HEARTLAND PAYMENT SYSTEMS INC
Form 10-Q
August 07, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File 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)

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 ¨ NO

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

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

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

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

As of August 3, 2009, there were 37,461,310 shares of the registrant s Common Stock, $0.001 par value, outstanding.

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PART I. CONDENSED FINANCIAL INFORMATION

Item 1. Financial Statements

Heartland Payment Systems, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(In thousands, except share data)

(unaudited)

	June 30, 2009	December 31, 2008
Assets		
Current assets:		
Cash	**$ 31,473**	$ 27,589
Funds held for payroll customers	**25,164**	22,002
Receivables, net	**151,536**	140,145
Investments held to maturity	**1,396**	1,410
Inventory	**8,735**	8,381
Prepaid expenses	**4,757**	6,662
Current tax asset	**5,046**	2,440
Current deferred tax assets, net	**11,073**	6,723
Total current assets	**239,180**	215,352
Capitalized customer acquisition costs, net	**75,246**	77,737
Property and equipment, net	**92,778**	75,443
Goodwill	**59,050**	58,456
Intangible assets, net	**34,012**	36,453
Deposits and other assets, net	**1,642**	178
Total assets	**$ 501,908**	$ 463,619
Liabilities and stockholders equity		
Current liabilities:		
Due to sponsor banks	**$ 84,535**	$ 68,212
Accounts payable	**29,158**	25,864
Deposits held for payroll customers	**25,164**	22,002
Current portion of borrowings	**58,540**	58,522
Current portion of accrued buyout liability	**9,726**	10,547
Merchant deposits and loss reserves	**33,873**	16,872
Accrued expenses and other liabilities	**22,966**	26,196
Reserve for processing system intrusion	**14,399**	
Total current liabilities	**278,361**	228,215
Deferred tax liabilities, net	**5,453**	6,832
Reserve for unrecognized tax benefits	**1,704**	1,732
Long-term portion of borrowings	**12,698**	16,984
Long-term portion of accrued buyout liability	**31,486**	30,493

Total liabilities	**329,702**	284,256
Commitments and contingencies (Note 12)		
Equity		
Common Stock, $0.001 par value, 100,000,000 shares authorized, 37,461,310 and 37,675,543 shares issued at June 30, 2009 and December 31, 2008; 37,461,310 and 37,675,543 shares outstanding at June 30, 2009 and December 31, 2008	**38**	38
Additional paid-in capital	**167,729**	167,337
Accumulated other comprehensive loss	**(1,663)**	(2,145)
Retained earnings	**5,987**	14,014
Total stockholders equity	**172,091**	179,244
Noncontrolling minority interests	**115**	119
Total equity	**172,206**	179,363
Total liabilities and equity	**$ 501,908**	$ 463,619

See accompanying notes to condensed consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(In thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Total Revenues	**$ 417,373**	$ 394,554	**$ 789,545**	$ 734,173
Costs of Services:				
Interchange	**291,235**	283,830	**548,607**	529,107
Dues, assessments and fees	**19,586**	17,340	**35,866**	31,843
Processing and servicing	**49,866**	42,827	**97,922**	79,283
Customer acquisition costs	**12,757**	12,274	**25,332**	23,724
Depreciation and amortization	**3,874**	2,465	**7,608**	4,375
Total costs of services	**377,318**	358,736	**715,335**	668,332
General and administrative	**24,430**	16,747	**49,463**	32,228
Total expenses	**401,748**	375,483	**764,798**	700,560
Income from operations	**15,625**	19,071	**24,747**	33,613
Other income (expense):				
Interest income	**28**	169	**57**	469
Interest expense	**(545)**	(751)	**(1,086)**	(1,097)
Provision for processing system intrusion	**(19,380)**		**(31,970)**	
Other, net	**2**	1	**4**	(79)
Total other income (expense)	**(19,895)**	(581)	**(32,995)**	(707)
Income (loss) before income taxes	**(4,270)**	18,490	**(8,248)**	32,906
Provision for (benefit from) income taxes	**(1,669)**	6,994	**(3,170)**	12,428
Net income (loss)	**(2,601)**	11,496	**(5,078)**	20,478
Less: Net income (loss) attributable to noncontrolling minority interests	**14**	27	**(8)**	32
Net income (loss) attributable to Heartland	**$ (2,615)**	$ 11,469	**$ (5,070)**	$ 20,446
Net income (loss)	**$ (2,601)**	$ 11,496	**$ (5,078)**	$ 20,478
Other comprehensive income:				
Unrealized gains (losses) on investments, net of income tax of $14, $(3), $7 and $9	**24**	(6)	**13**	15
Foreign currency translation adjustment, net of income tax of $37 and $(124) in 2008	**727**	54	**469**	(205)
Comprehensive income (loss)	**(1,850)**	11,544	**(4,596)**	20,288
Less: Net Income (loss) attributable to noncontrolling minority interests	**14**	27	**(8)**	32

Comprehensive income (loss) attributable to Heartland	**$ (1,864)**	$ 11,517	**$ (4,588)**	$ 20,256
Earnings (loss) per common share:				
Basic	**$ (0.07)**	$ 0.31	**$ (0.14)**	$ 0.55
Diluted	**$ (0.07)**	$ 0.30	**$ (0.14)**	$ 0.53
Weighted average number of common shares outstanding:				
Basic	**37,458**	37,387	**37,496**	37,464
Diluted	**37,748**	38,688	**37,795**	38,755

See accompanying notes to condensed consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries

Condensed Consolidated Statements of Stockholders Equity

(In thousands)

(unaudited)

	Heartland Stockholders Equity							
	Common Stock		Additional	Accumulated Other	(Accumulated Deficit)		Noncontrolling	
	Shares	Amount	Paid-In Capital	Comprehensive Loss	Retained Earnings	Treasury Stock	Minority Interests	Total Equity
Six Months Ended June 30, 2008:								
Balance, January 1, 2008	37,990	$ 40	$ 173,346	$ (62)	$ 36,729	$ (44,384)	$	$ 165,669
Issuance of Common Stock options exercised	241		1,783					1,783
Excess tax benefit on stock options exercised under SFAS No. 123R			562					562
Repurchase of Common Stock	(782)					(17,995)		(17,995)
Retirement of Treasury Stock		(2)	(11,311)		(51,066)	62,379		
Stock-based compensation under SFAS No. 123R			775					775
Accumulated other comprehensive income:								
Unrealized losses on available for sale investments				15				15
Foreign currency translation adjustment				(205)			(4)	(209)
Dividends on Common Stock					(6,724)			(6,724)
Noncontrolling minority interests in subsidiary acquired							117	117
Net income for the period					20,446		32	20,478
Balance June 30, 2008	37,449	$ 38	$ 165,155	$ (252)	$ (615)	$	$ 145	$ 164,471
Six Months Ended June 30, 2009:								
Balance, January 1, 2009	37,676	$ 38	$ 167,337	$ (2,145)	$ 14,014	$	$ 119	$ 179,363
Issuance of Common Stock options exercised	135		530					530
Excess tax benefit on stock options exercised under SFAS No. 123R			322					322
Repurchase of Common Stock	(350)					(3,202)		(3,202)
Retirement of Treasury Stock			(1,556)		(1,646)	3,202		
Stock-based compensation under SFAS No. 123R			1,096					1,096
Accumulated other comprehensive income:								
Unrealized gain on available for sale investments				13				13
Foreign currency translation adjustment				469			4	473
Dividends on Common Stock					(1,311)			(1,311)
Net (loss) for the period					(5,070)		(8)	(5,078)
Balance June 30, 2009	37,461	$ 38	$ 167,729	$ (1,663)	$ 5,987	$	$ 115	$ 172,206

