PACIFIC ENTERPRISES INC
Form 10-Q
November 02, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

Commission File Number	Name of Registrant, State of Incorporation, Address and Telephone Number	I.R.S. Employer Identification No.
1-40	Pacific Enterprises (A California Corporation) 101 Ash Street San Diego, California 92101 (619) 696-2000	94-0743670
1-1402	Southern California Gas Company (A California Corporation) 555 West Fifth Street Los Angeles, California 90013 (213) 244-1200	95-1240705

No Change

(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 X No

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

Large accelerated filer	[ ]	Accelerated filer	[ ]	Non-accelerated filer	[X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock outstanding:

Pacific Enterprises	Wholly owned by Sempra Energy
Southern California Gas Company	Wholly owned by Pacific Enterprises

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INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report contains statements that are not historical fact and constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words "estimates," "believes," "expects," "anticipates," "plans," "intends," "may," "could," "would" and "should" or similar expressions, or discussions of strategy or of plans are intended to identify forward-looking statements. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Future results may differ materially from those expressed in these forward-looking statements.

Forward-looking statements are necessarily based upon various assumptions involving judgments with respect to the future and other risks, including, among others, local, regional and national economic, competitive, political, legislative and regulatory conditions and developments; actions by the California Public Utilities Commission, the California State Legislature, and the Federal Energy Regulatory Commission and other regulatory bodies in the United States; capital markets conditions, inflation rates, interest rates and exchange rates; energy and trading markets, including the timing and extent of changes in commodity prices; the availability of natural gas; weather conditions and conservation efforts; war and terrorist attacks; business, regulatory, environmental and legal decisions and requirements; the status of deregulation of retail natural gas and electricity delivery; the timing and success of business development efforts; the resolution of litigation; and other uncertainties, all of which are difficult to predict and many of which are beyond the control of the companies. Readers are cautioned not to rely unduly on any forward-looking statements and are urged to review and consider carefully the risks, uncertainties and other factors which affect the companies' business described in this report and other reports filed by the companies from time to time with the Securities and Exchange Commission.

PART I. FINANCIAL INFORMATION
ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

PACIFIC ENTERPRISES AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME

	Three months ended September 30,		Nine months ended September 30,	
(Dollars in millions)	2006	2005	2006	2005
		(unaudited)		
Operating revenues	$ 812	$ 910	$ 3,145	$ 3,091
Operating expenses				
Cost of natural gas	365	466	1,827	1,794
Other operating expenses	220	245	691	678
Litigation expense (adjustment)	2	88	(3)	88
Depreciation	67	66	200	198
Franchise fees and other taxes	26	26	92	87
Total operating expenses	680	891	2,807	2,845
Operating income	132	19	338	246
Other income (expense), net (Note 3)	(1)	5	(3)	4
Interest income	13	8	52	18
Interest expense	(20)	(13)	(57)	(37)
Income before income taxes	124	19	330	231
Income tax expense (benefit)	63	(24)	151	61
Net income	61	43	179	170
Preferred dividend requirements	1	1	3	3
Earnings applicable to common shares	$ 60	$ 42	$ 176	$ 167

See notes to Consolidated Financial Statements.

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PACIFIC ENTERPRISES AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	September 30, 2006	December 31, 2005
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 341	$ 90
Accounts receivable - trade	324	694
Accounts receivable - other	22	37
Interest receivable	10	9
Due from unconsolidated affiliates	41	5
Income taxes receivable	90	166
Deferred income taxes	24	20
Regulatory assets arising from fixed-price contracts and other derivatives	--	52
Other regulatory assets	35	36
Inventories	191	121
Other	21	16
Total current assets	1,099	1,246
Other assets:		
Due from unconsolidated affiliates	446	414
Other regulatory assets	169	143
Sundry	33	55
Total other assets	648	612
Property, plant and equipment:		
Property, plant and equipment	8,003	7,764
Less accumulated depreciation	(3,211)	(3,091)
Property, plant and equipment, net	4,792	4,673
Total assets	$ 6,539	$ 6,531

See notes to Consolidated Financial Statements.

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PACIFIC ENTERPRISES AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	September 30, 2006 (unaudited)	December 31, 2005
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term debt	$ --	$ 88
Accounts payable - trade	346	344
Accounts payable - other	100	76
Due to unconsolidated affiliates	80	176
Regulatory balancing accounts, net	109	13
Fixed-price contracts and other derivatives	6	52
Customer deposits	86	80
Current portion of long-term debt	--	8
Other	272	280
Total current liabilities	999	1,117
Long-term debt	1,107	1,100
Deferred credits and other liabilities:		
Customer advances for construction	87	74
Postretirement benefits other than pensions	60	65
Deferred income taxes	116	125
Deferred investment tax credits	36	38
Regulatory liabilities arising from removal obligations	1,118	1,097
Asset retirement obligations	527	504
Deferred taxes refundable in rates	220	200
Preferred stock of subsidiary	20	20
Deferred credits and other	328	357
Total deferred credits and other liabilities	2,512	2,480
Commitments and contingencies (Note 6)		
Shareholders' equity:		
Preferred stock	80	80
Common stock (600 million shares authorized;		

84 million shares outstanding; no par value)	1,464	1,453
Retained earnings	382	306
Accumulated other comprehensive income (loss)	(5)	(5)
Total shareholders' equity	1,921	1,834
Total liabilities and shareholders' equity	$ 6,539	$ 6,531

See notes to Consolidated Financial Statements.

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PACIFIC ENTERPRISES AND SUBSIDIARIES
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS

	Nine months ended September 30,	
(Dollars in millions)	2006	2005
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 179	$ 170
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	200	198
Deferred income taxes and investment tax credits	2	(16)
Accretion of interest	5	--
Other	(4)	(2)
Quasi-reorganization resolution	12	--
Net changes in other working capital components	476	114
Changes in other assets	3	7
Changes in other liabilities	8	100
Net cash provided by operating activities	881	571
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(284)	(245)
Increase in loans to affiliates, net	(114)	(161)
Proceeds from sale of assets	9	--
Other	--	(1)
Net cash used in investing activities	(389)	(407)
CASH FLOWS FROM FINANCING ACTIVITIES		
Common dividends paid	(150)	(150)
Preferred dividends paid	(3)	(3)
Decrease in short-term debt, net	(88)	(30)
Net cash used in financing activities	(241)	(183)
Increase (decrease) in cash and cash equivalents	251	(19)
Cash and cash equivalents, January 1	90	34
Cash and cash equivalents, September 30	$ 341	$ 15

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION				
Interest payments, net of amounts capitalized	$	45	$	29
Income tax payments, net of refunds	$	74	$	146

See notes to Consolidated Financial Statements.

SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME

	Three months ended September 30,		Nine months ended September 30,	
(Dollars in millions)	2006	2005	2006	2005
		(unaudited)		
Operating revenues	$ 812	$ 910	$ 3,145	$ 3,091
Operating expenses				
Cost of natural gas	365	466	1,827	1,794
Other operating expenses	220	245	690	678
Litigation expense (adjustment)	2	88	(3)	88
Depreciation	67	66	200	198
Franchise fees and other taxes	26	26	92	87
Total operating expenses	680	891	2,806	2,845
Operating income	132	19	339	246
Other expense, net (Note 3)	--	--	(1)	(1)
Interest income	7	3	23	8
Interest expense	(19)	(12)	(53)	(34)
Income before income taxes	120	10	308	219
Income tax expense (benefit)	59	(26)	139	55
Net income	61	36	169	164
Preferred dividend requirements	--	--	1	1
Earnings applicable to common shares	$ 61	$ 36	$ 168	$ 163

See notes to Consolidated Financial Statements.

SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	September 30,	December 31,
(Dollars in millions)	2006	2005
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 341	$ 90
Accounts receivable - trade	324	694
Accounts receivable - other	22	37
Interest receivable	10	9
Due from unconsolidated affiliates	36	1
Income taxes receivable	23	85
Deferred income taxes	23	20
Regulatory assets arising from fixed-price contracts and other derivatives	--	52
Other regulatory assets	35	36
Inventories	191	121
Other	21	15
Total current assets	1,026	1,160
Other assets:		
Other regulatory assets	169	143
Sundry	11	33
Total other assets	180	176
Property, plant and equipment:		
Property, plant and equipment	8,001	7,762
Less accumulated depreciation	(3,211)	(3,091)
Property, plant and equipment, net	4,790	4,671
Total assets	$ 5,996	$ 6,007

See notes to Consolidated Financial Statements.

SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	September 30, 2006	December 31, 2005
	(unaudited)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term debt	$ --	$ 88
Accounts payable - trade	346	344
Accounts payable - other	100	76
Due to unconsolidated affiliates	3	102
Regulatory balancing accounts, net	109	13
Fixed-price contracts and other derivatives	6	52
Customer deposits	86	80
Current portion of long-term debt	--	8
Other	271	280
Total current liabilities	921	1,043
Long-term debt	1,107	1,100
Deferred credits and other liabilities:		
Customer advances for construction	87	74
Postretirement benefits other than pensions	60	65
Deferred income taxes	133	145
Deferred investment tax credits	36	38
Regulatory liabilities arising from removal obligations	1,118	1,097
Asset retirement obligations	527	504
Deferred taxes refundable in rates	220	200
Deferred credits and other	302	324
Total deferred credits and other liabilities	2,483	2,447
Commitments and contingencies (Note 6)		
Shareholders' equity:		
Preferred stock	22	22
Common stock (100 million shares authorized;		
91 million shares outstanding; no par value)	866	866

Retained earnings		602		534
Accumulated other comprehensive income (loss)		(5)		(5)
Total shareholders' equity		1,485		1,417
Total liabilities and shareholders' equity	$	5,996	$	6,007

See notes to Consolidated Financial Statements.

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SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS

	Nine months ended September 30,	
(Dollars in millions)	2006	2005
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 169	$ 164
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	200	198
Deferred income taxes and investment tax credits	3	(7)
Accretion of interest	5	--
Other	(4)	--
Net changes in other working capital components	460	89
Changes in other assets	3	5
Changes in other liabilities	12	104
Net cash provided by operating activities	848	553
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(284)	(245)
Increase in loans to affiliate, net	(83)	(196)
Proceeds from sale of assets	9	--
Net cash used in investing activities	(358)	(441)
CASH FLOWS FROM FINANCING ACTIVITIES		
Common dividends paid	(150)	(100)
Preferred dividends paid	(1)	(1)
Decrease in short-term debt, net	(88)	(30)
Net cash used in financing activities	(239)	(131)
Increase (decrease) in cash and cash equivalents	251	(19)
Cash and cash equivalents, January 1	90	34
Cash and cash equivalents, September 30	$ 341	$ 15

SUPPLEMENTAL DISCLOSURE OF CASH FLOW

INFORMATION				
Interest payments, net of amounts capitalized	$	41	$	26
Income tax payments, net of refunds	$	74	$	152

See notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. GENERAL

This Quarterly Report on Form 10-Q is that of Pacific Enterprises (PE) and of Southern California Gas Company (SoCalGas) (collectively referred to as the company or the companies). PE's common stock is wholly owned by Sempra Energy, a California-based Fortune 500 holding company, and PE owns all of the common stock of SoCalGas. The financial statements herein are, in one case, the Consolidated Financial Statements of PE and its subsidiary, SoCalGas, and, in the other case, the Consolidated Financial Statements of SoCalGas and its subsidiaries, which comprise less than one percent of SoCalGas' consolidated financial position and results of operations.

Sempra Energy also indirectly owns all of the common stock of San Diego Gas & Electric Company (SDG&E). SoCalGas and SDG&E are collectively referred to herein as the Sempra Utilities.

The accompanying Consolidated Financial Statements have been prepared in accordance with the interim-period-reporting requirements of Form 10-Q. Results of operations for interim periods are not necessarily indicative of results for the entire year. In the opinion of management, the accompanying statements reflect all adjustments necessary for a fair presentation. These adjustments are only of a normal recurring nature.

Information in this Quarterly Report should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2005 (the Annual Report) and the Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006.

The companies' significant accounting policies are described in Note 1 of the notes to Consolidated Financial Statements in the Annual Report. The same accounting policies are followed for interim reporting purposes.

Certain prior period financial statement items have been reclassified to conform to current period presentation.

SoCalGas accounts for the economic effects of regulation on utility operations in accordance with Statement of Financial Accounting Standards (SFAS) 71*, Accounting for the Effects of Certain Types of Regulation.*

Quasi-reorganization

In 1993, PE effected a quasi-reorganization for financial reporting purposes as of December 31, 1992. During the third quarter of 2006, certain of the liabilities established in connection with the quasi-reorganization were favorably resolved, resulting in adjustments to common equity. Cash received from the resolution of an insurance claim related to quasi-reorganization issues was recorded as "quasi-reorganization resolution" on the Condensed Statements of Consolidated Cash Flows. The remaining liabilities of $26 million will be resolved in future years and management believes the provisions established for these matters are adequate.

Asset Retirement Obligations

Following are the changes in asset-retirement obligations, as defined in SFAS 143, *Accounting for Asset Retirement Obligations* and Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 47*, Accounting for Conditional Asset Retirement Obligations, an interpretation of SFAS 143*, for the nine months ended September 30, 2006 and 2005. FIN 47 was adopted prospectively on December 31, 2005.

(Dollars in millions)	2006	2005
Balance as of January 1	$ 505 *	$ 9
Accretion expense	24	1
Payments	--	(1)
Revision to estimated cash flows	1	1
Balance as of September 30	$ 530 *	$ 10

* The current portion of the obligation is included in Other Current Liabilities on the Consolidated Balance Sheets.

FIN 47 requires companies to record a liability for removing asbestos-containing materials, if the liability is determinable. The company's liability could not be determined and, therefore, no liability has been recognized for the related removal obligations. Since substantially all of the cost of removing such materials is expected to be recovered in rates, the effect of not recognizing these liabilities is not material to the company's financial condition or results of operations.

Pension and Other Postretirement Benefits

In accordance with SFAS 132 (revised), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, the following tables provide the components of benefit costs for the periods ended September 30:

	Pension Benefits		Other Postretirement Benefits	
	Three months ended		Three months ended	
	September 30,		September 30,	
(Dollars in millions)	2006	2005	2006	2005
Service cost	$ 9	$ 9	$ 4	$ 4
Interest cost	23	24	7	7
Expected return on assets	(24)	(25)	(9)	(8)
Amortization of:				
Prior service cost	2	2	(1)	--
Actuarial loss	1	2	(1)	--
Regulatory adjustment	(10)	(12)	1	7
Total net periodic benefit cost	$ 1	$ --	$ 1	$ 10

	Pension Benefits		Other Postretirement Benefits	
	Nine months ended		Nine months ended	
	September 30,		September 30,	
(Dollars in millions)	2006	2005	2006	2005
Service cost	$ 30	$ 27	$ 13	$ 14
Interest cost	71	72	27	30
Expected return on assets	(73)	(74)	(28)	(27)
Amortization of:				
Prior service cost	5	5	(4)	--
Actuarial loss	4	7	2	4
Regulatory adjustment	(35)	(35)	4	7
Total net periodic benefit cost	$ 2	$ 2	$ 14	$ 28

The company expects to contribute $1 million to its pension plan and $19 million to its other postretirement benefit plans in 2006. For the nine months ended September 30, 2006, $1 million and $19 million of contributions have been made to the pension and other postretirement benefit plans, respectively, including $1 million and $7 million, respectively, for the three months ended September 30, 2006.

NOTE 2. NEW ACCOUNTING STANDARDS

Pronouncements that have recently become effective that are relevant to the company and/or have had or may have a significant effect on the company's financial statements are described below.

SFAS 123 (revised 2004), "Share-Based Payment" (SFAS 123R): Effective January 1, 2006, Sempra Energy adopted SFAS 123 (revised 2004), which requires compensation costs related to share-based transactions, including employee stock options, to be recognized in the financial statements based on fair value. SFAS 123R revises SFAS 123, *Accounting for Stock-Based Compensation,* (SFAS 123) and supersedes Accounting Principles Board Opinion (APBO) 25, *Accounting for Stock Issued to Employees*. In March 2005, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin (SAB) 107 (SAB 107) regarding the SEC's interpretation of SFAS 123R and the valuation of share-based payments for public companies. Sempra Energy has applied the provisions of SAB 107 in its adoption of SFAS 123R.

Sempra Energy adopted the provisions of SFAS 123R using the modified prospective transition method. In accordance with this transition method, Sempra Energy's consolidated financial statements for prior periods have not been restated to reflect the impact of SFAS 123R. Under the modified prospective transition method, share-based compensation expense for the first quarter of 2006 includes compensation expense for all share-based compensation awards granted prior to, but for which the requisite service has not yet been performed as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. Share-based compensation expense for all share-based compensation awards granted after January 1, 2006 is based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Sempra Energy recognizes compensation costs net of an assumed forfeiture rate and recognizes the compensation costs for nonqualified stock options and restricted shares on a straight-line basis over the requisite service period of the award, which is generally four years. Sempra Energy estimates the forfeiture rate based on its historical experience. On January 1, 2006, Sempra Energy clarified for most restricted stock awards issued in 2003, 2004 and 2005, that Sempra Energy will offer to repurchase only enough shares to cover minimum tax withholding requirements upon vesting of the awards. Sempra Energy changed the accounting of these awards from liability to equity awards in accordance with SFAS 123R.

SFAS 154, "Accounting Changes and Error Corrections" (SFAS 154): SFAS 154 replaces APBO 20, *Accounting Changes*, and SFAS 3, *Reporting Accounting Changes in Interim Financial Statements*. Unless it is impracticable to do so, SFAS 154 requires retrospective application to prior periods' financial statements of voluntary changes in accounting principle and to changes required by an accounting pronouncement in instances where the pronouncement does not include specific transition provisions. This statement is effective for accounting changes and error corrections made in fiscal years beginning after December 15, 2005. No such changes have been made by the company in 2006.

SFAS 155, "Accounting for Certain Hybrid Financial Instruments" (SFAS 155): SFAS 155 is an amendment of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), and SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140). SFAS 155 amends SFAS 133 to allow financial instruments that have embedded derivatives to be accounted for as a whole, if the holder elects to account for the whole instrument on a fair value

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basis, and provides additional guidance on the applicability of SFAS 133 and SFAS 140 to certain financial instruments and subordinated concentrations of credit risk. SFAS 155 is effective for all hybrid financial instruments acquired or issued by the company on or after January 1, 2007. The company does not expect that this statement will have a significant effect on its consolidated financial statements.

SFAS 157, "Fair Value Measurements" (SFAS 157): SFAS 157 defines fair value, provides guidance for using fair value to measure assets and liabilities and expands disclosures about fair value measurements. SFAS 157 applies under other standards that require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The company is in the process of evaluating the effect of this statement on its consolidated financial position and results of operations.

SFAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS 158): SFAS 158 amends SFAS 87, *Employers' Accounting for Pensions,* SFAS 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,* SFAS 106, *Employers Accounting for Postretirement Benefits Other Than Pensions,* and SFAS 132 (revised), *Employers' Disclosures about Pensions and Other Postretirement Benefits*. SFAS 158 requires an employer to recognize in its statement of financial position an asset for a plan s overfunded status or a liability for a plan s underfunded status, measure a plan's assets and its obligations that determine its funded status as of the end of the company's fiscal year (with limited exceptions), and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in the company's comprehensive income and as a separate component of stockholders' equity. This statement is effective for fiscal years ending after December 15, 2006. Because the impact of this statement will be primarily at the Sempra Utilities, where the liabilities to be recorded are expected to be offset by regulatory assets, the company does not expect that this statement will have a significant impact on its consolidated financial condition or results of operations.

FIN 48, "Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109" (FIN 48): FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109, *Accounting for Income Taxes*. FIN 48 addresses how an entity should recognize, measure, classify and disclose in its financial statements uncertain tax positions that it has taken or expects to take in an income tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. The company is in the process of evaluating the effect of this guidance on its consolidated financial position and results of operations.

FASB Staff Position (FSP) FIN 46(R)-6, "Determining the Variability to Be Considered in Applying FIN 46(R)": FSP FIN 46(R)-6 addresses how variability should be considered when applying FIN 46(R), *Consolidation of Variable Interest Entities*. Variability affects the determination of whether an entity is a variable interest entity (VIE), which interests are variable interests, and which party, if any, is the primary beneficiary of the VIE required to be consolidated. This FSP is effective for the first reporting period beginning after June 15, 2006. The adoption of this FSP did not have an impact on the company's financial condition or results of operations. However, as the staff position is applied to future contracts, the impact in periods subsequent to adoption could be material.

