners. This option enables merchants to partner with any application developer to integrate gift and rewards into the application of their choosing. In addition, Heartland Marketing Solutions is piloting a mobile application solution in the hospitality space that

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enables merchants to offer consumers a branded application with robust functionality such as gift and rewards management, location look up and mobile ordering.
The core gift space, historically defined as merchant branded gift card, is highly competitive. Most solutions are currently sold and provisioned by merchant processors. However, with the emergence of mobile we are seeing new creative gift providers emerge, although with relatively slow market adoption. Competition usually focuses on one of two markets depending on their merchant base; medium to large merchant providers where solutions are highly flexible, feature rich and allow for customization, and small merchant providers where solutions are still feature rich but have been streamlined to minimize implementation costs. Competition includes First Data Gift Card, StoredValueSystems (owned by ComData), Valutec (owned by FIS) and Givex. We believe that very few gift card providers have a robust rewards platform, so merchants usually have to go to two different providers to satisfy their gift and rewards needs. Heartland Marketing Solutions is one of the few providers whose platform was specifically built to support both gift and rewards implementations.

Intellectual Property

Most of our services and products are based on proprietary software or processes that are updated to meet customer needs and remain competitive. Our proprietary software is critical, as it allows us to offer distinctive services and products to customers, which differentiates us from our competitors. We own and are pursuing numerous patents with the United States Patent and Trademark Office. In addition, we own various trademarks and have applied for numerous others.

WHERE YOU CAN GET ADDITIONAL INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy our reports or other filings made with the SEC at the SEC's Public Reference Room, located at 100 F Street, N.E., Washington, DC 20549. You can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You can also access these reports and other filings electronically on the SEC's web site, www.sec.gov.

In addition, certain of our SEC filings, including our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, can be viewed, free of charge, and printed from the investor information section of our website at www.heartlandpaymentsystems.com, as soon as reasonably practicable after filing with the SEC. Certain materials relating to our corporate governance, including our code of ethics for chief executive and senior financial officers, code of business conduct and ethics, corporate governance guidelines and board committee charters, are also available in the investor relations section of our website.

The information on the websites listed above, is not and should not be considered part of this Annual Report on Form 10-K or any other report or document we file with the SEC and is not incorporated by reference in this document or any other report or document we file with the SEC. These websites are, and are only intended to be, inactive textual references.

In May 2013, we submitted to the New York Stock Exchange the CEO certification required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual without qualification.

ITEM 1A. RISK FACTORS

An investment in our common stock involves a high degree of risk. You should consider carefully the following risks and other information contained in this Annual Report on Form 10-K and other SEC filings before you decide whether to buy our common stock. If any of the events contemplated by the following discussion of risks should occur, our business, results of operations and financial condition could suffer significantly. As a result, the market price of our common stock could decline, and you may lose all or part of the money you paid to buy our common stock.

Risks Relating to Our Business

Unauthorized disclosure of merchant, cardholder or other user data, whether through breach of our computer systems (such as the Processing System Intrusion discussed in Item 3 Legal Proceedings) or otherwise, could expose us to liability and protracted and costly litigation, as well as harm our reputation.

We collect and store sensitive data about merchants, including names, addresses, social security numbers, driver's license numbers and checking account numbers. In addition, we maintain a database of cardholder and other user data relating to specific transactions, including bankcard numbers, in order to process the transactions and for fraud prevention. Any loss of data by us or our merchants could result in significant fines and sanctions by the card networks or governmental bodies, which could have a material adverse effect upon our business, financial position and/or results of operations. In addition, a significant breach could result in our being prohibited from processing transactions for card networks.

Our computer systems have been, and could be in the future, subject to penetration by hackers and our encryption of data may not prevent unauthorized use. In this event, we may be subject to liability, including claims for unauthorized purchases with misappropriated bankcard information, impersonation or other similar fraud claims. We could also be subject to liability for claims relating to misuse of personal information, such as unauthorized marketing purposes. These claims also could result in protracted and costly litigation. In addition, we could be subject to penalties or sanctions from the card networks, or our reputation could be harmed, which may deter clients from using our services.

Although we generally require that our agreements with our service providers who have access to merchant and customer data include confidentiality obligations that restrict these parties from using or disclosing any customer or merchant data except as necessary to perform their services under the applicable agreements, we cannot assure you that these contractual measures will prevent the unauthorized use or disclosure of data. In addition, our agreements with financial institutions require us to take certain protective measures to ensure the confidentiality of merchant and consumer data. Any failure to adequately enforce these protective measures could result in protracted and costly litigation.

If we fail to comply with the applicable requirements of the Visa and MasterCard bankcard networks, Visa or MasterCard could seek to fine us, suspend us or terminate our registrations. Fines could have an adverse effect on our operating results and financial condition, and if these registrations are terminated, we will not be able to conduct our primary business.

On occasion, we have received notices of non-compliance and fines, which have typically related to excessive chargebacks by a merchant or data security failures on the part of a merchant. If we are unable to recover fines from our merchants, we will experience a financial loss. The termination of our registration, or any changes in the Visa or MasterCard rules that would impair our registration, could require us to stop providing Visa and MasterCard payment processing services, which would make it impossible for us to conduct our business on its current scale.

We rely on sponsor banks, which have substantial discretion with respect to certain elements of our business practices, in order to process bankcard transactions. If these sponsorships are terminated and we are unable to secure new bank sponsors, we will not be able to conduct significant portions of our business.

Over 73% of our revenue is derived from processing Visa and MasterCard bankcard transactions. Because we are not a bank, we are not eligible for membership in the Visa and MasterCard networks and are, therefore, unable to directly access the bankcard networks. Instead, Visa and MasterCard operating regulations require us to be sponsored by a member bank in order to process bankcard transactions. We are currently registered with Visa and MasterCard through Wells Fargo Bank N.A. since 2012, The Bancorp Bank since November 2009, and Barclays Bank Delaware since March 2011.