See accompanying notes to condensed consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flow

(In thousands)

(unaudited)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Cash flows from operating activities		
Net income (loss) attributable to Heartland	**$ (5,070)**	$ 20,446
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of capitalized customer acquisition costs	**28,451**	25,873
Other depreciation and amortization	**10,204**	5,882
Provision for processing system intrusion	**31,970**	
Addition to loss reserves	**3,203**	2,767
Provision for doubtful receivables	**548**	1,395
Stock-based compensation	**1,096**	775
Deferred taxes	**(5,757)**	2,292
Net income (loss) attributable to noncontrolling minority interests	**(8)**	32
Loss on investments		103
Other		4
Changes in operating assets and liabilities:		
Increase in receivables	**(11,924)**	(15,686)
(Increase) decrease in inventory	**(347)**	899
Payment of signing bonuses, net	**(17,765)**	(24,104)
Increase in capitalized customer acquisition costs	**(8,195)**	(7,647)
Decrease (increase) in prepaid expenses	**1,906**	(600)
(Increase) decrease in current tax asset	**(2,287)**	1,286
Increase in deposits and other assets	**(1,482)**	(43)
Excess tax benefits on options exercised under SFAS No. 123R	**(322)**	(811)
(Decrease) increase in reserve for unrecognized tax benefits	**(27)**	160
Increase in due to sponsor bank	**16,324**	48,383
Increase in accounts payable	**3,284**	4,697
Decrease in accrued expenses and other liabilities	**(13,117)**	(856)
Increase (decrease) in merchant deposits and loss reserves	**13,798**	(706)
Reserve for processing system intrusion	**(7,681)**	
Payouts of accrued buyout liability	**(4,904)**	(3,250)
Increase in accrued buyout liability	**5,076**	5,498
Net cash provided by operating activities	**36,974**	66,789
Cash flows from investing activities		
Purchase of investments held to maturity	**(569)**	(46)
Maturities of investments held to maturity	**589**	250
(Increase) decrease in funds held for payroll customers	**(3,139)**	1,245
Increase (decrease) in deposits held for payroll customers	**3,162**	(1,549)
Acquisition of business, net of cash acquired		(102,544)
Purchases of property and equipment	**(25,222)**	(12,375)
Net cash used in investing activities	**(25,179)**	(115,019)

Cash flows from financing activities		
Proceeds from borrowings		95,000
Principal payments on borrowings	**(4,269)**	(20,000)
Proceeds from exercise of stock options	**530**	1,783
Excess tax benefits on options exercised under SFAS No. 123R	**322**	811
Repurchase of common stock	**(3,202)**	(17,995)
Dividends paid on common stock	**(1,311)**	(6,724)
Net cash (used in) provided by financing activities	**(7,930)**	52,875
Net increase in cash	**3,865**	4,645
Effect of exchange rates on cash	**19**	(11)
Cash at beginning of year	**27,589**	35,508
Cash at end of period	**$ 31,473**	$ 40,142
Supplemental cash flow information:		
Cash paid during the period for:		
Interest	**$ 1,117**	$ 959
Income taxes	**4,945**	8,467

See accompanying notes to condensed consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

1. Organization and Operations

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

The accompanying condensed consolidated financial statements are unaudited. In the opinion of the Company s management, the unaudited condensed consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of the Company s financial position at June 30, 2009, its results of operations, changes in stockholders equity and cash flows for the six months ended June 30, 2009 and 2008. Results of operations reported for interim periods are not necessarily indicative of the results to be expected for the year ended December 31, 2009. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2008, as amended. The December 31, 2008 condensed consolidated balance sheet was derived from the audited 2008 consolidated financial statements.

In 2008, certain amounts for prior periods have been reclassified to conform with current presentation. Prior period amounts presented on the consolidated income statements reflect a change in classification of certain charges from VISA and MasterCard from Processing and Servicing expenses, to Dues, Assessments and Fees. This classification reflects the nature of these additional VISA and MasterCard bank card transaction authorization fees, which the Company passes through to its merchants. The Company believes that this change in presentation provides a more meaningful measure of its net revenue, which is a useful measure of profitability and operating performance. The Company defines net revenue as total revenues less interchange fees and dues, assessments and fees. These reclassifications had no effect on reported consolidated income before income taxes, net income or per share amounts. The amounts of Processing and Servicing expenses, which have been reclassified to Dues, Assessments and Fees for the three and six months ended June 30, 2008 were $4.6 million and $6.8 million, respectively.

Additionally, prior period amounts presented on the consolidated income statements reflect a change in classification of payroll tax expense incurred on up-front signing bonuses, residual commissions and buyouts of Accrued Buyout Liabilities from General and Administrative expenses, to Processing and Servicing expenses. This classification reflects these payments of payroll taxes as additional costs of services, rather than overhead. The Company believes that this presentation provides a more meaningful measure of the costs of providing services to its merchants. These reclassifications had no effect on reported consolidated income before income taxes, net income or per share amounts. The amounts of General and Administrative expenses, which have been reclassified to Processing and Servicing expenses for the three and six months ended June 30, 2008 were $1.5 million and $3.2 million, respectively.

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

Substantially all of the Company s revenue is derived from processing and settling Visa and MasterCard bank card transactions for its merchant customers. Because the Company is not a member bank as defined by Visa and MasterCard, in order to process and settle these bank card transactions for its

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

merchants the Company has entered into sponsorship agreements with member banks. Visa and MasterCard rules restrict the Company from performing funds settlement or accessing merchant settlement funds and require that these funds be in the possession of the member bank until the merchant is funded. A sponsorship agreement permits the Company to route Visa and MasterCard bank card transactions under the member bank s control and identification numbers to clear credit bank card transactions through Visa and MasterCard. A sponsorship agreement also enables the Company to settle funds between cardholders and merchants by delivering funding files to the member bank, which in turn transfers settlement funds to the merchants bank accounts. These restrictions place the settlement assets and obligations under the control of the member bank.

