VERIFONE SYSTEMS, INC.
Form 10-Q
June 07, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended April 30, 2016
Or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 001-32465
VERIFONE SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

Delaware	04-3692546
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

88 West Plumeria Drive
San Jose, CA 95134
(Address of principal executive offices with zip code)
(408) 232-7800
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ 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 þ 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 þ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ
The number of shares outstanding of each of the issuer's classes of common stock, as of the close of business on May 31, 2016
Class

	Number of shares
Common Stock, $0.01 par value per share	110,549,555

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VERIFONE SYSTEMS, INC.

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PART I — FINANCIAL INFORMATION

PART I — FINANCIAL INFORMATION

ITEM 1.FINANCIAL STATEMENTS (Unaudited)

VERIFONE SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended April 30,		Six Months Ended April 30,	
	2016	2015	2016	2015
	(Unaudited, in thousands, except per share data)			
Net revenues:				
Systems	$342,443	$324,300	$680,035	$637,700
Services	183,835	165,844	359,782	338,670
Total net revenues	526,278	490,144	1,039,817	976,370
Cost of net revenues:				
Systems	200,544	188,972	395,349	374,640
Services	115,355	97,269	218,804	198,657
Total cost of net revenues	315,899	286,241	614,153	573,297
Total gross margin	210,379	203,903	425,664	403,073
Operating expenses:				
Research and development	54,715	47,579	106,383	96,482
Sales and marketing	59,027	55,371	113,976	112,781
General and administrative	54,884	49,457	107,710	96,807
Litigation settlement and loss contingency expense	—	1,213	—	1,213
Amortization of purchased intangible assets	21,974	20,567	41,600	42,899
Total operating expenses	190,600	174,187	369,669	350,182
Operating income	19,779	29,716	55,995	52,891
Interest expense, net	(8,543)	(7,432)	(16,847)	(15,327)
Other income (expense), net	(4,809)	(3,169)	(6,989)	(2,926)
Income before income taxes	6,427	19,115	32,159	34,638
Income tax provision	3,087	1,449	5,086	2,844
Consolidated net income	3,340	17,666	27,073	31,794
Net income attributable to noncontrolling interests	(441)	(102)	(673)	(382)
Net income attributable to VeriFone Systems, Inc. stockholders	$2,899	$17,564	$26,400	$31,412
Net income per share attributable to VeriFone Systems, Inc. stockholders:				
Basic	$0.03	$0.15	$0.24	$0.28
Diluted	$0.03	$0.15	$0.24	$0.27
Weighted average number of shares used in computing net income per share attributable to VeriFone Systems, Inc. stockholders:				
Basic	110,314	113,940	110,808	113,688
Diluted	111,314	115,900	111,889	115,727

The accompanying notes are an integral part of these condensed consolidated financial statements.

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VERIFONE SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended April 30,		Six Months Ended April 30,	
	2016	2015	2016	2015
	(Unaudited, in thousands)			
Consolidated net income	$3,340	$17,666	$27,073	$31,794
Other comprehensive income (loss):				
Foreign currency translation adjustments	60,279	(30,260)	22,050	(164,164)
Unrealized gain (loss) on derivatives designated as cash flow hedges				
Change in unrealized loss on derivatives designated as cash flow hedges, net of tax	(374)	(213)	(2,061)	(4,400)
Amounts reclassified from Accumulated other comprehensive loss, net of tax	952	872	2,114	1,572
Net change in unrealized gain (loss) on derivatives designated as cash flow hedges	578	659	53	(2,828)
Net change in other	25	27	51	54
Other comprehensive income (loss)	60,882	(29,574)	22,154	(166,938)
Total comprehensive income (loss)	64,222	(11,908)	49,227	(135,144)
Less: net income attributable to noncontrolling interests	(441)	(102)	(673)	(382)
Comprehensive income (loss) attributable to VeriFone Systems, Inc. stockholders	$63,781	$(12,010)	$48,554	$(135,526)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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VERIFONE SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	April 30, 2016	October 31, 2015
	(Unaudited, in thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$156,569	$208,870
Accounts receivable, net of allowances of $12,280 and $8,752, respectively	397,429	361,988
Inventories	154,575	129,716
Prepaid expenses and other current assets	132,041	81,690
Total current assets	840,614	782,264
Property and equipment, net	217,177	190,965
Purchased intangible assets, net	368,017	317,517
Goodwill	1,164,744	1,084,031
Deferred tax assets, net	37,964	35,896
Other long-term assets	79,870	62,389
Total assets	$2,708,386	$2,473,062
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$217,493	$189,354
Accruals and other current liabilities	228,501	229,900
Deferred revenue, net	112,922	82,899
Short-term debt	55,296	39,088
Total current liabilities	614,212	541,241
Long-term deferred revenue, net	61,711	55,322
Deferred tax liabilities, net	113,508	102,921
Long-term debt	899,456	760,241
Other long-term liabilities	88,142	78,896
Total liabilities	1,777,029	1,538,621
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: $0.01 par value, 10,000 shares authorized, no shares issued and outstanding	—	—
Common stock: $0.01 par value, 200,000 shares authorized, 110,525 and 112,684 shares issued and outstanding as of April 30, 2016 and October 31, 2015, respectively	1,105	1,125
Additional paid-in capital	1,749,369	1,726,416
Accumulated deficit	(582,658)	(535,716)
Accumulated other comprehensive loss	(270,167)	(292,321)
Total VeriFone Systems, Inc. stockholders' equity	897,649	899,504
Noncontrolling interests in subsidiaries	33,708	34,937
Total equity	931,357	934,441
Total liabilities and equity	$2,708,386	$2,473,062

The accompanying notes are an integral part of these condensed consolidated financial statements.

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VERIFONE SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended April 30,	
	2016	2015
	(Unaudited, in thousands)	
Cash flows from operating activities		
Consolidated net income	$27,073	$31,794
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization, net	85,581	86,336
Stock-based compensation expense	22,039	21,027
Deferred income taxes, net	(5,103)	(7,216)
Other	6,227	10,019
Net cash provided by operating activities before changes in operating assets and liabilities	135,817	141,960
Changes in operating assets and liabilities:		
Accounts receivable, net	(12,602)	(35,249)
Inventories	(23,416)	(11,665)
Prepaid expenses and other assets	(24,221)	(19,295)
Accounts payable	26,015	17,331
Deferred revenue, net	30,882	12,656
Other current and long-term liabilities	(18,371)	(8,320)
Net change in operating assets and liabilities	(21,713)	(44,542)
Net cash provided by operating activities	114,104	97,418
Cash flows from investing activities		
Capital expenditures	(58,345)	(48,873)
Acquisition of businesses, net of cash acquired	(169,712)	(10,944)
Other investing activities, net	83	60
Net cash used in investing activities	(227,974)	(59,757)
Cash flows from financing activities		
Proceeds from debt, net of issuance costs	380,363	30,000
Repayments of debt	(238,616)	(70,204)
Proceeds from issuance of common stock through employee equity incentive plans	2,458	9,477
Stock repurchases	(79,866)	—
Other financing activities, net	(3,389)	(2,215)
Net cash provided by (used in) financing activities	60,950	(32,942)
Effect of foreign currency exchange rate changes on cash and cash equivalents	619	(20,687)
Net decrease in cash and cash equivalents	(52,301)	(15,968)
Cash and cash equivalents, beginning of period	208,870	250,187
Cash and cash equivalents, end of period	$156,569	$234,219

The accompanying notes are an integral part of these condensed consolidated financial statements.

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Unaudited

Note 1. Principles of Consolidation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of VeriFone Systems, Inc. and our wholly-owned and majority-owned subsidiaries and have been prepared in accordance with U.S. GAAP for interim financial information and with the instructions on Form 10-Q pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. The Condensed Consolidated Balance Sheet at October 31, 2015 has been derived from the audited Consolidated Balance Sheet at that date. All significant inter-company accounts and transactions have been eliminated. In accordance with the rules and regulations, we have omitted certain information and notes normally provided in our annual consolidated financial statements. In the opinion of management, the unaudited Condensed Consolidated Financial Statements contain all adjustments, consisting only of normal recurring items, necessary for the fair presentation of our financial position and results of operations for the interim periods. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2015. The results of operations for the three and six months ended April 30, 2016 are not necessarily indicative of the results expected for the entire fiscal year.

During December 2015, our Chief Executive Officer realigned the company's organizational structure to focus on two global product lines: Verifone Systems and Verifone Services. Verifone Systems delivers point of sale electronic payment devices that run our unique operating systems, security and encryption software, and certified payment software for both payments and commerce. Verifone Services delivers device related leasing and maintenance, payment transaction routing and reporting, and commerce based services such as advertising on digital screens. As a result of this organizational change, our reportable segments shifted from geographic-based segments to two global product segments effective for the first quarter of 2016. We determine our operating segments considering our overall management structure, how forecasts are approved, how executive compensation is determined, our organizational chart, as well as how our Chief Executive Officer, who is our chief operating decision maker, regularly reviews our operating results, assesses performance, allocates resources, and makes decisions regarding VeriFone's operations. Our reportable segments are the same as our operating segments. All prior period amounts reported by geographic segment have been reclassified to conform to the current presentation. See Note 12, Segment Information, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q for additional information.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions about future events that affect the amounts reported in our consolidated financial statements and accompanying notes. We evaluate our estimates on an ongoing basis when updated information related to such estimates becomes available. We base our estimates on historical experience and information available to us at the time these estimates are made. Actual results could differ materially from these estimates.

Significant Accounting Policies

During the three and six months ended April 30, 2016, there have been no changes in our significant accounting policies as described in our Annual Report on Form 10-K for the fiscal year ended October 31, 2015.

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Concentrations of Credit Risk

For the three and six months ended April 30, 2016 and 2015, no single customer accounted for more than 10% of our total Net revenues. As of April 30, 2016 and October 31, 2015 no single customer accounted for more than 10% of our total Accounts receivable, net.

Recent Accounting Pronouncements

During May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, as amended by ASU 2015-14, 2016-08, 2016-10, and 2016-12, which provides new guidance on the recognition of revenue and states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted as of reporting periods beginning after December 15, 2016. We are currently evaluating our adoption timing, the transition method we will use and the impact of this new pronouncement on our consolidated financial position and results of operations.

During January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities, which provides new guidance on the recognition, measurement, presentation, and disclosure of financial assets and liabilities. The standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted only for certain provisions. We are currently in the process of evaluating the impact of this new pronouncement on our consolidated financial position and results of operations.

During February 2016, the FASB issued ASU 2016-02, Leases, which increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. In connection with this new guidance, the FASB created Topic 842, Leases, which supersedes Topic 840, Leases. The standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients. Transition will require application of the new guidance at the beginning of the earliest comparative period presented. We are currently in the process of evaluating the impact of this new pronouncement on our consolidated financial position and results of operations.

During March 2016, the FASB issued ASU 2016-07, Investments - Equity Method and Joint Ventures, which eliminates the requirement to retrospectively apply the equity method in previous periods when an investor initially obtains significant influence over a previously held investment and requires the investor to apply the equity method prospectively from the date the investment qualifies for the equity method. The standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted for any interim and annual financial statements that have not yet been issued. We are currently in the process of evaluating the impact of this new pronouncement on our consolidated financial position and results of operations.

During March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation, to simplify various aspects related to how share-based payments are accounting for and presented in the financial statements, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted for any interim and annual financial statements that have not yet been issued, however, all of the guidance must be adopted in the same period. The new standard must be adopted either prospectively, retrospectively, or using a modified retrospective transition method, depending on the area covered in this ASU. We are currently in the process of evaluating the impact of this new pronouncement on our consolidated financial position and results of operations.

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 2. Business Combinations

Fiscal Year 2016 Acquisitions

On December 23, 2015, we acquired InterCard AG, a leading payment services provider in Germany, in exchange for 85.0 million Euro in cash paid on the acquisition date (approximately $92.4 million at the foreign exchange rate on the acquisition date) plus 1.2 million Euro (approximately $1.4 million at the foreign exchange rate as of April 30, 2016), that is due in the third quarter of fiscal 2016. The acquisition was accounted for using the acquisition method of accounting, and the results of InterCard are included in our financial results as of the acquisition date. We acquired InterCard to expand our services offerings in Germany. Tangible assets acquired, net of liabilities assumed, totaled $3.5 million. Purchased intangible assets, which have a weighted-average amortization useful life of 8.7 years, totaled $42.7 million related to customer relationships, $7.8 million related to developed and core technology, and $2.2 million related to other intangible assets. Goodwill from the acquisition totaled $37.6 million, was assigned to our Verifone Services reportable segment, and will not be deductible for income tax purposes. The primary areas of the preliminary purchase price allocation that have not yet been finalized are the fair value of income and non-income based taxes, and residual goodwill.

On February 2, 2016, we acquired AJB Software Design Inc., a Toronto-based provider of payment gateway and switching solutions for large merchants in the U.S. and Canada, for purchase consideration totaling approximately $87.5 million in cash and tax liabilities incurred, subject to certain upward adjustments, plus up to $10.0 million of additional contingent consideration with a fair value of $1.4 million at the acquisition date. This acquisition was accounted for using the acquisition method of accounting, and the results of AJB are included in our financial results as of the acquisition date. We acquired AJB to expand our suite of services offerings. Tangible assets acquired, net of liabilities assumed, totaled $17.4 million. Purchased intangible assets, which have a weighted-average amortization useful life of 4.5 years, totaled $27.6 million related to customer relationships, $13.1 million related to developed software technology, and $0.4 million related to other intangible assets. Goodwill from the acquisition totaled $30.4 million, was assigned to our Verifone Services reportable segment, and is partially deductible for income tax purposes. The primary areas of the preliminary purchase price allocation that have not yet been finalized are the fair value of income and non-income based taxes, and residual goodwill.

Fiscal Year 2015 Acquisitions

In fiscal year 2015, we completed five business combinations for consideration totaling $29.6 million, including $22.1 million of cash paid on the relevant acquisition date, $5.7 million in future consideration and contingent consideration with a fair value of $1.8 million at the relevant acquisition date. Each acquisition was accounted for using the acquisition method of accounting. These acquisitions were completed to augment our existing service offerings. Purchased intangible assets totaled $9.0 million related to developed and core technology, $2.8 million related to customer relationships, and $0.5 million related to other intangible assets. Goodwill from these acquisitions totaled $16.6 million, of which $5.1 million will be deductible for income tax purposes.