Our sponsorship agreements with Wells Fargo Bank N.A., The Bancorp Bank and Barclays Bank Delaware expire February 2016, February 2015 and March 2016, respectively. If our sponsorships are terminated and we are unable to secure another bank sponsor or sponsors, which could arise due to future consolidation of sponsor banks or because sponsor banks exit this line of business, we will not be able to process Visa and MasterCard transactions. Furthermore, some agreements give the sponsor banks substantial discretion in approving certain aspects of our business practices, including our solicitation, application and qualification procedures for merchants, the terms of our agreements with merchants and our customer service levels. Our sponsor banks' discretionary actions under these agreements could be detrimental to our operations.

Current or future bankcard network rules and practices could adversely affect our business.

We are registered with the Visa and MasterCard networks through our bank sponsors as an Independent Sales Organization with Visa and a Member Service Provider with MasterCard. We are currently a sales agent and service agent for American Express and a registered acquirer with Discover. The rules of the bankcard networks are set by their boards, which may be strongly influenced by card issuers, and some of those card issuers are our competitors with respect to these processing services. Many banks directly or indirectly sell processing services to merchants in direct competition with us. These banks could attempt, by virtue of their influence on the networks, to alter the networks' rules or policies to the detriment of non-members like us. The termination of our registration or our status as an Independent Sales Organization or Member Service Provider, or any changes in card network or issuer rules that limit our ability to provide payment processing services, could have an adverse effect on our bankcard processing volumes, revenues or operating costs. In addition, if we were precluded from processing Visa and MasterCard bankcard transactions, we would lose the majority of our revenues.

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Any new laws and regulations, or revisions made to existing laws, regulations, or other industry standards affecting our business may have an unfavorable impact on our operating results and financial condition.

Our business is impacted by laws and regulations that affect the bankcard industry. The number of new and proposed regulations has increased significantly, particularly pertaining to interchange fees on bankcard transactions, which are paid to the bank card issuer. In July 2010, Congress passed The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which significantly changed financial regulation. Changes included restricting amounts of debit card fees that certain issuer banks can charge merchants and allowing merchants to offer discounts for different payment methods. The impact which new requirements imposed by the Dodd-Frank Act or other new regulation will have on our operating results is difficult to determine, as their implementation could result in the need for us to modify our services and processing platforms. As new requirements are mandated, these regulations could adversely affect our operating results and financial condition.

Furthermore, the requirements of the new regulations and the timing of their effective dates could result in changes in our clients' business practices that may alter their delivery of their products and services to consumers and the timing of their investment decisions, which could change the demand for our services as well as alter the type or volume of transactions that we process on behalf of our clients.

Additionally, all persons engaged in commerce, including, but not limited to, us and our merchant and financial institution customers, are subject to Section 5 of the Federal Trade Commission Act prohibiting unfair or deceptive acts or practices, or UDAP. The Federal Trade Commission, or FTC, has authority to take action against nonbanks that engage in UDAP and to the extent we are processing payments for a merchant engaged in UDAP, we may be subject to action by the FTC.

On July 26, 2011, the Financial Crimes Enforcement Network of the U.S. Department of the Treasury, or FinCEN, issued a final rule regarding the applicability of the Bank Secrecy Act's regulations to "prepaid access" products and services. This rulemaking clarifies the anti-money laundering obligations for entities engaged in the provision and sale of prepaid services such as prepaid cards. We have registered with FinCEN as a "money services business-provider of prepaid access" in accordance with the rule. Notwithstanding previously implemented anti-money laundering procedures pursuant to various contractual obligations, the rule increases our regulatory risks and, as with other regulatory requirements, violations of the rule could have a material adverse effect on our business, financial condition and results of operations.

These and other laws and regulations could adversely affect our business, financial condition and results of operations. In addition, even an inadvertent failure to comply with laws and regulations, given rapidly evolving social expectations of corporate fairness, could damage our business or our reputation.

Governmental regulations designed to protect or limit access to consumer information could adversely affect our ability to effectively provide our services to merchants.

Governmental bodies in the United States and abroad have adopted, or are considering the adoption of, laws and regulations restricting the transfer of, and safeguarding, non-public personal information. For example, in the United States, all financial institutions must undertake certain steps to ensure the privacy and security of consumer financial information. While our operations are subject to certain provisions of these privacy laws, we have limited our use of consumer information solely to providing services to other businesses and financial institutions. We limit sharing of non-public personal information to that necessary to complete the transactions on behalf of the consumer and the merchant and to that permitted by federal and state laws. In connection with providing services to the merchants and financial institutions that use our services, we are required by regulations and contracts with our merchants to provide assurances regarding the confidentiality and security of non-public consumer information. These contracts require periodic audits by independent companies regarding our compliance with industry standards and best practices established by regulatory guidelines. The compliance standards relate to our infrastructure, components, and operational procedures designed to safeguard the confidentiality and security of non-public consumer personal information shared by our clients with us. Our ability to maintain compliance with these standards and satisfy these audits will affect our ability to attract and maintain business in the future. The cost of such systems and procedures may increase in the future and could adversely affect our ability to compete effectively with other similarly situated service providers.

Global economics, political and other conditions may adversely affect trends in consumer spending, which may adversely impact the our revenue and profitability.

A recessionary economic environment could have a negative impact on our merchants, which may, in turn, adversely impact our revenue and profitability, particularly if the recessionary environment disproportionately affects some of the market

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segments that represent a larger portion of our card processing volume, like restaurants. If our merchants make fewer sales of their products and services, we will have fewer transactions to process, resulting in lower revenue. In addition, we have a certain amount of fixed and semi-fixed costs, including rent, processing contractual minimums and salaries, which could limit our ability to quickly adjust costs and respond to changes in our business and the economy.