The sponsorship agreements with the member banks require, among other things, that the Company abide by the by-laws and regulations of the Visa and MasterCard networks, and in certain cases maintain a certificate of deposit with the bank sponsors. If the Company breaches the sponsorship agreements, the bank sponsors may terminate the agreement and, under the terms of the agreement, the Company would have 180 days to identify an alternative bank sponsor. The Company is dependent on its bank sponsors, Visa and MasterCard for notification of any compliance breaches.

The Company entered into the sponsorship agreement with KeyBank on April 1, 1999 and the agreement expires in March 2012. The acquisition of Network Services in May 2008 resulted in the addition of World Financial Network National Bank as the sponsor bank for Network Services large national merchant processing. In August 2008, the Company entered into a sponsorship agreement with SunTrust Banks to replace World Financial Network National Bank as its sponsor bank for Network Services large national merchant processing. In February 2009, the sponsorship of the large national merchants processing was transferred from World Financial Network National Bank to SunTrust Banks.

In 2007, the Company entered into a sponsor bank agreement with Heartland Bank, which is based in Saint Louis, Missouri. Heartland Bank is not affiliated with Heartland Payment Systems. Our agreement with Heartland Bank involves substantially the same terms as apply with KeyBank and it expires in September 2010.

Of the Company s total Visa and MasterCard bank card processing volume for the month of June 2009, 67.3% was processed under its sponsorship agreement with KeyBank N.A., 16.9% was processed under its sponsorship agreement with Heartland Bank (an unrelated third party), and 15.8% was processed under its sponsorship arrangement with SunTrust Banks.

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

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

For the three and six months ended June 30, 2009, the Company expensed a total of $19.4 million and $32.0 million, respectively, or about $0.32 and $0.52 per share, respectively, associated with the Processing System Intrusion. Over the six months ended June 30, 2009, the majority of these charges, or $22.1 million, related to fines imposed by certain card brands in April 2009 against the Company and its sponsor banks and a settlement offer made by the Company in an attempt to resolve certain of the claims asserted against its sponsor banks (who have asserted rights to indemnification from the Company pursuant to the Company s agreements with them) relating to the Processing System Intrusion. Notwithstanding its belief that the Company and its sponsor banks have strong defenses against the claims that are the subject of the settlement offer, the Company decided to make the settlement offer in an attempt to avoid the costs and uncertainty of litigation. The Company is prepared to vigorously defend itself against all the claims relating to the Processing System Intrusion that have been asserted against it and its sponsor banks to date. In particular, the Company is prepared to vigorously contest (and it has recommended to its sponsor banks that they vigorously contest) through all available means, including litigation if necessary, any liability that may be asserted or assessments that may be imposed against the Company or its sponsor banks by certain card brands.

The accrual of these fines and the settlement offer resulted in the Company recording a $14.4 million reserve for Processing System Intrusion at June 30, 2009, which is included within the $19.4 million expensed for the three months ended June 30, 2009. To date, the Company has not received any response to the settlement offer and it should not be assumed that the Company will resolve the claims that are the subject of the settlement offer for the amount of the settlement offer. The Company understands that the portion of this reserve related to the settlement offer is required by SFAS No. 5, *Accounting for Contingencies* (SFAS No. 5), based solely on the fact the Company tendered an offer of settlement in the amount it has accrued. The ultimate cost of resolving the claims that are the subject of the settlement offer may substantially exceed the amount the Company has accrued. Moreover, even if the claims that are the subject of the settlement offer were resolved for the amount the Company has accrued, that would still leave unresolved most of the claims that have been asserted against the Company or its sponsor banks relating to the Processing System Intrusion. The Company feels it has strong defenses to all the claims that have been asserted against it and its sponsor banks relating to the Processing System Intrusion, including those claims that are not the subject of the settlement offer. However, it is possible the Company will end up resolving the claims that are not the subject of the settlement offer, either through settlements or pursuant to litigation, for amounts that are significantly greater than the amount it has reserved to date in respect of those claims. The Company may also be required to reserve significant additional amounts in the future, either in respect of the claims that are the subject of the settlement offer or in respect of the other claims that have been asserted against the Company and its sponsor banks relating to the Processing System Intrusion (or in respect of both categories of claims).

The remainder of the expenses and accruals related to the Processing System Intrusion recorded in the three and six months ended June 30, 2009 were primarily for legal fees and costs the Company incurred for investigations, remedial actions and crisis management services.

While the Company has determined that the Processing System Intrusion has triggered other loss contingencies, to date an unfavorable outcome is not believed by it to be probable on those claims that are pending or have been threatened against it, or that the Company considers to be probable of assertion against it, and the Company does not have sufficient information to reasonably estimate the loss it would incur in the event of an unfavorable outcome on any such claim. Therefore, in accordance with SFAS No. 5, no reserve/liability has been recorded as of June 30, 2009 with respect to any such claim, except for the fines actually assessed by MasterCard and Visa and the amount of the settlement offer by the Company. As more information becomes available, if the Company should determine that an unfavorable outcome is probable on such a claim and that the amount of such probable loss that it will incur on that claim is reasonably estimable, it will record a reserve for the claim in question. If and when, the Company records such a reserve, it could be material and could adversely impact its results of operations, financial condition and cash flow.

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

Additional costs the Company expects to incur for investigations, remedial actions, legal fees, and crisis management services related to the Processing System Intrusion will be recognized as incurred. Such costs are expected to be material and could adversely impact the Company s results of operations, financial condition and cash flow.

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

2. Summary of Significant Accounting Policies

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

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

Generally, the Company uses cash available for investment to fund these advances to SME merchants; when available cash has been expended, the Company directs its sponsor banks to make these advances, thus generating a payable to the sponsor banks. We pay our sponsor banks the prime rate on these payables. To help fund the purchase price for Network Services, during the second quarter of 2008 we suspended using our available cash to fund merchant advances and borrowed $75.0 million. During the first quarter of 2009, we re-established our practice of partially funding merchant advances with our cash, but at reduced amounts. At June 30, 2009, the Company used $10.0 million of its available cash to fund merchant advances and at December 31, 2008, the Company used $17.5 million of its cash to fund merchant advances. The amount due to sponsor banks for funding advances was $84.5 million at June 30, 2009 and $68.2 million at December 31, 2008. The payable to sponsor banks is repaid at the beginning of the following month out of the fees the Company collects from its merchants. Receivables from merchants also include receivables from the sale of point of sale terminal equipment and check processing terminals.