NOTE 3. OTHER FINANCIAL DATA

Committed Lines of Credit

SoCalGas and its affiliate, SDG&E, have a combined $600 million five-year syndicated revolving credit facility expiring in 2010, under which each utility individually may borrow up to $500 million, subject to the combined borrowing limit for both utilities of $600 million. At September 30, 2006 and December 31, 2005, the company had no amounts outstanding under this facility. The facility provided support for $88 million of commercial paper outstanding at December 31, 2005. Additional information concerning this credit facility is provided in the Annual Report.

The company's weighted average interest rate on the total short-term debt outstanding was 4.26 percent at December 31, 2005.

Comprehensive Income

For the three months and nine months ended September 30, 2006 and 2005, comprehensive income was equal to net income.

Capitalized Interest

The company recorded $1 million and $2 million of capitalized interest for the three months and the nine months ended September 30, 2006, respectively, including the debt-related portion of allowance for funds used during construction. The company recorded $0.4 million and $1 million of capitalized interest for the three months and the nine months ended September 30, 2005, respectively, including the debt-related portion of allowance for funds used during construction.

Unpaid Capital Expenditures

During the nine months ended September 30, 2006, the amount of unpaid capital expenditures decreased by $5 million.

Other Income (Expense), Net

Other Income (Expense), Net consists of the following:

	Three months ended September 30,		Nine months ended September 30,	
(Dollars in millions)	2006	2005	2006	2005
Regulatory interest, net	$ (2)	$ (1)	$ (5)	$ (4)
Allowance for equity funds used during construction	2	2	5	4
Sundry, net	--	(1)	(1)	(1)
Total at SoCalGas	--	--	(1)	(1)
Additional at Pacific Enterprises:				
Preferred dividends of subsidiary	--	--	(1)	(1)
Sundry, net	(1)	5	(1)	6
Total	$ (1)	$ 5	$ (3)	$ 4

NOTE 4. FINANCIAL INSTRUMENTS

Fair Value Hedges

Interest-Rate Swaps

The company periodically enters into interest-rate swap agreements to moderate its exposure to interest-rate changes and to lower its overall cost of borrowing. These are described in Note 6 of the notes to Consolidated Financial Statements in the Annual Report.

Natural Gas Contracts

The use of derivative instruments is subject to certain limitations imposed by company policy and regulatory requirements. These instruments allow the company to estimate with greater certainty the effective prices to be received by the company and the prices to be charged to its customers. The company records transactions for natural gas contracts in Cost of Natural Gas in the Statements of Consolidated Income. Unrealized gains and losses related to these derivative instruments are offset by regulatory assets and liabilities on the Consolidated Balance Sheets to the extent derivative gains and losses associated with these derivative instruments will be payable or recoverable in future rates.

NOTE 5. REGULATORY MATTERS

CPUC RULEMAKING REGARDING ENERGY UTILITIES, THEIR HOLDING COMPANIES AND NON-REGULATED AFFILIATES

The California Public Utilities Commission (CPUC) continues to pursue its Order Instituting Ratemaking (OIR) regarding energy utilities, their holding companies and non-regulated affiliates, and a final CPUC decision is expected in late 2006. In September 2006, the CPUC staff issued its proposed draft changes to the rules governing affiliate transactions and executive compensation reporting which intend to strengthen the separation between the utility, its parent company and affiliates by eliminating perceived loopholes, requiring more complete reporting, eliminating certain shared services and protecting a utility's financial integrity from the business activities of its unregulated affiliates and parent company. A workshop was also held in September 2006 to discuss the proposed staff rule changes. An Administrative Law Judge proposed decision was issued in October 2006, recommending the approval of a number of the staff proposals but with certain measures clarified or eliminated altogether. Oral argument on the recommended rule changes was held in October 2006, and the CPUC is expected to issue a final decision by the end of 2006.

GAIN ON SALE RULEMAKING

In the second quarter of 2006, the CPUC adopted a decision standardizing the treatment of gains and losses on future sales of utility property. It provides for an allocation of 100 percent of the gains and losses from depreciable property to ratepayers and a 50/50 allocation of gains and losses from non-depreciable property between ratepayers and shareholders. Under certain circumstances the CPUC would be able to depart from the standard allocation. The CPUC's Division of Ratepayer Advocates and The Utility Reform Network filed a joint request for rehearing of the decision requesting, among other things, that the CPUC adopt a 90/10 allocation of gains from non-depreciable assets between ratepayers and shareholders. The request is pending before the CPUC.

GENERAL RATE CASE

In August 2006, SoCalGas tendered to the CPUC a Notice of Intent (NOI) to file a General Rate Case application to establish authorized 2008 revenue requirements and the ratemaking mechanisms by which those revenue requirements will change on an annual basis over the subsequent five-year period (2009-2013). Not included in the proceeding are natural gas costs. Included in the NOI are proposed mechanisms for earnings sharing, as well as performance indicators with a maximum annual reward/penalty of $13 million during the 2008-2013 period. Relative to authorized revenue requirements for 2006, the NOI represents an increase of $233 million in 2008. SoCalGas will file its General Rate Case application in December 2006, and a final CPUC decision is expected in December 2007.

NATURAL GAS MARKET OIR

The CPUC is considering natural gas market issues, including market design and infrastructure requirements, as part of its Natural Gas Market OIR. A final decision in Phase II of this proceeding was issued in September 2006, reaffirming the adequacy of the capacity of the SoCalGas and SDG&E systems to meet current demand. In particular, the Phase II decision establishes natural gas quality standards that would accommodate regasified liquefied natural gas (LNG) supplies. Several parties have recently filed applications with the CPUC for rehearing of the September 2006 decision, contending that the California Environmental Quality Act applies and that impacts on the environment should be fully considered.

In May 2006, in a related proceeding, the CPUC approved the Sempra Utilities' Phase I proposal to combine the natural gas transmission costs for SDG&E and SoCalGas so that their customers will pay the same rate for natural gas deliveries at any receipt point once LNG deliveries begin at the Otay Mesa interconnection. Phase II of this implementation proceeding addresses the Sempra Utilities' proposal to establish firm access rights and off-system delivery services to ensure that customers have reliable access to diverse supply sources. The CPUC held hearings on these proposals in July of 2006 and plans to issue a Phase II decision by the end of 2006.

UTILITY RATEMAKING INCENTIVE AWARDS

Performance-Based Regulation (PBR), demand-side management (DSM) and Gas Cost Incentive Mechanism (GCIM) awards are not included in the company's earnings until CPUC approval of each award is received. During the nine months ended September 30, 2006, SoCalGas included in pretax earnings $0.9 million related to PBR, none of which was recorded during the third quarter of 2006.

In October 2006, the CPUC approved SoCalGas' Year 11 GCIM shareholder award of $2.5 million, which was filed with the CPUC in June 2005. SoCalGas will recognize the award in pretax earnings in the fourth quarter of 2006. In June 2006, SoCalGas filed its GCIM Year 12 application requesting a shareholder award of $9.8 million. A schedule for the proceeding has not been established, but SoCalGas expects a CPUC decision in the first half of 2007.

The cumulative amount of the GCIM awards subject to refund based on the outcome of the Border Price Investigation discussed in Note 6 below is $69.2 million, of which $56.9 million has been included in current and/or prior years' pretax income.

NOTE 6. LITIGATION

At September 30, 2006, the company's reserves for litigation matters were $114 million, all of which related to settlements reached in January 2006 to resolve certain litigation arising out of the 2000 - 2001 California energy crisis. The uncertainties inherent in complex legal proceedings make it difficult to estimate with any degree of certainty the costs and effects of resolving legal matters. Accordingly, costs ultimately incurred may differ materially from estimated costs and could materially adversely affect the company's business, cash flows, results of operations and financial condition.

Continental Forge Settlement

The litigation that is the subject of the January 2006 settlements is frequently referred to as the Continental Forge litigation, although the settlements also include other cases. The Continental Forge class-action and individual antitrust and unfair competition lawsuits alleging that Sempra Energy and the Sempra Utilities unlawfully sought to control natural gas and electricity markets, claimed damages of $23 billion after applicable trebling. A second settlement resolves class-action litigation brought by the Nevada Attorney General in Nevada Clark County District Court involving virtually identical allegations to those in the Continental Forge litigation.

On June 14, 2006, the San Diego County Superior Court approved the settlement of the Continental Forge class-action litigation as fair and reasonable and a final order was entered on July 20, 2006. The California Attorney General, the Department of Water Resources (DWR), the Utility Consumers Action Network and two class members have filed notices of appeal of the final order. With respect to the individual Continental Forge lawsuits, the Los Angeles City Council has not yet voted to approve the City of Los Angeles' participation in the settlement and it may elect to continue pursuing its individual case against Sempra Energy and the Sempra Utilities. The Nevada Clark County District Court entered an order approving the Nevada class-action settlement on September 8, 2006. Both the California and Nevada settlements must be approved for either settlement to take effect, but Sempra Energy is permitted to waive this condition. The settlements are not conditioned upon approval by the CPUC, the DWR, or any other governmental or regulatory agency to be effective.

To settle the California and Nevada litigation, Sempra Energy would make cash payments in installments aggregating $377 million, of which $347 million relates to the Continental Forge and California class action price reporting litigation and $30 million relates to the Nevada antitrust litigation. Of the $377 million, Sempra Energy and the Sempra Utilities paid $83 million in August 2006.

Additional consideration for the California settlement includes an agreement that Sempra LNG would sell to the Sempra Utilities, subject to CPUC approval, regasified LNG from its LNG terminal being constructed in Baja California, Mexico at the California border index price minus $0.02. The Sempra Utilities agreed to seek approval from the CPUC to integrate their natural gas transmission facilities and to develop both firm, tradable natural gas receipt point rights for access to their combined intrastate transmission system and SoCalGas' underground natural gas storage system and filed for approval at the CPUC on July 25, 2006. In addition, Sempra Generation voluntarily would reduce the price that it charges for power and limit the places at which it would deliver power under its contract with the DWR. The price reductions would be reduced by any amounts that exceed a $150 million threshold up to the full amount of the price reduction that Sempra Generation is ordered to pay or incurs as a monetary award, any reduction in future revenues or profits, or any increase in future costs in connection with arbitration proceedings involving the DWR contract.

Other Natural Gas Cases

In November 2005, the California Attorney General and the CPUC filed a lawsuit in San Diego County Superior Court alleging that in 1998 Sempra Energy and the Sempra Utilities intentionally misled the CPUC, resulting in the utilities' California natural gas pipeline capacity being used to enable Sempra Energy to deliver natural gas to a power plant in Mexico. Plaintiffs also alleged that due to insufficient utility pipeline capacity, SDG&E curtailed natural gas service to electric generators and others, resulting in increased air pollution and higher electricity prices for California consumers from the use of oil as an alternate fuel source. On September 21, 2006, the parties entered into a settlement that provides for the

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Sempra Utilities to pay $2 million for attorneys' fees and costs incurred by the California Attorney General, SDG&E to be given the option to purchase Sempra Generation's El Dorado power plant in 2011 for book value subject to FERC approval, and Sempra Energy to pay approximately $5.7 million to SDG&E electricity customers beginning in 2009 to reduce SDG&E's electric procurement costs. The decisions by SDG&E and the CPUC as to whether the option should be exercised are expected to be made in 2007. In addition to resolving the lawsuit, the settlement includes as a condition precedent that within 90 days after the effective date of the agreement, the CPUC will permanently close the Border Price Investigation and Sempra Energy Affiliate Order Instituting Investigation. The company recorded after-tax expense of $0.8 million in the third quarter of 2006 to reflect these settlement costs.

In April 2003, Sierra Pacific Resources and its utility subsidiary Nevada Power filed a lawsuit in U.S. District Court in Las Vegas against major natural gas suppliers, including Sempra Energy, the Sempra Utilities and Sempra Commodities, seeking recovery of damages alleged to aggregate in excess of $150 million (before trebling). The lawsuit alleges that the Sempra Energy defendants conspired with El Paso Natural Gas Company to eliminate competition, prevent the construction of natural gas pipelines to serve Nevada and other Western states, and to manipulate natural gas pipeline capacity and supply and the data provided to price indices, in violation of Nevada's antitrust laws and RICO. Plaintiffs also assert a breach of contract claim against Sempra Commodities. The U.S. District Court dismissed the case in November 2004, determining that the FERC had exclusive jurisdiction to resolve claims. In January 2005, plaintiffs filed an appeal with the Ninth Circuit Court of Appeals, and the matter is pending oral argument before that court.

Apart from the claims settled in connection with the Continental Forge settlement, there remain pending 13 antitrust actions that were filed and have been coordinated in San Diego Superior Court against Sempra Energy and one or more of its affiliates (the Sempra Utilities and Sempra Commodities, depending on the lawsuit) and various, unrelated energy companies, alleging that energy prices were unlawfully manipulated by the reporting of artificially inflated natural gas prices to trade publications and by entering into wash trades and churning transactions. The plaintiffs suing the company claim that all of the defendants in the lawsuit have damaged them in the amount of $357 million before trebling. In June 2005, the court denied the defendants' motion to dismiss on preemption and Filed Rate Doctrine grounds. No trial date has been scheduled for these actions. Pending in the federal court system are five cases against Sempra Energy, Sempra Commodities, the Sempra Utilities and various other companies, which make similar allegations to those in the state proceedings, four of which also include conspiracy allegations similar to those made in the Continental Forge litigation. The District Court has dismissed four of these actions on the grounds that the claims asserted in these suits were preempted under federal law and the Filed Rate Doctrine. The remaining case, which includes conspiracy allegations, has been stayed. Plaintiffs have appealed the dismissals and the matters are pending oral argument in the Ninth Circuit Court of Appeals.

CPUC Border Price Investigation

In November 2002, the CPUC instituted an investigation into the Southern California natural gas market and the price of natural gas delivered to the California - Arizona border between March 2000 and May 2001. The portion of this investigation relating to the Sempra Utilities is currently stayed pending CPUC review and approval of a settlement (see below). If the investigation were to determine that the conduct of either of the Sempra Utilities contributed to the natural gas price spikes that occurred during the investigation period, the CPUC may modify the party's natural gas procurement incentive mechanism, reduce the amount of any shareholder award for the period involved and/or order the party to issue a refund to ratepayers. At September 30, 2006, the cumulative amount of these shareholder awards was $69.2 million, of which $56.9 million has been included in current and/or prior years' pretax income.

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Southern California Edison Company (Edison) has been the only party investigating the activities of SoCalGas, SDG&E and other Sempra Energy companies in the Border Price Investigation, and pursuing claims against them in the investigation. SoCalGas, SDG&E and Sempra Energy reached a settlement in May 2006 with Edison that, subject to CPUC review and approval, would resolve disputes between SoCalGas, SDG&E, the other Sempra Energy companies and Edison arising over the last several years regarding the actions and activities being reviewed in the Border Price Investigation, and Edison agreed to support dismissal of the Border Price Investigation. In June 2006, the CPUC granted the motion to stay the Border Price Investigation proceedings to allow the CPUC to consider the settlement. In September 2006, Edison filed a motion with the CPUC withdrawing all of its claims made against the Sempra Energy companies in the investigation, and the Sempra Utilities and Edison jointly requested that the Border Price Investigation be closed.

As discussed in the preceding paragraphs, a condition precedent of the September 2006 settlement of litigation discussed above under "Other Natural Gas Cases" is that the CPUC must permanently close the Border Price Investigation.

Other Litigation

In 1998, SoCalGas converted its traditional pension plan for non-union employees to a cash balance plan. In July 2005, a lawsuit was filed against the company in the U.S. District Court for the Central District of California alleging that the conversion unlawfully discriminated against older employees and failed to provide required disclosure of a reduction in benefits. In October 2005, the court dismissed three of the four causes of action. In March 2006, the court dismissed the remaining cause of action. The plaintiffs have appealed the court's ruling.

INCOME TAX MATTERS

The company's income tax returns are routinely examined by federal and state tax agencies. During 2005, the company resolved a number of issues in its federal and state income tax examinations that span the 1998 - 2001 period and recorded their effects. During 2006, the company resolved many of the remaining issues for these periods and several issues related to 2002 and 2003. Since not all issues have been resolved, the income tax liabilities for these years are not yet finally determined and the company continues to work with the agencies to respond to inquiries and resolve issues.

The company believes it has adequately provided for income tax issues not yet resolved with federal, state and foreign tax authorities. Although not probable, the most adverse resolution of these issues could result in additional charges to earnings in future periods. Based upon a consideration of all relevant facts and circumstances, the company does not believe the ultimate resolution of income tax issues for all open periods will have a materially adverse effect upon its results of operations or financial condition.

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Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the financial statements contained in this Form 10-Q and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" contained in the company's 2005 Annual Report on Form 10-K (the Annual Report).

RESULTS OF OPERATIONS

Comparison of Earnings

To assist the reader in understanding the trend of earnings, the following tables summarize the major unusual factors affecting net income and operating income for the nine month and three month periods ended September 30, 2006 and 2005. These factors are discussed elsewhere in this Quarterly Report and/or the Annual Report, and this summary should be read in conjunction with those discussions.

Pacific Enterprises (PE)

Nine months ended September 30

	Net Income		Operating Income	
(Dollars in millions)	2006	2005	2006	2005
Reported amounts	$ 179	$ 170	$ 338	$ 246
California energy crisis litigation reserves	(3)	53	(5)	88
Resolution of prior years' income tax issues	2	(22)	--	--
	$ 178	$ 201	$ 333	$ 334

Three months ended September 30

	Net Income		Operating Income	
(Dollars in millions)	2006	2005	2006	2005
Reported amounts	$ 61	$ 43	$ 132	$ 19
California energy crisis litigation reserves	--	53	1	88
Resolution of prior years' income tax issues	2	(18)	--	--
	$ 63	$ 78	$ 133	$ 107

Southern California Gas

Nine months ended September 30

	Net Income		Operating Income	
(Dollars in millions)	2006	2005	2006	2005
Reported amounts	$ 169	$ 164	$ 339	$ 246
California energy crisis litigation reserves	(3)	53	(5)	88
Resolution of prior years' income tax issues	1	(22)	--	--
	$ 167	$ 195	$ 334	$ 334

Three months ended September 30

	Net Income		Operating Income	
(Dollars in millions)	2006	2005	2006	2005
Reported amounts	$ 61	$ 36	$ 132	$ 19
California energy crisis litigation reserves	--	53	1	88
Resolution of prior years' income tax issues	1	(18)	--	--
	$ 62	$ 71	$ 133	$ 107

Revenue

During the nine months ended September 30, 2006, natural gas revenues increased compared to the corresponding period in 2005 as a result of higher volumes and higher natural gas costs, which are passed on to customers. Natural gas revenues decreased in the three months ended September 30, 2006 due to lower costs of natural gas and lower natural gas sales volumes.

Under the current regulatory framework, the cost of natural gas purchased for customers and the variations in that cost are passed through to customers on a substantially concurrent basis. However, SoCalGas' gas cost incentive mechanism (GCIM) allows SoCalGas to share in the savings or costs from buying natural gas for customers below or above market-based monthly benchmarks. Further discussion is provided in Notes 1 and 8 of the notes to Consolidated Financial Statements in the Annual Report.

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The table below summarizes natural gas volumes and revenues by customer class for the nine month periods ended September 30.

Natural Gas Sales, Transportation and Exchange

(Volumes in billion cubic feet, dollars in millions)

	Natural Gas Sales		Transportation and Exchange		Total	
	Volumes	Revenue	Volumes	Revenue	Volumes	Revenue
2006:						
Residential	176	$ 2,009	1	$ 4	177	$ 2,013
Commercial and industrial	79	747	203	157	282	904
Electric generation plants	--	--	147	59	147	59
Wholesale	--	--	99	27	99	27
	255	$ 2,756	450	$ 247	705	3,003
Balancing accounts and other						142
Total						$ 3,145
2005:						
Residential	174	$ 1,893	1	$ 4	175	$ 1,897
Commercial and industrial	79	725	203	132	282	857
Electric generation plants	--	--	110	38	110	38
Wholesale	--	--	110	50	110	50
	253	$ 2,618	424	$ 224	677	2,842
Balancing accounts and other						249
Total						$ 3,091

Litigation Expense

Litigation expense decreased by $91 million (103%) in the nine months ended September 30, 2006 and by $86 million (98%) in the three months ended September 30, 2006, primarily due to lower California energy crisis litigation expense.