Note 3. Net Income per Share of Common Stock

Basic net income per share of common stock is computed by dividing net income attributable to VeriFone Systems, Inc. stockholders by the weighted average number of shares of common stock outstanding for the period. Diluted net income per share of common stock is computed using the weighted average number of shares of common stock outstanding plus the effect of common stock equivalents, unless the common stock equivalents are anti-dilutive. The potential dilutive shares of our common stock resulting from assumed exercises of equity related instruments are determined using the treasury stock method. Under the treasury stock method, an increase in the fair market value of our common stock will result in a greater number of dilutive securities.

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table presents the computation of net income per share of common stock (in thousands, except per share data):

	Three Months Ended April 30,		Six Months Ended April 30,	
	2016	2015	2016	2015
Basic and diluted net income per share attributable to VeriFone Systems, Inc. stockholders:				
Numerator:				
Net income attributable to VeriFone Systems, Inc. stockholders	$2,899	$17,564	$26,400	$31,412
Denominator:				
Weighted average shares attributable to VeriFone Systems, Inc. stockholders - basic	110,314	113,940	110,808	113,688
Weighted average effect of dilutive securities:				
Stock options, RSUs and RSAs	1,000	1,960	1,081	2,039
Weighted average shares attributable to VeriFone Systems, Inc. stockholders - diluted	111,314	115,900	111,889	115,727
Net income per share attributable to VeriFone Systems, Inc. stockholders:				
Basic	$0.03	$0.15	$0.24	$0.28
Diluted	$0.03	$0.15	$0.24	$0.27

For the three and six months ended April 30, 2016, equity incentive awards representing 2.6 million shares of common stock were excluded from the calculation of weighted average shares for diluted net income per share as they were anti-dilutive. For the three and six months ended April 30 2015, equity incentive awards representing 1.3 million shares of common stock were excluded from the calculation of weighted average shares for diluted net income per share as they were anti-dilutive. Anti-dilutive awards, which include stock options, RSUs and RSAs, could impact future calculations of diluted net income per share if the fair market value of our common stock increases.

Note 4. Stock Repurchase Program

In September 2015, our Board of Directors authorized a program to repurchase shares of our common stock with an aggregate value of up to $200.0 million, with no expiration from the date of authorization. Shares may be repurchased from time to time in the open market, private purchases, through forward, derivative, accelerated repurchase or automatic repurchase transactions or otherwise. Certain of our share repurchases have been and may from time to time be effected through Exchange Act Rule 10b5-1 repurchase plans. The timing and actual amount of the share repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities, including mergers and acquisitions, market conditions and other factors. We are not obligated to repurchase any specific number of shares under the program and the repurchase program may be modified, suspended or discontinued at any time.

During the six months ended April 30, 2016, we repurchased approximately 2.6 million shares of our common stock on the open market at an average repurchase price of $28.02 per share. There were no stock repurchase activities during the three months ended April 30, 2016. As of April 30, 2016, there was approximately $50.0 million remaining available for stock repurchases under this program.

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 5. Income Taxes

We recorded tax provisions totaling $3.1 million and $1.4 million for the three months ended April 30, 2016 and 2015, respectively. The income tax provisions for the three months ended April 30, 2016 and 2015 are primarily related to foreign taxes and other discrete activity. We recorded tax provisions totaling $5.1 million and $2.8 million for the six months ended April 30, 2016 and 2015, respectively. The income tax provisions for the six months ended April 30, 2016 were primarily related to foreign taxes and other discrete activity. The income tax provisions for the six months ended April 30, 2015 were primarily related to foreign taxes offset by the reversal of unrecognized tax benefits where statutes of limitations expired and audits were settled.

Our total unrecognized tax benefits were approximately $110.8 million as of April 30, 2016. The amount of unrecognized tax benefits could be reduced upon closure of tax examinations or if the statute of limitations on certain tax filings expires without assessment from the relevant tax authorities. We believe that it is reasonably possible that there could be an immaterial reduction in unrecognized tax benefits due to statute of limitation expirations in multiple tax jurisdictions during the next 12 months. Interest and penalties accrued on these uncertain tax positions will also be released upon the expiration of the applicable statute of limitations.

U.S. Internal Revenue Service Tax Audit Assessment

We were audited by the U.S. Internal Revenue Service for fiscal years 2005 through 2010 related to our five year net operating loss carry back for fiscal year 2010. In December 2014 we received a Notice of Proposed Adjustment indicating the denial of our worthless stock deduction of $154.3 million, related to the insolvency of one of our UK subsidiaries, recorded on our 2010 tax return. The impact of the Notice of Proposed Adjustment was the denial of the loss carryback to 2005 and 2006 which resulted in an approximately $25.0 million cash refund and the disallowance of approximately $29.0 million of future tax benefits residing in the NOL carryover which are offset with a valuation allowance. We filed a protest to the Notice of Proposed Assessment in April 2015. In June 2016 we reached a final settlement with the U.S. Internal Revenue Service sustaining our worthless stock deduction at 75% of the originally claimed value. The impact of this settlement will be a reduction in our net operating loss carryforward of $38.6 million and an offsetting reduction of our valuation allowance against the deferred tax asset. The net result will not have a material impact on our financial position or results of operations.

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Israel Tax Audit Assessment

We are currently under audit by the Israeli Tax Authorities for fiscal years 2008 through 2009, and 2011 through 2013. The Israeli Tax Authorities issued a tax assessment in October 2014 for fiscal year 2009 or alternatively for fiscal year 2008 claiming there was a business restructuring that resulted in a transfer of some functions, assets and risks from VeriFone Israel Ltd. to the U.S. parent company that the Israeli Tax Authorities claim was a sale valued at 1.36 billion New Israeli Shekels (approximately $363.5 million at the foreign exchange rate as of April 30, 2016). The Israeli Tax Authorities argued that the claim applies to fiscal year 2009 or alternatively to fiscal year 2008. We filed our objection to the tax assessment in January 2015 and received the Israeli Tax Authorities decision through an Order (a second stage assessment) in January 2016. The Order increased the value of the sale to 2.20 billion New Israeli Shekels in fiscal year 2009 (approximately $587.6 million at the foreign exchange rate as of April 30, 2016) or alternatively 2.23 billion New Israeli Shekels in fiscal year 2008 (approximately $594.4 million at the foreign exchange rate as of April 30, 2016) and contended secondary adjustments relating to a deemed dividend and/or interest.

Based on the Order, these and other claims result in a tax liability and deficiency penalty assessment in the amount of 1.25 billion New Israeli Shekels (approximately $333.1 million at the foreign exchange rate as of April 30, 2016), if the claim was assessed for fiscal year 2009, to 1.47 billion New Israeli Shekels (approximately $391.7 million at the foreign exchange rate as of April 30, 2016) if the claim was assessed for fiscal year 2008, including interest, the required Israeli price index adjustments (referred to as the linkage differentials) and deficiency fines (as applicable) through April 30, 2016. The Israeli Tax Authorities' contention regarding secondary adjustments relating to deemed dividend was not quantified by them.

We continue to believe the Israeli Tax Authorities' assessment position is without merit and plan on appealing the assessment to the district court. We have agreed with the Israeli Tax Authorities to repay our $69.0 million intercompany loan from VeriFone Israel Ltd. to the extent of the amount of a final agreed tax assessment concerning fiscal year 2008 and fiscal year 2009 or a judgment of a district court in an appeal on the decision of the Israeli Tax Authorities in the objection, if any.

Note 6. Balance Sheet and Statement of Operations Details

Inventories

Inventories consisted of the following (in thousands):

	April 30, 2016	October 31, 2015
Raw materials	$33,578	$ 30,297
Work-in-process	1,516	2,588
Finished goods	119,481	96,831
Total inventories	$154,575	$ 129,716

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Accruals and Other Current Liabilities

Accruals and other current liabilities consisted of the following (in thousands):

	April 30, 2016	October 31, 2015
Accrued expenses	$80,990	$ 85,973
Accrued compensation	60,751	69,174
Other current liabilities	86,760	74,753
Total accruals and other current liabilities	$228,501	$ 229,900

Other current liabilities were comprised primarily of sales and value-added taxes payable and accrued warranty.

Accrued Warranty

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

	Six Months Ended April 30,	
	2016	2015
Balance at beginning of period	$16,320	$15,411
Warranty charged to Cost of net revenues	7,156	5,977
Utilization of warranty accrual	(7,348)	(5,434)
Other	124	(869)
Balance at end of period	16,252	15,085
Less: current portion	(12,918)	(12,824)
Long-term portion	$3,334	$2,261

Deferred Revenue, Net

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

	April 30, 2016	October 31, 2015
Deferred revenue	$192,831	$157,747
Deferred cost of revenue	(18,198)	(19,526)
Deferred revenue, net	174,633	138,221
Less: current portion	(112,922)	(82,899)
Long-term portion	$61,711	$55,322

Other Long-Term Liabilities

Other long-term liabilities consisted of the following (in thousands):

	April 30, 2016	October 31, 2015
Unrecognized tax benefits liability, net	$37,663	$ 35,860
Contingent consideration payable	11,760	10,776
Other long-term liabilities	38,719	32,260
Total other long-term liabilities	$88,142	$ 78,896

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Stock-Based Compensation Expense

The following table presents the stock-based compensation expense recognized in our Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended April 30,		Six Months Ended April 30,	
	2016	2015	2016	2015
Cost of net revenues	$880	$409	$1,692	$1,128
Research and development	1,886	1,208	3,794	3,952
Sales and marketing	3,840	3,499	7,099	7,579
General and administrative	4,973	3,756	9,454	8,368
Total stock-based compensation expense	$11,579	$8,872	$22,039	$21,027

Accumulated Other Comprehensive Loss

Activity related to Accumulated other comprehensive loss consisted of the following (in thousands):

	Foreign currency translation adjustments	Unrealized loss on derivatives designated as cash flow hedges (1)	Other (2)	Total
Balance at October 31, 2015	$(286,662)	$(4,409)	$(1,250)	$(292,321)
Gains (losses) before reclassifications, net of tax	22,050	(2,061)	—	19,989
Amounts reclassified from Accumulated other comprehensive loss, net of tax	—	2,114	51	2,165
Other comprehensive gain	22,050	53	51	22,154
Balance at April 30, 2016	$(264,612)	$(4,356)	$(1,199)	$(270,167)

(1) Amounts reclassified from Accumulated other comprehensive loss, net of tax, were recorded in Interest expense, net in the Condensed Consolidated Statements of Operations. The related tax impacts were insignificant.
(2) Amounts reclassified from Accumulated other comprehensive loss, net of tax, were recorded in General and administrative expenses in the Condensed Consolidated Statements of Operations. The related tax impacts were insignificant.

Note 7. Financial Instruments

Fair Value Measurements

Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis

Our financial assets and liabilities consist principally of cash, accounts receivable, accounts payable, debt, foreign exchange forward contracts, interest rate swaps, and contingent consideration payable. We measure and record certain of our financial assets and liabilities at fair value on a recurring basis. The estimated fair value of cash, accounts receivable, and accounts payable approximates their carrying value. The estimated fair value of our debt approximates the carrying value because the interest rate on such debt adjusts to market rates on a periodic basis. Contingent consideration payable, interest rate swaps, and foreign exchange forward contracts are recorded at estimated fair value.

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables present our significant assets and liabilities that are measured at fair value on a recurring basis and their classification within the fair value hierarchy (in thousands). There were no transfers between levels of fair value hierarchy in the six months ended April 30, 2016 and the fiscal year ended October 31, 2015.

	April 30, 2016				October 31, 2015			
	Carrying Value	Level 1	Level 2	Level 3	Carrying Value	Level 1	Level 2	Level 3
Assets								
Other current and long-term assets:								
Derivative financial instruments	$23	$ —	$23	$—	$53	$ —	$53	$—
Total assets measured and recorded at fair value	$23	$ —	$23	$—	$53	$ —	$53	$—
Liabilities								
Other current and long-term liabilities:								
Contingent consideration payable	$14,657	$ —	$—	$14,657	$12,786	$ —	$—	$12,786
Derivative financial instruments	4,477	—	4,477	—	4,784	—	4,784	—
Total liabilities measured and recorded at fair value	$19,134	$ —	$4,477	$14,657	$17,570	$ —	$4,784	$12,786

Fair Value of Contingent Consideration Payable

The following table presents changes in our contingent consideration payable which is categorized in Level 3 of the fair value hierarchy for the six months ended April 30, 2016 (in thousands):

Balance at beginning of period	$12,786
Additions	1,389
Payments	(207)
Changes in estimates, included in Other income (expense), net	(317)
Interest expense, net	1,006
Balance at end of period	$14,657

Contingent consideration payable is comprised substantially of amounts payable for acquired media contracts. The contingent consideration payable is classified as Level 3 because we use significant unobservable inputs to determine the expected payments and an appropriate discount rate to calculate the fair value. The significant unobservable inputs we use include our estimate of the future net revenues we expect to generate from the acquired media contracts, the probability of achieving those revenues, and the revenue share rate for a media contract. The discount rate used to determine the fair value of the contingent consideration payable is 18.5%. The maximum liability on contingent consideration payable is indeterminate because it is based on future revenues generated from the acquired business. We evaluate changes in the assumptions used to calculate the fair value of contingent consideration payable at the end of each period.

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Derivative Financial Instruments

Interest Rate Swap Agreements Designated as Cash Flow Hedges

We use interest rate swap agreements to hedge the variability in cash flows related to interest payments. As of April 30, 2016, we had outstanding interest rate swap agreements to effectively convert $500.0 million of the term A loan from a floating rate plus applicable margin to a 1.20% fixed rate plus applicable margin. The principal amount under the term A loan covered by the new interest rate swap agreements will decrease to $450.0 million from April 1, 2017 through September 30, 2017, and $400.0 million from October 1, 2017 through March 30, 2018. The swap agreements expire March 30, 2018.

The interest rate swaps qualify for hedge accounting treatment as cash flow hedges. The notional amounts of interest rate swap agreements outstanding as of April 30, 2016 and October 31, 2015 were each $500.0 million.