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

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

Investments and Funds Held for Payroll Customers Investments, including those carried on the consolidated balance sheet as Funds Held for Payroll Customers, consist primarily of fixed income

Heartland Payment Systems, Inc. and Subsidiaries

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(unaudited)

bond funds, corporate and U.S. Government debt securities, certificates of deposit and cost basis equity securities. Funds Held for Payroll Customers also include overnight bank deposits. The majority of investments carried in Funds Held for Payroll Customers are available-for-sale and recorded at the fair value based on quoted market prices. Certificates of deposit are classified as held to maturity and recorded at cost. Cost basis equity securities are recorded at cost and periodically evaluated for impairment. In the event of a sale, cost is determined on a specific identification basis. At June 30, 2009, Funds Held for Payroll Customers included cash and cash equivalents of $23.9 million and investments available for sale of $1.3 million.

Capitalized Customer Acquisition Costs, net Capitalized customer acquisition costs consist of (1) up-front signing bonus payments made to Relationship Managers and sales managers (the Company s sales force) for the establishment of new merchant relationships, and (2) a deferred acquisition cost representing the estimated cost of buying out the commissions of vested sales employees. Pursuant to Staff Accounting Bulletin Topic 13, *Revenue Recognition*, and Financial Accounting Standards Board (FASB) Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*, capitalized customer acquisition costs represent incremental, direct customer acquisition costs that are recoverable through gross margins associated with merchant contracts. The capitalized customer acquisition costs are amortized using a method which approximates a proportional revenue approach over the initial three-year term of the merchant contract.

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

Management evaluates the capitalized customer acquisition costs for impairment at each balance sheet date by comparing, on a pooled basis by vintage month of origination, the expected future net cash flows from underlying SME merchant relationships to the carrying amount of the capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the value of the capitalized customer acquisition costs, the impairment loss will be charged to operations. The Company believes that no impairment has occurred as of June 30, 2009 and December 31, 2008.

Merchant Deposits and Loss Reserves The Company maintains merchant deposits to offset potential liabilities from merchant chargeback processing, which is discussed below, as well as deposits representing debit processing and check processing funds in transit. Previously, the debit processing funds in transit were netted against receivables. Disputes between a cardholder and a merchant periodically arise due to the cardholder s dissatisfaction with merchandise quality or the merchant s service, and the disputes may not always be resolved in the merchant s favor. In some of these cases, the transaction is charged back to the merchant and the purchase price is refunded to the cardholder by the credit card-issuing institution. If the merchant is unable to fund the refund, the Company is liable for the full amount of the transaction. Under FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Other* (FIN 45), the Company s obligation to stand ready to perform is minimal. The Company maintains a deposit or the pledge of a letter of credit from certain merchants as an offset to potential contingent liabilities that are the responsibility of such merchants. The Company evaluates its ultimate risk and records an estimate of potential loss for chargebacks related to merchant fraud based upon an assessment of actual historical fraud loss rates compared to recent bank card processing volume levels. The Company believes that the liability recorded as loss reserves approximates fair value.

Accrued Buyout Liability The Company s historic focus has been on SME merchants, and it has a sales compensation arrangement in this market that has been essentially unchanged since its inception. Under this approach, Relationship Managers and sales managers are paid residual commissions based on the gross margin generated by monthly SME merchant processing activity. The Company has the right, but is not obligated, to buy out some or all of these commissions, and intends to do so periodically.

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Such purchases of the commissions are at a fixed multiple of the last twelve months commissions. Because of the Company s intent and ability to execute purchases of the residual commissions, and the mutual understanding between the Company and the Relationship Managers and sales managers, the Company has accounted for this deferred compensation arrangement pursuant to the substantive nature of the plan. The Company therefore records the amount that it would have to pay (the settlement cost) to buy out non-servicing related commissions in their entirety from vested Relationship Managers and sales managers, and an accrual, based on their progress towards vesting, for those unvested Relationship Managers and sales managers who are expected to vest in the future. As noted above, as the liability increases over the first year of a SME merchant contract, the Company also records a related deferred acquisition cost asset for currently vested Relationship Managers and sales managers. The accrued buyout liability associated with unvested Relationship Managers and sales managers is not included in the deferred acquisition cost asset since future services are required in order to vest. Subsequent changes in the settlement cost, due to account attrition, same-store sales growth and changes in gross margin are included in the same income statement caption as customer acquisition cost amortization expense.

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

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

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

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

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

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The provision for/(benefit from) income taxes for the three and six months ended June 30, 2009 and 2008 and the resulting effective tax rates were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Provision for/(benefit from) income taxes	**$ (1,669)**	$ 6,994	**$ (3,170)**	$ 12,428
Effective tax rate	**39.09%**	37.80%	**38.43%**	37.80%

At June 30, 2009, our reserve for unrecognized tax benefits related to uncertain tax positions was $1.7 million, of which $1.3 million would, if recognized, impact the effective tax rate.

Stock Options The Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R) on January 1, 2006.

In the third quarter of 2008, the Company s Board of Directors approved a performance-based stock option program. Under this program, the Company granted 2.5 million performance-based stock options to its employees. These stock options were granted to those employees who the Board of Directors determined could have significant impact on successfully integrating the recently acquired Network Services business and effectively executing the Company s growth plan. These stock options have a five-year term and will vest in equal amounts in 2011, 2012 and 2013 only if, over the term of the stock options, both of the following performance conditions are achieved:

- Consolidated net revenue grows at a compound annual rate of at least 15%; and

- Fully diluted EPS grows at a compound annual rate of at least 25%.

As of December 31, 2008, management believed that achieving these performance conditions was not more likely than not to occur; therefore, no share-based compensation expense was recorded for these stock options in 2008. As of June 30, 2009, management continues to believe that achieving these performance conditions is not more likely than not to occur; therefore, no share based compensation expense has been recorded for these stock options in 2009. The evaluation of the likelihood of achieving these performance conditions will be repeated quarterly, and at such point that vesting of some or all of the options becomes more likely than not, share-based compensation expense will be recorded.

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

Also in the second quarter of 2009, the Company s Board of Directors approved grants of 336,000 Restricted Share Units. These Restricted Share Units are nonvested share awards which will vest over a four-year service period as employees perform service. The closing price of the Company s common stock on the grant date equals the grant date fair value of these nonvested share awards and will be recognized as compensation expense over their four-year service periods.

Diluted earnings per share for the three and six months ended June 30, 2009 and 2008 were computed based on the weighted average outstanding common shares plus equivalent shares assuming exercise of stock options, where dilutive.

Foreign Currency The Canadian dollar is the functional currency of CPOS, which operates in Canada. CPOS revenues and expenses are translated at the average exchange rates prevailing during the period. The foreign currency assets and liabilities of CPOS are translated at the period-end rate of exchange. The resulting translation adjustment is recorded as a component of other comprehensive income

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and is included in stockholders equity. At June 30, 2009, the cumulative foreign currency translation loss was $1.7 million. The Company intends to indefinitely reinvest undistributed earnings of CPOS and has not tax affected the cumulative foreign currency translation loss. Determination of the amount of unrecognized deferred tax liability related to indefinitely reinvested profits is not material.