Interest Income

Interest income increased by $34 million (189%) ($15 million (188%) at SoCalGas) for the nine months ended September 30, 2006 to $52 million ($23 million at SoCalGas), and by $5 million (63%) ($4 million (133%) at SoCalGas) for the three months ended September 30, 2006 to $13 million ($7 million at SoCalGas). The increase in the nine months ended September 30, 2006 was due to $13 million from the resolution of an insurance claim at PE related to a quasi-reorganization issue in the second quarter of 2006, higher interest resulting from increases in short-term investments and $6 million from a 2006 income tax audit settlement.

The increase in the three months ended September 30, 2006 was due to higher interest resulting from increases in short-term investments.

Interest Expense

Interest expense increased by $20 million (54%) ($19 million (56%) at SoCalGas) for the nine months ended September 30, 2006 to $57 million ($53 million at SoCalGas), and by $7 million (54% at PE and 58% at SoCalGas) for the three months ended September 30, 2006 to $20 million ($19 million at SoCalGas).

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The increases were due to higher interest expense at SoCalGas associated with the $250 million first mortgage bonds issued in November 2005, higher variable rates, and the accretion of interest related to the California energy crisis litigation settlement.

Income Taxes

Income tax expense was $151 million and $61 million ($139 million and $55 million for SoCalGas) for the nine months ended September 30, 2006 and 2005, respectively, and the effective income tax rates for the company were 46 percent and 26 percent (45 percent and 25 percent for SoCalGas), respectively.

Income tax expense (benefit) was $63 million and $(24) million ($59 million and $(26) million for SoCalGas) for the three months ended September 30, 2006 and 2005, respectively, and the effective income tax rates were 51 percent and (126) percent (49 percent and (260) percent for SoCalGas), respectively.

The increases in income tax expense for both the three months and nine months ended September 30, 2006 were due primarily to higher pretax income in 2006 and the favorable resolution of prior years' income tax issues in 2005. The increases in the effective tax rates were due primarily to the lower favorable resolution of prior years' income tax issues in 2006.

Net Income

Net income for SoCalGas increased by $5 million (3%) to $169 million for the nine months ended September 30, 2006, due primarily to a $56 million reduction in litigation expense as a result of the California energy crisis reserve established in 2005 and $7 million from the positive resolution in 2006 of a natural gas royalty matter, offset by $23 million lower favorable resolution of prior years' income tax issues, $11 million from the reversal in 2005 of the 2004 revenue sharing reserve resulting from the California Public Utilities Commission (CPUC)'s 2004 Cost of Service decision and higher income tax expense of $24 million. Net income for SoCalGas for the three months ended September 30, 2006 increased by $25 million (69%) to $61 million due to a $53 million reduction in California energy crisis litigation expense and an increase of $11 million due to improved margins, offset by $19 million lower favorable resolution of prior years' income tax issues and higher income tax expense of $21 million. The nine months ended September 30, 2006 included $8 million of after-tax interest income at PE only related to the resolution of an insurance claim.

CAPITAL RESOURCES AND LIQUIDITY

At September 30, 2006, the company had $341 million in unrestricted cash and $500 million in available unused, committed lines of credit at SoCalGas which are shared with SDG&E and which are discussed more fully in Note 3 of the notes to Consolidated Financial Statements. Management believes that these amounts and cash flows from operations and security issuances will be adequate to finance capital expenditures and meet liquidity requirements and other commitments. Management continues to regularly monitor SoCalGas' ability to finance the needs of its operating, investing and financing activities in a manner consistent with its intention to maintain strong, investment-quality credit ratings.

CASH FLOWS FROM OPERATING ACTIVITIES

Net cash provided by PE's operating activities increased by $310 million (54%) to $881 million for 2006. For SoCalGas, net cash provided by operating activities increased by $295 million (53%) to $848 million for 2006. The changes were primarily due to a higher increase in overcollected regulatory balancing accounts in 2006 and an increase in income taxes payable in 2006 compared to a decrease in 2005, offset by a decrease in other liabilities in 2006.

For the nine months ended September 30, 2006, the company made contributions of $1 million and $19 million to the pension and other postretirement benefit plans, respectively.

CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used in PE's investing activities decreased by $18 million (4%) to $389 million for 2006. Net cash used in SoCalGas' investing activities decreased by $83 million (19%) to $358 million for 2006. The decreases were primarily due to lower advances to Sempra Energy in 2006, offset by increased capital expenditures.

Significant capital expenditures in 2006 are expected to be $450 million for improvements to distribution and transmission systems. These expenditures are expected to be financed by cash flows from operations and security issuances.

CASH FLOWS FROM FINANCING ACTIVITIES

Net cash used in PE's financing activities increased by $58 million (32%) to $241 million for 2006. Net cash used in SoCalGas' financing activities increased by $108 million (82%) to $239 million for 2006. The increases were attributable to higher payments on short-term debt in 2006. The increase in cash used at SoCalGas in financing activities was also attributable to $50 million in common dividends paid to PE in 2006 that were declared in the fourth quarter of 2005.

COMMITMENTS

At September 30, 2006, there were no significant changes to the commitments that were disclosed in the Annual Report, except for an increase of $2.7 billion related to new natural gas contracts at SoCalGas. Additionally, the pension and postretirement benefit obligation from 2006 through 2015 increased by $221 million at September 30, 2006 due to the enactment of the Pension Protection Act of 2006, which generally accelerates the required funded status of the company's pension plans. The future payments under the new natural gas contracts are expected to be $137 million for 2006, $871 million for 2007, $553 million for 2008, $467 million for 2009, $426 million for 2010 and $255 million thereafter.

FACTORS INFLUENCING FUTURE PERFORMANCE

Performance of the company will depend primarily on the ratemaking and regulatory process, natural gas industry restructuring, and the changing energy marketplace. Performance will also depend on the successful completion of construction programs, which are discussed in various places in this report. These factors are discussed in Note 5 of the notes to Consolidated Financial Statements herein.

Litigation

Note 6 of the notes to Consolidated Financial Statements herein and Note 9 of the notes to Consolidated Financial Statements in the Annual Report describe litigation (primarily cases arising from the California energy crisis), the ultimate resolution of which could have a material adverse effect on future performance.

Industry Developments

Note 5 of the notes to Consolidated Financial Statements herein and Note 8 of the notes to Consolidated Financial Statements in the Annual Report describe natural gas restructuring and rates, and other pending proceedings and investigations.

NEW ACCOUNTING STANDARDS

Relevant pronouncements that have recently become effective and have had or may have a significant effect on the company's financial statements are described in Note 2 of the notes to Consolidated Financial Statements.

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

There have been no significant changes in the risk issues affecting the company subsequent to those discussed in the Annual Report.

As of September 30, 2006, the total Value at Risk of SoCalGas' positions was not material.

ITEM 4. **CONTROLS AND PROCEDURES**

Company management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rules 13a-15(f). The company has designed and maintains disclosure controls and procedures to ensure that information required to be disclosed in the company's reports is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and is accumulated and communicated to the company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating these controls and procedures, management recognizes that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired objectives and necessarily applies judgment in evaluating the cost-benefit relationship of other possible controls and procedures.

There have been no changes in the company's internal controls over financial reporting during the company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the company's internal controls over financial reporting.

The company evaluates the effectiveness of its internal control over financial reporting based on the framework in *Internal Control--Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, the company evaluated the effectiveness of the design and operation of the company's disclosure controls and procedures as of September 30, 2006, the end of the period covered by this report. Based on that evaluation, the company's Chief Executive Officer and Chief Financial Officer concluded that the company's disclosure controls and procedures were effective at the reasonable assurance level.

PART II - OTHER INFORMATION

ITEM 1. **LEGAL PROCEEDINGS**

Except as described in Notes 5 and 6 of the notes to Consolidated Financial Statements herein, neither the company nor its subsidiaries are party to, nor is their property the subject of, any material pending legal proceedings other than routine litigation incidental to their businesses.

ITEM 1A. **RISK FACTORS**

There have been no material changes from risk factors as previously disclosed in the company's 2005 Annual Report on Form 10-K.

ITEM 6. **EXHIBITS**

Exhibits

Exhibit 12 - Computation of ratios

12.1 Computation of Ratio of Earnings to Fixed Charges of PE.

12.2 Computation of Ratio of Earnings to Fixed Charges and Preferred Stock Dividends of SoCalGas.

Exhibit 31 -- Section 302 Certifications

31.1 Statement of PE's Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

31.2 Statement of PE's Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

31.3 Statement of SoCalGas' Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

31.4 Statement of SoCalGas' Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

Exhibit 32 -- Section 906 Certifications

32.1 Statement of PE's Chief Executive Officer pursuant to 18 U.S.C. Sec. 1350.

32.2 Statement of PE's Chief Financial Officer pursuant to 18 U.S.C. Sec. 1350.

32.3 Statement of SoCalGas' Chief Executive Officer pursuant to 18 U.S.C. Sec. 1350.

32.4 Statement of SoCalGas' Chief Financial Officer pursuant to 18 U.S.C. Sec. 1350.

SIGNATURES

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

	PACIFIC ENTERPRISES, (Registrant)
Date: November 2, 2006	By: /s/ Dennis V. Arriola
	Dennis V. Arriola Sr. Vice President and Chief Financial Officer
	SOUTHERN CALIFORNIA GAS COMPANY, (Registrant)
Date: November 2, 2006	By: /s/ Dennis V. Arriola
	Dennis V. Arriola Sr. Vice President and Chief Financial Officer

uarter of 2006. The payment of dividends on our common stock in the future will be at the discretion of our Board of Directors and will depend on, among other factors, our earnings, stockholders' equity, cash position and financial condition. On February 2, 2016, our Board of Directors declared a quarterly cash dividend of $0.10 per share of common stock, payable on March 15, 2016 to stockholders of record as of March 1, 2016.

Securities Authorized For Issuance Under Equity Compensation Plans

We maintain the Heartland Payment Systems, Inc. Amended and Restated 2008 Equity Incentive Plan under which shares of our common stock are authorized for issuance. For more information on this plan, see Note 14, Stock Incentive Plans. Information regarding the common stock issuable under this plan as of December 31, 2015 is set forth in the following table:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)
Equity compensation plans approved by security holders	1,035,950	$54.87	1,035,950
Equity compensation plans not approved by security holders	None	N/A	None
Total	1,035,950	$54.87	1,035,950

Purchases of Equity Securities by the Issuer

Open Repurchase Authorization. On May 8, 2014, our Board of Directors authorized the repurchase of up to $75 million of our outstanding stock. We intend to fund any repurchases with cash flow from operations, existing cash on the balance sheet, and other sources including our 2014 Revolving Credit Facility. The manner, timing and amount of repurchases,

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if any, will be determined by management and will depend on a variety of factors, including price, corporate and regulatory requirements, market conditions and other corporate liquidity requirements. The repurchase program may be modified or discontinued at any time. As of December 31, 2015, we have not repurchased any shares under the May 8, 2014 authorization.

Under the Merger Agreement, our repurchase activity after December 15, 2015 is limited to repurchases made to satisfy tax withholding amounts arising from stock option exercises or vesting of restricted shares.

Performance Graph

The following graph compares the percentage change in cumulative total stockholder return on our common stock for the past five years with the cumulative total returns over the same period of (i) the S&P 500 Index and (ii) the S&P Information Technology Index.

The below comparison assumes $100 was invested on December 31, 2010 in our common stock and in the S&P 500 Index and the S&P Information Technology Index, and assumes reinvestment of dividends, if any. Historical stock prices are not indicative of future stock price performance.

	Base Period	Period Ended				
	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
Heartland Payment Systems, Inc.	$100.00	$159.25	$194.43	$331.09	$361.08	$638.98
S&P 500	100.00	102.11	118.45	156.82	178.29	180.75
S&P Information Technology Index	100.00	102.41	117.59	151.03	181.40	192.15

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected historical consolidated financial information and other data for the years ended December 31, 2015, 2014, and 2013, which are derived from our consolidated financial statements included elsewhere in this report. Historical consolidated financial information for 2012 and 2011 are derived from our consolidated financial statements for those years (not included herein). The information in the following table should be read together with “Management's Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes included elsewhere in this report.

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	Year Ended December 31,				
	2015	2014	2013	2012	2011
Income Statement Data:	(In thousands, except per share data)				
Total revenues	$2,682,396	$2,311,381	$2,135,372	$2,013,436	$1,985,577
Total costs of services	2,292,843	2,001,342	1,835,706	1,763,701	1,783,731
General and administrative	244,005	190,554	173,568	139,934	125,765
Goodwill impairment charge	—	18,490	—	—	—
Asset impairment charges	—	18,875	—	—	—
Total expenses	2,536,848	2,229,261	2,009,274	1,903,635	1,909,496
Income from operations	145,548	82,120	126,098	109,801	76,081
Net income from continuing operations	84,732	31,868	74,102	64,353	42,988
Net income attributable to Heartland	84,732	33,879	78,626	65,889	43,939
Basic earnings per share:					
Income from continuing operations	$2.31	$0.93	$2.03	$1.67	$1.10
Income from discontinued operations	$—	$—	$0.11	$0.04	$0.03
Basic earnings per share	$2.31	$0.93	$2.14	$1.71	$1.13
Diluted earnings per share:					
Income from continuing operations	$2.28	$0.91	$1.96	$1.60	$1.07
Income from discontinued operations	$—	$—	$0.10	$0.04	$0.02
Diluted earnings per share	$2.28	$0.91	$2.06	$1.64	$1.09
Weighted average number of common shares outstanding:					
Basic	36,646	36,354	36,791	38,468	38,931
Diluted	37,237	37,187	38,053	40,058	40,233
Dividends declared per share	$0.40	$0.34	$0.28	$0.24	$0.16
Other Data:					
Net revenue*	$822,958	$672,625	$598,982	$529,895	$470,896
Operating margin	17.7 %	12.2 %	21.1 %	20.7 %	16.2 %

*Net revenue is defined as total revenues less Interchange fees and dues, assessments, and fees.

	As of December 31,				
	2015	2014	2013	2012	2011
Balance Sheet Data (a):	(In thousands)				
Total assets	$1,536,679	$1,378,465	$890,757	$802,939	$590,175
Current portion of borrowings	43,793	36,792	—	102,001	15,003
Long-term borrowings	437,842	523,122	150,000	50,000	70,000
Total liabilities	1,200,857	1,127,705	624,094	591,778	370,123
Total equity	335,822	250,760	260,475	209,786	219,410

(a) Total assets and total liabilities have been retrospectively adjusted to reflect the adoption of the new accounting standards update regarding the classification of deferred taxes. See "Note 2, Summary of Significant Accounting Policies — New Accounting Pronouncements" for a discussion of this new accounting standards update.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and the accompanying notes to consolidated financial statements and the risk factors included elsewhere in this report.

Overview

General

Our primary business is to provide Payment Processing services to merchants throughout the United States. This involves providing end-to-end electronic payment processing services to merchants by facilitating the exchange of information and funds between them and cardholders' financial institutions. To accomplish this, we undertake merchant set-up and training,

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transaction authorization and electronic draft capture, clearing and settlement, merchant accounting, merchant assistance and support, and risk management. Our card-accepting customers primarily fall into two categories: our core small and mid-sized merchants (referred to as "Small and Midsized Enterprises," or “SME merchants”) and Network Services merchants, predominantly petroleum industry merchants of all sizes (referred to as “Network Services merchants”).

We provide additional services such as:

- Integrated commerce solutions, payment processing, higher education loan services and open and closed-loop payment solutions to higher-education institutions through Campus Solutions,
- School nutrition, point-of-sale solutions ("POS"), and associated payment solutions, including online prepayment solutions, to kindergarten through 12th grade ("K-12") schools through Heartland School Solutions,
- Full-service payroll processing and related tax filing services throughout the United States provided by Heartland Payroll Solutions, and
- Other, including (1) prepaid and stored-value card solutions throughout the United States and Canada provided by Micropayments, (2) POS solutions and other adjacent business service applications provided by Heartland Commerce, and (3) marketing solutions including loyalty and gift cards which we provide through Heartland Marketing Solutions.

Agreement and Plan of Merger

On December 15, 2015, we entered into the Merger Agreement with Global and the Merger Subs. Pursuant to the terms and subject to the conditions set forth in the Merger Agreement, Global will acquire the Company through a two-step transaction. First, Merger Sub One will merge with and into the Company, with the Company continuing as a wholly owned subsidiary of Global. Second, the Company will merge with and into Merger Sub Two immediately following the initial merger, with Merger Sub Two surviving the second merger as a wholly owned subsidiary of Global.

As a result of the merger, subject to the terms and conditions of the Merger Agreement, each outstanding share of our common stock (other than certain shares owned by the parties to the Merger Agreement or by stockholders who have validly exercised their appraisal rights) will be converted into the right to receive (subject to adjustment as set forth in the next sentence) $53.28 in cash, without interest, and 0.6687 shares of Global common stock. Under the terms of the Merger Agreement, in the event that the number of shares of Global common stock issuable as a result of the merger would exceed 19.9% of the issued and outstanding shares of Global common stock immediately prior to the closing of the merger, the stock consideration will be reduced so that no more than 19.9% of the outstanding shares of Global common stock will be issuable in the merger and the cash consideration will be increased by a corresponding amount, so that the value of the per share merger consideration will remain the same.

Consummation of the merger is subject to customary conditions, including without limitation, (1) approval by the holders of at least a majority of the outstanding shares of our common stock, (2) the absence of any law or order of any governmental entity which prohibits the consummation of the merger, (3) the effectiveness under the Securities Act of 1933 (as amended) of the Registration Statement on Form S-4 filed by Global with respect to the merger, and (4) subject to certain materiality exceptions, the accuracy of the representations and warranties made by the parties and compliance by the parties with their respective obligations under the Merger Agreement.

Each of the Company and Global has made customary representations and warranties in the Merger Agreement. The Merger Agreement also contains customary covenants, including, without limitation, (1) covenants providing for the parties to use reasonable best efforts to cause the closing of the merger to be consummated, and (2) the Company’s agreement to not solicit proposals relating to alternative transactions to the merger or engage in discussions or negotiations with respect thereto, subject to certain exceptions. Additionally, the parties have agreed to select two Company nominees for appointment to Global’s board of directors in connection with the closing of the merger.

The Merger Agreement contains certain termination rights for Global and the Company, including a mutual termination right in the event the merger is not consummated by June 15, 2016 (subject to extension under certain circumstances). Upon termination of the Merger Agreement under specified circumstances described in the Merger Agreement, including (1) if Global terminates the Merger Agreement following a change of recommendation of the Company's board of directors, (2) if the Company terminates the Merger Agreement to enter into a definitive agreement with a third party with respect to a superior acquisition proposal, or (3) if the Merger Agreement is terminated under certain circumstances and the Company subsequently enters into, or consummates, an alternative acquisition proposal within 12 months, the Company will be required to pay Global a termination fee of $153,000,000.

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Certain terms of the Merger Agreement are summarized in, and the Merger Agreement has been filed as an exhibit to, the Current Report on Form 8-K filed by the Company on December 17, 2015.

See "Item 1A. Risk Factors-Risks Relating to the Merger with Global" for a description of certain risks related to this proposed transaction.

Payment Processing
At December 31, 2015, we provided our card payment processing services to 182,526 active SME merchants located across the United States. This compares to 169,831 active SME merchants at December 31, 2014. At December 31, 2015, we provided card payment processing services to approximately 3,194 Network Services merchants with approximately 43,987 locations, compared to 2,181 Network Services merchants with 42,397 locations at December 31, 2014. The increase in the number of Network Services merchants in 2015 primarily reflects adding smaller-size merchants (merchants with single or few locations), predominantly in the petroleum industry.

Our total card processing volume for the year ended December 31, 2015 was $117.4 billion, a 6.8% increase from the $109.9 billion processed during the year ended December 31, 2014. Our SME card processing volume for the year ended December 31, 2015 was $93.1 billion, a 14.8% increase over $81.1 billion in 2014. This increase in processing volume reflects same store sales growth and the addition of SME merchants whose processing volume exceeded that of merchants who attrited during the year. The increase in SME processing volume also reflects the impact of American Express Card Acceptance Program (referred to as "OptBlue") provided to new and existing merchants. We converted a majority of our existing merchants processing under the former sales and servicing agreement with American Express to OptBlue during the third quarter of 2014. For the year ended December 31, 2015, our OptBlue processing volume was $6.5 billion as compared to $2.6 billion for the year ended December 31, 2014. Our card processing volume for 2015 also includes $24.3 billion of settled volume for Network Services merchants, compared to $28.8 billion for 2014. The decrease in Network Services card processing volume primarily reflects lower gasoline prices at our petroleum industry customers. Card processing volume for the years ended December 31, 2015, 2014 and 2013 was as follows:

	Year Ended December 31,		
	2015	2014	2013
	(In millions)		
SME merchants	$93,080	$81,077	$74,578
Network Services merchants	24,295	28,848	27,710
Canada (a)	—		59
Total card processing volume (b)	$117,375	$109,925	$102,347

(a) Canadian operations were discontinued as result of the sale of CPOS in January 2013.
(b) Card processing volume includes volume for credit and signature debit transactions.