In a recessionary environment our merchants could also experience a higher rate of business closures, which could adversely affect our business and financial condition. During prior recessions, including the 2008-2009 recession, we experienced negative same-store sales growth (or contraction) and an increase in business closures. In the event of a closure of a merchant, we are unlikely to receive our fees for any transactions processed by that merchant in its final month of operation.

We have faced, and will in the future face, chargeback liability when our merchants refuse or cannot reimburse chargebacks resolved in favor of their customers, reject losses when our merchants go out of business, and merchant fraud. We cannot accurately anticipate these liabilities, which may adversely affect our results of operations and financial condition.

In the event a billing dispute between a cardholder and a merchant is not resolved in favor of the merchant, the transaction is normally “charged back” to the merchant and the purchase price is credited or otherwise refunded to the cardholder. If we or our clearing banks are unable to collect such amounts from the merchant's account, or if the merchant refuses or is unable, due to closure, bankruptcy or other reasons, to reimburse us for the chargeback, we bear the loss for the amount of the refund paid to the cardholder. The risk of chargebacks is typically greater with those merchants that promise future delivery of goods and services rather than delivering goods or rendering services at the time of payment. We may experience significant losses from chargebacks in the future. Any increase in chargebacks not paid by our merchants may adversely affect our financial condition and results of operations.

Reject losses arise from the fact that we typically collect our fees from our SME merchants on the first day after the monthly billing period. This results in the build-up of a substantial receivable from our customers, which significantly exceeds the receivables of any of our competitors which assess their fees on a daily basis. If a merchant has gone out of business during the billing period, changes their demand deposit account, or institutes blocks on its demand deposit account, we may be unable to collect such fees. In addition, if our sponsor bank is unable, due to system disruption or other failure, to collect our fees from our merchants, we would face a substantial loss.

We have potential liability for fraudulent bankcard transactions initiated by merchants. Merchant fraud occurs when a merchant knowingly uses a stolen or counterfeit bankcard or card number to record a false sales transaction, processes an invalid bankcard or intentionally fails to deliver the merchandise or services sold in an otherwise valid transaction. We have established systems and procedures designed to detect and reduce the impact of merchant fraud, but we cannot assure you that these measures are or will be effective. It is possible that incidents of fraud could increase in the future. Failure to effectively manage risk and prevent fraud would increase our chargeback liability. Increases in chargebacks could have an adverse effect on our operating results and financial condition.

We incurred charges relating to chargebacks, reject losses and merchant fraud of $3.1 million, $2.0 million and $5.1 million in the years ended December 31, 2013, 2012 and 2011, respectively.

We rely on various financial institutions to provide clearing services in connection with our settlement activities. If we are unable to maintain clearing services with these financial institutions and are unable to find a replacement, our business may be adversely affected.

We rely on various financial institutions to provide clearing services in connection with our settlement activities. If such financial institutions should stop providing clearing services, we must find other financial institutions to provide those services. If we are unable to find a replacement financial institution we may no longer be able to provide processing services to certain customers, which could negatively impact our revenue and earnings.

Increased merchant attrition that we cannot offset with increased card processing volume from same store sales growth or new accounts would cause our revenues to decline.

We experience attrition in merchant card processing volume resulting from several factors, including business closures, transfers of merchants' accounts to our competitors and account closures that we initiate due to heightened credit risks. During the years ended December 31, 2013, 2012 and 2011, we experienced average annualized attrition in our SME card processing volume of 12.9% , 12.8% and 13.5% , respectively. Substantially all of our SME processing contracts may be terminated by either party on relatively short notice. We cannot predict the level of attrition in the future, and it could increase.

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Increased attrition in merchant card processing volume may have an adverse effect on our financial condition and results of operations. If we are unable to establish accounts with new merchants or otherwise increase our card processing volume in order to counter the effect of this attrition, our revenues will decline.

If we cannot pass increases in bankcard network interchange fees, assessments and transaction fees along to our merchants, our operating margins will be reduced.

We pay interchange fees and other network fees set by the bankcard networks to the card issuing bank and the bankcard networks for each transaction we process. From time to time, the bankcard networks increase the interchange fees and other network fees that they charge payment processors and the sponsor banks. At their sole discretion, our sponsor banks have the right to pass any increases in interchange fees on to us and have always done so in the past. We are allowed to, and in the past we have been able to, pass these fee increases along to our merchants through corresponding increases in our processing fees. However, if we are unable to do so in the future, our operating margins will be reduced.

The payment processing industry is highly competitive and we compete with certain firms that are larger and that have greater financial resources. Such competition could increase, which would adversely influence our prices to merchants, and as a result, our operating margins.

The market for payment processing services is highly competitive. Other providers of payment processing services have established a sizable market share in the small and mid-sized merchant processing sector. Maintaining our historic growth will depend on a combination of the continued growth in electronic payment transactions and our ability to increase our market share. The weakness of the current economic recovery could cause future growth in electronic payment transactions to slow compared to historical rates of growth and the Processing System Intrusion could negatively impact our ability to increase our market share. According to The Nilson Report, we accounted for approximately 4.5% of the 72.9 billion of purchase transactions processed by all bankcard acquirers in 2012. The competition we face may affect the prices we are able to charge. If the competition causes us to reduce the prices we charge, we will have to aggressively control our costs or our profit margins will decline. In addition, some of our competitors are financial institutions, subsidiaries of financial institutions or well-established payment processing companies. Our competitors that are financial institutions or subsidiaries of financial institutions do not incur the costs associated with being sponsored by a bank into the card networks and can settle transactions more quickly for their merchants than we can for ours. These competitors have substantially greater financial, technological, management and marketing resources than we have. This may allow our competitors to offer more attractive fees to our current and prospective merchants, or other products or services that we do not offer. This could result in a loss of customers, greater difficulty attracting new customers, and a reduction in the price we can charge for our products and services.