Noncontrolling Minority Interests Noncontrolling minority interests represent noncontrolling minority stockholders share of the equity and after-tax net income or loss of consolidated subsidiaries. Noncontrolling minority stockholders share of after-tax net income or loss of consolidated subsidiaries is included in Net income (loss) attributable to noncontrolling minority interests in the Consolidated Income Statement. The minority stockholders interests included in Noncontrolling minority interests in the June 30, 2009 Consolidated Balance Sheet were $115,000 and reflect the investments by these minority shareholders in the consolidated subsidiaries, along with their proportionate share of the earnings or losses of the subsidiaries.

Subsequent Events The Company evaluated subsequent events with respect to the Consolidated Financial Statements as of and for the six months ended June 30, 2009 through August 7, 2009, the date of issuance. See Note 16, Subsequent Events, for references to reportable items evaluated during this period.

New Accounting Pronouncements In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141(R)), which replaces SFAS No. 141. SFAS No. 141(R) applies the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses and establishes principles and requirements for how the acquirer recognizes and measures identifiable assets acquired and liabilities assumed, including assets and liabilities arising from contingencies, any noncontrolling interest in the acquiree and goodwill acquired or gain realized from a bargain purchase. SFAS No. 141(R) is effective prospectively for business combinations for which the acquisition date is on or after the first annual reporting period beginning after December 15, 2008. The adoption of SFAS No. 141 (R) will impact the Company s Consolidated Financial Statements prospectively in the event of any business combinations entered into after the effective date in which the Company is the acquirer and retroactively for any business combinations entered into before the effective date in regards to deferred income and contingency adjustments.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS No. 160), which amends Accounting Research Bulletin No. 51, *Consolidated Financial Statements.* SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, SFAS No. 160 requires a noncontrolling interest in a subsidiary to be reported as equity, separate from the parent s equity, in the consolidated statement of financial position and the amount of net income or loss and comprehensive income or loss attributable to the parent and noncontrolling interest to be presented separately on the face of the consolidated financial statements. Changes in a parent s ownership interest in its subsidiary in which a controlling financial interest is retained are accounted for as equity transactions. If a controlling financial interest in the subsidiary is not retained, the subsidiary is deconsolidated and any retained noncontrolling equity interest is initially measured at fair value. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008 and is to be applied prospectively, except that presentation and disclosure requirements are to be applied retrospectively for all periods presented. The adoption of SFAS No. 160 did not have a material effect on the Company s Consolidated Financial Statements.

In December 2007, the SEC issued SAB No. 110, *Certain Assumptions Used in Valuation Methods* (SAB 110). SAB 110 amends SAB 107 to allow the continued use, under certain circumstances, of the simplified method in developing the expected term for stock options. SAB 110 was effective January 1, 2008. The adoption of SAB 110 will impact the Company s Consolidated Financial Statements prospectively in the event circumstances provide for application of the simplified method to future stock option grants made by the Company.

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In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142) in order to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) and other GAAP. FSP FAS 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008 and is to be applied prospectively to intangible assets acquired after the effective date. Disclosure requirements are to be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. Early adoption is not permitted. The adoption of FSP FAS 142-3 did not have a material effect on the Company s Consolidated Financial Statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and FSP APB 28-1). FSP FAS 107-1 and FSP APB 28-1 require the disclosure of fair value for interim and annual reporting periods for all financial instruments for which it is practicable to estimate the value, whether recognized or not recognized in the statement of financial position. FSP FAS 107-1 and FSP APB 28-1 are effective for financial statements issued for interim periods ending after June 15, 2009. This guidance applies only to financial statement disclosures, the adoption will not have a material effect on the Company s Consolidated Financial Statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS No. 165). The objective of SFAS No. 165 is to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 introduces the concept of financial statements being available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events as well as the rationale for why that date was selected, that is, whether that date represents the date the financial statements were issued or were available to be issued. SFAS No. 165 should not result in significant changes in the subsequent events that an entity reports either through recognition or disclosure in its financial statements. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009. The adoption of SFAS No. 165 did not have a material effect on the Company s Consolidated Financial Statements.

3. Acquisitions

Chockstone, Inc.

As of November 14, 2008, the Company acquired the assets of Chockstone, Inc. for a cash payment of $4.1 million. Chockstone expands our ability to equip businesses nationwide with enhanced gift card and loyalty programs. This acquisition is not expected to have a material impact on earnings in the near term. Pro forma results of operations have not been presented because the effect of the acquisition was not material. The transaction was accounted for under the purchase method of accounting. The fair values of the Chockstone assets acquired and the liabilities assumed were estimated at the acquisition date. The fair values are preliminary, based on estimates, and may be adjusted in accordance with Statement of Financial Accounting Standards No. 141(SFAS No. 141), *Business Combinations,* as more information becomes available and valuations are finalized. Beginning November 14, 2008, Chockstone s results of operations were included in the Company s results of operations. The total purchase price was allocated as follows: $2.4 million to intangible assets, $1.6 million to goodwill, and $0.1 million to net tangible assets. The entire amount of goodwill is expected to be deductible for income tax reporting.

Network Services

As of May 31, 2008, the Company closed its acquisition of Network Services. Network Services is a provider of payment processing solutions, serving a variety of industries such as petroleum, convenience store, parking and retail. Services include payment processing, prepaid services, POS terminal, helpdesk services and merchant bankcard services. The Network Services acquisition will provide the Company with a substantial portfolio of merchants in the petroleum industry segment. Network Services settled over $17

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billion of total annual Visa and MasterCard bank card processing volume representing 604 million annual Visa and MasterCard transactions in 2007. In addition to Visa and MasterCard transactions, Network Services handles a wide range of payment transactions for its predominantly petroleum customer base, including providing approximately 2.6 billion transaction authorizations in 2007.

The Company acquired the Network Services business, including tangible personal property, intellectual property, licenses, contracts and related assets, and assumed certain liabilities related to Network Services, for a cash payment of $92.5 million. The Company funded the cash purchase price using $25.0 million it borrowed under its term loan facility, $50.0 million it borrowed under its revolving credit facility, and the balance from its available cash position. Beginning June 1, 2008, Network Services results of operations were included in the Company s results of operations

The acquisition was accounted for under the purchase method of accounting. The following table summarizes the allocation of the acquisition costs, including direct transaction costs, to the tangible and intangible assets acquired and the liabilities assumed based on their estimated fair values on May 31, 2008. The excess of the acquisition costs over the fair value of net assets acquired was allocated to goodwill. The goodwill acquired is expected to be deductible for tax purposes.

		Allocation of Acquisition Costs (in thousands)
Net fair value of assets acquired and liabilities assumed:		
Receivables	$	18,160
Other current assets		3,660
Property and equipment		1,822
Accrued expenses and other liabilities		(7,653)
Total net assets acquired		15,989
Intangible assets acquired:		
Customer relationships		26,100
Software		7,900
Non-competition agreement		400
Total intangible assets		34,400
Goodwill		43,800
Total acquisition costs (a)	$	94,189

(a) Total acquisition costs include $92.5 million of cash consideration paid, plus $1.7 million of direct transaction costs.