Merchant attrition is expected in the card payment processing industry in the ordinary course of business. We experience attrition in merchant card processing volume resulting from several factors, including business closures, transfers of merchants' accounts to our competitors and account closures that we initiate due to heightened credit risks. We measure SME processing volume attrition relative to all SME merchants that were processing with us in the same month a year earlier. During the year ended December 31, 2015, we experienced 10.0% attrition in our SME card processing volume compared to attrition of 12.7% and 12.9% for the years ended December 31, 2014 and 2013, respectively.

In our SME business, we measure same store sales growth, or contraction, as the change in card processing volume for all card merchants that were processing with us in the same month a year earlier. In 2015, same store sales grew 3.5% on average, compared to 2.0% same store sales growth in both 2014 and 2013, respectively. Same store sales growth or contraction results from the combination of the increasing or decreasing use by consumers of bankcards for the purchase of goods and services at the POS, and sales growth or contraction experienced by our retained SME merchants. Historically, our same store sales experience has tracked with the overall economic conditions in the industries we serve. The following table compares our same store sales growth or contraction during 2015, 2014 and 2013:

Same Store Sales Growth (Contraction)	2015	2014	2013
First Quarter	4.4%	(0.2)%	2.2%
Second Quarter	3.4%	2.4%	1.9%
Third Quarter	4.1%	1.8%	1.6%
Fourth Quarter	2.2%	3.9%	2.4%
Full Year	3.5%	2.0%	2.0%

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We measure the overall production of our sales force by new gross margin installed, which reflects the expected annual gross profit from a merchant contract after deducting processing and servicing costs associated with that revenue. We measure installed margin primarily for our SME card processing, payroll processing and loyalty and gift card marketing businesses. In 2015, our newly installed gross margin for the year increased 21% from the gross margin we installed during the year ended December 31, 2014; in 2014 and 2013 the comparable growth rates were 17% and 22%, respectively. We attribute this increase in newly installed gross margin to higher volumes and margins at newly installed merchants and improved individual productivity achieved by our salespersons as well as growth in the sales force. Our combined Relationship Managers, Territory Managers, and Senior Product Advisors ("SPAs") totaled 1,240, 985 and 844 at December 31, 2015, 2014 and 2013, respectively. We expect to drive increases in year-over-year installed margin in future periods primarily by increasing the number of SPAs and Relationship and Territory Managers.

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

In contrast to SME card processing revenues, revenues from our Network Services merchants are largely driven by the number of transactions we process (whether settled, or only authorized), not our processing volume, as the merchants which comprise Network Services' customer base pay on a per transaction basis for processing services. The number of Network Services transactions increased in 2015 primarily due to an increase in the number of transactions at our large petroleum merchants and the addition of smaller-size merchants.

Additionally, we provide authorization, settlement and account servicing services on our front and back end systems for American Express transactions for SME merchants and merchants originally signed to American Express by other processors. For those services we receive compensation from American Express on a per transaction basis. We converted a majority of our existing merchants processing under the former sales and servicing agreement with American Express to OptBlue during the third quarter of 2014. The number of transactions we processed for Network Services merchants and American Express for the years ended December 31, 2015, 2014 and 2013 were as follows:

	Year Ended December 31,		
	2015	2014	2013
Network Services merchants:	(In thousands)		
Authorized	2,403,163	2,384,723	2,347,776
Settled	1,208,448	1,083,606	967,230
Total Network Services	3,611,611	3,468,329	3,315,006
American Express (a)	1,025	17,150	32,016
Total	3,612,636	3,485,479	3,347,022

(a) Includes only those transactions not eligible for residual compensation

Our ability to manage our front-end authorization systems, HPS Exchange, VAPS and NWS, provides us greater control of the electronic transaction process, allows us to offer our merchants a differentiated product offering, and offers economies of scale that we expect will increase our long-term profitability. During the years ended December 31, 2015, 2014 and 2013, approximately 97%, 96% and 96%, respectively, of our SME transactions were processed through HPS Exchange. All of our Network Services transactions were processed through VAPS or NWS.

We provide clearing, settlement and merchant accounting services through our own internally developed back-end processing system, Passport. Passport enables us to customize these services to the needs of our Relationship Managers and merchants. At December 31, 2015, 2014, and 2013, substantially all of SME merchants were processing on Passport and all Network Services settled transactions were processed on Passport.

We sold our interest in Collective POS Solutions Ltd. ("CPOS") in a transaction settled in January 2013. CPOS has historically represented an insignificant component of our financial position and results of operations. However, as further disclosed elsewhere in the notes to consolidated financial statements, we recognized a gain on the sale of CPOS in the first quarter of 2013.

Campus Solutions
Campus Solutions provides payment processing, integrated commerce solutions, higher education loan services and open- and closed-loop payment solutions to campuses throughout the United States and Canada.

We provide a suite of solutions to support administrative services for higher education including student loan payment processing, delinquency and default services, refund management, tuition payment plans, electronic billing and payment, tax document services, and business outsourcing. Our OneCard product enables personal identification, door access, cashless vending and laundry transactions, meal plans and cashless printing at campus facilities. Our Give Something Back Network adds internet and phone accessible closed-loop debit card based financial services to the students, faculty, staff and local community merchants of an educational institution.

On September 4, 2014, we acquired TouchNet Information Systems, Inc. ("TouchNet"), an integrated commerce solutions provider to higher-education institutions. TouchNet became a part of our Campus Solutions business. See “—Liquidity and Capital Resources — Acquisitions” for additional information on this transaction. TouchNet adds over 700 higher education clients serving over seven million students which is nearly one-third of higher education enrollment in the United States.

As of December 31, 2015, we provided services to more than 3,400 colleges and universities serving over 12 million students and borrowers. During 2015, we supported approximately $25.3 billion in higher education payments, 28.3 million payment transactions, prepared 5 million tax documents, and made over $1.2 billion in annual refunds.

Heartland School Solutions
We provide school nutrition, POS solutions, and associated payment solutions including online prepayment, to K-12 schools throughout the United States. At both December 31, 2015 and December 31, 2014 our Heartland School Solutions business provided services to more than 34,000 public and private schools. Our Heartland School Solutions business has been built through a series of six acquisitions, including the April 2014 acquisition of MCS Software. This acquisition continued the expansion of our market-leading position in the K-12 school nutrition and POS technology industry. The more than 34,000 K-12 schools that Heartland School Solutions serves nationwide, represent a 35% share of the public schools in the U.S.

Heartland Payroll Solutions
We provide payroll processing services throughout the United States. At December 31, 2015, we processed payroll for 33,937 customers, an increase of 31.7% from 25,764 payroll customers at December 31, 2014. In 2015, 2014 and 2013, we added 7,302, 5,821 and 5,797, respectively, new payroll processing customers. We operate a comprehensive payroll management platform, which we refer to as HPS (formerly PlusOne Payroll, and Heartland Ovation Payroll or HOP), that streamlines all aspects of the payroll process to enable time and cost savings. The HPS platform enables us to process payroll on a large scale and provide customizable solutions for businesses of all sizes.

On February 27, 2015, we purchased the stock of Payroll 1, Inc. ("Payroll 1") for a $30.0 million cash payment, plus net working capital. The purchase price was financed from the 2014 Revolving Credit Facility. The acquisition of Payroll 1 expanded our existing payroll processing business and customer base by adding 6,573 customers at acquisition.

Heartland Commerce
We provide the hospitality and retail industries with leading-edge POS solutions, payments processing capabilities and other adjacent business service applications through our Heartland Commerce business. Heartland Commerce is comprised of Xpient Solutions, LLC (“Xpient” acquired in October 2014); Merchant Software Corporation (referred to as "Liquor POS" which was acquired in February 2014); Automation, Inc. (d/b/a “pcAmerica” acquired in January 2015); Dinerware, Inc. (“Dinerware” acquired in February 2015) and Menusoft Systems Corporation (a.k.a. “Digital Dining” acquired in October 2015). Heartland Commerce is in the process of developing cloud-based POS systems that complement our well-established on-premise POS solutions. Digital Dining offers restaurants the convenience of a handheld POS on an iPhone, iPod and iPad in a hybrid environment with conventional fixed terminals, and is also

used by restaurateurs for table management, delivery, reservations, labor scheduling, inventory and loyalty programs. See "— Liquidity and Capital Resources — Acquisitions" for more detail on these acquisitions.

In the fourth quarter of 2014, management considered the overlapping cloud-based POS systems in development at Heartland Commerce businesses and decided that it would stop POS development efforts at Leaf Acquisition, LLC (“Leaf”), a previous Heartland Commerce business. This decision caused a significant adverse change in the extent or manner in which the long-lived asset group of Leaf would be used, including Prosper, an internally developed POS software technology. Due to these changes in circumstances, the implied fair value of the Leaf reporting unit was determined to be significantly below its carrying value. This led to a Goodwill Impairment charge for the full balance of Leaf Goodwill as of December 31, 2014. In the fourth quarter of 2014, we recorded pre-tax Goodwill and Asset Impairment charges of $18.5 million and $18.9 million, respectively. As of June 30, 2015, losses from Leaf have concluded. Leaf's operations lost $10.4 million, or $0.08 per share, during the year ended December 31, 2014.

2015 Financial Highlights

Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

For the year ended December 31, 2015, we recorded net income of $84.7 million, or $2.28 per share, compared to $33.9 million, or $0.91 per share, for the year ended December 31, 2014.

Net income for the year ended December 31, 2015 reflects a gain on sale of assets for the sale of SmartLink of $7.0 million pre-tax ($4.3 million after-tax, or $0.11 per share). See "— Results of Operations — Year Ended December 31, 2015 Compared to Year Ended December 31, 2014" for further details on this sale.

Net income for the year ended December 31, 2014 reflected the following:

- Asset impairment charges related to our investment in Leaf and other POS assets, and our investment in the stock of TabbedOut, of $41.4 million pre-tax ($37.6 million after-tax, or $1.02 per share). See "— Overview — Heartland Commerce" for further details on these impairment charges.
- Pre- and after-tax gain of $3.6 million, or $0.10 per share, recognized as a result of our August 6, 2014 acquisition of all shares of Leaf common stock held by noncontrolling shareholders and the concurrent release from a contingent earn-out liability to those noncontrolling shareholders.
- Out of period adjustments of $2.3 million, or $.04 per share, as a result of immaterial errors that originated in 2013 in our Heartland School Solutions business. See "— Results of Operations — Year Ended December 31, 2015 Compared to Year Ended December 31, 2014" for further details on these out of period adjustments.

Our income from operations, which we also refer to as operating income, increased $63.4 million, or 77.2%, to $145.5 million for the year ended December 31, 2015, from $82.1 million for the year ended December 31, 2014. Our operating margin, which we measure as operating income divided by net revenue, was 17.7% for the year ended December 31, 2015, compared to 12.2% for the year ended December 31, 2014. Operating income and operating margin for 2014 reflect the impact of the POS asset and goodwill impairment charges described above. Excluding the impact of the goodwill and asset impairment charges, our 2014 operating income and operating margin would have been $119.5 million and 17.8%, respectively.

Our operating income for the year ended December 31, 2015, as compared to the year ended December 31, 2014, benefited from 22.4% year-over-year growth in net revenue partially offset by increased expenses, including increases of 28.1% in general and administrative expenses and 15.3% in processing and servicing costs.

The following is a summary of our results of operations for the year ended December 31, 2015:

- Net revenue, which we define as total revenues less interchange fees and dues, assessments and fees, increased $150.3 million, or 22.4%, from $672.6 million in the year ended December 31, 2014 to $823.0 million in the year ended December 31, 2015. The increase in net revenue reflects $81.2 million or 12.1% growth from our 2014 and 2015 acquisitions. The remaining $69.1 million, or 10.3%, organic increase in net revenue reflects the following:

Increased Payment Processing net revenue of $45.6 million, or 9.6%, which reflects growth in SME processing volume. During the year ended December 31, 2015, our SME processing volume increased 14.8% to $93.1 billion from $81.1 billion during the year ended December 31, 2014. The year-over-year increase reflects same store sales growth and the addition of SME merchants whose processing volume and net revenue exceeded that of merchants who attrited in the same period. The increase in SME processing volume also reflects the conversion of new and existing merchants to OptBlue. We converted a majority of our existing merchants processing under the former sales and servicing agreement with American Express to OptBlue during the third quarter of 2014. For the year ended December 31, 2015, our OptBlue processing volume was $6.5 billion as compared to $2.6 billion for the year ended December 31, 2014.

Organic increases in revenues across other business segments including Heartland School Solutions, Heartland Payroll Solutions and Campus Solutions. These organic increases are further detailed in "— Results of Operations — Year Ended December 31, 2015 Compared to Year Ended December 31, 2014."

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- Our processing and servicing expense increased 15.3% from $285.0 million for the year ended December 31, 2014 to $328.6 million for the year ended December 31, 2015. The increase in processing and servicing expenses includes a $22.0 million increase from our 2014 and 2015 acquisitions. The remaining increase is attributable to increased costs associated with processing and servicing higher SME bankcard processing volume, increased sales and incentive compensation and increased cost of sales and servicing related to higher Heartland Payroll Solutions and Campus Solutions net revenue. Partially offsetting these increases was a decrease in merchant losses. Merchant losses for the year ended December 31, 2014 included $4.6 million of chargebacks from a single merchant who entered bankruptcy in the fourth quarter of 2014.
- Our general and administrative expenses increased 28.1% from $190.6 million for the year ended December 31, 2014 to $244.0 million for the year ended December 31, 2015. The increase in general and administrative expenses includes $33.4 million from our 2014 and 2015 acquisitions. The remaining increase reflects higher personnel expense including incentive and share-based compensation increases, higher acquisition related expenses and increased expense across various general and administrative expense categories supporting our organic growth.

See "— Results of Operations — Year Ended December 31, 2015 Compared to Year Ended December 31, 2014" for a more detailed discussion of our full year operating results.

Fourth Quarter Ended December 31, 2015 Compared to Fourth Quarter Ended December 31, 2014

For the fourth quarter ended December 31, 2015, we recorded net income of $22.7 million, or $.61 per share, compared to a net loss of $19.8 million, or $.55 per share, for the fourth quarter ended December 31, 2014.

Net income for the fourth quarter ended December 31, 2015 reflects a gain on sale of assets for the sale of SmartLink of $7.0 million pre-tax ($4.3 million after-tax, or $0.11 per share). See "— Results of Operations — Year Ended December 31, 2015 Compared to Year Ended December 31, 2014" for further details on this sale.

Net income for the fourth quarter ended December 31, 2014 reflected asset impairment charges related to our investment in Leaf and other POS assets, and our investment in the stock of TabbedOut, of $41.4 million pre-tax ($37.6 million after-tax, or $1.02 per share). See "— Overview — Heartland Commerce" for further details on these impairment charges.

Our income from operations, which we also refer to as operating income, increased $39.4 million to $34.8 million for the fourth quarter ended December 31, 2015, from a loss from operations of $4.6 million for the fourth quarter ended December 31, 2014. Our operating margin, which we measure as operating income divided by net revenue, was 16.3% for the fourth quarter ended December 31, 2015, compared to (2.4)% for the fourth quarter ended December 31, 2014. Operating loss for the fourth quarter of 2014 reflects the impact of the POS asset and goodwill impairment charges described above. Excluding the impact of the goodwill and asset impairment charges, our fourth quarter of 2014 operating income and operating margin would have been $32.8 million and 17.4%, respectively.

Our operating income for the fourth quarter ended December 31, 2015, as compared to the fourth quarter ended December 31, 2014, benefited from 13.7% quarter-over-quarter growth in net revenue partially offset by increased expenses, including increases of 30.1% in general and administrative expenses and 3.0% in processing and servicing costs.

The following is a summary of our results of operations for the fourth quarter ended December 31, 2015:

- Net revenue, which we define as total revenues less interchange fees and dues, assessments and fees, increased $25.8 million, or 13.7%, from $188.3 million in the fourth quarter ended December 31, 2014 to $214.1 million in the fourth quarter ended December 31, 2015. The increase in net revenue reflects $11.6 million or 6.2% growth from our 2014 and 2015 acquisitions. The remaining $14.2 million, or 7.5%, organic increase in net revenue reflects the following:

Increased Payment Processing net revenue of $6.1 million, or 4.8%, which reflects growth in SME processing volume. During the fourth quarter ended December 31, 2015, our SME processing volume increased to $24.0 billion from $21.0 billion during the fourth quarter ended December 31, 2014. The year-over-year increase reflects same store sales growth and the addition of SME merchants whose processing volume and net revenue exceeded that of merchants who attrited in the same period. The increase in SME processing volume also reflects the conversion of new and existing merchants to OptBlue. We converted a majority of our existing merchants processing under the former sales and servicing agreement with American Express to OptBlue during the third quarter of 2014. For the fourth quarter ended December 31, 2015, our OptBlue processing volume was $1.8 billion as compared to $1.4

billion for the fourth quarter ended December 31, 2014. Payment Processing net revenue for the fourth quarter ended December 31, 2014 included one-time revenues associated with the conversion to OptBlue.

- Organic increases in revenues across other business segments including Heartland School Solutions, Heartland Payroll Solutions and Campus Solutions.

- Our processing and servicing expense increased 3.0% from $80.0 million for the fourth quarter ended December 31, 2014 to $82.4 million for the fourth quarter ended December 31, 2015. The increase in processing and servicing expenses includes a $3.3 million increase from our 2014 and 2015 acquisitions. Excluding acquisitions, processing and servicing expense reflects a decrease for the fourth quarter of 2015 compared to the fourth quarter of 2014. This decrease is primarily due to lower merchant losses. Merchant losses for the fourth quarter ended December 31, 2014 included $4.6 million of chargebacks from a single merchant who entered bankruptcy within the quarter. This decrease is partially offset by higher processing and servicing expense associated with higher SME bankcard processing volume, increased sales and incentive compensation and increased cost of sales and servicing related to higher Heartland Payroll Solutions and Campus Solutions net revenue.

- Our general and administrative expenses increased 30.9% from $53.3 million for the fourth quarter ended December 31, 2014 to $69.8 million for the fourth quarter ended December 31, 2015. The increase in general and administrative expenses includes $5.8 million from our 2014 and 2015 acquisitions. The remaining increase reflects higher personnel expense including incentive and share-based compensation increases, higher acquisition related expenses (including $2.2 million of costs associated with the pending merger with Global) and increased expense across various general and administrative expense categories supporting our organic growth.

Components of Revenues and Expenses

Revenue. We report revenue as part of the following reporting segments: (i) Payment Processing, (ii) Campus Solutions, (iii) Heartland School Solutions, (iv) Heartland Payroll Solutions and (v) Other. We recognize revenue when (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been performed; (3) the price is fixed or determinable; and (4) collectability is reasonably assured. We also evaluate our contractual arrangements for indications that multiple element arrangements may exist, including instances where more-than-incidental software deliverables are included.

Payment Processing revenue primarily consists of discount, per-transaction and periodic (primarily monthly) fees from the processing of Visa, MasterCard, American Express and Discover transactions for SME merchants and per-transaction fees for the authorization and settlement of transactions for Network Services merchants. Also included in this category are American Express servicing fees, merchant service fees, fees for processing chargebacks and termination fees on terminated contracts. Interchange fees, which are our most significant expense, are set by the card networks and paid to the card issuing banks. For the majority of SME card processing revenue, we do not offset processing revenues and interchange fees because our business practice is to advance the interchange fees to most SME merchants when settling their daily transactions (thus paying the full amount of the transaction to the merchant), and then to collect the full discount fees from merchants on the first business day of the next month. For SME merchants to whom we do not advance interchange, we record card processing revenues net of interchange fees. As Network Services does not advance interchange fees to its merchants, we record card processing revenues net of interchange fees.

Campus Solutions revenue includes fees associated with providing integrated commerce solutions to support administrative services for higher education, as well as, student loan payment processing, delinquency and default services, refund management, tuition payment plans, electronic billing and payment, tax document services and business outsourcing. Campus Solutions revenue also includes fees from the sale and maintenance of open- and closed-loop payment hardware and software solutions for college or university campuses to process small value electronic transactions.