Gains and losses arising from the effective portion of interest rate swap agreements are recorded in Accumulated other comprehensive loss, and are subsequently reclassified into earnings in the period or periods during which the underlying transactions affect earnings. As of April 30, 2016, the estimated net derivative loss related to our cash flow hedges included in Accumulated other comprehensive loss that will be reclassified into earnings in the next 12 months is $3.0 million.

Foreign Exchange Forward Contracts Not Designated as Hedging Instruments

We arrange and maintain foreign exchange forward contracts so as to yield gains or losses to offset changes in foreign currency denominated assets or liabilities due to changes in foreign exchange rates, with the objective to mitigate the volatility associated with foreign currency transaction gains or losses. Our foreign currency exposures are predominantly inter-company receivables and payables arising from product sales and loans from one of our entities to another. Our foreign exchange forward contracts generally mature within 90 days. The notional amounts of such contracts outstanding as of April 30, 2016 and October 31, 2015 were $184.1 million and $219.6 million, respectively.

We recognized the following gains (losses) on foreign exchange forward contracts not designated as cash flow hedges (in thousands):

	Three Months Ended April 30,		Six Months Ended April 30,	
	2016	2015	2016	2015
Gains (losses) recognized in Other income (expense), net in our Condensed Consolidated Statements of Operations	$(2,689)	$(631)	$1,621	$10,903

Note 8. Goodwill and Purchased Intangible Assets

Goodwill

Activity related to goodwill by reportable segment for the six months ended April 30, 2016 consisted of the following (in thousands):

	Verifone Systems	Verifone Services	Total
Balance at beginning of period	$512,182	$571,849	$1,084,031
Acquisitions	—	68,010	68,010

Other adjustments	—	(762)	(762)
Currency translation adjustments	4,946	8,519	13,465
Balance at end of period	$517,128	$647,616	$1,164,744

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VERIFONE SYSTEMS, INC.
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As a result of the change to our two new operating segments in December 2015, we have realigned our reporting units. Verifone Systems represents one reporting unit, and Verifone Services is comprised of two reporting units, Taxi Solutions and Verifone Payment Services. In connection with this reporting unit realignment, during the three months ended January 31, 2016, we also updated our goodwill impairment assessment based on a quantitative analysis. We first evaluated the goodwill of our reporting units immediately prior the realignment and concluded that there was no impairment. We then allocated our goodwill to the new reporting units using a relative fair value approach, and re-confirmed that there is no impairment.

Based on our review for potential indicators of impairment performed during the three months ended April 30, 2016 and the fiscal year ended October 31, 2015, there were no indicators of impairment. During the fourth quarter of fiscal year 2016, we will perform our annual goodwill impairment assessment.

Purchased Intangible Assets, Net

Purchased Intangible assets, net consisted of the following (in thousands):

	April 30, 2016			October 31, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	$662,417	$(333,778)	$328,639	$591,930	$(298,812)	$293,118
Other	105,606	(66,228)	39,378	115,143	(90,744)	24,399
Total	$768,023	$(400,006)	$368,017	$707,073	$(389,556)	317,517

Other intangible assets, net, were comprised primarily of developed and core technology and trade names.

Activity related to purchased intangible assets during the six months ended April 30, 2016 includes a $12.2 million currency translation adjustment to Gross carrying amount and a $6.0 million currency translation adjustment to Accumulated amortization.

Amortization of purchased intangible assets was allocated as follows (in thousands):

	Three Months Ended April 30,		Six Months Ended April 30,	
	2016	2015	2016	2015
Included in Cost of net revenues	$3,820	$4,609	$7,809	$9,269
Included in Operating expenses	21,974	20,567	41,600	42,899
Total amortization of purchased intangible assets	$25,794	$25,176	$49,409	$52,168

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VERIFONE SYSTEMS, INC.
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Total future amortization expense for purchased intangible assets that have finite lives, based on our existing intangible assets and their current estimated useful lives as of April 30, 2016, is estimated as follows (in thousands):

	Cost of Net Revenues	Operating Expenses	Total
Fiscal Years Ending October 31:			
Remaining of fiscal year 2016	$ 7,667	$44,853	$52,520
2017	8,379	66,555	74,934
2018	6,205	59,906	66,111
2019	4,911	56,306	61,217
2020	3,248	39,012	42,260
Thereafter	3,464	67,511	70,975
Total future amortization expense	$ 33,874	$334,143	$368,017

Note 9. Financings

Amounts outstanding under our financing arrangements consisted of the following (in thousands):

	April 30, 2016	October 31, 2015
Credit Agreement		
Term A loan	$547,500	$562,500
Term B loan	196,500	197,500
Revolving loan	218,237	54,000
Capital leases and other debt	5,435	342
Total principal payments due	967,672	814,342
Less: original issue discount and debt issuance cost	(12,920)	(15,013)
Total amounts outstanding	954,752	799,329
Less: current portion	(55,296)	(39,088)
Long-term portion	$899,456	$760,241

Credit Agreement

Key terms of our credit agreement include financial maintenance covenants and certain representations, warranties, covenants, and conditions that are customarily required for similar financings. We were in compliance with all financial covenants under our credit agreement as of April 30, 2016.

Borrowings under the credit agreement may be “Base Rate Borrowings” or “Eurodollar Borrowings” at our option. As of April 30, 2016, we have elected the Eurodollar option for all of our borrowings. Eurodollar loans bear interest at a monthly market interest rate plus a margin according to the credit agreement. As of April 30, 2016, the monthly market interest rate was 0.44% for our term A and revolver loans, and 0.75% for our term B loan, and the margins were 1.75% for our term A and revolver loans and 2.75% for our term B loan. Accordingly, as of April 30, 2016, the interest rate was 2.19% for the term A and revolving loans and 3.50% for the term B loan.

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We have a number of interest rate swap agreements under which we pay banks a fixed rate of 1.20% and receive a monthly floating rate, which effectively converts $500.0 million of the term A loan from a floating interest rate to a fixed interest rate as of April 30, 2016.

As of April 30, 2016, the commitment fee for the unused portion of the revolving loan was 0.250% per annum, payable quarterly in arrears, and the amount available to draw under the revolving loan was $281.8 million.

Capital Lease

In February 2016, we entered into a $15.0 million capital leasing facility. As of April 30, 2016, we leased approximately $4.5 million under this arrangement.

Note 10. Restructurings

As part of cost optimization and corporate transformation initiatives, our management has approved, committed to and initiated restructuring plans to reduce headcount, and consolidate facilities and data centers. Plans initiated in 2014 and 2015 are expected to be substantially complete by the end of fiscal year 2016.

Activity related to our restructuring plans for the six months ended April 30, 2016 consisted of the following (in thousands):

	Restructuring Plans			
	June 2014 Plan		July 2015 Plan	
	Employee Involuntary Termination Benefits	Facilities Related Costs	Employee Involuntary Termination Benefits	Total
Balance at October 31, 2015	$1,027	$ 5	$ 5,090	$6,122
Charges, net of adjustments	734	—	(256)	478
Cash payments	(567)	(5)	(3,168)	(3,740)
Balance at April 30, 2016	$1,194	$ —	$ 1,666	$2,860
Cumulative costs to date	$12,957	$ 853	$ 7,087	

The following table presents the restructuring expense recognized in our Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended April 30,		Six Months Ended April 30,	
	2016	2015	2016	2015
Cost of net revenues	$(28)	$(48)	$(89)	$35
Research and development	595	32	628	154
Sales and marketing	(13)	108	(483)	793
General and administrative	21	69	422	552
Total restructuring expense	$575	$161	$478	$1,534

Note 11. Commitments and Contingencies

Commitments

There have been no material changes to our leases and manufacturing agreements since October 31, 2015.

Bank Guarantees

We have issued bank guarantees with maturities ranging from two months to six years to certain of our customers and vendors as required in some countries to support certain performance obligations under our service or other agreements with those parties. As of April 30, 2016, the maximum amount that may become payable under these guarantees was $11.9 million, of which $1.4 million was collateralized by restricted cash deposits.

Contingencies

We evaluate the circumstances regarding outstanding and potential litigation and other contingencies on a quarterly basis to determine whether there is at least a reasonable possibility that a loss exists requiring accrual or disclosure, and if so, whether an estimate of the possible loss or range of loss can be made, or whether such an estimate cannot be made. When a loss is probable and reasonably estimable, we accrue for such amount based on our estimate of the probable loss considering information available at the time. When a loss is reasonably possible, we disclose the estimated possible loss or range of loss in excess of amounts accrued if material. Except as otherwise disclosed below, we do not believe that material losses were probable or that there was a reasonable possibility that a material loss may have been incurred with respect to the matters disclosed.

Brazilian Tax Assessments

State Value-Added Tax

The Brazilian subsidiary we acquired as part of our acquisition of Hypercom in August 2011 received an unfavorable administrative decision on a tax enforcement action against it filed by the São Paulo State Revenue Department for collection of state sales taxes related to purported sales of software for the 1998 and 1999 tax years. In 2004, an appeal against this unfavorable administrative decision was filed in a judicial proceeding. The first level decision in the judicial proceeding was issued in our favor. The São Paulo State Revenue Department filed an appeal of this decision. The second level administrative decision ordered that the case be returned to the lower court in order to allow the production of further evidence. Based on our current understanding of the underlying facts of this matter, we believe it is reasonably possible that we may receive an unfavorable decision in this proceeding. The tax assessment including estimated interest through April 30, 2016 for this matter totals approximately 8.8 million Brazilian reais (approximately $2.5 million at the foreign exchange rate as of April 30, 2016). As of April 30, 2016, we have not accrued for this matter, but we have posted a bank bond as a guaranty.

Federal Tax Assessments

Brazilian Federal Tax Amnesty

In December 2013, without admitting any fault or liability, we elected to enroll certain of our pending Brazilian tax assessments in the Brazilian Federal Tax Amnesty Program created by Law n. 11.941/2009 in 2009 and reopened for enrollment from October 2013 to December 2013, known as the “REFIS Amnesty.” The REFIS Amnesty is a program administered by the Brazilian tax authorities and allows entities charged with tax assessments that fall within the program's scope to voluntarily settle such assessments with certain discounts applied to the amounts due. After conducting an evaluation of our existing Brazilian federal tax assessments and the terms offered by the REFIS Amnesty, we determined to voluntarily settle a number of our pending assessments.

Tax assessment matters that fall within the REFIS Amnesty's scope are generally listed in the program's web-based portal for enrollment. Although no formal acceptance by the tax authorities is issued at the time of our enrollment of a matter, we expect the tax authorities to confirm our enrollment as they complete their process to formally consolidate the matters we enrolled in the REFIS Amnesty. In connection with our enrollment of the tax assessments into the REFIS Amnesty, we were required to forgo any further legal defense or proceedings with respect to the merits of such assessments. In exchange, the enrolled assessments were closed and we were granted discounts on our payment of the related accrued interest and penalties and are able to pay under an installment plan, subject to our compliance with the terms of the program. For certain assessments, existing net operating loss carryforwards, or net operating losses, may be used to satisfy a portion of the settlement obligation. Under the terms of the REFIS Amnesty, our right to fund the settlement through the installment payment plan would be canceled after three instances of our not timely paying the installment amounts as scheduled, in which case the full amounts of the original tax debts, including interest and penalties without the benefit of discount, would become immediately due and payable. We have included the terms and amounts below for those assessments that we have placed into the REFIS Amnesty.

Federal Tax Assessments related to Brazilian Subsidiaries from Lipman Acquisition

Two of our Brazilian subsidiaries that were acquired as a part of the November 2006 acquisition of Lipman Electronic Engineering Ltd. (“Lipman”) were notified of assessments regarding Brazilian customs penalties that relate to alleged infractions in the importation of goods. The assessments were issued by the Federal Revenue Department in the City of Vitória, the City of São Paulo, and the City of Itajai. In each of these cases, the tax authorities allege that the structure used for the importation of goods was simulated with the objective of evading taxes levied on the importation by under-invoicing the imported goods. The tax authorities allege that the simulation was created through an interposition of parties and that the real sellers and buyers of the imported goods were hidden. In February 2013, the São Paulo assessment was canceled following a favorable second level decision that was not appealed.

In the Vitória tax assessment, the fines were reduced from 4.7 million Brazilian reais (approximately $1.3 million at the foreign exchange rate as of April 30, 2016) to 1.5 million Brazilian reais (approximately $410,000 at the foreign exchange rate as of April 30, 2016) on a first level administrative decision on January 26, 2007. Both we and the tax authorities filed appeals of the first level administrative decision. In this appeal, we argued that the tax authorities did not have enough evidence to determine that the import transactions were indeed fraudulent and that, even if there were some irregularities in such importations, they could not be deemed to be our responsibility since all the transactions were performed by the third-party importer of the goods. On June 30, 2010, the Taxpayers Administrative Council of Tax Appeals decided to reinstate the original claim amount of 4.7 million Brazilian reais (approximately $1.3 million at the foreign exchange rate as of April 30, 2016) against us. On February 27, 2013, the Taxpayers Administrative Council of Tax Appeals issued its formal ruling reinstating the original claim amount. On May 31, 2013, we filed a motion to clarify such ruling, which is pending a decision.

In the Itajai tax assessment, we were notified on January 18, 2008, of a first level administrative decision rendered that maintained the total fine of 2.0 million Brazilian reais (approximately $560,000 at the foreign exchange rate as of April 30, 2016) as imposed, excluding interest. On May 27, 2008, we appealed the first level administrative decision to the Taxpayers Council. This matter is pending second level decision.

In December 2013, we sought to enroll the entire amount of tax liabilities in dispute for both the Vitória and Itajai assessments in the REFIS Amnesty. However, because we are named as a jointly-liable party rather than as the primary defendant in these matters, these assessments were not listed in the REFIS Amnesty web-based portal as available for election under the REFIS Amnesty. We believe these matters qualify for inclusion in the REFIS Amnesty and have filed the required notifications to our local tax office and commenced payments to indicate our decision to enroll these matters in the REFIS Amnesty. We expect the tax authorities' confirmation that these matters have been included in the REFIS Amnesty once they complete their procedures to consolidate the enrolled assessments. We elected to make the amnesty payments for these matters in monthly installments over a 30-month period for total payments, inclusive of interest and penalties, of 7.6 million Brazilian reais (approximately $2.1 million at the foreign exchange rate as of April 30, 2016). We accrued the full amount of the payments, plus estimated interest, under the REFIS Amnesty for these matters in December 2013 when we enrolled in the program, and made our first payment on December 26, 2013. As of April 30, 2016, we have remaining installment payments totaling 0.3 million Brazilian reais (approximately $70,000 at the foreign exchange rate as of April 30, 2016).