The following unaudited pro forma operating results for the six months ended June 30, 2008 assume that the Network Services acquisition occurred on January 1, 2007. The pro forma results of operations are based on historical results of operations, adjusted for the impacts of purchase price allocations and financing costs, and are not necessarily indicative of the actual results which would have been achieved had the Network Services acquisition occurred as of January 1, 2007, or the results which may be achieved in the future.

(in thousands, except per share)	Six Months Ended June 30, 2008
Total revenues	$ 780,278
Costs of services	700,768
General and administrative expenses	45,805
Total expenses	746,672
Income from operations	33,606
Net income	19,763
Diluted earnings per share	$ 0.51

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Collective Point of Sale Solutions Ltd.

On March 3, 2008 the Company acquired a majority interest in Collective Point of Sale Solutions Ltd. (CPOS) for a cash payment of $10.5 million plus transaction costs of approximately $0.4 million. CPOS is a Canadian provider of payment processing services and secure point-of-sale solutions. This acquisition provides the Company an entrée into the Canadian credit and debit card processing market. The Company and CPOS are now able to service merchants that have locations in both the United States and Canada. Pro forma results of operations have not been presented because the effect of the acquisition was not material.

The transaction was accounted for under the purchase method of accounting. Beginning March 3, 2008, CPOS results of operations were included in the Company s results of operations. The allocation of the total purchase price was as follows: $9.4 million to goodwill, $1.5 million to intangible assets and net tangible liabilities, which were immaterial. Under Canada tax regulations, the goodwill acquired is not expected to be deductible for tax purposes.

4. Receivables

A summary of receivables by major class was as follows at June 30, 2009 and December 31, 2008:

	June 30, 2009	December 31, 2008
	(In thousands)	
Accounts receivable from merchants	**$ 147,545**	$ 132,699
Accounts receivable from others	**4,551**	7,945
	152,096	140,644
Less allowance for doubtful accounts	**(560)**	(499)
Total receivables, net	**$ 151,536**	$ 140,145

Included in accounts receivable from others are $1,879,000 and $1,497,000 which are due from employees at June 30, 2009 and December 31, 2008, respectively.

A summary of the activity in the allowance for doubtful accounts for the three and six months ended June 30, 2009 and 2008 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Beginning balance	**$ 463**	$ 146	**$ 499**	$ 165
Balance of acquired entity allowance		87		87
Additions to allowance	**552**	1,049	**548**	1,309
Charges against allowance	**(455)**	(966)	**(487)**	(1,245)
Ending balance	**$ 560**	$ 316	**$ 560**	$ 316

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5. Funds Held for Payroll Customers and Investments

A summary of Funds Held for Payroll Customers and Investments, including the cost, gross unrealized gains (losses) and estimated fair value for investments held to maturity and investments available-for-sale by major security type and class of security were as follows at June 30, 2009 and December 31, 2008:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(In thousands)		
June 30, 2009				
Funds Held for Payroll Customers:				
Fixed income bond fund	**$ 965**	**$ 29**	**$**	**$ 994**
Debt securities of the U.S. Government				
Corporate debt securities	**335**		**(29)**	**306**
Total investments available-for-sale	**1,300**	**29**	**(29)**	**1,300**
Cash held for payroll customers	**23,864**			**23,864**
Total Funds Held for Payroll Customers	**$ 25,164**	**$ 29**	**$ (29)**	**$ 25,164**
Investments:				
Investments held to maturity Certificates of deposit (a)	**$ 1,396**	**$**	**$**	**$ 1,396**
Total investments	**$ 1,396**	**$**	**$**	**$ 1,396**

(a) Certificates of deposits have remaining terms ranging from 2 months to 14 months.

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(In thousands)		
December 31, 2008				
Funds Held for Payroll Customers:				
Fixed income bond fund	$ 965	$	$	$ 965
Debt securities of the U.S. Government				
Corporate debt securities	335		(23)	312
Total investments available-for-sale	1,300		(23)	1,277
Cash held for payroll customers	20,725			20,725

Total Funds Held for Payroll Customers		$ 22,025	$		$	(23)	$	22,002
Investments:								
Investments held to maturity	Certificates of deposit	$ 1,410	$		$		$	1,410
Total investments		$ 1,410	$		$		$	1,410

On January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The framework provides a three-level hierarchy, which prioritizes the factors (inputs) used to calculate the fair value of assets and liabilities as follows:

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

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

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

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As of June 30, 2009, all investments in available-for-sale securities held by the Company were measured using Level 1 inputs.

During the six months ended June 30, 2009, the Company did not experience any other-than-temporary losses on its investments. During the twelve months ended December 31, 2008, the Company recognized $258,000 of other-than-temporary impairment losses on its investment in the fixed income bond fund and $137,000 of realized losses on a sale of corporate debt securities.

The maturity schedule of all available-for-sale and held to maturity investments along with amortized cost and estimated fair value as of June 30, 2009 is as follows:

	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	**$ 2,329**	**$ 2,359**
Due after one year through five years	**367**	**337**
	$ 2,696	**$ 2,696**

6. Capitalized Customer Acquisition Costs, Net

A summary of the capitalized customer acquisition costs, net, as of June 30, 2009 and December 31, 2008 was as follows:

	June 30, 2009	December 31, 2008
	(In thousands)	
Capitalized signing bonuses	**$ 119,296**	$ 117,776
Less accumulated amortization	**(59,676)**	(55,307)
	59,620	62,469
Capitalized customer deferred acquisition costs	**37,787**	37,010
Less accumulated amortization	**(22,161)**	(21,742)
	15,626	15,268
Capitalized Customer Acquisition Costs, Net	**$ 75,246**	$ 77,737

A summary of the activity in capitalized customer acquisition costs, net for the three and six month periods ended June 30, 2009 and 2008 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Balance at beginning of period	**$ 76,551**	$ 73,143	**$ 77,737**	$ 70,498
Plus additions to:				
Capitalized signing bonuses, net	**8,758**	12,671	**17,765**	24,104
Capitalized customer deferred acquisition costs	**4,259**	3,913	**8,195**	7,647
	13,017	16,584	**25,960**	31,751
Less amortization expense on:				
Capitalized signing bonuses, net	**(10,335)**	(9,622)	**(20,614)**	(18,535)
Capitalized customer deferred acquisition costs	**(3,987)**	(3,729)	**(7,837)**	(7,338)
	(14,322)	(13,351)	**(28,451)**	(25,873)
Balance at end of period	**$ 75,246**	$ 76,376	**$ 75,246**	$ 76,376

Net signing bonus adjustments from estimated amounts to actual were $(0.2) million and $0.9 million, respectively, for the three months ended June 30, 2009 and 2008, and $(0.2) million and $0.9 million, respectively, for the six months ended June 30, 2009 and 2008. Net signing bonus adjustments are netted against additions in the table above. Positive signing bonus adjustments occur when the actual gross

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margin generated by the merchant contract during the first year exceeds the estimated gross margin for that year, resulting in the underpayment of the up-front signing bonus and would be paid to the relevant salesperson. Negative signing bonus adjustments could result from the prior overpayment of signing bonuses and would be recovered from the relevant salesperson.