Heartland School Solutions' revenue includes fees from sales and maintenance of cafeteria POS solutions and associated payment solutions, including online prepayment solutions, back office management and hardware and technical support.

Heartland Payroll Solutions revenue includes fees charged for payroll processing services, including check printing, direct deposit, related federal, state and local tax deposits and providing accounting documentation and interest income earned on funds held for customers.

Other revenues include Micropayments’ fees from selling hardware and software for unattended online wireless credit card based payment systems, and unattended value top up systems for off-line closed-loop smart (chip) card based payment

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systems. Also included in this category are Heartland Marketing Solutions' fees from selling mobile and card-based marketing services, gift cards and rewards services as well as fees from selling, renting and deploying POS devices. Other revenues also include Heartland Commerce, which provides POS solutions, payments processing capabilities and other adjacent business service applications, serving the hospitality and retail industry.
Net Revenue. We define net revenue as total revenues less interchange fees and dues, assessments and fees. Management uses net revenue to assess our operating performance, including operating margin.

Expenses. In addition to interchange fees, we also pay Visa, MasterCard, American Express and Discover, as well as certain PIN networks, dues, assessments and fees, which are a combination of a percentage of the dollar volume processed and per-transaction fees. Interchange fees and dues, assessments and fees are recognized at the time transactions are processed. It is our policy to pass along to our merchants any changes in interchange fees and card network dues, assessments and fees. Since the card networks regularly adjust those rates, our gross card processing revenue will increase or decrease, but all the impact of such changes will be paid to the card issuing banks or networks, and our net revenue and income from operations will not be affected.

Costs of services also include processing and servicing costs, customer acquisition costs, and depreciation and amortization. Processing and servicing costs include:

- processing costs, which are either paid to third parties, including our bank sponsors, or represent the cost of our own authorization/capture and accounting/settlement systems. During 2015 and 2014, costs we paid to third parties represented about 31% and 34% of our processing costs, respectively;
- residual commission payments to our Relationship Managers, sales managers, trade associations, agent banks and value-added resellers, which are a percentage of the gross margin we generated from our merchant contracts during the accounting period;
- the costs of operating our service center and other customer support locations, including telecommunications costs, personnel costs, occupancy costs, losses due to merchant defaults, depreciation and amortization, and other direct servicing costs; and
- the costs of merchant supplies, bankcard terminals, POS systems, hardware and software deployed in our businesses.

Customer acquisition costs reflect the amortization over the initial three-year contract term of the cash signing bonus paid, and the deferred acquisition costs accrued for vested Relationship Managers and sales managers, as well as changes in the accrued buyout liability, which reflect the impact of buying out residual commissions and volume attrition (see “— Critical Accounting Estimates — Accrued Buyout Liability”).

Depreciation and amortization expenses consist of depreciation on our investments in property, equipment and software, and our amortization of acquired intangible assets. Depreciation and amortization expenses are primarily recognized on a straight-line basis over the estimated useful life of the asset, except for the amortization of customer relationships intangible assets which is recognized using a proportional cash flow method.

General and administrative expenses include personnel and other administrative expenses related to our information technology infrastructure costs, our marketing expenses and other administrative functions.

Critical Accounting Estimates
The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results could differ from those estimates. Our significant accounting policies are more fully described in Note 2 to our consolidated financial statements included elsewhere in this report. The critical accounting estimates described here are those that are most important to the depiction of our financial condition and results of operations, including those whose application requires

management's most subjective judgment in making estimates about the effect of matters that are inherently uncertain. The line items on our income statement and balance sheet, which are impacted by management's estimates, are described below.

Revenue

Our card processing revenue is derived from processing and settling Visa, MasterCard, American Express and Discover bankcard transactions for our merchant customers. Our most significant expense related to the generation of those revenues is interchange fees, which are set by the card networks, and paid to the card issuing banks. For our SME merchant card processing, we do not offset card processing revenues and interchange fees in our income statement because our business practice is to advance the interchange fees to most of our SME merchants when settling their daily transactions (thus paying the full amount of the transaction to the merchant), and then to collect our full discount fees from our merchants on the first business day of the next month. We fund interchange advances to our SME merchants from a combination of our operating cash, processing cash and advances from our sponsor banks. We believe this policy aids in new business generation, as our merchants benefit from bookkeeping simplicity. However, this practice results in our carrying a large receivable from our merchants at each period-end, and a corresponding but smaller payable to our sponsor banks, which are settled on the first business day after the period-end. As we are at risk for the advance receivables, we record the associated revenues on a gross processing revenue basis in our consolidated Statements of Income. We have merchant portability, credit risk, and the ultimate responsibility to the merchant and, as such, revenue is reported at the time of settlement on a gross basis. Payment processing services are transaction based and priced either as a fixed fee per transaction or calculated as a percentage of the transaction value. The fees are charged for the processing services provided and do not include the gross sales price paid by the ultimate buyer to the merchant. Certain of our competitors report their processing revenue net of interchange fees. This is because the card issuing banks make their payments to these competitors net of those interchange fees, and these acquirers pay this reduced amount to their merchants. For our Network Services merchants, we also record a portion of our processing revenues net of interchange fees because the daily cash settlement with Network Services' merchants is net of interchange fees.

We also evaluate contractual arrangements for indications that multiple element arrangements may exist including instances where more-than-incidental software deliverables are included. Both Campus Solutions and Heartland School Solutions have arrangements that contain multiple elements, such as hardware, software products, including perpetual licenses and Software-as-a-Service (“SaaS”) services, maintenance, and professional installation and training services. We allocate revenues to each element based on the selling price hierarchy. The selling price for a deliverable is based on vendor specific objective evidence (“VSOE”) of selling price, if available, third party evidence ("TPE") if VSOE of selling price is not available, or estimated selling price (“ESP”) if neither VSOE or selling price nor TPE is available. We establish ESP, based on our judgment, considering internal factors such as margin objectives, pricing practices and controls, customer segment pricing strategies and the product life cycle. In arrangements with multiple elements, we determine allocation of the transaction price at inception of the arrangement based on the relative selling price of each unit of accounting.

In multiple element arrangements where more-than-incidental software deliverables are included, we have applied the residual method to determine the amount of software license revenues to be recognized. Under the residual method, if fair value exists for undelivered elements in a multiple-element arrangement, such fair value of the undelivered elements is deferred with the remaining portion of the arrangement consideration recognized upon delivery of the software license or services arrangement. We allocate the fair value of each element of a software related multiple-element arrangement based upon its fair value as determined by VSOE, with any remaining amount allocated to the software license. If evidence of the fair value cannot be established for the undelivered elements of a software arrangement then the entire amount of revenue under the arrangement is deferred until these elements have been delivered or objective evidence can be established.

Capitalized Customer Acquisition Costs

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

The amount of the up-front signing bonus paid for new SME card, payroll and loyalty marketing accounts is based on the estimated gross margin for the first year of the merchant contract. The gross signing bonuses paid during 2015, 2014 and 2013 were $53.3 million, $42.7 million and $32.7 million, respectively. The signing bonus paid, amount capitalized, and related amortization are adjusted at the end of the first year to reflect the actual gross margin generated by the merchant contract during that year. The net signing bonus adjustments made during 2015, 2014 and 2013 were $(5.1) million, $(4.0) million and $(3.7) million, respectively. Negative signing bonus adjustments occur when the actual gross margin generated by the merchant contract during the first year is less than the estimated gross margin for that year, resulting in the overpayment of the up-front signing bonus, which overpayment would be recovered from the relevant salesperson. Positive signing bonus adjustments result from prior underpayments of up-front signing bonuses, and would be paid to the relevant salesperson.

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The deferred acquisition cost component of capitalized customer acquisition costs is accrued for vested salespersons over the first year of SME card, payroll and loyalty marketing merchant processing, consistent with the build-up in the accrued buyout liability, which is described below.

Management evaluates the capitalized customer acquisition costs for impairment by comparing, on a pooled basis by vintage month of origination, the expected future net cash flows from underlying merchant relationships to the carrying amount of the capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the value of the capitalized customer acquisition costs, the impairment loss will be charged to operations. We have not recognized an impairment loss of this type in 2015, 2014 or 2013.

Accrued Buyout Liability

We pay our salespersons residual commissions based on the gross margin generated from the monthly processing activity of SME, payroll, and loyalty marketing merchant accounts signed by them. We refer to these residual commissions as the "owned" portion of such commissions, or "portfolio equity." The salesperson has no obligation to perform additional services for the merchant for so long as the merchant continues processing with us. We have the right, but not the obligation, to buy out some or all of these commissions, and intend to do so periodically. We accrue the buyout liability, which represents the estimated current settlement cost of buying out all vested and expected-to-vest salespersons for the owned portion of such commissions. We also record a deferred acquisition cost asset related to those buyouts, and amortize that asset as an expense over the initial three year contract term.

We consider a salesperson to be vested once they have established merchant relationships that generate on average the equivalent of $10,000 of monthly gross margin for a rolling 90 day period. Vested status entitles the salesperson to his or her residual commissions for as long as the merchant processes with us, even if the salesperson is no longer employed by us.

The accrued buyout liability is based on the merchants we have under contract at the balance sheet date, the gross margin we generated from those accounts in the prior twelve months, the “owned” commission rate, and the fixed buyout multiple of 2.5 times the commissions. The liability related to a new merchant is therefore zero when the merchant is installed, and increases over the twelve months following the installation date. A small portion of our accrued buyout liability, approximately 6%, relates to salespersons who have opted to receive a multiple of 2.0 times commissions in exchange for a larger company contribution towards their health insurance.

For unvested salespersons, the accrued buyout liability is accrued over the expected vesting period; however, no deferred acquisition cost is capitalized as future services are required in order to vest. In calculating the accrued buyout liability for unvested salespersons, we have assumed that 31% of unvested salespersons will vest in the future, which represents our historical vesting rate. A 5% increase to 36% in the expected vesting rate would have increased the accrued buyout liability for unvested salespersons by $0.3 million and $0.2 million at December 31, 2015 and 2014, respectively.

Buyout payments made to salespersons reduce the outstanding accrued buyout liability. Given our view of the duration of the cash flows associated with a pool of merchant contracts, we believe that the benefits of such buyouts significantly exceed the cost, which typically represents 2 ½ years of commissions. If the cash flows associated with a pool of bought out contracts does not exceed this cost, we will incur an economic loss on our decision to buyout the contracts. During 2015, 2014, and 2013, we made buyout payments of approximately $15.4 million, $11.6 million and $13.7 million, respectively.

Processing Liabilities

Processing liabilities result primarily from our card processing activities and include merchant deposits maintained to offset potential liabilities arising from merchant chargebacks. At December 31, 2015 and 2014, processing liabilities totaled approximately $152.2 million and $119.4 million, respectively.

Disputes between a cardholder and a merchant periodically arise as a result of, among other things, the cardholder's dissatisfaction with merchandise quality or merchant services. Such disputes may not be resolved in the merchant's favor. In
these cases, the transaction is "charged back" to the merchant, which means the purchase price is refunded to the customer by the card-issuing bank and charged to the merchant. If the merchant is unable to fund the refund, we must do so. We also bear the risk of reject losses arising from the fact that we collect our fees from our merchants on the first day after the monthly billing period. If the merchant has gone out of business during such period, we may be unable to collect such fees. We maintain cash deposits or require the pledge of a letter of credit from certain merchants, generally those with higher average transaction size where the card is not present when the charge is made or the product or service is delivered after the charge is made, in order to offset potential contingent liabilities such as chargebacks and reject losses that would arise if the

merchant went out of business. At December 31, 2015 and 2014, we held SME merchant deposits totaling $6.6 million and $6.2 million, respectively. Most chargeback and reject losses are charged to processing and servicing as they are incurred. However, we also maintain a loss reserve against losses including major fraud losses, which are both less predictable and involve larger amounts. The loss reserve was established using historical loss rates, applied to recent card processing volume. At December 31, 2015 and 2014, our loss reserve totaled $1.0 million and $3.4 million (including amounts reserved for chargebacks from a single merchant described below), respectively. Aggregate SME merchant losses were $2.9 million, $7.3 million and $3.1 million, or 0.31 basis points, 0.90 basis points and 0.41 basis points, respectively, of our SME card processing volume for the years ended December 31, 2015, 2014 and 2013. In 2014, our losses included $4.6 million resulting from chargebacks from a single merchant who entered bankruptcy in the fourth quarter. Chargeback losses originating from Network Services card processing on Passport during the year ended December 31, 2015, 2014 and 2013 were immaterial.

Share-based Compensation

We expense employee share-based payments under the fair value method. Share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the requisite service period.

Restricted Share Units. We grant three types of Restricted Share Units ("RSUs"); service-based RSUs, performance-based RSUs ("PRSUs"), and total shareholder return RSUs ("TRSUs"). With regard to PRSUs and TRSUs, estimates and judgments are made concerning ultimate achievement of performance targets which impact the amount of share-based compensation expense recorded. The closing price of our common stock on the grant date equals the grant date fair value of our unvested service-based RSUs and PRSUs. A lattice valuation model was applied to measure the grant date fair value of our TRSUs.

PRSUs. In the fourth quarters of 2013, 2014 and 2015, the Compensation Committee of our Board of Directors approved grants of PRSUs having rights to earn 0% to 250% of a target number of shares of our common stock depending on the achievement of grant-specific three-year performance targets and service vesting. The target number of shares for these PRSUs will be earned only if we achieve target pro forma diluted earnings per share growth rates of 30% to 40% over the three-year periods. Pro forma diluted earnings per share for performance targets are calculated excluding non-operating gains and losses, if any, and excluding the after-tax impact of share-based compensation expense.

The closing price of our common stock on the grant date equals the grant date fair value of these nonvested Restricted Share Units awards and will be recognized as compensation expense over their vesting periods. We have recorded expense on these PRSUs based on achieving the performance targets.

TRSUs. Additionally, in the fourth quarters of 2013 and 2014, the Compensation Committee of our Board of Directors approved grants of TRSUs having rights to earn 0% to 225% of a target number of shares of our common stock depending on the achievement of grant-specific three- and four -year measures of total shareholder returns and service vesting. We have recorded expense on these TRSUs based on achieving the targets.

Certain Impacts of the Merger Agreement on Vesting of Share-Based Awards. All unvested share-based awards would become vested and be settled at the close of the transaction contemplated by the Merger Agreement. Any performance-based vesting condition will be deemed to have been satisfied at maximum or target levels, depending on whether the award was granted prior to or after December 1, 2015, respectively. See "Item 1. Business - Agreement and Plan of Merger" for more detail regarding this transaction.

In December 2015, we accelerated the vesting of 2016 vesting tranches for selected equity awards held by eight of our executive officers so that these awards vested on December 22, 2015. The value of these awards, based on the closing price of our common stock on the NYSE on December 22, 2015 of $95.02, was $8.3 million. Under Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic 718, this acceleration of 2016 vesting tranches qualifies as a Type I Modification to vesting terms which requires acceleration of expense at original grant date fair value. This action resulted in the acceleration of $1.7 million of share-based compensation expense from 2016 to 2015. There was no incremental compensation cost recorded in connection with this modification as the modification only affects the service period of the awards, which is shorter than the requisite service period of the original awards.

Goodwill

Goodwill represents the excess of acquisition costs over the fair values of net assets acquired in business combinations. We test goodwill for impairment at least annually in the fourth quarter and between annual tests if an event occurs or changes in circumstances suggest a potential decline in the fair value of the reporting unit. A significant amount of judgment is involved in determining if an indicator or change in circumstances relating to impairment has occurred. Such changes may include, among others: a significant decline in expected future cash flows; a sustained decline in market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; and slower growth rates.

We have the option of performing a qualitative assessment of impairment to determine whether any further quantitative testing for impairment is necessary. The option of whether or not to perform a qualitative assessment is made annually and may vary by reporting unit. Factors we consider in the qualitative assessment include general macroeconomic conditions, industry and market conditions, cost factors, overall financial performance of our reporting units, events or changes affecting the composition or carrying amount of the net assets of our reporting units, sustained decrease in our share price, and other relevant entity-specific events. If we elect to bypass the qualitative assessment or if we determine, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not less than the carrying value, we perform a two-step quantitative test for that reporting unit. In the first step, the fair value of each reporting unit is compared to the reporting unit's carrying value, including goodwill. If the fair value of a reporting unit is less than its carrying value, the second step of the goodwill impairment test is performed to measure the amount of impairment, if any. In the second step, the fair value of the reporting unit is allocated to the assets and liabilities of the reporting unit as if it had been acquired in a business combination and the purchase price was equivalent to the fair value of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is referred to as the implied fair value of goodwill. The implied fair value of the reporting unit's goodwill is then compared to the actual carrying value of the goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized for the difference.

Significant estimates and assumptions are used in our goodwill impairment review and include the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units and determining the fair value of each reporting unit. Our assessment of qualitative factors involves significant judgments about expected future business performance and general market conditions. In a quantitative assessment, the fair value of each reporting unit is determined based on a combination of techniques, including the present value of future cash flows, applicable multiples of competitors and multiples from sales of like businesses, and requires us to make estimates and assumptions regarding discount rates, growth rates and our future long-term business plans. Changes in any of these estimates or assumptions could materially affect the determination of fair value and the associated goodwill impairment charge for each reporting unit.

As of December 31, 2015, we performed a qualitative assessment for each of our reporting units, except one, for which we performed a quantitative assessment. Based on our annual test as of December 31, 2015, we determined on the basis of qualitative factors that the fair values of the reporting units for which we performed a qualitative assessment were not more likely than not less than their respective carrying amounts. Based on the quantitative assessment we did for one of our reporting units, we determined that the goodwill for that reporting unit was not impaired. We believe that the fair values of our reporting units are substantially in excess of their carrying amounts.

At December 31, 2015 and 2014, goodwill of $490.0 million and $425.7 million, respectively, was recorded in our Consolidated Balance Sheets. We may be required to record goodwill impairment losses in future periods, whether in connection with our next annual impairment testing in the fourth quarter of 2016 or prior to that, if any such indicators constitute a triggering event in other than the quarter in which the annual goodwill impairment test is performed. It is not possible at this time to determine if any such future impairment loss would result or, if it does, whether such charge would be material.

Income Taxes

We account for income taxes by recognizing deferred tax assets and liabilities, which are recorded to reflect the future tax consequences attributable to the effects of differences between the carrying amounts of existing assets and liabilities for financial reporting and for income tax purposes. Judgments are required in determining the amount and probability of future taxable income, which in turn is critical to a determination of whether a valuation allowance against the deferred tax assets is appropriate.

We also account for the recognition and measurement of tax benefits associated with uncertain tax positions. This requires evaluations of individual tax positions to determine whether any part of that position can be recognized or continues to be recognized in the financial statements. An uncertain tax position exists if it is unclear how a transaction will be treated under tax law. We had approximately $6.6 million of total gross unrecognized tax benefits as of December 31, 2015, approximately $4.5 million of which would impact the effective tax rate.