The payment processing market in which we compete is subject to rapid technological changes. These markets are characterized by technological change, new product introductions, evolving industry standards and changing customer needs. In order to remain competitive, we are continually involved in a number of projects to offer our customers convenient and efficient solutions for their payment needs. These projects carry the risks associated with any development effort, including cost overruns, delays in delivery and performance problems. In the payment processing market these risks are even more acute. In addition, many of our competitors may have the ability to devote more financial and operational resources than we can to the development of new technologies and services, including Internet payment processing services and mobile payment processing services that provide improved operating functionality and features to their product and service offerings. If more successful than ours, their development efforts could render our product and services offerings less desirable to customers, again resulting in the loss of customers or a reduction in the price we could demand for our offerings.
Our systems and our third-party providers' systems may fail due to factors beyond our control, which could interrupt our service, cause us to lose business and increase our costs.

We depend on the efficient and uninterrupted operation of our computer network systems, software, data center and telecommunications networks, as well as the systems of third parties. Our systems and operations or those of our third-party providers could be exposed to damage or interruption from, among other things, fire, natural disaster, power loss, telecommunications failure, unauthorized entry and computer viruses. Our property and business interruption insurance may not be adequate to compensate us for all losses or failures that may occur. Defects in our systems or those of third parties, errors or delays in the processing of payment transactions, telecommunications failures or other difficulties could result in:

- loss of revenues;
- loss of merchants, although our contracts with merchants do not expressly provide a right to terminate for business interruptions;
- loss of merchant and cardholder data;
- harm to our business or reputation;

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- exposure to fraud losses or other liabilities;
- negative publicity;
- additional operating and development costs; and/or
- diversion of technical and other resources.

If we fail to protect our intellectual property rights and defend ourselves from potential patent infringement claims, our competitive advantages may diminish or our ability to offer services to our customers could be restricted.

Our patents, trademarks, proprietary software and other intellectual property are critical to our future success. We rely on proprietary technology. It is possible that others will independently develop the same or similar technologies. Assurance of protecting our rights and proprietary information cannot be guaranteed. Our patents could be challenged, invalidated or circumvented by others and may not be of sufficient scope or strength to provide any meaningful protection or advantage. If we are unable to maintain the proprietary nature of our technologies, we could lose competitive advantages and be materially adversely affected. Adverse determinations in judicial or administrative proceedings could prevent us from precluding others from selling competing services, and thereby may have a material adverse affect on our business and results of operations.

Additionally, claims have been made, and other claims may be made in the future, with regard to our services or technology infringing on a patent or other intellectual property rights of others. Third parties may have, or may eventually be issued, patents that could be infringed by our services or technology. Any of these third parties could make a claim of infringement against us with respect to our services or technology. We may also be subject to claims by third parties for breach of copyright, trademark, license usage or other intellectual property rights. Any claim from third parties may result in a limitation on our ability to use the intellectual property subject to these claims, restrict us from delivering the related service or result in an unfavorable settlement that could be material to our operating results, financial condition and cash flow. Also, in recent years, individuals and groups have been purchasing intellectual property assets for the sole purpose of making claims of infringement and attempting to extract settlements from companies like ours. Even if we believe that intellectual property related claims are without merit, defending against such claims is time consuming and expensive and could result in the diversion of the time and attention of our management and employees. Claims of intellectual property infringement also might require us to redesign affected services, enter into costly settlement or license agreements, pay costly damage awards, or face a temporary or permanent injunction prohibiting us from marketing or selling certain of our services. Even if we have an agreement for indemnification against such costs, the indemnifying party, if any in such circumstances, may be unable to uphold its contractual obligations. If we cannot or do not license the infringed technology on reasonable terms or substitute similar technology from another source, our revenue and earnings could be adversely impacted.

Finally, we use open source software in connection with our technology and services. Companies that incorporate open source software into their products have, from time to time, faced claims challenging the ownership of open source software. As a result, we could be subject to suits by parties claiming ownership of what we believe to be open source software. Some open source software licenses require users who distribute open source software as part of their software to publicly disclose all or part of the source code to such software and/or make available any derivative works of the open source code on unfavorable terms or at no cost. While we monitor the use of open source software in our technology and services and try to ensure that none is used in a manner that would require us to disclose the source code to the related technology or service, such use could inadvertently occur and any requirement to disclose our proprietary source code could be harmful to our business, financial condition and results of operations.

Adverse conditions in markets in which we obtain a substantial amount of our card processing volume, such as our largest SME merchant markets of California, Texas, New York, Florida, and Pennsylvania, could negatively affect our results of operations.

Adverse economic or other conditions in California, Texas, New York, Florida, and Pennsylvania would negatively affect our revenue and could materially and adversely affect our results of operations. In December 2013, SME merchants located in the following states represented the following percentages of our SME processing volume:

California represented 9.6%, Texas represented 6.6%, New York represented 4.8%, Florida represented 4.7%, and Pennsylvania represented 4.2% . As a result of this geographic concentration of our merchants in these markets, we are exposed to the risks of downturns in these local economies and to other local conditions, which could adversely affect the operating results of our merchants in these markets. No other state represented more than 4% of our SME card processing volume in December 2013.

If we lose key personnel or are unable to attract additional qualified personnel as we grow, our business could be adversely affected.