Fully amortized signing bonuses of $9.1 million and $6.9 million respectively, were written off during the three month periods ended June 30, 2009 and 2008, and $16.2 million and $13.5 million respectively, were written off during the six month periods ended June 30, 2009 and 2008. In addition, fully amortized customer deferred acquisition costs of $3.8 million and $3.6 million, respectively, were written off during the three month ended June 30, 2009 and 2008, and $7.4 million and $6.6 million, respectively, were written off during the six month ended June 30, 2009 and 2008.

The Company believes that no impairment of capitalized customer acquisition costs has occurred as of June 30, 2009 and December 31, 2008.

7. Intangible Assets and Goodwill

Intangible Assets Intangible assets consisted of the following as of June 30, 2009 and December 31, 2008:

	June 30, 2009				
	Gross Assets	Accumulated Amortization (In thousands)	Net Asset	Amortization Life and Method	
Finite Lived Assets:					
Customer relationships	$ 28,590	$ 1,734	$ 26,856	2 to 18 years	proportional cash flow
Software	9,154	2,916	6,238	2 to 5 years	straight line
Non-compete agreements	994	350	644	2 to 5 years	straight line
Other	384	110	274	2 to 5 years	straight line
	$ 39,122	$ 5,110	$ 34,012		

	December 31, 2008				
	Gross Assets	Accumulated Amortization (In thousands)	Net Asset	Amortization Life and Method	
Finite Lived Assets:					
Customer relationships	$ 28,749	$ 1,024	$ 27,725	3 to 18 years	proportional cash flow
Software	9,154	1,503	7,651	3 to 5 years	straight line
Non-compete agreements	994	211	783	3 to 5 years	straight line
Other	326	32	294	3 to 5 years	straight line
	$ 39,223	$ 2,770	$ 36,453		

Amortization expense related to the intangible assets was $1,161,000 and $597,000, respectively, for the three months ended June 30, 2009 and 2008 and $2,299,000 and $647,000, respectively, for the six months ended June 30, 2009 and 2008.

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The estimated amortization expense related to intangible assets for the next five years is as follows:

For the Twelve Months Ending June 30,	
	(In thousands)
2010	$ 4,624
2011	4,081
2012	2,008
2013	1,842
2014	1,947
Thereafter	19,510
	$ 34,012

Goodwill The changes in the carrying amount of goodwill for the six months ended June 30, 2009 and 2008 were as follows:

	Six Months Ended June 30,	
	2009	**2008**
	(In thousands)	
Beginning balance	**$ 58,456**	$ 5,489
Goodwill acquired during the period		53,345
Effects of foreign currency translation	**401**	(163)
Other, primarily adjustments to allocations of purchase price	**193**	103
Ending balance	**$ 59,050**	$ 58,774

8. Merchant Deposits and Loss Reserves

The Company s merchants have the liability for any charges properly reversed by the cardholder through a mechanism known as a chargeback. If the merchant is unable to pay this amount, the Company will be liable to the Visa and MasterCard networks for the reversed charges. Under FIN 45, the Company determined that the fair value of its obligation to stand ready to perform is minimal. The Company requires personal guarantees, merchant deposits and letters of credit from certain merchants to minimize its obligation. Merchants deposits also include deposits representing debit processing and check processing funds in transit. Previously, the debit processing funds in transit were netted against receivables. As of June 30, 2009 and December 31, 2008, the Company held merchant deposits totaling $32.7 million and $15.8 million, respectively, and letters of credit totaling $438,000 and $513,000, respectively.

The Visa and MasterCard networks generally allow chargebacks up to four months after the later of the date the transaction is processed or the delivery of the product or service to the cardholder. As the majority of the Company s SME merchant transactions involve the delivery of the product or service at the time of the transaction, a reasonable basis for determining an estimate of the Company s exposure to chargebacks is the last four months processing volume on the SME portfolio, which was $19.8 billion and $18.7 billion for the four months ended June 30, 2009 and December 31, 2008, respectively. However, for the four months ended June 30, 2009 and December 31, 2008, the Company was presented with $11.2 million and $10.2 million, respectively, in chargebacks by issuing banks. In the six months ended June 30, 2009 and the year ended

December 31, 2008, the Company incurred merchant credit losses of $3.0 million and $5.1 million, respectively, on total SME dollar volume processed of $28.5 billion and $57.9 billion, respectively. These credit losses are included in processing and servicing costs in the Company s consolidated statements of income.

The loss recorded by the Company for chargebacks associated with any individual merchant is typically small, due both to the relatively small size and the processing profile of the Company s SME merchants. However, from time to time the Company will encounter instances of merchant fraud, and the resulting chargeback losses may be considerably more significant to the Company. The Company has established a contingent reserve for estimated currently existing credit and fraud losses on its consolidated balance sheets, amounting to $1,157,000 on June 30, 2009 and $1,097,000 on December 31, 2008. This reserve is determined by performing an analysis of the Company s historical loss experience applied to current processing volume and exposures.

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A summary of the activity in the loss reserve for the three and six month periods ended June 30, 2009 and 2008 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Beginning balance	**$ 1,122**	$ 737	**$ 1,097**	$ 663
Additions to reserve	**1,674**	1,288	**3,203**	2,767
Charges against reserve (a)	**(1,639)**	(1,284)	**(3,143)**	(2,689)
Ending balance	**$ 1,157**	$ 741	**$ 1,157**	$ 741

(a) Included in these amounts are payroll segment losses of $23,000 and $19,000, respectively, for the three months ended June 30, 2009 and 2008, and $101,000 and $39,000, respectively, for the six months ended June 30, 2009 and 2008.

Chargebacks originating from large national merchant bank card processing are processed and carried by Fifth Third Bank, which is the Company s third-party outsourced processor for settling large national merchant accounts.

9. Accrued Buyout Liability

A summary of the accrued buyout liability was as follows as of June 30, 2009 and December 31, 2008:

	June 30, 2009	December 31, 2008
	(In thousands)	
Vested Relationship Managers and sales managers	**$ 39,605**	$ 39,879
Unvested Relationship Managers and sales managers	**1,607**	1,161
	41,212	41,040
Less current portion	**(9,726)**	(10,547)
Long-term portion of accrued buyout liability	**$ 31,486**	$ 30,493

In calculating the accrued buyout liability for unvested Relationship Managers and sales managers at June 30, 2009 and December 31, 2008, the Company has assumed that 31% of the unvested Relationship Managers and sales managers will vest in the future, which represents the Company s historical vesting rate. A 5% increase to 36% in the expected vesting rate would have increased the accrued buyout liability for unvested Relationship Managers and sales managers by $0.2 million at June 30, 2009 and December 31, 2008.