We had previously accrued the estimated liability for both the Vitória and Itajai assessments. Based on our understanding of the underlying facts of these matters, we believe it is probable we may receive an unfavorable decision for each of these assessments unless we are able to resolve these matters through the REFIS Amnesty. Upon confirmation of acceptance of these matters into the REFIS Amnesty, we will reduce our accrued liabilities related to these matters to reflect the discounted amounts due under the REFIS Amnesty. As of April 30, 2016, we have accruals totaling 12.3 million Brazilian reais (approximately $3.5 million at the foreign exchange rate as of April 30, 2016).

Federal Tax Assessments related to Brazilian Subsidiary from Hypercom Acquisition

The Brazilian subsidiary we acquired as part of our acquisition of Hypercom in August 2011 is the subject of outstanding tax assessments by the federal tax authorities alleging unpaid IRPJ, CSL, COFINS and PIS taxes from 2002 and 2003. The 2002 assessments are the subject of an administrative proceeding and the 2003 assessments are the subject of a civil enforcement action. Three of the four claims for the 2002 assessments were previously settled prior to our acquisition of Hypercom. The first level administrative court issued an unfavorable decision for the remaining claim related to the 2002 tax assessments. Our appeal to the Administrative Tax Appeals Council was denied in December 2013. With respect to the 2003 tax assessments, we received a partially favorable ruling, and our appeal for the remaining assessments is pending decision in the civil courts. In December 2013, we elected to enroll the tax liability for the remaining 2002 assessment in dispute and the portion of the 2003 assessments for which we received an unfavorable ruling in the REFIS Amnesty.

For the 2002 assessment, we applied available net operating losses, to the extent permitted, toward the interest and penalties portion of the settlement obligation under the REFIS Amnesty. For the remaining balance, we elected to make the amnesty payments in monthly installments over a 90-month period for total payments of 2.2 million Brazilian reais (approximately $630,000 at the foreign exchange rate as of April 30, 2016). We accrued the full amount of the payments, plus estimated interest, under the REFIS Amnesty for this matter in December 2013 when we enrolled in the program, and made our first payment on December 26, 2013. In the first quarter of fiscal year 2015, based on new provisions made available under the REFIS Amnesty, we elected to pay all remaining outstanding amounts due under the REFIS Amnesty in relation to the 2002 assessment, and settled such payments using cash and additional available net operating losses.

For the 2003 assessments, we applied available net operating losses, to the extent permitted, toward the interest and penalties portion of the settlement obligation under the REFIS Amnesty. At the time we initially appealed the 2003 assessments to the civil courts, we were required to make a deposit of 2.8 million Brazilian reais (approximately $800,000 at the foreign exchange rate as of April 30, 2016) to the court in order to perfect our appeal. In light of our enrollment of certain of the 2003 assessments in the REFIS Amnesty, we have notified the civil court of our enrollment and requested the release of the portion of the deposit for the assessments enrolled in the REFIS Amnesty, which totals 675,000 Brazilian reais (approximately $190,000 at the foreign exchange rate as of April 30, 2016). Once approved by the court, the released funds will be applied against the settlement obligation under the REFIS Amnesty. Approximately 2.2 million Brazilian reais (approximately $610,000 at the foreign exchange rate as of April 30, 2016) will remain deposited in connection with the 2003 assessments that will continue in the civil courts and which deposits will be released to the prevailing party after resolution of the underlying assessments.

Excluding the assessments that have been enrolled in the REFIS Amnesty for this matter, which have been accrued as described above, and excluding the net operating losses still at issue, the remaining assessments total approximately 3.1 million Brazilian reais (approximately $870,000 at the foreign exchange rate as of April 30, 2016), including estimated penalties and interest, as of April 30, 2016. Based on our current understanding of the underlying facts of this matter, we believe it is reasonably possible we may receive an unfavorable decision related to these remaining assessments.

We also elected to enroll a number of outstanding tax offset requests that were previously applied for by the Brazilian subsidiary we acquired as part of our acquisition of Hypercom in August 2011 in the REFIS Amnesty. These outstanding tax offset requests relate to different tax debts, primarily for IRPJ, PIS and COFINS for past tax years, and total approximately 2.5 million Brazilian reais (approximately $710,000 at the foreign exchange rate as of April 30, 2016), including estimated penalties and interest. We applied available net operating losses toward the interest and penalties portion of the settlement obligation under the REFIS Amnesty. For the remaining balance, we elected to make the amnesty payments in monthly installments over a 90-month period for total payments of 1.3 million Brazilian reais (approximately $380,000 at the foreign exchange rate as of April 30, 2016). We accrued the full amount of the payments, plus estimated interest, under the REFIS Amnesty for these matters in December 2013 when we enrolled in the program, and made our first payment on December 26, 2013. After further review, the tax authorities agreed with our positions in certain of these cases and reduced our liabilities under the REFIS Amnesty. In the first quarter of fiscal year 2015, based on new provisions made available under the REFIS Amnesty, we elected to pay all remaining outstanding amounts due under the REFIS Amnesty in relation to the remaining tax offset requests, and settled such payments using cash and additional available net operating losses.

Municipality Services Tax Assessments

In December 2009, one of the Brazilian subsidiaries that was acquired as part of the Lipman acquisition was notified of a tax assessment regarding alleged nonpayment of tax on services rendered for the period from September 2004 to December 2004. This assessment was issued by the municipality of São Paulo (the "municipality"), and asserts a services tax deficiency and related penalties totaling 875,000 Brazilian reais (approximately $250,000 at the foreign exchange rate as of April 30, 2016), excluding interest. The municipality claims that the Brazilian subsidiary rendered certain services within the municipality of São Paulo but simulated that those services were rendered in another city. At the end of December 2010 the municipality issued further tax assessments alleging the same claims for 2005 through June 2007. These additional subsequent claims assert services tax deficiencies and related penalties totaling 5.9 million Brazilian reais (approximately $1.7 million at the foreign exchange rate as of April 30, 2016), excluding interest. We received unfavorable decisions from the administrative courts, which ruled to maintain the tax assessments for each of these matters. No further grounds of appeal are available to us for these assessments within the administrative courts. In October 2012, as a result of the decision at the administrative level, the tax authorities filed an enforcement action in the civil courts to collect on the services tax assessments amounts awarded by the administrative court, and seeking other related costs and fees. On March 6, 2013, we filed our defensive claims in the civil courts in response to the tax authorities' enforcement action. In February 2013 the tax authorities filed an additional enforcement action in the civil courts to collect on the penalties related to the services tax assessments amounts awarded by the administrative courts. Based on our understanding of the underlying facts of this matter and our evaluation of the potential outcome at the judicial level, we believe it is reasonably possible that our Brazilian subsidiary will be required to pay some amount of the alleged tax assessments and penalties related to these matters, as well as amounts of interest and certain costs and fees imposed by the court related thereto. As of April 30, 2016, the amount of the alleged tax assessments and penalties related to these matters was approximately 23.3 million Brazilian reais (approximately $6.6 million at the foreign exchange rate as of April 30, 2016), including interest, costs and fees related thereto.

The Brazilian subsidiary we acquired as part of our acquisition of Hypercom in August 2011 received an unfavorable administrative decision on a tax enforcement action against it filed by the municipality of Curitiba for collection of alleged services tax deficiency. An appeal against this unfavorable administrative decision was filed in a judicial proceeding and currently the case is pending the municipality of Curitiba's compliance with the writ of summons. As of April 30, 2016, the underlying assessment, including estimated interest, was approximately 5.4 million Brazilian reais (approximately $1.5 million at the foreign exchange rate as of April 30, 2016). Based on our current understanding of the underlying facts of this matter, we believe it is reasonably possible that we may receive an unfavorable decision in this proceeding.

Patent Infringement Claims

Cardsoft, Inc. et al v. VeriFone Holdings, Inc., VeriFone, Inc., Hypercom Corporation, et al.

On March 6, 2008, Cardsoft, Inc. and Cardsoft (Assignment for the Benefit of Creditors), LLC (collectively, “Cardsoft”) commenced an action in the United States District Court for the Eastern District of Texas, Marshall Division, against us and Hypercom Corporation, among others, alleging infringement of U.S. Patents No. 6,934,945 and No. 7,302,683 purportedly owned by Cardsoft. Cardsoft sought, in its complaint, a judgment of infringement, an injunction against further infringement, damages, interest and attorneys' fees. On June 8, 2012, the jury returned an unfavorable verdict finding that Cardsoft's patents were valid and were infringed by the accused VeriFone and Hypercom devices, and further determined that a royalty rate of $3 per unit should be applied. Accordingly, the jury awarded Cardsoft infringement damages and royalties of approximately $15.4 million covering past sales of the accused devices by

VeriFone and Hypercom. The jury concluded there was no willful infringement by either VeriFone or Hypercom.

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Following the jury's verdict, we determined that it was probable we would incur a loss on this litigation based on the jury's verdict and the status of the litigation proceedings at that time. Accordingly, we accrued for the full amount of the jury's verdict plus estimated pre-judgment interest and, effective from July 31, 2012, we began accruing estimated ongoing royalties of $3 per unit of accused device to Cost of net revenues. During the fiscal quarter ended October 31, 2012, we completed redesigns of the terminals subject to the jury's verdict specifically to address the Cardsoft allegations, and implemented such redesigns in the U.S. We further obtained the legal opinion of independent intellectual property counsel that our terminals, as redesigned, do not infringe the Cardsoft patents-in-suit. We concluded based on the procedures taken and legal reviews obtained, that it was not probable that an ongoing royalty based on the jury's verdict applies to our terminals as redesigned, and ceased accruing an ongoing royalty.

On October 30, 2013, the District Court issued judgment upholding the jury's verdict that the patent was valid and infringed. The judgment confirmed the jury's award of infringement damages and royalties of approximately $15.4 million covering past sales of the VeriFone and Hypercom accused devices, plus pre-judgment interest, post-judgment interest and costs. The court also ruled that an ongoing royalty should be applied for sales of the accused devices after the verdict date and ordered the parties to mediate on the issue of an ongoing royalty rate. The parties participated in mediation but were unable to reach a resolution. In March 2014, Cardsoft filed a motion requesting the court to set an ongoing royalty rate. We opposed, arguing (among other things) that no ongoing royalty applies in light of our redesigns of the products subject to the District Court's infringement ruling.

We appealed the District Court's judgment to the U.S. Court of Appeals for the Federal Circuit. On October 17, 2014, a three-judge panel of the Federal Circuit issued a unanimous opinion in our favor. The Federal Circuit ruling reversed the District Court's judgment and, further, concluded that our products did not infringe the Cardsoft patents as a matter of law. As a result, the District Court's finding of infringement and order of past and ongoing royalties, as well as related interest and costs, have been reversed. Previously, based on our assessment and the status of this matter before the District Court, we had accrued a total estimated loss of approximately $20.0 million, including estimated pre-judgment interest, potential ongoing royalties and statutory post-judgment interest related to this litigation. As a result of the Federal Circuit's favorable opinion reversing the District Court's judgment and ruling that our products do not infringe as a matter of law, in October 2014, we reversed the total estimated loss previously accrued.

On December 22, 2014, the Federal Circuit denied Cardsoft's petition for rehearing by the panel and hearing en banc, and issued its mandate on December 29, 2014. On March 23, 2015, Cardsoft filed a petition for certiorari with the U.S. Supreme Court, requesting the Court to grant its petition, vacate the Federal Circuit's decision and remand for the Federal Circuit to review using a more deferential standard of review of the District Court’s claim construction. On June 29, 2015, the U.S. Supreme Court granted Cardsoft’s petition, vacated the Federal Circuit's decision and remanded the case to the Federal Circuit for reconsideration under a more deferential standard of review of the District Court’s claim construction. On August 24, 2015, both parties submitted briefs regarding this more deferential standard of review and its applicability to the case.

Cardsoft also filed motions before the District Court claiming that it was entitled to a new trial to allege infringement under the doctrine of equivalents and seeking to reopen the case before the District Court. We opposed these motions and filed a cross motion to dismiss this matter in its entirety.

On December 2, 2015, the Federal Circuit again granted judgment in our favor of no infringement as a matter of law. Cardsoft did not timely file another petition for certiorari with the U.S. Supreme Court. On April 28, 2016, the District Court entered a Stipulation of Dismissal, and this matter is now concluded.

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VERIFONE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Class Action and Derivative Lawsuits

In re VeriFone Holdings, Inc. Shareholder Derivative Litigation Proceedings

Beginning on December 13, 2007, several actions were filed against certain current and former directors and officers derivatively on our behalf. These derivative lawsuits were filed in: (1) the U.S. District Court for the Northern District of California, as In re VeriFone Holdings, Inc. Shareholder Derivative Litigation, Lead Case No. C 07-6347 MHP, which consolidates King v. Bergeron, et al. (Case No. 07-CV-6347), Hilborn v. VeriFone Holdings, Inc., et al. (Case No. 08-CV-1132), Patel v. Bergeron, et al. (Case No. 08-CV-1133), and Lemmond, et al. v. VeriFone Holdings, Inc., et al. (Case No. 08-CV-1301); and (2) the Superior Court of California, County of Santa Clara, as In re VeriFone Holdings, Inc. Derivative Litigation, Lead Case No. 1-07-CV-100980, which consolidates Catholic Medical Mission Board v. Bergeron, et al. (Case No. 1-07-CV-100980) and Carpel v. Bergeron, et al. (Case No. 1-07-CV-101449). We prevailed in our motion to dismiss the federal derivative claims before the U.S. District Court for the Northern District of California and, on November 28, 2011, in ruling on lead plaintiff's appeal against the district court's judgment dismissing lead plaintiff's derivative claims, the Ninth Circuit issued judgment affirming the dismissal of lead plaintiff's complaint against us. The time period for the lead plaintiff to appeal the Ninth Circuit's judgment has expired.