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We are dependent upon the ability and experience of a number of our key personnel who have substantial experience with our operations, the rapidly changing payment processing industry and the selected markets in which we offer our services. It is possible that the loss of the services of one or a combination of our senior executives or key managers, particularly Robert O. Carr, our Chief Executive Officer, would have an adverse effect on our operations. Our success also depends on our ability to continue to attract, manage and retain other qualified middle management and technical and clerical personnel as we grow. We may not continue to attract or retain such personnel.

If we are unable to attract and retain qualified sales people, our business and financial results may suffer.

Unlike many of our competitors who rely on Independent Sales Organizations or salaried salespeople and telemarketers, we rely on a direct sales force whose compensation is entirely commission-based. Through our direct sales force of approximately 844 Relationship Managers and Territory Managers and 58 product specialists (SPAs), we seek to increase the number of merchants using our products and services. We intend to significantly increase the size of our sales force. Our success partially depends on the skill and experience of our sales force. If we are unable to retain and attract sufficiently experienced and capable Relationship Managers, Territory Managers and SPAs, our business and financial results may suffer.

Any potential strategic acquisitions or buyouts of our sales persons portfolio equity that we make could disrupt our business and harm our financial condition.

We expect to evaluate potential strategic acquisitions of complementary businesses, products or technologies. We may not be able to successfully finance or integrate any businesses, products or technologies that we acquire. Furthermore, the integration of any acquisition may divert management's time and resources from our core business and disrupt our operations. We may spend time and money on projects that do not increase our revenue. To the extent we pay the purchase price of any acquisition in cash, it would reduce our cash reserves or increase our borrowings, and to the extent the purchase price is paid with our stock, it could be dilutive to our stockholders. While we, from time to time, evaluate potential acquisitions of businesses, products and technologies, and anticipate continuing to make these evaluations, we have no present understandings, commitments or agreements with respect to any acquisitions.

We also regularly buy out the residual commissions of our Relationship Managers and sales managers, at multiples that typically amount to 2 1/2 years of such commissions. If the merchants included in the portfolios we purchase do not generate sufficient incremental margin after the purchase, we will not achieve a positive return on the cash expended.

Our operating results are subject to seasonality, which could result in fluctuations in our quarterly net income.

We have experienced in the past, and expect to continue to experience, seasonal fluctuations in our revenues as a result of consumer spending patterns. Historically our revenues have been strongest in our second and third quarters, and weakest in our first quarter.

We may become subject to additional U.S., state or local taxes that cannot be passed through to our merchants, which could negatively affect our results of operations.

Companies in the payment processing industry, including us, may become subject to taxation in various tax jurisdictions based on our net income or revenues. Taxing jurisdictions have not yet adopted uniform positions on taxation. If we are required to pay additional taxes on our net income or revenues and are unable to pass the tax expense through to our merchants, our costs would increase and our net income would be reduced.

We may need to raise additional funds to finance our future capital needs, which may prevent us from growing our business.

We may need to raise additional funds to finance our future capital needs, including developing new products and technologies, and operating expenses. We may need additional financing earlier than we anticipate if we:

- expand faster than our internally generated cash flow can support;
- purchase portfolio equity (the portion of our commissions that we have committed to our sales force for as long as the merchant processes with us, which we may buy out at an agreed multiple) from a large number of Relationship Managers or sales managers;
- add new merchant accounts faster than expected;
- need to reduce pricing in response to competition;
- repurchase our common stock or pay dividends; or
- acquire complementary products, business or technologies.

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If we raise additional funds through the sale of equity securities, these transactions may dilute the value of our outstanding common stock. We may also decide to issue securities, including debt securities that have rights, preferences and privileges senior to our common stock. We may be unable to raise additional funds on terms favorable to us or at all. If financing is not available or is not available on acceptable terms, we may be unable to fund our future needs. This may prevent us from increasing our market share, capitalizing on new business opportunities or remaining competitive in our industry.

Risks Related to Our Company

Borrowings under our Credit Agreement could adversely affect our financial condition, and the related debt service obligations may adversely affect our cash flow and ability to invest in and grow our businesses.

The interest rates on debt outstanding under our Credit Agreement are floating based on the LIBOR rate; accordingly, if the LIBOR rate increases, our interest expense will be higher on the portion of our debt outstanding not managed with interest rate swaps. At December 31, 2013, there was $150.0 million outstanding under our Credit Agreement. We are party to fixed-pay amortizing interest rate swaps having a notional amount of $25.0 million at December 31, 2013. These interest rate swaps convert $25.0 million of our borrowings under our Credit Agreement to fixed rate. These interest rate swaps amortize at $2.5 million per quarter in 2014 and $3.75 million per quarter in 2015 until their expiry in November 2015. At December 31, 2013 the fair value of these interest rate swaps, a liability of $0.4 million, was recorded in accrued expenses and other liabilities.

We intend to fulfill our total debt service obligations primarily from cash generated by our operations. Such funds will not be available to use in future operations, or investing in our businesses. This may adversely impact our ability to expand our businesses or make other investments. If we are unable to meet our debt obligations, we could be forced to restructure or refinance our obligations, to seek additional equity financing or to sell assets, which we may not be able to do on satisfactory terms or at all. As a result, we could default on those obligations and in the event of such default, our lenders could accelerate our debt or take other actions that could restrict our operations.

Our borrowing agreements contain restrictions which may limit our flexibility in operating and growing our business.

Our borrowing agreements contain covenants regarding our maintenance of certain leverage and fixed charge coverage ratios. Our borrowing agreements also include covenants that limit our ability to engage in specified types of transactions, including among other things:

- incur additional indebtedness or issue equity;
- pay dividends on, repurchase or make distributions in respect of our common stock;
- make certain investments (including acquisitions) and distributions;
- sell certain assets;
- create liens;
- consolidate, merge, sell or otherwise dispose of all or substantially all of our assets;
- enter into certain transactions with respect to our affiliates,
- ability to enter into business combinations, and
- certain other financial and non-financial covenants.