A summary of the activity in the accrued buyout liability for the three and six month periods ended June 30, 2009 and 2008 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
		(In thousands)		
Beginning balance	**$ 40,709**	$ 39,226	**$ 41,040**	$ 37,773
Increase in settlement obligation, net	**2,694**	2,835	**5,076**	5,498
Buyouts	**(2,191)**	(2,040)	**(4,904)**	(3,250)
Ending balance	**$ 41,212**	$ 40,021	**$ 41,212**	$ 40,021

The increase in the settlement obligation is due to new SME merchant account signings, as well as same-store sales growth, if any, and changes in gross margin, partially offset by the impact of SME merchant attrition.

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10. Credit Facility

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

The Amended and Restated Credit Agreement provides for a revolving credit facility in the aggregate amount of up to $50 million (the Revolving Credit Facility), of which up to $5 million may be used for the issuance of letters of credit and up to $5 million is available for swing line loans. Upon the prior approval of the administrative agent, the Company may increase the total commitments by $25 million for a total commitment under the Revolving Credit Facility of $75 million. The Revolving Credit Facility is available to the Company on a revolving basis commencing on May 30, 2008 and ending on September 4, 2012.

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

Twelve Months Ended June 30,	(In thousands)
2010	$ 8,333
2011	8,333
2012	4,167
	$ 20,833

The Amended and Restated Credit Agreement contains covenants, which include the maintenance of certain leverage and fixed charge coverage ratios, limitations on the Company s indebtedness, liens on its properties and assets, investments in, and loans to, other business units, the Company s ability to enter into business combinations and asset sales, and certain other financial and non-financial covenants. In accordance with the August 3, 2009 amendment to the Amended and Restated Credit Agreement, the Company was in compliance with these covenants as of June 30, 2009.

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

The Revolving Credit Facility may be used to finance future construction projects and acquisitions in accordance with the terms of the Credit Agreement and for other working capital needs and general corporate purposes. On May 30, 2008, the Company borrowed $50 million under the Revolving Credit Facility and $25 million under the Term Credit Facility. All of the proceeds of both such borrowings were applied to finance and pay expenses related to the acquisition of certain assets from ADS Alliance Data Systems, Inc., as described in more detail in Note 3. At June 30, 2009, there was $50.0 million outstanding under the Revolving Credit Facility and $20.8 million outstanding under the Term Credit

Facility. The weighted average interest rate at June 30, 2009 was 0.93%. Total fees and direct costs paid for the Amended and Restated Credit Agreement through June 30, 2009 were $306,000. These costs are being amortized to interest expense over the life of the Amended and Restated Credit Agreement.

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11. Stockholders Equity

Common Stock Repurchases. On January 13, 2006, the Company s Board of Directors authorized management to repurchase up to the lesser of (a) 1,000,000 shares of the Company s common stock or (b) $25,000,000 worth of its common stock in the open market. On August 1, 2006, the Company s Board of Directors authorized management to repurchase up to an additional 1,000,000 shares of its common stock in the open market using the proceeds from the exercise of stock options.

On May 3, 2007, the Company s Board of Directors eliminated the restriction in the August 1, 2006 repurchase authorization which required the Company to use only proceeds from the issuance of stock options for repurchases, and increased the total authorized number of shares to be repurchased to 2,000,000. Management intends to use these authorizations to repurchase shares opportunistically as a means of offsetting dilution from shares issued upon the exercise of options under employee benefit plans, and to use cash to take advantage of declines in the Company s stock price. Management has no obligation to repurchase shares under the authorization, and the specific timing and amount of the stock repurchase will vary based on market conditions, securities law limitations and other factors.

Under these authorizations, the Company repurchased an aggregate of 2,924,684 shares of its common stock at a cost of $65.1 million, or an average cost of $22.25 per share. This includes 350,400 shares repurchased at a cost of $3.2 million, or $9.14 per share during the six months ended June 30, 2009 and 781,584 shares repurchased at a cost of $18.0 million, or $23.02 per share during the six months ended June 30, 2008.

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

Dividends on Common Stock. During the six months ended June 30, 2009 and the twelve months ended December 31, 2008, the Company s Board of Directors declared the following quarterly cash dividends on common stock:

Date Declared	Record Date	Date Paid	Amount Paid Per Common Share	
Six Months Ended June 30, 2009:				
February 20, 2009	March 9, 2009	March 16, 2009	$	0.025
May 7, 2009	May 25, 2009	June 15, 2009	$	0.01
Twelve Months Ended December 31, 2008:				
February 13, 2008	February 28, 2008	March 15, 2008	$	0.09
April 30, 2008	May 23, 2008	June 15, 2008	$	0.09
August 5, 2008	August 22, 2008	September 15, 2008	$	0.09
November 4, 2008	November 24, 2008	December 15, 2008	$	0.09

On August 3, 2009, the Company s Board of Directors declared a quarterly cash dividend of $0.01 per share of common stock, payable on September 15, 2009 to stockholders of record as of August 25, 2009.

12. Commitments and Contingencies

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

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

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

Future minimum lease commitments under non-cancelable leases as of June 30, 2009 were as follows:

	(In thousands)	
Twelve Months Ended June 30,	**Capital Leases**	**Operating Leases**
2010	$ 243	$ 4,514
2011	194	3,417
2012	9	2,149
2013		1,769
2014		1,307
Thereafter		2,584
Total Minimum Payments	446	$ 15,740
Interest Amount	(40)	
Present Value of Minimum Payments	$ 406	

Rent expense for leased property was $760,000 and $796,000, respectively, for the three months ended June 30, 2009 and 2008, and $1.6 million and $1.2 million, respectively, for the six months ended June 30, 2009 and 2008.

Commitments Robert O. Carr, the Company s Chairman and Chief Executive Officer, has entered into an amendment to his employee confidential information and non-competition agreement under which he is entitled to severance pay equal to his base salary and medical benefits for 24 months (or 12 months if upon a change in control of the Company) and a pro-rated bonus in the event he is terminated by the Company other than for cause. Certain other officers of the Company have entered into an employee confidential information and non-competition agreement under which they are entitled to severance pay equal to their base salary and medical benefits for 12 months and a pro-rated bonus in the event they are terminated by the Company other than for cause. There were no payouts under these agreements in 2008 or 2009.

The following table reflects the Company s other significant contractual obligations, including leases from above, as of June 30, 2009:

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 year**	**1 to 3 Years**	**3 to 5 years**	**More than 5 years**
			(In thousands)		
Processing providers (a)					