On October 31, 2008, the state derivative plaintiffs filed their consolidated derivative complaint in the Superior Court of California, County of Santa Clara naming us as a nominal defendant and bringing claims for insider selling, breach of fiduciary duty, unjust enrichment, waste of corporate assets and aiding and abetting breach of fiduciary duty against certain of our current and former officers and directors and our largest stockholder as of October 31, 2008, GTCR Golder Rauner LLC. On February 18, 2009, plaintiff Catholic Medical Mission Board voluntarily dismissed itself from the action. In November 2008, we filed a motion to stay the state court action pending resolution of the parallel federal actions, and the parties agreed by stipulation to delay briefing on the motion to stay until after the issue of demand futility was resolved in the federal derivative case. On June 2, 2011, the court entered a stipulated order requiring the parties to submit a case status report on August 1, 2011 and periodically thereafter. The parties submitted status reports to the court through February 1, 2013 as requested by the court. On January 30, 2013, counsel for plaintiff informed us that Mr. Carpel, the nominal plaintiff, had sold his shares in the company and therefore no longer had standing to maintain a derivative action against us. On February 15, 2013, plaintiff filed a motion for leave to publish notice to our stockholders seeking a new nominal plaintiff. On May 10, 2013, the court adopted its tentative order granting the motion to publish notice, which was formally entered on May 17, 2013. Under the terms of the order, the parties were ordered to publish notice of the potential dismissal of the action and any qualifying shareholder who wishes to intervene must notify the court within ninety days from the formal entry of the order. Otherwise, the action will be dismissed. On August 14, 2013, counsel for the former nominal plaintiff, Mr. Carpel, filed a notice of intent to substitute a new nominal plaintiff, Joel Gerber, into the action. On September 16, 2013, counsel for former plaintiff Carpel filed a motion to substitute a new plaintiff, Joel Gerber, into the action. On October 16, 2013, the court granted the motion and deemed the amended complaint filed as of the same date. Our demurrer to the amended complaint was filed on April 7, 2014. On May 23, 2014, plaintiff filed a statement of non-opposition to our demurrer and filed a motion to stay the action to allow plaintiff to make a demand on our current Board of Directors. We filed our opposition to the motion to stay on June 18, 2014 and plaintiff filed his reply on July 25, 2014.

On December 3, 2014, the Court issued an order sustaining our demurrer and granting plaintiff's motion to stay. Plaintiff made a demand on the Board of Directors on December 23, 2014.

On June 11, 2015, the parties entered into a stipulation of settlement, pursuant to which we agreed to implement certain non-monetary corporate governance reforms and to provide support for plaintiff’s request for attorneys’ fees. On

December 9, 2015, the Court entered an order and final judgment approving the settlement. The deadline for us to implement the non-monetary corporate governance reforms will be August 5, 2016, unless an appeal is timely filed.

Israel Securities Class Actions

On January 27, 2008, a class action complaint was filed against us in the Central District Court in Tel Aviv, Israel on behalf of purchasers of our stock on the Tel Aviv Stock Exchange. The complaint sought compensation for damages allegedly incurred by the class of plaintiffs due to the publication of erroneous financial reports. We filed a motion to stay the action, in light of the proceedings already filed in the U.S., on March 31, 2008. A hearing on the motion was held on May 25, 2008. Further briefing in support of the stay motion, specifically with regard to the threshold issue of applicable law, was submitted on June 25, 2008. On September 11, 2008, the Israeli District Court ruled in our favor, holding that U.S. law would apply in determining our liability. On October 7, 2008, plaintiffs filed a motion for leave to appeal the Israeli District Court's ruling to the Israeli Supreme Court. Our response to plaintiffs' appeal motion was filed on January 21, 2009. The Israeli District Court stayed its proceedings until the Israeli Supreme Court rules on plaintiffs' motion for leave to appeal. On January 27, 2010, after a hearing before the Israeli Supreme Court, the court dismissed the plaintiffs' motion for leave to appeal and addressed the case back to the Israeli District Court. The Israeli Supreme Court instructed the Israeli District Court to rule whether the Israel class action should be stayed, under the assumption that the applicable law is U.S. law. Plaintiffs subsequently filed an application for reconsideration of the Israeli District Court's ruling that U.S. law is the applicable law. Following a hearing on plaintiffs' application, on April 12, 2010, the parties agreed to stay the proceedings pending resolution of the U.S. securities class action, without prejudice to plaintiffs' right to appeal the Israeli District Court's decision regarding the applicable law to the Israeli Supreme Court. On May 24, 2010, plaintiff filed a motion for leave to appeal the decision regarding the applicable law with the Israeli Supreme Court. In August 2010, plaintiff filed an application to the Israeli Supreme Court arguing that the U.S. Supreme Court's decision in Morrison et al. v. National Australia Bank Ltd., 561 U.S. 247, 130 S. Ct. 2869 (2010), may affect the outcome of the appeal currently pending before the Court and requesting that this authority be added to the Court's record. Plaintiff concurrently filed an application with the Israeli District Court asking that court to reverse its decision regarding the applicability of U.S. law to the Israel class action, as well as to cancel its decision to stay the Israeli proceedings in favor of the U.S. class action in light of the U.S. Supreme Court's decision in Morrison. On August 25, 2011, the Israeli District Court issued a decision denying plaintiff's application and reaffirming its ruling that the law applicable to the Israel class action is U.S. law. The Israeli District Court also ordered that further proceedings in the case be stayed pending the decision on appeal in the U.S. class action.

On November 13, 2011, plaintiff filed an amended application for leave to appeal addressing the Israeli District Court's ruling. We filed an amended response on December 28, 2011. On January 1, 2012, the Israeli Supreme Court ordered consideration of the application by three justices. On July 2, 2012, the Israeli Supreme Court ordered us to file an updated notice on the status of the proceedings in the U.S. securities class action then pending in the U.S. Court of Appeals for the Ninth Circuit by October 1, 2012. On October 11, 2012, we filed an updated status notice in the Israeli Supreme Court on the proceedings in the U.S. securities class action pending at the time in the U.S. Court of Appeals for the Ninth Circuit. On January 9, 2013, the Israeli Supreme Court held a further hearing on the status of the appeal in the U.S. Court of Appeals for the Ninth Circuit and recommended that the parties meet and confer regarding the inclusion of the Israeli plaintiffs in the federal class action pending in the U.S. On February 10, 2013, the Israeli Supreme Court issued an order staying the case pursuant to the joint notice submitted to the court by the parties on February 4, 2013. The plaintiff and putative class members in this action are included in the stipulated settlement of the federal securities class action, In re VeriFone Holdings, Inc., disclosed above unless an individual plaintiff opts out. Following the February 25, 2014 judgment and orders by the U.S. court, on May 1, 2014, the parties in the Israel class action filed a joint motion requesting that the Israeli Supreme Court renew the proceedings on appeal concerning the determination of the applicable law. A hearing was held on June 23, 2014 concerning whether the Israel class action should proceed in light of the settlement in the U.S. class action. On July 27, 2014, the plaintiff filed a supplemental pleading at the court’s request. We filed our reply pleading on August 21, 2014, and plaintiff filed a further response pleading on September 4, 2014. On April 2, 2015, the Israeli Supreme Court ruled that the Israeli class action is estopped by the U.S. class action settlement and dismissed the case.

On May 12, 2015, a new class action complaint was filed against us in Israel alleging similar claims as the dismissed Israeli class action, and alleging that Israeli shareholders were deprived of due process in the U.S. class action settlement proceedings. We are opposing the new class action on substantially the same grounds on which the previous case was dismissed.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On June 29, 2015, the plaintiff in the 2008 Israel Securities Class Action filed a motion for award of compensation and attorneys’ fees based on the amount of settlement compensation received by Israelis in the U.S. class action. On January 14, 2016, the Israeli District Court denied this motion. Plaintiff has not timely appealed, and this ruling is now final.

In re VeriFone Securities Litigation

On March 7, 2013, a putative securities class action was filed in the U.S. District Court for the Northern District of California against us, certain of our former officers and one of our current officers and alleged claims in connection with our February 20, 2013 announcement of preliminary financial results for the fiscal quarter ended January 31, 2013. The action, captioned Sanders v. VeriFone Systems, Inc. et al., Case No. C 13-1038, and subsequently re-captioned In re VeriFone Securities Litigation, was initially brought on behalf of a putative class of purchasers of VeriFone securities between December 14, 2011 and February 19, 2013 and asserted claims under the Securities Exchange Act Sections 10(b) and 20(a) and SEC Rule 10b-5 for securities fraud and control person liability. The claims were based on allegations that we and the individual defendants made false or misleading public statements regarding our business, operations, and financial controls during the putative class period. The complaint sought unspecified monetary damages and other relief. Two additional class actions related to the same matter (Laborers Local 235 Benefit Funds v. VeriFone Systems, Inc. et al., Case No. CV 13-1676 and Bland v. VeriFone Systems, Inc. et al., Case No. CV 13-1853) were filed in April 2013. On May 6, 2013, several putative plaintiffs and plaintiffs' law firms filed motions to consolidate these three securities class actions and requesting appointment as lead plaintiff and lead counsel, respectively. The plaintiffs in Laborers Local 235 Benefit Funds v. VeriFone Systems, Inc. et al. and Bland v. VeriFone Systems, Inc. et al. voluntarily dismissed their respective actions, without prejudice, on July 10, 2013 and July 17, 2013, respectively, and filed motions to be appointed lead plaintiff in the action previously captioned Sanders v. VeriFone Systems, Inc. et al. On October 7, 2013, the court entered an order appointing the Selz Funds as lead plaintiffs and appointing Gold Bennett Cera & Sidener LLP as lead counsel. Lead plaintiffs' first amended complaint was filed on December 16, 2013. The first amended complaint expanded the putative class period to December 14, 2011 and February 20, 2013, inclusive, and removed the current officer who was named in the original complaint from the action. We filed our motion to dismiss the amended complaint on February 14, 2014, lead plaintiffs filed their opposition on April 15, 2014 and we filed our reply on May 16, 2014. On May 27, 2014, the court took the motion to dismiss under submission without oral argument. On August 8, 2014, the court dismissed the amended complaint, with leave to amend. Lead plaintiffs filed their second amended complaint on October 7, 2014. On March 29, 2016, the Court granted our motion to dismiss the second amended complaint, finding it insufficiently pled, and granted leave to amend by June 3, 2016. Instead of filing a third amended complaint, lead plaintiffs are stipulating to a judgment of dismissal with prejudice so they can appeal the court’s dismissal of their second amended complaint.

Dolled v. Bergeron et al.

On April 19, 2013, a derivative action, Dolled v. Bergeron et al., Case No. 113-CV-245056, was filed in the Superior Court of California, County of Santa Clara in connection with our February 20, 2013 announcement of preliminary financial results for the fiscal quarter ended January 31, 2013. The action, brought derivatively on behalf of VeriFone, names VeriFone as a nominal defendant and brings claims for insider selling, breach of fiduciary duty and unjust enrichment variously against certain of our current and former officers and directors. The complaint seeks unspecified monetary damages, restitution and disgorgement of profits and compensation paid to defendants, injunctive relief directing us to reform its corporate governance, and payment of the plaintiff's costs and attorneys' fees. On May 30, 2013, the court entered the parties' stipulation and proposed order, which appointed plaintiff and plaintiff's counsel as lead plaintiff and lead counsel, respectively, in the consolidated action, captioned In re VeriFone Systems, Inc.

Derivative Litigation. The next case management conference is scheduled for September 23, 2016.

Zoumboulakis v. McGinn et al.

On May 24, 2013, a federal derivative action, Zoumboulakis v. McGinn et al., Case No. 13-CV-02379, was filed in the U.S. District Court for the Northern District of California against certain current and former directors and officers derivatively on our behalf. The complaint, which names us as a nominal defendant, alleges breach of fiduciary duty and abuse of control and asserts claims under Section 14(a) of the Securities Exchange Act of 1934 for false or misleading financial statements and proxy statement disclosures. The complaint seeks unspecified monetary damages, including exemplary damages, restitution from defendants, injunctive relief directing us to make certain corporate governance reforms, and payment of the plaintiff's costs and attorneys' fees. On August 12, 2013, the court entered defendants' motion seeking to relate this action to the pending shareholder class action, Sanders v. VeriFone Systems, Inc. et al. On October 31, 2013, the court entered a stipulation and order setting a December 31, 2013 deadline for the filing of an amended complaint and setting a January 30, 2014 deadline for defendants to move or answer. An initial case management conference was held on January 17, 2014. On January 21, 2014, plaintiff filed an amended complaint, which removed one of our former officers from the action and added an additional former director as a defendant. The amended complaint brings claims against the defendants for breach of fiduciary duty, abuse of control, violations of Securities Exchange Act Section 14(a), and unjust enrichment. The amended complaint also brings claims for insider trading against three of the named former and current directors. We filed our motion to dismiss the amended complaint on March 7, 2014, plaintiff filed an opposition on April 23, 2014, and we filed our reply on May 16, 2014. On May 27, 2014, the court took the motion to dismiss under submission without oral argument. On August 7, 2014, the court dismissed the amended complaint, with leave to amend. Plaintiff filed a second amended complaint on October 17, 2014. We filed a motion to dismiss the second amended complaint on December 18, 2014. On December 3, 2015, the court granted our motion to dismiss, with leave to amend. On January 20, 2016, plaintiff filed a third amended complaint alleging demand futility with respect to the current Board. We filed our motion to dismiss on March 1, 2016, which motion is scheduled for hearing on September 29, 2016.

If any of these class action or derivative lawsuits is resolved adversely to us, it could have a material adverse effect on our business, financial condition, results of operations, and cash flows.

Antitrust Investigation

The Competition Commission of India ("CCI") investigated certain complaints made against us alleging unfair practices based on certain provisions in our software development license arrangements in India. We cooperated with requests by the CCI in its investigation. In March 2014, the director general of the CCI investigating the allegations issued a report rejecting certain of the allegations, but also finding that certain provisions of our licenses may constitute unfair business practices. VeriFone India Sales Pvt. Ltd. filed objections to that report.