We were in compliance with these covenants as of December 31, 2013. Failure to be in compliance with these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all or a portion of our outstanding indebtedness, which would have a material adverse effect on our business, financial condition and results of operations.

Our balance sheet includes significant amounts of goodwill and intangible assets. The impairment of a significant portion of these assets would negatively affect our business, financial condition, and results of operations.

As a result of recent acquisitions, a significant portion of our total assets consist of goodwill and intangible assets. Combined goodwill and intangible assets, net of amortization, accounted for approximately 27% of the total assets on our balance sheet at both December 31, 2013 and 2012. We may not realize the full carrying value of our intangible assets and goodwill. We test goodwill for impairment at least annually and between annual tests if an event occurs or changes in circumstances suggest a potential decline in the fair value of goodwill. We also evaluate intangible assets on an ongoing basis for indicators of impairment. A significant amount of judgment is involved in determining if an indicator or change in circumstances relating to impairment has occurred. If testing indicates that impairment has occurred, we would be required to write-off the impaired portion of goodwill and such intangible assets, resulting in a charge to our earnings. An impairment of a significant portion of goodwill or intangible assets could have a material adverse effect on our business, financial condition, and results of operations.

The costs and effects of pending and future litigation, investigations or similar matters, or adverse facts and developments related thereto, could materially affect our business, financial position, results of operations and cash flow.

We are from time-to-time involved in various litigation matters and governmental or regulatory investigations or similar matters arising out of our current or future business. Our insurance or indemnities may not cover all claims that may be asserted against us, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation. Furthermore, there is no guarantee that we will be successful in defending ourselves in pending or future litigation or similar matters under various laws. Should the ultimate judgments or settlements in any pending litigation or future litigation or investigation significantly exceed our insurance coverage, they could have a material adverse effect on our business, financial condition, results of operations and cash flow. For more information about the Company's legal proceedings, refer to "Item 3: Legal Proceedings" herein.

Future sales of our common stock, or the perception in the public markets that these sales may occur, could depress our stock price.

Sales of substantial amounts of our common stock in the public market, or the perception in the public markets that these sales may occur, could cause the market price of our common stock to decline. This could also impair our ability to raise additional capital through the sale of our equity securities. At December 31, 2013, we had 36,950,886 shares of our common stock outstanding. In addition, as of December 31, 2013, we had outstanding stock options and restricted share units totaling 2,035,646 shares issued under our amended and restated 2008 Equity Incentive Plan and our 2000 Incentive Stock Option Plan, of which 394,252 were vested. Assuming the exercise of all outstanding options to acquire our common stock and the vesting of all restricted share units and performance share units, our current stockholders would own on a fully-diluted basis 95% of the outstanding shares of our common stock, and the number of shares of our common stock available to trade could cause the market price of our common stock to decline. In addition to the adverse effect a price decline could have on holders of our common stock, such a decline could impede our ability to raise capital or to make acquisitions through the issuance of additional shares of our common stock or other equity securities.

Failure to maintain effective systems of internal control over financial reporting and disclosure controls and procedures could cause a loss of confidence in our financial reporting and adversely affect the trading price of our common stock.

Effective internal control over financial reporting is necessary for us to provide accurate financial information. Section 404 of the Sarbanes-Oxley Act requires us to evaluate the effectiveness of our internal control over financial reporting as of the end of each fiscal year and to include a management report assessing the effectiveness of our internal control over financial reporting in our Annual Report on Form 10-K. If we fail to maintain the adequacy of our internal control, we may not be able to conclude and report that we have effective internal control over financial reporting. If we are unable to adequately maintain our internal control over financial reporting, we may not be able to accurately report our financial results, which could cause investors to lose confidence in our reported financial information, negatively affecting the trading price of our common stock, or our ability to access the capital markets.

Provisions in our charter documents and Delaware law could discourage a takeover that our stockholders may consider favorable or could cause current management to become entrenched and difficult to replace.

Provisions in our amended and restated certificate of incorporation, in our bylaws and under Delaware law could make it more difficult for other companies to acquire us, even if doing so would benefit our stockholders. Our amended and restated certificate of incorporation and bylaws contain the following provisions, among others, which may inhibit an acquisition of our company by a third party:

- advance notification procedures for matters to be brought before stockholder meetings;
- a limitation on who may call stockholder meetings;
- a prohibition on stockholder action by written consent; and
- the ability of our Board of Directors to issue up to 10 million shares of preferred stock without a stockholder vote.

If any shares of preferred stock are issued that contain an extraordinary dividend or special voting power, a change in control could be impeded.

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We are also subject to provisions of Delaware law that prohibit us from engaging in any business combination with any “interested stockholder,” meaning, generally, that a stockholder who beneficially owns more than 15% of our stock cannot acquire us for a period of three years from the date this person became an interested stockholder unless various conditions are met, such as approval of the transaction by our Board of Directors. Any of these restrictions could have the effect of delaying or preventing a change in control.

We may be unable or we may decide not to pay dividends on our common stock at a level anticipated by stockholders, which could depress our stock price.

The payment of dividends on our common stock in the future will be at the discretion of our Board of Directors and will depend on, among other factors, our earnings, stockholders' equity, cash position and financial condition. No assurance can be given that we will be able to or will choose to pay any dividends in the foreseeable future.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable.

ITEM 2. PROPERTIES

At December 31, 2013, we owned one facility and leased twenty two facilities which we use for operational, sales and administrative purposes.