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Results of Operations
Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

The following table shows certain income statement data as a percentage of net revenue for the periods indicated (in thousands of dollars):

	2015	% of Net Revenue	2014	% of Net Revenue	Change Amount	%
Net revenue:						
Total revenue	$2,682,396		$2,311,381		$371,015	16.1 %
Less: Interchange	1,617,671		1,422,894		194,777	13.7 %
Less: Dues, assessments and fees	241,767		215,862		25,905	12.0 %
Total net revenue	822,958	100.0 %	672,625	100.0 %	150,333	22.4 %
Expenses:						
Processing and servicing	328,630	39.9 %	285,011	42.4 %	43,619	15.3 %
Customer acquisition costs	59,458	7.2 %	46,977	7.0 %	12,481	26.6 %
Depreciation and amortization	45,317	5.5 %	30,598	4.5 %	14,719	48.1 %
General and administrative	244,005	29.6 %	190,554	28.3 %	53,451	28.1 %
Goodwill impairment charge	—	— %	18,490	2.7 %	(18,490)	(100.0)%
Asset impairment charges	—	— %	18,875	2.8 %	(18,875)	(100.0)%
Total expenses	677,410	82.3 %	590,505	87.8 %	86,905	14.7 %
Income from operations	145,548	17.7 %	82,120	12.2 %	63,428	77.2 %
Other income (expense):						
Interest income	105	— %	125	— %	(20)	(16.0)%
Interest expense	(14,184)	(1.7)%	(8,057)	(1.2)%	(6,127)	(76.0)%
Gain on sale of assets	7,008	0.9 %	—	— %	7,008	100.0 %
Other, net	(402)	— %	(444)	(0.1)%	42	9.5 %
Total other expense	(7,473)	(0.9)%	(8,376)	(1.2)%	903	10.8 %
Income before income taxes	138,075	16.8 %	73,744	11.0 %	64,331	87.2 %
Provision for income taxes	53,343	6.5 %	41,876	6.2 %	11,467	27.4 %
Net income	84,732	10.3 %	31,868	4.7 %	52,864	165.9 %
Less: Net loss attributable to noncontrolling interests	—	— %	(2,011)	(0.3)%	2,011	100.0 %
Net income attributable to Heartland	$84,732	10.3 %	$33,879	5.0 %	$50,853	150.1 %

Revenue. The following tables summarize total revenue and total net revenue (which we define as total revenue less interchange fees and dues, assessments and fees) by segment for the years ended December 31, 2015 and 2014 (in thousands of dollars):

	Year Ended December 31,		Change from Prior Year	
Total revenue:	2015	2014	Amount	%
Payment Processing	$2,371,878	$2,111,487	$260,391	12.3 %
Campus Solutions	117,208	61,538	55,670	90.5 %
Heartland School Solutions (a)	60,870	57,570	3,300	5.7 %
Heartland Payroll Solutions	69,037	50,394	18,643	37.0 %
Other	63,403	30,392	33,011	108.6 %
Total revenue	$2,682,396	$2,311,381	$371,015	16.1 %

	Year Ended December 31,		Change from Prior Year	
Total net revenue:	2015	2014	Amount	%

Payment Processing	$518,313	$472,731	$45,582	9.6	%
Campus Solutions	111,335	61,538	49,797	80.9	%
Heartland School Solutions (a)	60,870	57,570	3,300	5.7	%
Heartland Payroll Solutions	69,037	50,394	18,643	37.0	%
Other	63,403	30,392	33,011	108.6	%
Total net revenue	$822,958	$672,625	$150,333	22.4	%

(a) See below for discussion of Out-of-Period Adjustments.

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Payment Processing

Payment Processing net revenue increased $45.6 million, or 9.6%, from $472.7 million in 2014 to $518.3 million in 2015. This increase was driven by a $43.1 million or 10.3% increase in SME net revenue, reflecting a 14.8% increase in SME processing volume from $81.1 billion in 2014 to $93.1 billion in 2015. This increase reflects same store sales growth and the addition of SME merchants whose processing volume and net revenue exceeded that of merchants who attrited in the same period. This increase in processing volume also reflects the conversion of new and existing merchants to OptBlue. We converted a majority of our existing merchants processing under the former sales and servicing agreement with American Express to OptBlue during the third quarter of 2014. In 2015, our OptBlue processing volume was $6.5 billion as compared to $2.6 billion in 2014. Our reported SME processing volume includes processing volumes for merchants in our Heartland School Solutions, Campus Solutions, and Other businesses. Net revenue related to that processing volume is included in the net revenue reported for those businesses.

Campus Solutions

Campus Solutions net revenue increased 80.9% from $61.5 million in 2014 to $111.3 million in 2015. The increase in Campus Solutions net revenue included $44.1 million of net revenue from acquisitions, primarily from TouchNet. The remaining increase in Campus Solutions net revenue was due primarily to higher student loan servicing related revenue.

Heartland School Solutions

Heartland School Solutions net revenue increased 5.7% from $57.6 million in 2014 to $60.9 million in 2015. The increase in Heartland School Solutions net revenue is due primarily to an increase in transaction processing revenue reflecting growth in the number of parents who are adopting our electronic payment options. Also, in the second quarter of 2014, we recorded out-of-period adjustments decreasing our revenue and increasing bad debt expense (included in Processing and Servicing in our Consolidated Statements of Income) by $1.4 million and $0.9 million, respectively. These adjustments related to immaterial errors that originated in the prior year. These adjustments included revenue which was incorrectly recorded in prior periods and a reassessment of the collectability of certain customer accounts receivable. Partially offsetting the increases in net revenue was a decrease of $3.8 million in pass-through installation services net revenue for the year ended December 31, 2015 associated with a large school district customer in 2014 that did not repeat in 2015.

Heartland Payroll Solutions

Heartland Payroll Solutions net revenue increased 37.0% from $50.4 million in 2014 to $69.0 million in 2015. The increase in payroll processing net revenue included $10.6 million of net revenue added by the acquisition of Payroll 1. The remaining organic increase of $8.0 million is primarily due to a 6.2% increase in payroll processing customers (excluding 6,573 customers added by Payroll 1) from 25,764 at December 31, 2014 to 33,937 at December 31, 2015, as well as an overall increase in payroll processing revenue per customer.

Other

Other net revenue increased $33.0 million, or 108.6%, from $30.4 million in 2014 to $63.4 million in 2015. The increase in other revenue included $26.4 million of net revenue added by Xpient, pcAmerica, Dinerware, and Digital Dining (which are all included in Heartland Commerce). The remaining increase reflects organic growth in software sales at Heartland Commerce.

Total expenses. Total expenses increased 14.7% from $590.5 million in 2014 to $677.4 million in 2015, due to the increases in all major expense categories, reflecting acquisition related and organic growth and are further discussed below. Total expenses represented 82.3% of total net revenue in 2015, compared to 87.8% in 2014.

Processing and servicing expense in 2015 increased by $43.6 million, or 15.3%, compared to 2014. The increase in processing and servicing expenses includes a $22.0 million increase from our 2014 and 2015 acquisitions. The remaining increase is attributable to increased costs associated with processing and servicing higher SME bankcard processing volume, increased sales and incentive compensation, increased card equipment costs and increased cost of sales and servicing related to higher Heartland Payroll Solutions and Campus Solutions net revenue. Partially offsetting these increases was a decrease in merchant losses. Merchant losses for the year ended December 31, 2014 included $4.6 million of chargebacks from a single merchant who entered bankruptcy in the fourth quarter of 2014. As a percentage of net revenue, processing and servicing expense decreased to 39.9% in 2015, compared with 42.4% in 2014.

Customer acquisition costs in 2015 increased by $12.5 million, or 26.6% compared with 2014. As reflected in the table below, this increase reflects higher amortization on increased capitalized deferred acquisition costs resulting from

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improved levels of new installed margin and the impact of subsequent changes in the estimated accrued buyout liability due to lower merchant attrition and same-store sales growth. As a percentage of total net revenue, customer acquisition costs were 7.2% and 7.0% for the years ended December 31, 2015 and 2014, respectively.

Customer acquisition costs for the years ended December 31, 2015 and 2014 included the following components (in thousands of dollars):

	Year Ended December 31, 2015	2014	Change from Prior Year Amount	%
Amortization of signing bonuses, net (a)	$35,653	$30,345	$5,308	17.5 %
Amortization of capitalized customer deferred acquisition costs	25,310	21,281	4,029	18.9 %
Increase in accrued buyout liability	27,264	20,182	7,082	35.1 %
Capitalized customer deferred acquisition costs	(28,562)	(24,831)	(3,731)	(15.0)%
Total customer acquisition costs	$59,665	$46,977	$12,688	27.0 %

(a) Includes the write off of signing bonuses related to the December 31, 2015 sale of assets of SmartLink included in "Gain on sale of assets" on the Consolidated Statements of Income.

Depreciation and amortization expense included in the consolidated income statement for the years ended December 31, 2015 and 2014, by financial statement line item is as follows (in thousands of dollars):

	Year Ended December 31, 2015	2014	Change from Prior Year Amount	%
Processing and servicing				
Amortization – capitalized system development	$13,800	$14,780	$(980)	(6.6)%
Other	3,838	2,892	946	32.7 %
Total processing and servicing	17,638	17,672	(34)	(0.2)%
Depreciation and amortization				
Acquired intangibles	20,351	13,580	6,771	49.9 %
Amortization – capitalized system development	17,007	10,781	6,226	57.7 %
Other	7,959	6,237	1,722	27.6 %
Total depreciation and amortization	45,317	30,598	14,719	48.1 %
Total depreciation and amortization	$62,955	$48,270	$14,685	87.8 %

Total depreciation and amortization expenses increased $14.7 million, or 87.8%, from $48.3 million in 2014 to $63.0 million in 2015. The increase in total depreciation and amortization expenses in 2015 includes increases in acquired intangibles amortization of $6.8 million due to our 2014 and 2015 acquisitions. See "— Liquidity and Capital Resources — Acquisitions" for further information on these acquisitions. The increase in total depreciation and amortization expense is also due to a $5.2 million increase in capitalized system development amortization in 2015.

Most of our investments in information technology have supported the continuing development of our product, servicing and sales-related initiatives. Additionally, we capitalized outsourced programming costs as well as salaries, fringe benefits and other expenses incurred by our employees who worked on internally developed software projects. Amortization does not begin on the internally developed software until the project is complete and placed in service, at which time we begin to amortize the asset over expected lives of three to seven years. The amount capitalized decreased from $40.3 million in 2014 to $36.9 million in 2015. The total amount of capitalized costs for projects placed in service in 2015 and 2014 was $39.7 million and $36.5 million, respectively.

General and administrative expenses increased $53.5 million, or 28.1%, from $190.6 million in 2014 to $244.0 million in 2015. The increase in general and administrative expenses includes $33.4 million from our 2014 and 2015 acquisitions. The remaining increase reflects higher personnel expense including incentive and share-based compensation increases, higher acquisition related expenses and increased expense across various general and administrative expense categories supporting our organic growth. General and administrative expenses as a percentage of net revenue in 2015 was 29.6%, an increase from 28.3% in 2014.

In 2014, we recorded pre-tax asset impairment charges related to our investment in Leaf and other POS assets of $37.4 million, including $18.5 million for goodwill impairment. Management considered the overlapping cloud-based POS systems in development at Heartland Commerce businesses and decided that it would stop POS development efforts at Leaf

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Acquisition, LLC (“Leaf”), a previous Heartland Commerce business. This decision caused a significant adverse change in the extent or manner in which the long-lived asset group of Leaf would be used, including Prosper, an internally developed POS software technology. Due to these changes in circumstances, the implied fair value of the Leaf reporting unit was determined to be significantly below its carrying value. This led to a Goodwill Impairment charge for the full balance of Leaf Goodwill as of December 31, 2014.

Income from operations. Our income from operations, which we also refer to as operating income, increased to $145.5 million for 2015, from $82.1 million for 2014, as a result of an increase in net revenue and a decrease in goodwill and asset impairment charges. This increase is partially offset by increases in processing and servicing expenses, customer acquisition costs, depreciation and amortization and general and administrative expenses. Our operating margin, which we measure as operating income divided by net revenue, was 17.7% for 2015, compared to 12.2% for 2014. Excluding the impact of the goodwill and asset impairment charges during the fourth quarter of 2014, our operating income would have been $119.5 million or 17.8% for 2014.

Interest expense. Interest expense for 2015 and 2014 was $14.2 million and $8.1 million, respectively. Interest expense in both periods includes interest incurred under our credit facilities and interest we recorded on payables to our sponsor banks. The increase in interest expense reflects higher borrowings under our 2014 Revolving Credit Facility (as defined in —Liquidity and Capital Resources—Credit Facilities herein) as well as interest expense on $375 million under our 2014 Term Credit Facility (as defined in —Liquidity and Capital Resources—Credit Facilities herein) that was used to fund the TouchNet Acquisition. See “— Liquidity and Capital Resources — Credit Facilities” for more detail on our borrowings.

Other income (expense), net. Other, net for 2015 includes the following:

•Pre-tax gain of $7.0 million relating to the December 31, 2015 sale of the assets of the SmartLink division (“SmartLink”), which included our secure payment gateways and managed network services technologies, to a third party, for a $10 million cash payment. We also entered into a channel partner agreement, whereby Heartland’s sales professionals will continue to promote the secure payment gateway and managed network services solutions to merchants. Our SmartLink division was included in the Payment Processing Segment. The sale of SmartLink resulted in a $7.0 million pre-tax gain ($4.3 million after-tax, or $0.11 per share) which was included in “Gain on sale of assets” as part of Other income (expense) in our Consolidated Statements of Income for the year ended December 31, 2015.

Other income (expense), net. Other, net for 2014 includes the following:

•Pre and after-tax gain of $3.6 million relating to a release from a contingent earn-out liability to the noncontrolling shareholders of Leaf. As a result of the Stock Purchase Agreement we entered into on August 6, 2014 with the noncontrolling shareholders of Leaf, we were released from a contingent earn-out liability to those noncontrolling shareholders. The non-cash impact of the gain associated with the release of the contingent earn-out liability is recorded in "Other, net" in the Consolidated Statements of Income and "Write-off of fixed assets and other" in the Consolidated Statement of Cash Flows.

•Pre-tax charge of $4.0 million relating to an other than temporary impairment ("OTTI") of an investment in the stock of TabbedOut. During the fourth quarter of 2014, we reviewed our investment in the stock of TabbedOut and estimated that the fair value of its investment in Tabbedout was substantially impaired, and therefore, an impairment charge was recorded as of December 31, 2014.

Income taxes. We recorded an income tax provision of $53.3 million for the year ended December 31, 2015 which resulted in an effective income tax rate for the year ended December 31, 2015 of 38.6% compared to an income tax provision of $41.9 million and an effective tax rate of 56.8% for the year ended December 31, 2014.

The effective income tax rate for the year ended December 31, 2014 was negatively impacted by an increase in the valuation allowance against deferred tax assets and the impact of a non-deductible goodwill impairment charge. The increase in the valuation allowance in 2014 resulted from Leaf's operating losses during the 66.67% ownership period from January 1 to August 5, 2014 and from the write down of our investment in TabbedOut. On August 6, 2014, we acquired 100% of the common stock shares of Leaf. As a result, we are able to utilize the losses generated from Leaf against consolidated taxable income for the period beginning on and after August 6, 2014. See "- Liquidity and Capital Resources - Acquisitions" for a description of the transaction involving Leaf's ownership interests. Partially offsetting the higher effective tax rate in 2014 was a benefit from recognition of research and development credits. On December 19, 2014, the Tax Increase Prevention Act of

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2014 was enacted which included an extension of the federal research and development credit retroactively for one year. On December 18, 2015, the Protecting Americans from Tax Hikes Act ("PATH") was enacted which made the federal research and development credit permanent. However, no benefit was recognized in 2015 for the federal research and development credit as we did not meet the threshold of qualifying expenses.

Net income attributable to Heartland. As a result of the above factors, we recorded net income of $84.7 million for 2015. This compares to a net income of $33.9 million for 2014.

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013

The following table shows certain income statement data as a percentage of net revenue for the periods indicated (in thousands of dollars):

	2014	% of Net Revenue	2013	% of Net Revenue	Change Amount	%
Net revenue:						
Total revenue	$2,311,381		$2,135,372		$176,009	8.2 %
Less: Interchange	1,422,894		1,335,487		87,407	6.5 %
Less: Dues, assessments and fees	215,862		200,903		14,959	7.4 %
Total net revenue	672,625	100.0 %	598,982	100.0 %	73,643	12.3 %
Expenses:						
Processing and servicing	285,011	42.4 %	237,232	39.6 %	47,779	20.1 %
Customer acquisition costs	46,977	7.0 %	42,109	7.0 %	4,868	11.6 %
Depreciation and amortization	30,598	4.5 %	19,975	3.3 %	10,623	53.2 %
General and administrative	190,554	28.3 %	173,568	29.0 %	16,986	9.8 %
Goodwill impairment charge	18,490	2.7 %	—	— %	18,490	100.0 %
Asset impairment charge	18,875	2.8 %	—	— %	18,875	100.0 %
Total expenses	590,505	87.8 %	472,884	78.9 %	117,621	24.9 %
Income from operations	82,120	12.2 %	126,098	21.1 %	(43,978)	(34.9)%
Other income (expense):						
Interest income	125	— %	124	— %	1	0.8 %
Interest expense	(8,057)	(1.2)%	(5,429)	(0.9)%	(2,628)	(48.4)%
Other, net	(444)	(0.1)%	(241)	— %	(203)	(84.2)%
Total other expense	(8,376)	(1.2)%	(5,546)	(0.9)%	(2,830)	(51.0)%
Income from continuing operations before income taxes	73,744	11.0 %	120,552	20.1 %	(46,808)	(38.8)%
Provision for income taxes	41,876	6.2 %	46,450	7.8 %	(4,574)	(9.8)%
Net income (loss) from continuing operations	31,868	4.7 %	74,102	12.4 %	(42,234)	(57.0)%
Income from discontinued operations, net of income tax	—	— %	3,970	0.7 %	(3,970)	(100.0)%
Net income	31,868	4.7 %	78,072	13.0 %	(46,204)	(59.2)%
Less: Net income attributable to noncontrolling interests						
Continuing operations	(2,011)	(0.3)%	(610)	(0.1)%	(1,401)	(229.7)%
Discontinued operations	—	— %	56	— %	(56)	(100.0)%
Net income attributable to Heartland	$33,879	5.0 %	$78,626	13.1 %	$(44,747)	(56.9)%

Revenue. The following tables summarize total revenue and total net revenue (which we define as total revenue less interchange fees and dues, assessments and fees) by segment for the years ended December 31, 2014 and 2013 (in thousands of dollars):

Total revenue:	Year Ended December 31, 2014	2013	Change from Prior Year Amount	%	
Payment Processing	$2,111,487	$1,979,579	$131,908	6.7	%
Campus Solutions	61,538	36,186	25,352	70.1	%
Heartland School Solutions (a)	57,570	50,541	7,029	13.9	%
Heartland Payroll Solutions	50,394	44,565	5,829	13.1	%
Other	30,392	24,501	5,891	24.0	%
Total revenue	$2,311,381	$2,135,372	$176,009	8.2	%

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	Year Ended December 31,		Change from Prior Year		
Total net revenue:	2014	2013	Amount	%	
Payment Processing	$472,731	$443,189	$29,542	6.7	%
Campus Solutions	61,538	36,186	25,352	70.1	%
Heartland School Solutions (a)	57,570	50,541	7,029	13.9	%
Heartland Payroll Solutions	50,394	44,565	5,829	13.1	%
Other	30,392	24,501	5,891	24.0	%
Total net revenue	$672,625	$598,982	$73,643	12.3	%

(a) See below for discussion of Out-of-Period Adjustments.

Payment Processing

Payment Processing net revenue increased $29.5 million, or 6.7%, from $443.2 million in 2013 to $472.7 million in 2014. This increase was driven by a $26.1 million or 6.6% increase in SME net revenue, reflecting a 8.7% increase in SME processing volume from $74.6 billion in 2013 to $81.1 billion in 2014. This increase in processing volume reflects the addition of SME merchants whose processing volume exceeded that of merchants who attrited and the impact of same store sales growth in 2014. The increase in SME processing volume also reflects the conversion of new and existing merchants to OptBlue. We converted a majority of our existing merchants currently processing under the former sales and servicing agreement with American Express to OptBlue during the third and fourth quarter of 2014. Our reported SME processing volume includes processing volumes for merchants in our Heartland School Solutions, Campus Solutions, and Other businesses. However, net revenue related to that processing volume is included in the net revenue reported for those businesses.

Campus Solutions

Campus Solutions net revenue increased 70.1% from $36.2 million in 2013 to $61.5 million in 2014. The increase included $19.9 million of revenue added by TouchNet since its September 4, 2014 acquisition. The remaining increase in Campus Solutions net revenue is due to higher student loan servicing related revenue, as well as growth in transaction processing revenue related to our student tuition payment processing and tuition payment plan products.

Heartland School Solutions

Heartland School Solutions net revenue increased 13.9% from $50.5 million in 2013 to $57.6 million in 2014. The increase in Heartland School Solutions net revenue is due primarily to an increase in transaction processing revenue (partially aided by the April 2014 acquisition of MCS Software) and equipment-related revenues as a result of a sale of equipment and related installation services to a large new school district customer. Partially offsetting the increase in net revenue for Heartland School Solutions is a decrease associated with out-of-period adjustments. In the second quarter of 2014, we recorded out-of-period adjustments decreasing its revenue and increasing bad debt expense (included in Processing and Servicing in our Consolidated Statements of Income) by $1.4 million and $0.9 million, respectively. These adjustments related to immaterial errors that originated in the prior year in our Heartland School Solutions business. These adjustments included revenue which was incorrectly recorded in prior periods and a reassessment of the collectability of certain customer accounts receivable. These out-of-period adjustments reduced earnings before income taxes and net income in 2014 by $2.3 million and $1.4 million, respectively, and reduced diluted earnings per share by $0.04.