In April 2015, the CCI issued rulings directing Verifone India to cease and desist from engaging in the alleged anti-competitive conduct and imposing a penalty, the amount of which is not material to our results of operations. We have deposited 10% of this penalty amount and accrued the balance while we appeal these rulings.

On June 15, 2015, we filed appeals and interim applications to stay the CCI orders. The appellate court has granted our interim applications to stay all proceedings at least until the final appellate hearing, which commenced on January 19, 2016, continued on January 29, March 28, and April 28, 2016, and is scheduled to continue on August 4, 2016.

The CCI's rulings reserved the right to pursue additional proceedings against individuals that it deems responsible for the alleged conduct. We are unable to make any estimate of potential loss for any further proceedings the CCI may pursue but do not expect it to be material to our results of operations.

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Other Litigation

Certain of the foregoing cases are still in the preliminary stages, and we are not able to quantify the extent of our potential liability, if any, other than as described above. Further, the outcome of litigation is inherently unpredictable and subject to significant uncertainties. If any of these matters are resolved adversely to us, this could have a material adverse effect on our business, financial condition, results of operations, and cash flows. In addition, defending these legal proceedings is likely to be costly, which may have a material adverse effect on our financial condition, results of operations and cash flows, and may divert management's attention from the day-to-day operations of our business. We are subject to various other legal proceedings related to commercial, customer, and employment matters that have arisen during the ordinary course of business. The outcome of such legal proceedings is inherently unpredictable and subject to significant uncertainties. Although there can be no assurance as to the ultimate disposition of these matters, our management has determined, based upon the information available at the date of these financial statements, including anticipated expected availability of insurance coverage, that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Income Tax Uncertainties

As of April 30, 2016, the amount payable for unrecognized tax benefits was $37.7 million, including accrued interest and penalties, none of which is expected to be paid within one year. This amount is included in Other long-term liabilities in our Condensed Consolidated Balance Sheet as of April 30, 2016. We are unable to make a reasonably reliable estimate as to when cash settlement with a taxing authority may occur.

Note 12. Segment Information

In December 2015, we realigned our organizational structure and changed our reportable segments to be Verifone Systems and Verifone Services. Net revenues and operating income of each segment reflect net revenues and expenses that are directly attributable to that segment. Net revenues and expenses not allocated to segment net revenues and segment operating income include amortization of purchased intangible assets, amortization of step-down in deferred services net revenues and associated costs of net revenues at acquisition, restructuring expenses, stock-based compensation, as well as general and administrative and corporate research and development expense. We do not separately evaluate assets by segment, and therefore assets by segment are not presented below.

The following table sets forth net revenues for our reportable segments and reconciles segment net revenues to total net revenues (in thousands):

	Three Months Ended April 30,		Six Months Ended April 30,	
	2016	2015	2016	2015
Segment net revenues:				
Verifone Systems	$342,443	$324,300	$680,035	$637,700
Verifone Services	189,913	165,966	365,877	339,480
Total segment net revenues	532,356	490,266	1,045,912	977,180
Amortization of step down in deferred services net revenues at acquisition	(6,078)	(122)	(6,095)	(810)
Total net revenues	$526,278	$490,144	$1,039,817	$976,370

The following table sets forth operating income for our reportable segments and reconciles segment operating income to consolidated operating income (in thousands):

	Three Months Ended April 30,		Six Months Ended April 30,	
	2016	2015	2016	2015
Operating income by segment:				
Verifone Systems	$77,969	$78,592	$158,870	$151,005
Verifone Services	46,446	38,535	88,575	81,351
Total segment operating income	124,415	117,127	247,445	232,356
Items not attributable to segment operating income:				
Amortization of step down in deferred services gross margin at acquisition	(4,408)	(122)	(4,425)	(810)
Unallocated general and administrative expenses	(49,891)	(45,632)	(97,835)	(87,887)
Unallocated research and development expenses	(4,705)	(5,215)	(9,593)	(10,476)
Other unallocated costs	(7,684)	(1,020)	(7,671)	(4,350)
Amortization of purchase intangible assets	(25,794)	(25,176)	(49,409)	(52,168)
Stock-based compensation expense	(11,579)	(8,872)	(22,039)	(21,027)
Litigation settlement and loss contingency expense	—	(1,213)	—	(1,213)
Restructuring expense	(575)	(161)	(478)	(1,534)
Total operating income	$19,779	$29,716	$55,995	$52,891

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

This section should be read in conjunction with our consolidated financial statements and related notes included in our 2015 Annual Report on Form 10-K and the Condensed Consolidated Financial Statements and Notes included in Part I, Item I of this Quarterly Report on Form 10-Q. This section and other parts of this Quarterly Report on Form 10-Q and certain information incorporated by reference herein contain forward-looking statements that involve risks and uncertainties. In some cases, forward-looking statements can be identified by words such as "may," "should," "expect," "plan," "intend," "anticipate," "believe," "estimate," "predict," "potential," or "continue," the negative of such terms, or comparable terminology. Such forward-looking statements are based on current expectations, estimates, and projections about our industry and management's beliefs and assumptions, and do not reflect the potential impact of any mergers, acquisitions, or other business combinations or divestitures that have not been completed. Forward-looking statements are not guarantees of future performance, and our actual results may differ materially from the results expressed or implied in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part I, Item 1A, Risk Factors, in our 2015 Annual Report on Form 10-K and in Part II, Item 1A, Risk Factors, of this Quarterly Report on Form 10-Q, and elsewhere in these reports, including our disclosures of Critical Accounting Policies and Estimates in Part II, Item 7 in our 2015 Annual Report on Form 10-K and in Part I, Item 2 of this Quarterly Report on Form 10-Q, and our disclosures in Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk in our 2015 Annual Report on Form 10-K and in Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk of this Quarterly Report on Form 10-Q, as well as in our Condensed Consolidated Financial Statements and Notes thereto. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report on Form 10-Q to conform such statements to actual results or to changes in expectations. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.
In this Quarterly Report on Form 10-Q, each of the terms “VeriFone,” "Company," "us," "we," and "our" refers to VeriFone Systems, Inc. and its consolidated subsidiaries.

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is provided in addition to our Condensed Consolidated Financial Statements and accompanying notes to assist readers in understanding our results of operations, financial condition, and cash flows. This section is organized as follows:
Overview: Discussion of our business, significant matters, and financial results highlights for the periods presented.
Results of Operations:
Consolidated Results of Operations: An analysis and discussion of our financial results comparing our consolidated results of operations for the three and six months ended April 30, 2016 to the three and six months ended April 30, 2015.
Segment Results of Operations: An analysis and discussion of our financial results comparing the results of operations for each of our two reportable segments, Verifone Systems and Verifone Services, for the three and six months ended April 30, 2016 to the three and six months ended April 30, 2015.
Financial Outlook: A discussion of our expectations regarding certain trends that may affect our financial condition and results of operations.
Liquidity and Capital Resources: An analysis of changes in our balance sheets and cash flows, and discussion of our financial condition and potential sources of liquidity.
Contractual Obligations and Off-Balance Sheet Arrangements: Disclosures related to our contractual obligations, contingent liabilities, commitments, and off-balance-sheet arrangements, as of April 30, 2016.
Critical Accounting Policies and Estimates: A discussion of the accounting policies and estimates that we believe are most important to understanding the assumptions and judgments incorporated in our reported financial results and forecasts, as well as recent accounting pronouncements that have had or are expected to have a material impact on our results of operations.

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Overview

Our Business

We are a global leader in payments and commerce solutions. We provide expertise, solutions and services that reduce risk and add value at the retail point-of-sale (POS), and enable innovative forms of commerce. For over 30 years, we have been a leader in designing, manufacturing, marketing and supplying a broad range of innovative payment devices and complementary services that enable secure electronic payment transactions and value-added services at the POS. We focus on delivering increasingly innovative POS payment capabilities, value-added services that increase merchant revenues and enhance the consumer experience, and solutions that enrich the interaction between merchants and consumers. For example, during April 2016 we introduced the first of a new family of integrated POS systems, known as Verifone Carbon, that we expect will provide more scalable solutions for our clients globally. Key industries in which we operate include financial services, retail, petroleum, restaurant, hospitality, taxi, transportation, and healthcare.

During December 2015 our Chief Executive Officer realigned the company's organizational structure to focus on two global product lines: Verifone Systems and Verifone Services. Verifone Systems delivers point of sale electronic payment devices that run our unique operating systems, security and encryption software, and certified payment software for payments and commerce. Verifone Services delivers device related leasing and maintenance, payment transaction routing and reporting, and commerce based services such as advertising on digital screens. As a result of this organizational change, effective for the first quarter of 2016, our reportable segments are Verifone Systems and Verifone Services. All prior period amounts reported by geographic segment have been reclassified to conform to the current presentation.

The markets in which we operate are highly competitive. We compete based on various factors, including product functions and features, pricing, product quality and reliability, design innovation, interoperability with third-party systems and brand reputation. We also compete based on product availability and certifications, as well as service offerings and support. We continue to experience intense competition in Verifone Systems from traditional POS terminal providers and we also see new companies entering our markets, including entrants offering various forms of mobile device based payment options. In certain geographic markets, such as China and Brazil, we see customers requiring a choice of offerings for a lower cost. This trend has increased competition and pricing pressures. Our competitors are introducing increasingly aggressive pricing in these markets and clients are relying more on pricing for their purchase decisions.

Verifone Systems

Sales of our point of sale electronic payment devices and systems by our Verifone Systems business comprise approximately 65.1% and 65.4% of our net revenues in the three and six months ended April 30, 2016, respectively. Our point of sale electronic payment devices run our unique operating systems, security and encryption software, and certified payment software, and are designed to suit our clients' needs in a variety of environments, including traditional multi-lane and countertop implementations, self-service and unattended environments, in-vehicle and portable deployments, as well as mobile commerce. Our systems can securely process a wide range of payment types including signature and PIN-based debit cards, credit cards, NFC/contactless/radio frequency identification cards, or RFID cards, smart cards, pre-paid gift and other stored-value cards, electronic bill payment, signature capture and electronic benefits transfer, or EBT. Our unique architecture enables multiple value-added applications, including third-party applications, such as gift card and loyalty card programs, healthcare insurance eligibility, and time and attendance tracking, and allows these applications to reside on the same system without requiring recertification upon the addition of new applications. With our newest line of Verifone Engage payment solutions, we will be able to deliver richer media and more complex commerce enablement services on our payment terminals to our merchant clients. Security continues to be an important factor for our clients and we have experienced increasing demand for Europay, MasterCard and Visa, or "EMV", capable terminal solutions.

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Verifone Services

Verifone Services drives an important part of our business and revenues, accounting for approximately 34.9% and 34.6% of our net revenues in the three and six months ended April 30, 2016, respectively. Our service offerings fall into four main product lines: (i) device-related services, (ii) payment-related services, (iii) commerce-related services, and (iv) omni-commerce services. Device-related services include mechanical and support services such as terminal leasing, “break fix” maintenance work, and call center support. Payment-related services include transaction routing, software development and licensing, and security services, such as encryption, tokenization, and our Secure Commerce Architecture. Commerce-related services include our digital media business, which delivers advertising and marketing content to over 100,000 screens, and taxi related services such as mobile hailing. Omni-commerce services bring together payments and commerce both in-store and online.

Timing of Revenue

The timing of our customer orders may cause our revenue to vary from period to period. Specifically, revenues recognized in our fiscal quarters can vary significantly when larger customers or our distributors delay orders due to regulatory and industry standards compliance, budget considerations, product feature availability, dual vendor sourcing requirements, technology refresh cycles, economic conditions or other concerns that impact their business or purchasing decisions. For example, the timing of customer orders is often impacted by the timing of technology refreshes or the timing of completed product certifications by a particular customer or in a particular market. Customer purchases have also been impacted by regulatory factors such as new or pending banking regulations and government initiatives to drive cashless transactions.

In addition, revenues can be back-end weighted when we receive sales orders and deliver a higher proportion of our systems toward the end of our fiscal quarters. This variability and back-end weighting of orders may adversely affect our results of operations in a number of ways, and could negatively impact revenues and profits. First, the product mix of orders may not align with manufacturing forecasts, which could result in a shortage of the components needed for production. Second, existing manufacturing capacity may not be sufficient to deliver the desired volume of orders in a concentrated time when they are received. Third, back-end weighted demand could negatively impact gross margins through higher labor, delivery, and other manufacturing and distribution costs. If, on the other hand, we were to seek to manage the fulfillment of back-end weighted orders through holding increased inventory levels, we would risk higher inventory obsolescence charges if our sales fall short of our expectations.

Because our revenue recognition depends on, among other things, the timing of product shipments, decisions we make about product shipments, particularly toward the end of a fiscal quarter, may impact our reported revenues. The timing of product shipments may depend on a number of factors, including costs of air shipments if required, the delivery date requested by customers, and our operating capacity to fill orders and ship products, as well as our own long and short-term business planning and supply chain management. These factors may affect timing of shipments and consequently revenues recognized for a particular period.

Significant Matters

Business Combinations

On December 23, 2015, we acquired InterCard AG, a leading payment-related services provider in Germany, in exchange for 85.0 million Euro in cash paid on the acquisition date (approximately $92.4 million at the foreign exchange rate on the acquisition date) plus 1.2 million Euro (approximately $1.4 million at the foreign exchange rate as of April 30, 2016), that will be paid in the third quarter of fiscal 2016. We acquired InterCard to expand our payment-related services offerings in Germany. This acquisition was accounted for using the acquisition method of accounting, and the results of InterCard were included in our Results of Operations since the acquisition date.

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On February 2, 2016, we acquired AJB Software Design Inc., a Toronto-based provider of payment gateway and switching solutions for large merchants in the U.S. and Canada, for cash payments totaling approximately $87.5 million, subject to certain upward adjustments, plus up to $10.0 million of additional contingent consideration with a fair value of $1.4 million at the acquisition date. We acquired AJB to expand our suite of services offerings. This acquisition was accounted for using the acquisition method of accounting, and the results of AJB were included in our Results of Operations since the acquisition date.