Our principal executive offices are located in approximately 9,300 square feet of leased office space on Nassau Street in Princeton, New Jersey. The Nassau Street lease expires in June 2023. We own 54 acres of land in Jeffersonville, Indiana, on which we constructed our card processing operations and service center, including 19 acres we purchased on October 4, 2013, which will be used for future expansion of the service center. The current facility is comprised of 238,000 square feet of space supporting customer service, operations, deployment, day care, fitness, cafeteria, and large company meetings.

We also leased the following facilities as of December 31, 2013:

Location	Square Feet	Expiration
Alpharetta, Georgia	11,484	May 31, 2016
Auburn, Alabama	8,035	May 15, 2016
Chattanooga, Tennessee	9,461	June 30, 2014
Cleveland, Ohio	41,595	June 30, 2019
Colorado Springs, Colorado	9,920	February 28, 2015
Coraopolis, Pennsylvania	8,186	July 31, 2016
Coraopolis, Pennsylvania	41,556	July 31, 2016
Edmond, Oklahoma	3,038	January 31, 2015
Edmond, Oklahoma	2,932	August 31, 2018
Harlan, Kentucky	5,000	May 25, 2014
Johnson City, Tennessee	5,252	April 17, 2014
Plano, Texas	26,020	January 31, 2015
Plano, Texas	53,976	May 31, 2015 for 26,988 square feet. January 14, 2019 for 26,988 square feet.
Pleasanton, California	3,306	July 31, 2015
Portland, Oregon	10,838	December 31, 2016
Rochester, New York	18,000	June 30, 2023

Rochester, New York	12,708	November 30, 2018
Santa Ana, California	6,186	June 30, 2014
Tempe, Arizona	14,315	February 28, 2020
Tempe, Arizona	2,500	February 28, 2020
West Windsor Township, New Jersey	22,414	May 31, 2023

We believe that our facilities are suitable and adequate for our current business operations and, if necessary, could be replaced with little disruption to our Company. We periodically review our space requirements and may acquire new space to meet our business needs or consolidate and dispose of or sublet facilities which are no longer required.

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ITEM 3. LEGAL PROCEEDINGS

Processing System Intrusion Legal Proceedings
On January 20, 2009, the Company publicly announced the discovery of a criminal breach of its payment systems environment (the “Processing System Intrusion”). The Processing System Intrusion involved malicious software that appears to have been used to collect in-transit, unencrypted payment card data while it was being processed by the Company during the transaction authorization process. The Company believes the breach did not extend beyond 2008.

To date, we have had several lawsuits filed against us and additional lawsuits may be filed. These include lawsuits which assert claims against us by banks that issued payment cards to cardholders whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion (including various putative class actions seeking to represent all financial institutions that issued payment cards to cardholders whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion), seeking damages allegedly arising out of the Processing System Intrusion and other related relief. The actions generally assert various common-law claims such as claims for negligence and breach of contract, as well as, in some cases, statutory claims such as violation of the Fair Credit Reporting Act, state data breach notification statutes, and state unfair and deceptive practices statutes. The putative financial institution class actions seek compensatory damages, including recovery of the cost of issuance of replacement cards and losses by reason of unauthorized transactions, as well as injunctive relief, attorneys' fees and costs.

The putative financial institution class actions filed against us through February 27, 2014 are described below.

Putative Financial Institution Class Actions

Name of the Court	Date Filed	Principal Parties
United States District Court for the District of New Jersey	February 6, 2009	Lone Summit Bank v. Heartland Payment Systems, Inc. et al., 3:09-cv-00581
United States District Court for the District of New Jersey	February 13, 2009	TriCentury Bank et al. v. Heartland Payment Systems, Inc. et al., 3:09-cv-00697
United States District Court for the Southern District of Texas	February 16, 2009	Lone Star National Bank v. Heartland Payment Systems, Inc. et al., 7:09-cv-00064
United States District Court for the District of New Jersey	February 20, 2009	Amalgamated Bank et al. v. Heartland Payment Systems, Inc. et al., 3:09-cv-00776
United States District Court for the Southern District of Florida	March 19, 2009	First Bankers Trust Co., N.A. v. Heartland Payment Systems, Inc. et al., 4:09-cv-00825
United States District Court for the Southern District of Florida	March 31, 2009	PBC Credit Union et al. v. Heartland Payment Systems, Inc. et al., 9:09-cv-80481
United States District Court for the Southern District of Texas	April 22, 2009	Community West Credit Union, et al. v. Heartland Payment Systems, Inc. et al., 4:09-cv-01201
United States District Court for the Southern District of Texas	April 22, 2009	Eden Financial Corp. v. Heartland Payment Systems, Inc. et al., 4:09-cv-01203
		Heritage Trust Federal Credit

United States District Court for the Southern District of Texas	April 28, 2009	Union v. Heartland Payment Systems, Inc. et al., 4:09-cv-01284
United States District Court for the Southern District of Texas	May 1, 2009	Pennsylvania State Employees Credit Union v. Heartland Payment Systems, Inc. et al., 4:09-cv-01330

On June 10, 2009, the Judicial Panel on Multidistrict Litigation (the “JPML”) entered an order centralizing the class action cases for pre-trial proceedings before the United States District Court for the Southern District of Texas, under the caption In re Heartland Payment Systems, Inc. Customer Data Security Breach Litigation, MDL No. 2046, 4:09-md-2046. On August 24, 2009, the court appointed interim co-lead and liaison counsel for the financial institution plaintiffs.