Heartland Payroll Solutions

Heartland Payroll Solutions net revenue increased 13.1% from $44.6 million in 2013 to $50.4 million in 2014. The increase in payroll processing net revenue is primarily due to a 7.0% increase in payroll processing customers from 24,088 at December 31, 2013 to 25,764 at December 31, 2014.

Other

Other net revenue increased 24.0% from $24.5 million in 2013 to $30.4 million in 2014, primarily due to growth in Micropayments revenue which reflects higher equipment sales and payment processing for unattended payment locations such as laundry facilities, kiosks and vending machines. The increase also included $1.4 million of revenue added by Xpient since its October 31, 2014 acquisition.

Total expenses. Total expenses increased 24.9% from $472.9 million in 2013 to $590.5 million in 2014, due to the increases in processing and servicing, depreciation and amortization, customer acquisition costs, general and administrative expenses and asset impairment charges related to our investment in Leaf and other POS assets . These increases are further discussed below and resulted in total expenses representing 87.8% of total net revenue in 2014, compared to 78.9% in 2013.

Processing and servicing expense for the year ended December 31, 2014 increased by $47.8 million, or 20.1%, compared with the year ended December 31, 2013. The increase in processing and servicing expense reflects the acquisitions of MCS Software, TouchNet and Xpient, as well as, increased costs associated with processing and servicing higher SME bankcard processing volume, increased sales compensation, higher merchant losses as a result of chargebacks from a single merchant who entered bankruptcy in the fourth quarter and increased cost of sales and servicing related to higher Heartland School Solutions, Heartland Payroll Solutions, Campus Solutions, and Other revenues (primarily our Micropayments business). The increase in processing and servicing expenses also reflects approximately $6.5 million of expenses which were classified as general and administrative expense in the prior year. This reclassification brings operating expenses in our legacy payroll business and Ovation business into alignment. As a percentage of total net revenue, processing and servicing expense increased to 42.4% for the year ended December 31, 2014 compared with 39.6% for the year ended December 31, 2013.

Customer acquisition costs for the year ended December 31, 2014 increased by $4.9 million, or 11.6% compared with the year ended December 31, 2013. As reflected in the table below, this increase reflects higher amortization on increased capitalized deferred acquisition costs resulting from improved levels of new installed margin and the impact of subsequent changes in the estimated accrued buyout liability due to lower merchant attrition and same-store sales growth. As a percentage of total net revenue, customer acquisition costs remained consistent at 7.0% for the year ended December 31, 2014 and 2013.

Customer acquisition costs for the years ended December 31, 2014 and 2013 included the following components (in thousands of dollars):

	Year Ended December 31,	
	2014	2013
Amortization of signing bonuses, net	$30,345	$27,767
Amortization of capitalized customer deferred acquisition costs	21,281	17,881
Increase in accrued buyout liability	20,182	17,620
Capitalized customer deferred acquisition costs	(24,831)	(21,159)
Total customer acquisition costs	$46,977	$42,109

Depreciation and amortization expenses increased 53.2% from $20.0 million in 2013 to $30.6 million in 2014. The increase in depreciation and amortization expenses include increases in acquisition related amortization of intangible assets in 2014 compared to 2013. As a percentage of total net revenue, depreciation and amortization expenses increased to 4.5% for the year ended December 31, 2014 compared with 3.3% for the year ended December 31, 2013. See "— Liquidity and Capital Resources — Acquisitions" for further information on these acquisitions.

Most of our investments in information technology have supported the continuing development of HPS Exchange, Passport and other processing-related initiatives. Depreciation and amortization expense recorded on these investments is included in processing and servicing expense. Additionally, we capitalized salaries, fringe benefits and other expenses incurred by our employees that worked on internally developed software projects and outsourced programming. Amortization does not begin on the internally developed software until the project is complete and placed in service, at which time we begin to amortize the asset over expected lives of three to five years. The amount capitalized increased from $38.4 million in 2013 to $40.3 million in 2014. The total amount of capitalized costs for projects placed in service in 2014 and 2013 was $36.5 million and $25.7 million, respectively.

General and administrative expenses increased $17.0 million, or 9.8%, from $173.6 million in 2013 to $190.6 million in 2014. General and administrative expenses increased primarily due to a $15.2 million increase in personnel costs and an increase of $2.7 million in occupancy costs. The increase in personnel and occupancy costs primarily reflects the acquisitions of Leaf in September 2013, MCS Software in April 2014, TouchNet in September 2014 and Xpient in October 2014, as well as other headcount increases. The remaining increase in general and administrative expenses resulted from our acquisitions, including $3.7 million of acquisition-related expenses. Partially offsetting these increases was a decrease due to the reclassification of $6.5 million of payroll related expenses from general and administrative to processing and servicing expense for our payroll business as well as lower equipment lease and information technology related expenses. General and administrative expenses as a percentage of total net revenue for 2014 was 28.3%, a slight decrease from 29.0% for 2013.

We recorded pre-tax asset impairment charges related to our investment in Leaf and other POS assets of $37.4 million, including $18.5 million for goodwill impairment. Management considered the overlapping cloud-based POS systems in development at Heartland Commerce businesses and decided that it would stop POS development efforts at Leaf Acquisition, LLC ("Leaf"), a previous Heartland Commerce business. This decision caused a significant adverse change in the extent or manner in which the long-lived asset group of Leaf would be used, including Prosper, an internally developed POS software technology. Due to these changes in circumstances, the implied fair value of the Leaf reporting unit was determined to be significantly below its carrying value. This led to a Goodwill Impairment charge for the full balance of Leaf Goodwill as of December 31, 2014.

Income from operations. Our income from operations, which we also refer to as operating income, decreased to $82.1 million for 2014, from $126.1 million for 2013, as a result of increases in processing and servicing expenses, depreciation and amortization, general and administrative expenses, and goodwill and asset impairments, partially offset by an increase in net revenue. Our operating margin, which we measure as operating income divided by net revenue, was 12.2% for 2014, compared to 21.1% for 2013. Excluding the impact of the goodwill and asset impairment charges during the fourth quarter, our operating income would have been $119.7 million or 17.8% for 2014.

Interest expense. Interest expense for 2014 and 2013 was $8.1 million and $5.4 million, respectively. Interest expense in both periods includes interest incurred under our credit facilities and interest we recorded on payables to our sponsor banks. The increase in interest expense reflects higher borrowings under our 2014 Revolving Credit Facility (as defined in —Liquidity and Capital Resources—Credit Facilities herein) as well as interest expense on $375 million under our 2014 Term Credit Facility (as defined in —Liquidity and Capital Resources—Credit Facilities herein) that was used to fund the TouchNet Acquisition. See "— Liquidity and Capital Resources — Credit Facilities" for more detail on our borrowings.

Other income (expense), net. Other, net for 2014 includes the following:

•Pre and after-tax gain of $3.6 million relating to a release from a contingent earn-out liability to the noncontrolling shareholders of Leaf. As a result of the Stock Purchase Agreement we entered into on August 6, 2014 with the noncontrolling shareholders of Leaf, we were released from a contingent earn-out liability to those noncontrolling shareholders. The non-cash impact of the gain associated with the release of the contingent earn-out liability is recorded in "Other, net" in the Consolidated Statements of Income and "Write-off of fixed assets and other" in the Consolidated Statement of Cash Flows.

•Pre-tax charge of $4.0 million relating to an other than temporary impairment ("OTTI") of an investment in the stock of TabbedOut. See "— 2014 Financial Highlights," for information on this OTTI.

Income taxes. Income tax expense for 2014 was $41.9 million, reflecting an effective tax rate of 56.8%. This compares to income tax expense of $46.5 million for 2013, an effective tax rate of 38.5%. The effective income tax rate for the year ended December 31, 2014 was unfavorably impacted by an increase in the valuation allowance against deferred tax assets and the impact of a non-deductible goodwill impairment charge. Our effective tax rate without these two charges would have been 39.2%. The increase in the valuation allowance resulted from Leaf's operating losses during the 66.67% ownership period from January 1 to August 5, 2014 and from the write down of our investment in TabbedOut. On August 6, 2014, we acquired 100% of the common stock shares of Leaf. As a result, we will be able to utilize the losses generated from Leaf against consolidated taxable income for the period beginning on and after August 6, 2014. See "— Liquidity and Capital Resources — Acquisitions" for a description of the transaction involving Leaf's ownership interests. The effective tax rate for 2014 and 2013 benefited from recognition of research and development credits. On December 19, 2014, the Tax Increase Prevention Act of 2014 was enacted which included an extension of the federal research and development credit retroactively for one year and is reflected in 2014. On January 2, 2013, the American Taxpayer Relief Act of 2012 ("ATR Act") was enacted which included an extension of the federal research and development credit retroactively to 2012 and prospectively through 2013. We recognized the effects of the research and development credits in 2013 in conjunction with filing our 2012 tax return. The favorable impact of the research and development credits on the effective tax rate for 2013 was partially offset by a valuation allowance recorded against the deferred tax assets arising from Leaf's operating losses and an increase in the state tax rates.

Net income attributable to Heartland. As a result of the above factors, we recorded net income of $33.9 million for 2014. This compares to a net income of $78.6 million for 2013.

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Balance Sheet Information

	December 31, 2015	December 31, 2014
	(In thousands)	
Selected Balance Sheet Data		
Cash and cash equivalents	$56,483	$70,793
Funds held for customers	228,234	176,492
Receivables, net	267,292	234,104
Property and equipment, net	166,692	154,303
Goodwill	490,020	425,712
Intangible assets, net	197,223	192,553
Total assets	1,536,679	1,378,465
Due to sponsor banks	31,803	31,165
Customer fund deposits	228,234	176,492
Processing liabilities	152,188	119,398
Borrowings:		
Current portion	43,793	36,792
Long-term portion	437,842	523,122
Unearned revenue:		
Current portion	57,346	46,601
Long term portion	3,237	2,354
Total liabilities	1,200,857	1,127,705
Total equity	335,822	250,760

December 31, 2015 Compared to December 31, 2014

Total assets increased $158.2 million, or 11.5%, to $1,536.7 million at December 31, 2015 from $1,378.5 million at December 31, 2014. The increases at December 31, 2015 include $33.2 million in receivables, $51.7 million in funds held for customers (which is offset by an equal increase in customer fund deposits), $64.3 million in goodwill and $4.7 million in intangible assets. The increase in goodwill is primarily due to the acquisitions of pcAmerica, Dinerware, Payroll 1 and Digital Dining. These increases were partially offset by a decrease in cash of $14.3 million to partially fund these acquisitions. See "— Liquidity and Capital Resources" for further details on these acquisitions.

Our receivables, which increased $33.2 million or 14.2% from December 31, 2014, are primarily due from our card payment processing merchants and result in large part from our practice of advancing interchange fees to most of our SME merchants during the month and collecting those fees from our merchants at the beginning of the following month, as well as from transaction fees we charge merchants for processing transactions. Total receivables also include amounts due from Discover and American Express bankcard networks for merchant sales transactions. Receivables from the networks are recovered the following business day from the date of processing the transaction. Amounts due from SME bankcard processing merchants and bankcard networks at December 31, 2015 increased $29.6 million from December 31, 2014.

The amount due to sponsor banks primarily for funding merchant advances was $30.5 million and $29.9 million at December 31, 2015 and 2014, respectively. The liability to sponsor banks is repaid at the beginning of the following month out of the fees we collect from our merchants.

Total borrowings under our credit facility decreased $78.3 million, or 14.0%, to $481.6 million at December 31, 2015 from $559.9 million at December 31, 2014 reflecting our use of cash flow to reduce borrowings. See "—Liquidity and Capital Resources" for discussion of Credit Facilities.

Total equity increased $85.1 million from December 31, 2014 primarily due to net income of $84.7 million. Other increases in total stockholders' equity at December 31, 2015 include proceeds received from the exercise of stock options, tax benefits related to those stock option exercises and share-based compensation. Partially offsetting the increases in stockholders' equity were payments of cash dividends of $14.7 million and restricted stock units vested of $18.9 million during 2015.

Liquidity and Capital Resources

General. Liquidity and capital resource management is a process focused on providing the funding we need to meet our short and long-term cash and working capital needs. We have used our funding sources to build our merchant portfolio, our technology platforms, our service center, and to make acquisitions with the expectation that these investments will generate cash flows sufficient to cover our working capital needs and other anticipated needs for capital.

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Our cash requirements include funding payments to salespersons for signing bonuses, residual commissions and residual buyouts, paying interest expense and other operating expenses, including taxes, investing in our technology infrastructure, and making acquisitions of businesses or assets. We expect that our future cash requirements will continue to include amounts used to repurchase our common stock and pay dividends, both as authorized by our Board of Directors.

Other than borrowings we use to fund certain acquisitions and share repurchases, we fund our cash needs primarily with cash flow from our operating activities and through our agreements with our sponsor banks to fund SME merchant advances. We believe that our current cash and investment balances, cash generated from operations and our agreements with our sponsor banks to fund SME merchant advances will provide sufficient liquidity to meet our anticipated needs for operating capital for at least the next twelve months.

Working Capital. Our working capital, defined as current assets less current liabilities, was negative by $68.4 million at December 31, 2015 and positive by $5.8 million at December 31, 2014. The decrease in working capital is primarily due to the acquisitions of pcAmerica and Dinerware, which were partially funded by operating cash, and our use of operating cash to pay down borrowings under our 2014 Revolving Credit Facility which are generally classified as non-current liabilities.
At December 31, 2015 we had cash on our Consolidated Balance Sheet totaling $56.5 million compared to cash of $70.8 million at December 31, 2014. Our cash balance included processing-related cash in transit and collateral of $15.1 million and $17.8 million at December 31, 2015 and 2014, respectively.

On December 31, 2015, we had $269.7 million available under our Revolving Credit Facility. See "— Credit Facilities" for more details.

Acquisitions

Campus Solutions
On September 4, 2014, we completed the acquisition of TouchNet, an integrated commerce solutions provider to higher-education institutions for a cash payment of $375 million, less a net working capital deficit, for all outstanding common shares. The purchase was funded primarily with the proceeds from a five year, $375 million secured term loan. See "— Credit Facilities," for further discussion. TouchNet added over 600 higher education clients serving over 6 million students, nearly one-third of the higher education enrollment in the United States, to our Campus Solutions business.

Heartland School Solutions
On April 1, 2014, we purchased the net assets of MCS Software for a $17.3 million cash payment. The purchase price was financed under our 2013 Credit Facility and from operating cash flows. The acquisition further expanded our market-leading position in the K-12 school nutrition and POS technology industry in our Heartland School Solutions business.

Heartland Payroll Solutions
On February 27, 2015, we purchased the stock of Payroll 1 for a $30.0 million cash payment, plus net working capital. The purchase price was financed under our 2014 Revolving Credit Facility. The acquisition of Payroll 1 expanded our existing payroll processing business and customer base by adding 6,573 customers.

Heartland Commerce
On October 30, 2015, we acquired the stock of Digital Dining for a cash payment of $18.7 million. The purchase price was financed under our 2014 Revolving Credit Facility and from operating cash flows. Digital Dining is a national provider of restaurant POS and management systems. Digital Dining offers restaurants the convenience of a handheld

POS on an iPhone, iPod and iPad in a hybrid environment with conventional fixed terminals, and is also used by restaurateurs for table management, delivery, reservations, labor scheduling, inventory and loyalty programs.

On February 11, 2015, we acquired the stock of Dinerware for a cash payment of $15.0 million. The purchase was funded from a combination of operating cash and financing under the 2014 Revolving Credit Facility. Dinerware provides restaurant POS software solutions to the hospitality industry. Dinerware can be found in upscale restaurants, cafes, nightclubs, bar and grills, fast casual restaurants, counter service establishments, quick serve restaurants, hotels, casinos, cafeterias, golf courses, and wineries.

On January 30, 2015,we acquired the net assets of pcAmerica for a cash payment of $15.0 million. The purchase was funded from a combination of operating cash and financing under the 2014 Revolving Credit Facility. PcAmerica delivers POS

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systems to streamline daily operations, including customer transactions, inventory tracking, employee labor, and marketing reports to meet the evolving needs of retail stores or restaurants.

On October 31, 2014, we acquired the net assets of Xpient Solutions, LLC (“Xpient”) for a cash payment of $30.0 million, plus net working capital. The purchase price was funded from a combination of operating cash and financing under the 2014 Revolving Credit Facility. Xpient provides POS software solutions to customers primarily in the food service industry.

On February 15, 2014, we purchased the assets of Merchant Software Corporation (referred to as "Liquor POS") for a $3.3 million cash payment. The purchase price was financed from operating cash flows. Liquor POS is a leading provider of POS systems to the liquor retail vertical serving over 3,400 merchants.

On September 11, 2013, we purchased 66.67% of Leaf's outstanding capital stock for a $14.5 million cash payment. The purchase price was financed from operating cash flows. On August 6, 2014, we entered into a Stock Purchase Agreement with the noncontrolling shareholders of Leaf under which we acquired all shares of Leaf common stock held by the noncontrolling shareholders. As a result of this transaction, Leaf became our wholly-owned subsidiary.

Divestitures

Payment Processing

On December 31, 2015 we sold the assets of our SmartLink division (“SmartLink”), which included our secure payment gateways and managed network services technologies, to a third party, for a $10 million cash payment. We also entered into a channel partner agreement, whereby our sales professionals will continue to promote the secure payment gateway and managed network services solutions to merchants. The SmartLink division was included in the Payment Processing Segment. The sale of SmartLink resulted in a $7.0 million pre-tax gain ($4.3 million after-tax, or $0.11 per share) which was included in, “Gain on sale of assets”, as part of Other income (expense) in our Consolidated Statements of Income for the year ended December 31, 2015.

In the fourth quarter of 2012, we, along with the 30% noncontrolling shareholders of CPOS, entered into an agreement to sell CPOS to a third party. CPOS, which operates as a provider of payment processing services in Canada, was not a significant subsidiary and we had no continuing involvement in its operations. After receiving regulatory approval, the buyer settled this sale on January 31, 2013. The total sales price was $30.3 million cash including net working capital, of which we received $20.9 million for our 70% ownership position.

Cash Flow Provided By Operating Activities. We reported net cash provided by operating activities of $189.8 million in 2015, compared to $93.0 million in 2014 and $112.1 million in 2013.

Cash provided by operating activities in 2015, 2014, and 2013 reflects the benefit from net income as adjusted for non-cash operating items including increases in amortization of capitalized customer acquisition costs, depreciation and amortization and share-based compensation. Additionally, the net cash provided for 2015 reflects timing of collecting unearned revenue, net processing activities, and income tax payments. Net cash provided by operating activities in 2015 was reduced by higher payments for signing bonuses, increases in receivables, and higher payouts of accrued buyout liability.
Cash provided by operating activities for 2014 was also adjusted for the non-cash asset impairment charges. See "—Overview" for further detail. Cash provided by operating activities in 2014 was reduced by payments of signing bonuses, increases in receivables, increases in customer acquisition costs, payouts of accrued buyout liability, decreases in processing liabilities, decreases in accounts payable and decreases in accrued expenses and other liabilities. In 2013, cash provided by operating activities reflects uses of cash for an increase in receivables and a

decrease in amounts due to sponsor banks, partially offset by an increase in processing liabilities. Cash provided by operating activities in 2013 was reduced by payments for income taxes of $38.8 million.

Major determinants of operating cash flow are net signing bonus payments, which consume operating cash as we install new merchants, and payouts on the accrued buyout liability, which represent the costs of buying out residual commissions owned by our salespersons. See "— Critical Accounting Estimates — Capitalized Customer Acquisition Costs" and "— Critical Accounting Estimates — Accrued Buyout Liability" for more information. We paid net signing bonuses of $48.3 million, $38.9 million, and $29.1 million, respectively, in 2015, 2014 and 2013. In 2015, 2014 and 2013, we reduced our accrued buyout liability by making buyout payments of $15.4 million, $11.6 million, and $13.7 million, respectively.

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Cash Flow Used In Investing Activities. Net cash used in investing activities was $123.7 million for 2015, $447.2 million for 2014 and $52.0 million for 2013. Cash flows used in investing activities in 2015 reflect the purchases, net of cash acquired, of pcAmerica, Dinerware, Payroll 1 and Digital Dining for $15.0 million, $15.0 million, $30.0 million and $18.7 million, respectively. Partially offsetting cash flow used in investing activities were proceeds from sale of assets of $10.0 million relating to SmartLink (See "— Results of Operations — Year Ended December 31, 2015 Compared to Year Ended December 31, 2014" for further details on this sale. Cash flows used in investing activities in 2014 included the costs of acquiring, for a total of $392.1 million net of cash acquired, Liquor POS, MCS Software, TouchNet, and Xpient. Cash flows from investing activities for 2013 reflect the $19.3 million of net proceeds received from the sale of CPOS. The amount of cash used in investing activities during 2013 included $14.5 million for the investment in Leaf.