Stock Repurchase Program

In September 2015, our Board of Directors authorized a program to repurchase shares of our common stock with an aggregate value of up to $200.0 million, with no expiration from the date of authorization. During the six months ended April 30, 2016, we repurchased approximately 2.6 million shares of our common stock on the open market at an average repurchase price of $28.02 per share. There were no stock repurchase activities during the three months ended April 30, 2016. As of April 30, 2016, there was approximately $50.0 million remaining available for stock repurchases under this program.

Pursuant to this program, shares may be repurchased from time to time in the open market, private purchases, through forward, derivative, accelerated repurchase or automatic repurchase transactions or otherwise. The timing and actual amount of the share repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities, including mergers and acquisitions, market conditions and other factors. We are not obligated to repurchase any specific number of shares under the program and the repurchase program may be modified, suspended or discontinued at any time. See Note 4, Stock Repurchase Program, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q for additional information regarding this stock repurchase program.

Financial Results Highlights

Overall

- Consolidated net revenues for the three months ended April 30, 2016 were $526.3 million, compared to $490.1 million for the three months ended April 30, 2015, up 7.4% year over year, despite a $26.2 million unfavorable foreign currency impact.

- Gross margins for the three months ended April 30, 2016 were $210.4 million or 40.0% compared to $203.9 million or 41.6% for the three months ended April 30, 2015, up $6.5 million or 3.2%, but down 1.6 points.

- Net cash provided by operating activities for the three months ended April 30, 2016 totaled $50.9 million.

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Results of Operations

Consolidated Results of Operations

Three Months Ended April 30, 2016 compared to April 30, 2015

	Three Months Ended April 30,			
	2016	% of Net revenues (1)	2015	% of Net revenues (1)
	(in thousands, except percentages)			
Net revenues:				
Systems	$342,443	65.1%	$324,300	66.2%
Services	183,835	34.9%	165,844	33.8%
Total net revenues	526,278	100.0%	490,144	100.0%
Gross margin:				
Systems	141,899	41.4%	135,328	41.7%
Services	68,480	37.3%	68,575	41.3%
Total gross margin	210,379	40.0%	203,903	41.6%
Operating expenses:				
Research and development	54,715	10.4%	47,579	9.7%
Sales and marketing	59,027	11.2%	55,371	11.3%
General and administrative	54,884	10.4%	49,457	10.1%
Litigation settlement and loss contingency expense	—	—%	1,213	0.2%
Amortization of purchased intangible assets	21,974	4.2%	20,567	4.2%
Total operating expenses	190,600	36.2%	174,187	35.5%
Operating income	19,779	3.8%	29,716	6.1%
Interest expense, net	(8,543)	(1.6)%	(7,432)	(1.5)%
Other income (expense), net	(4,809)	(0.9)%	(3,169)	(0.6)%
Income before income taxes	6,427	1.2%	19,115	3.9%
Income tax provision	3,087	0.6%	1,449	0.3%
Consolidated net income	$3,340	0.6%	$17,666	3.6%

(1) Systems and Services gross margin as a percentage of net revenues is computed as a percentage of the corresponding Systems and Services net revenues.

Net revenues for the three months ended April 30, 2016 were $526.3 million, compared to $490.1 million for the three months ended April 30, 2015, up $36.2 million or 7.4%, net of a $26.2 million negative foreign currency impact. Systems net revenues increased $18.2 million due primarily to increased demand for EMV capable products in North America. Services net revenues increased $18.0 million due primarily to the benefit of acquired businesses and sales of additional services on increased device sales. The foreign currency impact was due primarily to a decrease in the value of the Brazilian real, the Argentine peso, the South African rand, and the Australian dollar. (See further discussion of revenues by segment and geography below.)

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Net Revenues by Geography

	Three Months Ended April 30,			
	2016	% of net revenues	2015	% of net revenues
	(in thousands, except percentages)			
Net Revenues				
North America	$209,338	39.8%	$192,970	39.4%
Latin America	69,788	13.3%	68,054	13.9%
EMEA	196,982	37.4%	179,531	36.6%
Asia-Pacific	50,170	9.5%	49,589	10.1%
Total	$526,278	100.0%	$490,144	100.0%

- North America net revenues increased $16.4 million year over year, due primarily to increased demand for our EMV capable products, including petroleum customers upgrading to products that support EMV requirements and increasing adoption of EMV capable devices by small and medium businesses, which outpaced the prior year revenues from EMV implementations by Tier 1 retailers.

- Latin America net revenues increased $1.7 million year over year, despite $16.3 million of unfavorable foreign currency fluctuations. Net revenue increases throughout Latin America markets were offset by a $11.3 million decrease in net revenues in Brazil that was influenced by factors such as economic weakness and competitive pricing pressures.

- EMEA net revenues increased $17.5 million year over year, due primarily to $12.7 million in net revenues from InterCard, which was acquired in December 2015. Net revenues also increased due to the timing of product certifications in certain countries, for example, increased demand for our products due to government fiscalization requirements in Turkey. EMEA net revenues include a $6.2 million negative impact due to unfavorable foreign currency fluctuations.

- Asia-Pacific net revenues remained relatively flat year over year. Increases in net revenues in some Asia-Pacific markets were almost entirely offset by a $6.0 million decrease in net revenues in China, where we have not yet released a lower cost suite of products to meet customer preferences in that market. Net revenues include a $3.5 million negative impact due to unfavorable foreign currency fluctuations.

Gross margin for the three months ended April 30, 2016 was $210.4 million or 40.0% of total net revenues, compared to $203.9 million or 41.6% of total net revenues, for the three months ended April 30, 2015, up $6.5 million but down 1.6 percentage points. Gross margin in dollars increased due primarily to the increase in net revenues. Gross margin as a percentage of net revenues decreased due primarily to changes in product, geographic and customer mix. For example, we experienced competitive pricing pressures in several markets, particularly Latin America, that have resulted in lower margins year over year. In addition, in North America net revenues have shifted to more purchases by our distributors and petroleum customers in the current year compared to net revenues from higher margin large customers completing substantial EMV roll outs in the prior year.

Research and development for the three months ended April 30, 2016 was $54.7 million compared to $47.6 million for the three months ended April 30, 2015, up $7.1 million or 14.9%, due primarily to an increase in personnel related and outside contractor expenses, which reflects our ongoing investment in additional resources to develop and bring next generation products and solutions to market.

Sales and marketing for the three months ended April 30, 2016 was $59.0 million, compared to $55.4 million for the three months ended April 30, 2015, up $3.6 million or 6.5%, due primarily to costs associated with the recent acquisitions of InterCard and AJB.

General and administrative for the three months ended April 30, 2016 was $54.9 million, compared to $49.5 million for the three months ended April 30, 2015, up $5.4 million or 10.9%, due primarily to costs associated with the recent acquisitions of InterCard and AJB.

Amortization of purchased intangible assets for the three months ended April 30, 2016 was $22.0 million, compared to $20.6 million for the three months ended April 30, 2015, up $1.4 million or 6.8%, due primarily to an increase in purchased intangible assets associated with recently acquired businesses.

Interest expense, net for the three months ended April 30, 2016 was $8.5 million, compared to $7.4 million for the three months ended April 30, 2015, up $1.1 million or 14.9%, due primarily to higher loan balances related to new borrowings for acquisitions.

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Income tax provision for the three months ended April 30, 2016 was $3.1 million, compared to $1.4 million for the three months ended April 30, 2015, up $1.7 million or 117.3%. The income tax provisions for the three months ended April 30, 2016 and 2015 were primarily related to foreign taxes and other discrete activities.

Six Months Ended April 30, 2016 compared to April 30, 2015

	Six Months Ended April 30,			
	2016	% of net revenues (1)	2015	% of net revenues (1)
	(in thousands, except percentages)			
Net revenues:				
Systems	$680,035	65.4%	$637,700	65.3%
Services	359,782	34.6%	338,670	34.7%
Total net revenues	1,039,817	100.0%	976,370	100.0%
Gross margin:				
Systems	284,686	41.9%	263,060	41.3%
Services	140,978	39.2%	140,013	41.3%
Total gross margin	425,664	40.9%	403,073	41.3%
Operating expenses:				
Research and development	106,383	10.2%	96,482	9.9%
Sales and marketing	113,976	11.0%	112,781	11.6%
General and administrative	107,710	10.4%	96,807	9.9%
Litigation settlement and loss contingency expense (benefit)	—	—%	1,213	0.1%
Amortization of purchased intangible assets	41,600	4.0%	42,899	4.4%
Total operating expenses	369,669	35.6%	350,182	35.9%
Operating income	55,995	5.4%	52,891	5.4%
Interest expense, net	(16,847)	(1.6)%	(15,327)	(1.6)%
Other income (expense), net	(6,989)	(0.7)%	(2,926)	(0.3)%
Income before income taxes	32,159	3.1%	34,638	3.5%
Income tax provision	5,086	0.5%	2,844	0.3%
Consolidated net income	$27,073	2.6%	$31,794	3.3%

(1) Systems and Services gross margin as a percentage of net revenues is computed as a percentage of the corresponding Systems and Services net revenues.

Net revenues for the six months ended April 30, 2016 were $1.04 billion, compared to $976.4 million for the six months ended April 30, 2015, up $63.4 million or 6.5%, net of a $62.8 million negative foreign currency impact. Systems net revenues increased $42.3 million due primarily to increased demand for EMV capable products in North America. Services net revenues increased $21.0 million due primarily to the benefit of acquired businesses and sales of additional services on increased device sales. The foreign currency impact was due primarily to a decrease in the values of the Brazilian real, the Argentine peso, the Euro, and the South African rand. (See further discussion of revenues by segment and geography below.)

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Net Revenues by Geography

	Six Months Ended April 30,			
	2016	% of net revenues	2015	% of net revenues
	(in thousands, except percentages)			
Net Revenues				
North America	$445,034	42.8%	$353,267	36.2%
Latin America	124,568	12.0%	139,150	14.3%
EMEA	367,370	35.3%	359,564	36.8%
Asia-Pacific	102,845	9.9%	124,389	12.7%
Total	$1,039,817	100.0%	$976,370	100.0%

- North America net revenues increased $91.8 million, due primarily to increased demand for our EMV capable products, including petroleum customers upgrading to products that support EMV requirements and increasing adoption of EMV capable devices by small and medium businesses, which outpaced the prior year revenues from EMV implementations by Tier 1 retailers.

- Latin America net revenues decreased $14.6 million, due primarily to the timing of purchase decisions by large customers. Decreased net revenues in Brazil, which were influenced by factors such as economic weakness and competitive pricing pressures, were partially offset by increases throughout Latin American markets. Net revenues include a $29.4 million negative impact due to unfavorable foreign currency fluctuations.

- EMEA net revenues increased $7.8 million, due primarily to $17.0 million in net revenues from InterCard, which was acquired in December 2015. Revenue also increased in the rest of EMEA due primarily to timing of product certifications in certain countries, for example, increased demand for our products due to government fiscalization requirements in Turkey. Net revenues include a $23.4 million negative impact due to unfavorable foreign currency fluctuations.

- Asia-Pacific net revenues decreased $21.5 million, primarily in China, where we have not yet released a lower cost suite of products to meet customer preferences in that market. Net revenues include a $9.3 million negative impact due to the unfavorable foreign currency fluctuations.

Gross margin for the six months ended April 30, 2016 was $425.7 million or 40.9% of net revenues, compared to $403.1 million, or 41.3% of net revenues, for the six months ended April 30, 2015, up $22.6 million but down 0.4 percentage points. Gross margin in dollars increased due primarily to the increase in net revenues. Gross margin as a percentage of net revenues decreased due primarily to changes in geographic and customer mix. For example, we experienced competitive pricing pressures in several markets, particularly China and Latin America, that have resulted in lower margins year over year. In addition, in North America net revenues have shifted to more purchases by our distributors and Petro customers in the current year compared to net revenues from higher margin large customers completing substantial EMV roll outs in the prior year.

Research and development for the six months ended April 30, 2016 was $106.4 million compared to $96.5 million for the six months ended April 30, 2015, up $9.9 million or 10.3%, due primarily to an increase in personnel related and outside contractor expenses, which reflects our ongoing investment in additional resources to develop and bring next generation products and solutions to market.

Sales and marketing for the six months ended April 30, 2016 was $114.0 million, compared to $112.8 million for the six months ended April 30, 2015, up $1.2 million or 1.1%, due primarily to costs associated with the recent acquisitions of InterCard and AJB.

General and administrative for the six months ended April 30, 2016 was $107.7 million compared to $96.8 million for the six months ended April 30, 2015, up $10.9 million or 11.3%, due primarily to costs associated with the recent acquisitions of InterCard and AJB.

Amortization of purchased intangible assets for the six months ended April 30, 2016 was $41.6 million compared to $42.9 million for the six months ended April 30, 2015, down $1.3 million or 3.0%, due primarily to the devaluation of the Euro, Swedish krona, South African rand, and Norwegian krone against the U.S. dollar year over year, as most of our purchased intangible assets are denominated in these currencies. The devaluation was partially offset by an increase in purchased intangible assets associated with recently acquired businesses.

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Interest expense, net for the six months ended April 30, 2016 was $16.8 million compared to $15.3 million for the six months ended April 30, 2015, up $1.5 million or 9.8%, due primarily to higher loan balances related to new borrowings for acquisitions and stock repurchases and lower cash balances.

Income tax provision for the six months ended April 30, 2016 was $5.1 million, compared to $2.8 million for the six months ended April 30, 2015, up $2.3 million or 82.1%. The income tax provision for the six months ended April 30, 2016 was primarily related to foreign taxes and other discrete activities. The income tax provision for the six months ended April 30, 2015 was primarily related to foreign taxes offset by the reversal of unrecognized tax benefits where statutes of limitations expired and audits were settled.

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Segment Results of Operations

In December 2015, we realigned our organizational structure and changed our reportable segments to be Verifone Systems and Verifone Services. Net revenues and operating income of each segment reflect net revenues and expenses that are directly attributable to that segment. Net revenues and expenses not allocated to segment net revenues and segment operating income include amortization of purchased intangible assets, amortization of step-down in deferred services net revenues and associated costs of net revenues at acquisition, restructuring expenses, stock-based compensation, as well as general and administrative and corporate research and development expense.