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On September 23, 2009, the financial institution plaintiffs filed a Master Complaint in the MDL proceedings, which we moved to dismiss on October 23, 2009. On December 1, 2011, the Court entered an order granting in part our motion to dismiss the financial institution plaintiffs' master complaint against us, but allowing the plaintiffs leave to amend to re-plead certain claims. Plaintiffs elected not to file an amended complaint. The parties then jointly moved for the entry of final judgment on those claims in the master complaint that the Court had dismissed. On August 16, 2012, the Court entered final judgment on the dismissed claims and, on September 17, 2012, Plaintiffs filed a notice of appeal from that final judgment to the United States Court of Appeals for the Fifth Circuit. On September 12, 2012, Plaintiffs stipulated to dismissal with prejudice of the remaining claims pending before the District Court. Briefing on Plaintiffs' appeal was complete on February 8, 2013. On September 3, 2013, the United States Court of Appeals for the Fifth Circuit reversed the District Court, holding that the economic loss doctrine under New Jersey law does not preclude the financial institution plaintiffs’ negligence claim at the motion to dismiss stage, but declined to address in the first instance Heartland’s other arguments for affirming the District Court. The Fifth Circuit remanded to the District Court for further proceedings.

Other actions have been filed against us seeking damages allegedly arising out of the Processing System Intrusion and other related relief on an individual basis. On December 28, 2009, Putnam Bank of Putnam, Connecticut filed a complaint in Connecticut Superior Court, Putnam Bank v. Heartland Payment Systems, Inc., case no. WWM-CV-10-6001208-S. On January 20, 2010, we removed the action to the United States District Court for the District of Connecticut, case no. 3:10-cv-0061 (JBA), and, on January 27, 2010, filed a Notice of Potential Tag-Along Action, requesting centralization of the action with the MDL proceedings. On March 17, 2010, the action was centralized with the MDL proceedings. On February 9, 2010, OmniAmerican Bank filed a complaint in the District Court for Collin County, Texas, Civ. No. 380-00563-2012. The complaint identifies as a party in interest the Federal Insurance Company, which is alleged to have insured plaintiff and reimbursed it for $1,005,077.50, less a $100,000 deductible. On March 15, 2010, we filed an answer to the complaint and removed the action to the United States District Court for the Eastern District of Texas, case no. 4:10-cv-114, and, on March 16, 2010, filed a Notice of Potential Tag-Along Action, requesting centralization of the action with the MDL proceedings. On April 29, 2010, the action was centralized with the MDL proceedings. On February 18, 2010, Quad City Bank and Trust filed a complaint in the District Court for Collin County, Texas, Civ. No. 380-00721-2010. The complaint identifies as a party in interest the Federal Insurance Company, which is alleged to have insured plaintiff and reimbursed it for $432,420.32, less a $100,000 deductible. On March 15, 2010, we filed an answer to the complaint and removed the action to the United States District Court for the Eastern District of Texas, case no. 4:10-cv-115 and, on March 16, 2010, filed a Notice of Potential Tag-Along Action, requesting centralization of the action with the MDL proceedings. On April 29, 2010, the action was centralized with the MDL proceedings. On May 5, 2010, Napus Federal Credit Union filed a complaint in the United States District Court for the Southern District of Texas, case no. 4:10-cv-1616, and the action was consolidated with the MDL proceedings on June 9, 2010.

On January 19, 2010, financial institution plaintiffs, including certain of the named plaintiffs in the MDL proceedings, commenced an action against our sponsor banks at the time of the Processing System Intrusion in the United States District Court for the Southern District of Texas, captioned Lonestar National Bank, N.A. et al. v. KeyBank NA, et al., Civ. No. 4:10-cv-00171. This action against our sponsor banks asserts common-law claims similar to those asserted against us, and likewise seeks to represent all financial institutions that issued payment cards to cardholders whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion. On March 4, 2010, this action was transferred to the judge overseeing the MDL proceedings. On April 9, 2010, our sponsor banks moved to dismiss the complaint. On March 31, 2011, the Court entered an order granting the sponsor banks' motions to dismiss the complaint and invited additional briefing on the effect of the Court's order on our pending motion to dismiss. On April 18, 2011, in accordance with its order dismissing the claims against Heartland Bank for lack of personal jurisdiction, the court transferred the action against Heartland Bank to the United States District Court for the Eastern District of Missouri. Heartland Bank filed a notice with the Judicial Panel on

Multidistrict Litigation on July 27, 2011 designating the transferred action as a potential tag-along action to the MDL proceedings. On August 11, 2011, the action was centralized with the MDL proceedings. On August 14, 2012, Plaintiffs stipulated to dismissal of the claims against Heartland Bank. The sponsor banks could seek indemnification from us in regard to the claims asserted in this action.

Although we intend to defend the lawsuits and inquiries described above vigorously, we cannot predict the outcome of such lawsuits and inquiries.

Since our announcement of the Processing System Intrusion on January 20, 2009 and through December 31, 2013, we have expensed a total of $148.0 million, before reducing those charges by $31.2 million of total insurance recoveries. The majority of the total charges, or approximately $114.7 million, were related to settlements of claims. Approximately $33.3 million of the total charges were for legal fees and costs we incurred for investigations, defending various claims and actions, remedial actions and crisis management services.

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We do not consider it a reasonable possibility that losses exceeding the amounts already recognized on the matters subject to the settlement agreements entered into to date will be incurred. With regard to the unsettled claims related to the Processing System Intrusion, we determined material losses in addition to those previously accrued are not considered reasonably possible on any such claim disclosed. We are prepared to vigorously defend ourselves against any unsettled claims relating to the Processing System Intrusion that have been asserted against us and our sponsor banks to date. We feel we have strong defenses to all the claims that have been asserted against us and our sponsor banks relating to the Processing System Intrusion.

Additional costs we expect to incur for legal fees and costs for defending the unsettled claims and actions associated with the Processing System Intrusion will be recognized as incurred. Such costs are not expected to be material to our results of operations, financial condition and cash flow.

Other Legal Proceedings

In the ordinary course of our business, we are party to various legal actions, which we believe are incidental to the operation of our business. We believe that the outcome of the proceedings to which we are currently a party will not have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information