Verifone Systems Net Revenues and Operating Income

Our Verifone Systems business delivers point of sale electronic payment devices that run our unique operating systems, security and encryption software, and certified payment software globally, for both payments and commerce.

Three Months Ended April 30, 2016 compared to April 30, 2015

	Three Months Ended April 30,					
	2016	% of net revenues		2015	% of net revenues	
	(in thousands, except percentages)					
Net revenues	$342,443	64.3	%	$324,300	66.2	%
Operating income	$77,969	22.8	%	$78,592	24.2	%

Net revenues for the three months ended April 30, 2016 were $342.4 million, compared to $324.3 million for the three months ended April 30, 2015, up $18.2 million or 5.6%, net of a $17.1 million negative impact due to unfavorable foreign currency fluctuations.

- Net revenues from the sale of desktop devices increased $14.8 million, due primarily to increased demand related to the release of new products and certifications received in certain markets, for example, due to government fiscalization requirements in Turkey, as well as due to the timing of purchase decisions by customers.

- Net revenues from the sale of multi-lane devices and our Petroleum product family increased $5.7 million, due primarily to increased demand for EMV compatible devices. Increased net revenues from customers in the North American petroleum market and small to medium businesses outpaced the decreased demand from North America Tier 1 retailers that rolled out EMV compatible devices in the prior year.

Operating income for the three months ended April 30, 2016 was $78.0 million or 22.8% of net revenues, compared to $78.6 million or 24.2% of net revenues for the three months ended April 30, 2015, down $0.6 million or 1.4 percentage points.

- Operating income in dollars decreased due primarily to changes in geographic and product mix, competitive pricing pressures in certain markets, as well as an increased research and development spend, which reflects our ongoing investment in additional resources to bring next generation products and solutions to market.

- Operating income as a percentage of net revenues decreased due primarily to changes in geographic and product mix, as well as competitive pricing pressures.

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Six Months Ended April 30, 2016 compared to April 30, 2015

	Six Months Ended April 30,					
	2016	% of net revenues		2015	% of net revenues	
	(in thousands, except percentages)					
Net revenues	$680,035	65.0	%	$637,700	65.3	%
Operating income	$158,870	23.4	%	$151,005	23.7	%

Net revenues for the six months ended April 30, 2016 were $680.0 million, compared to $637.7 million for the six months ended April 30, 2015, up $42.3 million or 6.6%, net of a $36.3 million negative impact due to unfavorable foreign currency fluctuations.

- Net revenues from the sale of desktop devices increased $28.8 million, due primarily to increased demand related to the release of new products and certifications received in certain markets, for example, due to government fiscalization requirements in Turkey, as well as due to the timing of purchase decisions by customers.

- Net revenues from the sale of multi-lane devices and our Petroleum product family increased $23.3 million, due primarily to increased demand for EMV compatible devices. Increased net revenues from customers in the North American petroleum market and small to medium businesses outpaced the decreased demand from North America Tier 1 retailers that rolled out EMV compatible devices in the prior year.

- Net revenues from the sale of portable devices decreased $12.2 million, primarily in Latin America due to the timing of purchase decisions by large customers, which were influenced, in part, by economic weakness, as well as the impact of foreign currency fluctuations.

Operating income for the six months ended April 30, 2016 was $158.9 million or 23.4% of net revenues, compared to $151.0 million or 23.7% of net revenues for the six months ended April 30, 2015, up $7.9 million but down 0.3 percentage points.

- Operating income in dollars increased due primarily to increases in net revenues.

- Operating income as a percentage of net revenues decreased due primarily to changes in geographic and customer mix during the six months ended April 30, 2016, as well as an increased research and development spend, which reflects our ongoing investment in additional resources to bring next generation products and solutions to market.

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Verifone Services Net Revenues and Operating Income

Verifone Services delivers a variety of service solutions that are designed to be complimentary to our systems. These solutions ensure secure electronic payment transactions, provide value-added services to our merchants and enhance the consumer experience. Device-related services include mechanical and support services such as terminal leasing, “break fix” maintenance work, and call center support. Payment-related services include transaction routing, software development and licensing, and security services, such as encryption, tokenization, and our Secure Commerce Architecture. Commerce-related services include our digital media business, which delivers advertising and marketing content to over 100,000 screens, and taxi related services such as mobile hailing.

Three Months Ended April 30, 2016 compared to April 30, 2015

	Three Months Ended April 30,					
	2016	% of net revenues		2015	% of net revenues	
	(in thousands, except percentages)					
Net revenues	$189,913	35.7	%	$165,966	33.9	%
Operating income	$46,446	24.5	%	$38,535	23.2	%

Net revenues for the three months ended April 30, 2016 were $189.9 million compared to $166.0 million for the three months ended April 30, 2015, up $23.9 million or 14.4%, net of a $9.1 million negative impact due to unfavorable foreign currency fluctuations.

- Net revenues increased $12.7 million from the acquisition of InterCard in December 2015 and $6.7 million from the acquisition of AJB in February 2016.

- The remaining increase in net revenues is due to growing demand for device-related and payment-related services, particularly in Australia and New Zealand, as additional devices are sold globally.

Operating income for the three months ended April 30, 2016 was $46.4 million or 24.5% of net revenues, compared to $38.5 million or 23.2% of net revenues for the three months ended April 30, 2015, up $7.9 million or 1.3 percentage points.

- Operating income in dollars increased due primarily to increases in net revenues.

- Operating income as a percentage of net revenues increased due primarily to changes in geographic mix and the higher margins from our recently acquired businesses, InterCard and AJB.

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Six Months Ended April 30, 2016 compared to April 30, 2015

	Six Months Ended April 30,					
	2016	% of net revenues		2015	% of net revenues	
	(in thousands, except percentages)					
Net revenues	$365,877	35.0	%	$339,480	34.8	%
Operating income	$88,575	24.2	%	$81,351	24.0	%

Net revenues for the six months ended April 30, 2016 were $365.9 million compared to $339.5 million for the six months ended April 30, 2015, up $26.4 million or 7.8%, net of a $26.5 million negative impact due to unfavorable foreign currency fluctuations.

- Net revenues increased $17.0 million from the acquisition of InterCard in December 2015 and $6.7 million from the acquisition of AJB in February 2016.

- The remaining increase in net revenues is due primarily to growing demand for device-related and payment related services solutions as additional devices are sold globally.

Operating income for the six months ended April 30, 2016 was $88.6 million or 24.2% of net revenues, compared to $81.4 million or 24.0% of net revenues for the six months ended April 30, 2015, up $7.2 million or 0.2 percentage points.

- Operating income in dollars increased due primarily to increases in net revenues.

- Operating income as a percentage of net revenues increased due primarily to changes in geographic mix and the higher margins from our recently acquired businesses, InterCard and AJB.

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Financial Outlook

Overview

We expect the timing and amount of overall revenue growth to continue to be impacted by factors such as macroeconomic conditions, increased competition and pricing pressures, the timing of new product releases and certifications, the timing of our customers' technology refresh cycles, changes in distribution and distributor inventory levels, and continued uncertain political conditions in certain markets.

Global Markets and Competition

As a result of our global customer base, we expect that our net revenues will continue to be impacted by macroeconomic conditions such as foreign currency fluctuations, economic sanctions and other trade restrictions, and changing global oil prices, particularly in certain markets such as Argentina, Brazil, Russia, the Middle East, and Africa. We expect that continued uncertain political conditions in certain markets will have a negative impact on our ability to do business or operate at a desired level.

We expect that the markets in which we conduct our business will remain highly competitive, characterized by changing technologies, evolving industry standards and government regulations that may favor one product or technology over others, and increased demand for new functionality, premium services, mobility, and security. In particular, we expect that there will be continued demand for lower priced products in certain emerging markets, such as Brazil, China and India. We expect the pricing pressures and/or aggressive pricing by competitors that we have seen in recent periods may have significant impact on our net revenues in the future. Market disruptions caused by new technologies, the entry of new competitors, mobile order and pay, the presence of strong local competition, consolidations among our customers and competitors, changes in regulatory requirements, timing of electronic payments initiatives that create demand for our products in emerging markets, new technology entrants, and other factors, can introduce volatility into our business.

Our Business and Focus

We continue to focus on expanding our Services offerings globally. We are investing in select markets in order to expand our payment-related services solutions into new countries and to improve the functionality of our payment-related services solutions in existing markets. We also continue to invest in digital media expansion and on commerce enablement solutions, using our consumer-facing point of sale terminals to offer services complementary to our payment solutions that facilitate commerce between merchants and consumers. We expect continued growth in Services net revenues as a result of these efforts. As we transition to more service oriented arrangements, we may experience a shift in the timing of Systems net revenues as revenue recognition will depend on when all of our performance obligations are complete.

We expect the timing of new product releases to continue to have a significant impact on our net revenues. Net revenues can vary significantly when larger customers or distributors cancel or delay orders due to changes in regulatory and industry standards, budget considerations, product feature availability, dual vendor sourcing requirements, technology refresh cycles, economic conditions or other concerns that impact their business or purchasing decisions. Also, demand for electronic payment systems may eventually reach a saturation point, at which time customers might slow or end expansion projects. We expect to generate additional net revenues in the U.S. related to the continued adoption of EMV standards in the future, particularly by the petroleum market and small and medium businesses, and increased desire for mobile payment devices, although the timing of any related revenues will depend on the timing of decisions by merchants. We expect growth in emerging markets as economic conditions improve and those markets make efforts to modernize to cashless payment systems.

As part of our transformation initiatives, we continue to focus on research and development activities and expect to continue at current spend levels as we focus on platform development efforts and gateway consolidation in order to increase standardization, shorten our product development life-cycle and time to market, and also ensure timely certification of our products in each market.

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We plan to continue efforts to improve our cost structure and streamline all aspects of our business, including a strategic review of under-performing products and businesses, as well as consolidating and upgrading some of our global suppliers. In connection with our transformation efforts, we have approved restructuring plans under which we have reduced headcount and closed facilities. We expect to incur additional costs under the previously approved plans and expect to approve additional plans and make strategic changes with regard to some under-performing businesses before our transformation efforts are complete. Our existing and future restructuring plans may generate ongoing savings, some of which will continue to be reinvested into growth initiatives as part of our transformation program. Overall, spending may increase further depending on the costs of any future restructuring plans, costs associated with new acquisitions or ongoing integration of past acquisitions, costs to exit under-performing businesses, as well as costs related to resolving legal and tax matters.

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Liquidity and Capital Resources

Our primary liquidity and capital resource needs are to finance working capital, pay for contractual commitments, service our debt, and make capital expenditures and investments. As of April 30, 2016, our primary sources of liquidity were $156.6 million of cash and cash equivalents, as well as amounts available to us under the revolving loan that is part of our 2011 Credit Agreement.

Cash and cash equivalents as of April 30, 2016 included $156.4 million held by our foreign subsidiaries. If we decide to distribute or use the cash and cash equivalents held by our foreign subsidiaries outside those foreign jurisdictions, including a distribution to the U.S., we may be subject to additional taxes or costs, or face regulatory restrictions on the amount of cash that can be distributed out of some countries.

We also held $10.6 million in restricted cash as of April 30, 2016, which was mainly comprised of pledged deposits.

As of April 30, 2016, our outstanding borrowings consisted of a $547.5 million term A loan, $196.5 million term B loan, $218.2 million drawn against a revolving loan commitment, and $5.4 million under capital leases and other debt. In addition, $281.8 million was available for draw on the revolving loan commitment, subject to covenant requirements. See Note 9, Financings, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q for additional information regarding our borrowings. We were in compliance with all financial covenants under our credit agreement as of April 30, 2016.

As of April 30, 2016, we had outstanding interest rate swap agreements to effectively convert $500.0 million of the term A loan from a floating rate plus applicable margin to a 1.20% fixed rate plus applicable margin. The principal amount under the term A loan covered by the new interest rate swap agreements will decrease to $450.0 million from April 1, 2017 through September 30, 2017, and $400.0 million from October 1, 2017 through March 30, 2018. See Note 7, Financial Instruments, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q for additional information regarding the swap agreements.

In September 2015, our Board of Directors authorized a program to repurchase shares of our common stock with an aggregate value of up to $200.0 million, with no expiration from the date of authorization. During the six months ended April 30, 2016 we repurchased approximately 2.6 million shares of our common stock on the open market at an average repurchase price of $28.02 per share. As of April 30, 2016, there was approximately $50.0 million remaining available for stock repurchases. The timing and actual amount of the share repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities, including mergers and acquisitions, market conditions and other factors. We are not obligated to repurchase any specific number of shares under the program and the repurchase program may be modified, suspended or discontinued at any time.

On December 23, 2015, in connection with the acquisition of InterCard AG, we paid 85.0 million Euro in cash (approximately $92.4 million at the foreign exchange rate on the acquisition date.) We will also pay 1.2 million Euro (approximately $1.4 million at the foreign exchange rate as of April 30, 2016), related to this acquisition during the third quarter of fiscal 2016.

During February 2016 we made cash payments totaling approximately $87.5 million in connection with the acquisition of AJB.

Our future capital requirements may vary significantly from prior periods as well as from those capital requirements we have currently planned. These requirements will depend on a number of factors, including operating factors such as our terms and payment experience with customers, the timing of annual recurring billings in some markets, the resolution of any legal proceedings against us or settlement of litigation in an amount in excess of our insurance coverage, costs related to acquisitions, restructuring expenses, stock repurchases and investments we may make in infrastructure, product or market development, or to expand our revenue generating asset base as well as timing and availability of financing. Based upon our current level of operations, we believe that we have the financial resources to meet our business requirements for the next year, including capital expenditures, working capital requirements, future strategic investments and debt servicing costs, stock repurchases, and to maintain compliance with our financial covenants.

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Bank Guarantees

We have issued bank guarantees with maturities ranging from two months to six years to certain of our customers and vendors as required in some countries to support certain performance obligations under our service or other agreements with those parties. As of April 30, 2016, the maximum amount that may become payable under these guarantees was $11.9 million, of which $1.4 million was collateralized by restricted cash deposits.

Statement of Cash Flows

The net decrease in cash and cash equivalents are summarized in the following table (in thousands):

	Six Months Ended April 30,		
	2016	2015	Change
Net cash provided by (used in):			