We made capital expenditures of $54.3 million, $54.9 million and $52.9 million in 2015, 2014, and 2013, respectively. We continue building our technology infrastructure, primarily for hardware and software needed for the development and expansion of our products and operating platforms. To further develop our technology, we anticipate that these expenditures will continue near current levels in the future.

Cash Flow (Used In) Provided By Financing Activities. Net cash used in financing activities was $80.4 million in 2015, compared to net cash provided by financing activities of $353.1 million in 2014 and used in financing activities of $38.8 million in 2013.

During 2015, we borrowed, net of financing costs, $230.0 million under our credit facilities, compared to $460.4 million in 2014 and $156.4 million in 2013. In 2015, 2014 and 2013 we made payments of $308.3 million, $54.2 million and $161.0 million, respectively, under our credit facilities. See "— Credit Facilities" for more details.

Cash provided by financing activities in 2015, 2014 and 2013 included exercised stock options generating cash proceeds in the aggregate of $2.9 million, $6.1 million and $14.2 million, respectively, and tax benefits of $9.6 million, $7.5 million and $11.6 million, respectively. Cash used in 2014 and 2013 included cash used for common stock repurchases. We used $54.5 million of cash to repurchase 1,347,817 shares of our common stock during 2014 and $49.6 million of cash to repurchase 1,486,783 shares of our common stock during 2013.

Cash dividends paid in 2015 were $14.7 million, compared to $12.3 million and $10.3 million, respectively, in 2014 and 2013. See "— Dividends" for more information on our common stock dividends.

Credit Facilities. On September 4, 2014, we entered into an amended and restated senior secured credit facility (the "2014 Credit Agreement") with Bank of America, N.A., as administrative agent, and certain lenders who are a party to the 2014 Credit Agreement. This 2014 Credit Agreement replaced our senior secured credit facility dated as of October 23, 2013 (the "2013 Credit Agreement"). Credit extended under the 2014 Credit Agreement is guaranteed by our subsidiaries and is secured by substantially all of our assets and the assets of our subsidiaries.

The 2014 Credit Agreement provides for a revolving credit facility in the aggregate amount of up to $400 million (the "2014 Revolving Credit Facility") and a term loan in an initial principal amount of $375 million (the "2014 Term Credit Facility"). The 2014 Revolving Credit Facility included up to $35 million that may be used for the issuance of letters of credit and up to $35 million that is available for swing line loans. All principal and interest not previously paid on the 2014 Revolving Credit Facility will mature and be due and payable on September 4, 2019. On September 4, 2014, we borrowed $375 million under the 2014 Term Credit Facility to fund the TouchNet Acquisition. The 2014 Term Credit Facility amortizes on a quarterly basis as follows, with the remaining principal balance due on September 4, 2019: (i) 5% of the initial 2014 Term Credit Facility to be payable in each of the first three years, (ii) 7.5% of the initial Term Credit Facility to be payable in the fourth year and (iii) 10% of the initial 2014 Term Credit Facility to be payable in the fifth year. The 2014 Term Credit Facility is also subject to mandatory prepayment from the net cash proceeds of certain asset dispositions, casualty or condemnation events, issuance of indebtedness and extraordinary receipts.

Subject to the terms and conditions of the 2014 Credit Agreement, without the consent of the then existing lenders (but subject to the receipt of commitments), the 2014 Revolving Credit Facility may be increased and new incremental term loans may be issued in an aggregate principal amount of up to $150 million for all such increases under the 2014 Revolving Credit Facility and new term loans, subject to certain minimum threshold amounts.

We had $351.6 million and $370.0 million outstanding under our 2014 Term Credit Facility at December 31, 2015 and December 31, 2014, respectively. We had $130.0 million and $189.5 million outstanding under our 2014 Revolving Credit Facility at December 31, 2015 and 2014, respectively.

The 2014 Credit Agreement contains covenants which include: maintenance of certain leverage and fixed charge coverage ratios; limitations on our indebtedness, liens on our properties and assets, investments in, loans to other business units, and our ability to enter into business combinations and asset sales; and certain other financial and non-financial covenants.

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These covenants also apply to certain of our subsidiaries. We were in compliance with these covenants as of December 31, 2015 and 2014 and expect we will remain in compliance with the covenants of the 2014 Credit Agreement for at least the next twelve months.

Dividends. During 2015, 2014 and 2013, our Board of Directors declared dividends of $0.40, $0.34 and $0.28 per share of common stock, respectively. During 2015, 2014 and 2013, we paid cash dividends of $14.7 million, $12.3 million and $10.3 million, respectively.

On February 2, 2016, our Board of Directors declared a quarterly cash dividend of $0.10 per share of common stock, payable on March 15, 2016 to stockholders of record as of March 1, 2016.

Contractual Obligations. The card brand networks generally allow chargebacks up to four months after the later of the date the transaction is processed or the delivery of the product or service to the cardholder. If the merchant incurring the chargeback is unable to fund the refund to the card issuing bank, we must do so. As the majority of our SME transactions involve the delivery of the product or service at the time of the transaction, a good basis to estimate our exposure to chargebacks is the last four months' bankcard processing volume on our SME portfolio, which was $31.8 billion for the four months ended December 31, 2015 and $27.8 billion for the four months ended December 31, 2014. However, during the four months ended December 31, 2015 and December 31, 2014, we were presented with $18.0 million and $16.0 million, respectively, of chargebacks by issuing banks. In 2015, 2014 and 2013, we experienced merchant losses of $2.9 million, $7.3 million and $3.1 million, respectively, or 0.31 basis points, 0.90 basis points and 0.41 basis points, respectively, on total SME bankcard dollar volumes processed of $93.1 billion, $81.1 billion and $74.6 billion, respectively. In 2014, our losses included $4.6 million resulting from chargebacks from a single merchant who entered bankruptcy in the fourth quarter. These losses are included in processing and servicing expense in our Consolidated Statements of Income.

	Payments Due by Period				
Contractual Obligations	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
	(In thousands)				
Processing providers (a)	$9,008	$4,013	$4,995	$—	$—
Telecommunications providers (b)	6,818	3,307	3,511	—	—
Facility and equipment leases	108,970	18,475	28,578	17,312	44,605
2014 Term Credit Facility	351,563	18,750	56,250	276,563	—
2014 Revolving Credit Facility (c)	130,000	—	—	130,000	—
Capital Lease Obligation	73	43	30	—	—
	$606,432	$44,588	$93,364	$423,875	$44,605

(a) We have agreements with several third-party processors to provide to us on a non-exclusive basis payment processing and transmittal, transaction authorization and data capture services, and access to various reporting tools. Our agreements with third-party processors require us to submit a minimum monthly number of transactions or volume for processing. If we submit a number of transactions or volume that is lower than the minimum, we are required to pay the third-party processors the fees that they would have received if we had submitted the required minimum number or volume of transactions.

(b) We have agreements in place with several large telecommunications companies that provide data center services, wide area network connectivity, and voice services that are used by both our call center and card payment processing platforms. These providers require both dollar and term commitments for the services they provide. If we do not meet the minimum terms, then there is a requirement to pay the remaining commitments.

(c) The 2014 Revolving Credit Facility is available on a revolving basis until September 4, 2019. While we are not contractually obligated to pay $25.0 million of the outstanding balance of the 2014 Revolving Credit Facility, we include this amount in the Current portion of borrowings on the Consolidated Balance Sheet since we intend to pay this amount in January 2016.

Unrecognized Tax Benefits. At December 31, 2015, we had gross tax-effected unrecognized tax benefits of approximately $6.6 million. See "— Critical Accounting Estimates — Income Taxes." As of December 31, 2015, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority, hence the unrecognized tax benefits have been excluded from the above commitment and contractual obligations table.

Off-Balance Sheet Arrangements

We have not entered into any transactions with third parties or unconsolidated entities whereby we have financial guarantees, subordinated retained interest, derivative instruments, or other contingent arrangements that expose us to material continuing risks, contingent liabilities, or other obligations other than for chargebacks and reject losses described under "— Critical Accounting Estimates."

Legal and Regulatory Considerations

Processing System Intrusion Legal Proceedings
To date, we have had several lawsuits filed against us and our sponsor banks in connection with the Processing System Intrusion. For information concerning the remaining lawsuit, see "— Item 3. Legal Proceedings."
Other Legal Proceedings
In the ordinary course of our business, we are party to various legal actions, which we believe are incidental to the operation of our business. We believe that the outcome of the proceedings to which we are currently a party will not have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Interest Rate Risk. Our primary market risk exposure is to increase in interest rates.

We have interest rate risk related to our amounts payable to our sponsor banks. Within our payable to our sponsor banks are balances which our sponsor banks have advanced to our SME merchants for interchange fees. The amount due to sponsor banks for funding merchant advances was $30.5 million at December 31, 2015. During the year ended December 31, 2015, the average daily interest-bearing balance of that payable was approximately $10.4 million. We incur interest expense on this payable at the prime rate. A hypothetical 100 basis point increase in the interest rate applied to our average payable to sponsor banks would result in a decrease of approximately $104,000 in annual pre-tax income.

We also incur interest rate risk on borrowings under our 2014 Credit Agreement. At December 31, 2015, there was $351.6 million outstanding under the 2014 Term Credit Facility and $130.0 million outstanding under the 2014 Revolving Credit Facility. We incur interest expense on these variable-rate borrowings based on short-term interest rates. The impact that a hypothetical 100 basis point increase in short-term interest rates would have on our outstanding December 31, 2015 balances under the Credit Agreement would be a decline of approximately $4.8 million in annual pre-tax income.

While the bulk of our cash and cash-equivalents, including Funds held for customers, are held in demand accounts or money market funds, we do hold certain fixed-income investments with remaining terms of less than five years. At December 31, 2015, a hypothetical 100 basis point increase in short-term interest rates would result in no material change in annual pre-tax income from investment holdings, but would result in a decrease in the value of fixed-rate investments of approximately $502,000.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Heartland Payment Systems, Inc.

We have audited the accompanying consolidated balance sheets of Heartland Payment Systems, Inc. and subsidiaries (the "Company") as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Heartland Payment Systems, Inc. and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board’s Accounting Standards Update 2015-17, Balance Sheet Classification of Deferred Taxes, and retrospectively applied the classification for deferred taxes in the consolidated balance sheet for the year ended December 31, 2014.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2015, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 29, 2016 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP
Philadelphia, Pennsylvania
February 29, 2016

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Heartland Payment Systems, Inc.

We have audited the internal control over financial reporting of Heartland Payment Systems, Inc. and subsidiaries (the "Company") as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2015 of the Company and our report dated February 29, 2016 expressed an unqualified opinion and on these consolidated financial statements included an explanatory paragraph related to the adoption of Accounting Standards Update 2015-17, Balance Sheet

Classification of Deferred Taxes.

/s/ Deloitte & Touche LLP
Philadelphia, Pennsylvania
February 29, 2016

Heartland Payment Systems, Inc. and Subsidiaries
Consolidated Balance Sheets
(In thousands, except share data)

	December 31,	
Assets	2015	2014
Current assets:		
Cash and cash equivalents	$56,483	$70,793
Funds held for customers	228,234	176,492
Receivables, net	267,292	234,104
Investments	109	106
Inventory	12,856	12,048
Prepaid expenses	20,733	22,658
Current tax assets	6,499	15,082
Total current assets	592,206	531,283
Capitalized customer acquisition costs, net	88,995	73,107
Property and equipment, net	166,692	154,303
Goodwill	490,020	425,712
Intangible assets, net	197,223	192,553
Deposits and other assets, net	1,543	1,507
Total assets	$1,536,679	$1,378,465
Liabilities and Equity		
Current liabilities:		
Due to sponsor banks	$31,803	$31,165
Accounts payable	70,418	58,460
Customer fund deposits	228,234	176,492
Processing liabilities	152,188	119,398
Current portion of accrued buyout liability	18,549	15,023
Current portion of borrowings	43,793	36,792
Current portion of unearned revenue	57,346	46,601
Accrued expenses and other liabilities	58,265	41,517
Total current liabilities	660,596	525,448
Deferred tax liabilities, net	51,283	36,496
Reserve for unrecognized tax benefits	6,599	7,315
Long-term borrowings	437,842	523,122
Long-term portion of accrued buyout liability	41,300	32,970
Long-term portion of unearned revenue	3,237	2,354
Total liabilities	1,200,857	1,127,705
Commitments and contingencies (Note 17)	—	—
Equity		
Common stock, $0.001 par value, 100,000,000 shares authorized, 36,933,825 and 36,344,921 shares issued and outstanding at December 31, 2015 and December 31, 2014	37	36
Additional paid-in capital	270,822	255,921
Accumulated other comprehensive loss	(31)	(130)
Retained earnings (accumulated deficit)	64,994	(5,067)
Total equity	335,822	250,760

Total liabilities and equity	$1,536,679	$1,378,465

See accompanying notes to consolidated financial statements.

Heartland Payment Systems, Inc. and Subsidiaries
Consolidated Statements of Income
(In thousands, except per share data)

	Year Ended December 31,		
	2015	2014	2013
Total revenues	$2,682,396	$2,311,381	$2,135,372
Costs of services:			
Interchange	1,617,671	1,422,894	1,335,487
Dues, assessments and fees	241,767	215,862	200,903
Processing and servicing	328,630	285,011	237,232
Customer acquisition costs	59,458	46,977	42,109
Depreciation and amortization	45,317	30,598	19,975
Total costs of services	2,292,843	2,001,342	1,835,706
General and administrative	244,005	190,554	173,568
Goodwill impairment charge	—	18,490	—
Asset impairment charges	—	18,875	—
Total expenses	2,536,848	2,229,261	2,009,274
Income from operations	145,548	82,120	126,098
Other income (expense):			
Interest income	105	125	124
Interest expense	(14,184)	(8,057)	(5,429)
Gain on sale of assets	7,008	—	—
Other, net	(402)	(444)	(241)
Total other expense	(7,473)	(8,376)	(5,546)
Income before income taxes	138,075	73,744	120,552
Provision for income taxes	53,343	41,876	46,450
Net income from continuing operations	84,732	31,868	74,102
Income from discontinued operations, net of income tax of $—, $—, and $2,135	—	—	3,970
Net income	84,732	31,868	78,072
Less: Net (loss) income attributable to noncontrolling interests			
Continuing operations	—	(2,011)	(610)
Discontinued operations	—	—	56
Net income attributable to Heartland	$84,732	$33,879	$78,626
Amounts attributable to Heartland:			
Net income from continuing operations	$84,732	$33,879	$74,712
Income from discontinued operations, net of income tax and noncontrolling interests	—	—	3,914
Net income attributable to Heartland	$84,732	$33,879	$78,626
Basic earnings per share:			
Income from continuing operations	$2.31	$0.93	$2.03
Income from discontinued operations	—	—	0.11
Basic earnings per share	$2.31	$0.93	$2.14
Diluted earnings per share:			
Income from continuing operations	$2.28	$0.91	$1.96
Income from discontinued operations	—	—	0.10

Diluted earnings per share	$2.28	$0.91	$2.06
Weighted average number of common shares outstanding:			
Basic	36,646	36,354	36,791
Diluted	37,237	37,187	38,053

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See accompanying notes to consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
(In thousands)

	Year Ended December 31,		
	2015	2014	2013
Net income	$84,732	$31,868	$78,072
Other comprehensive income (loss):			
Reclassification of losses (gains) on investments, net of income tax of $(7), $108 and $—	12	(170)	—
Unrealized gains (losses) on investments, net of income tax of $6, $(10) and $8	15	(50)	12
Unrealized gains on derivative financial instruments, net of income tax of $54, $106 and $153	72	178	254
Foreign currency translation adjustment	—	—	(54)
Comprehensive income	84,831	31,826	78,284
Less: Comprehensive loss attributable to noncontrolling interests	—	(2,011)	(570)
Comprehensive income attributable to Heartland	$84,831	$33,837	$78,854

See accompanying notes to consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries
Consolidated Statements of Equity
(In thousands)

	Heartland Stockholders' Equity							
	Common Stock							
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	(Accumulated Deficit) Retained Earnings	Treasury Stock	Noncontrolling Interests	Total Equity
Balance, January 1, 2013	36,856	$38	$222,705	$ (399)	$7,629	(20,187)	$ 1,375	$211,161
Issuance of common stock – options exercised	1,265	1	14,173	—	—	—	—	14,174
Issuance of common stock – RSU's vested	317	—	(6,233)	—	—	—	—	(6,233)
Excess tax benefit on employee share-based compensation	—	—	11,596	—	—	—	—	11,596
Repurchase of common stock	(1,487)	—	—	—	—	(50,302)	—	(50,302)
Retirement of treasury stock	—	(2)	(10,024)	—	(39,974)	50,000	—	—
Share-based compensation	—	—	12,838	—	—	—	—	12,838
Changes in equity from sale of discontinued operations	—	—	—	83	—	—	(1,415)	(1,332)
Other comprehensive income (loss)	—	—	—	228	—	—	(16)	212
Noncontrolling interests in subsidiary acquired	—	—	—	—	—	—	6,798	6,798
Dividends on common stock ($0.28 per share)	—	—	—	—	(10,321)	—	—	(10,321)
Net income (loss) for the year	—	—	—	—	78,626	—	(554)	78,072
Balance, December 31, 2013	36,951	$37	$245,055	$ (88)	$35,960	$(20,489)	$ 6,188	$266,663
Issuance of common stock – options exercised	453		6,109	—	—	—	—	6,109
	289		(7,245)	—	—	—	—	(7,245)

Issuance of common stock – RSU's vested								
Excess tax benefit on employee share-based compensation	—	—	7,524	—	—	—	—	7,524
Repurchase of common stock	(1,348)	—	—	—	—	(54,455)	—	(54,455)
Retirement of treasury stock	—	(1)	(12,368)	—	(62,575)	74,944	—	—
Share-based compensation	—	—	13,269	—	—	—	—	13,269
Other comprehensive loss	—	—	—	(42)	—	—	—	(42)
Acquisition of noncontrolling interest	—	—	3,577	—	—	—	(4,177)	(600)
Dividends on common stock ($0.34 per share)	—	—	—	—	(12,331)	—	—	(12,331)
Net income (loss) for the year	—	—	—	—	33,879	—	(2,011)	31,868
Balance, December 31, 2014	36,345	$36	$255,921	$ (130)	$ (5,067)	$—	$ —	$250,760
Issuance of common stock – options exercised	184		2,910					2,910
Issuance of common stock – RSU's vested	405	1	(18,905)					(18,904)
Excess tax benefit on employee share-based compensation			9,634					9,634
Share-based compensation			21,262					21,262
Other comprehensive income				99				99
Dividends on common stock ($0.40 per share)					(14,671)			(14,671)
Net income for the year					84,732			84,732
Balance, December 31, 2015	36,934	$37	$270,822	$ (31)	$ 64,994	$—	$ —	$335,822

See accompanying notes to consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(In thousands)

	Year Ended December 31,					
	2015		2014		2013	
Cash flows from operating activities						
Net income	$84,732		$31,868		$78,072	
Adjustments to reconcile net income to net cash provided by operating activities:						
Amortization of capitalized customer acquisition costs	60,755		51,626		45,648	
Other depreciation and amortization	62,955		48,270		35,389	
Asset impairment charges	—		37,365		—	
Addition to loss reserves	2,852		9,650		2,787	
Provision for doubtful receivables	6,155		3,279		195	
Deferred taxes	8,157		7,515		8,403	
Share-based compensation	21,262		13,269		12,838	
Gain on sale of assets	(7,008	)	—		(3,786	)
Write off of fixed assets and other	1,455		1,691		1,034	
Changes in operating assets and liabilities:						
Increase in receivables	(38,203	)	(18,134	)	(19,693	)
Increase in inventory	(1,302	)	(890	)	(1,343	)
Payment of signing bonuses, net	(48,289	)	(38,875	)	(29,091	)
Increase in capitalized customer acquisition costs	(28,562	)	(24,831	)	(21,159	)
Decrease (increase) in current tax assets	18,175		2,188		(3,138	)
Decrease (increase) in prepaid expenses, deposits and other assets	2,271		(3,153	)	(3,782	)
Excess tax benefits on employee share-based compensation	(9,634	)	(7,524	)	(11,596	)
(Decrease) increase in reserve for unrecognized tax benefits	(716	)	1,682		2,564	
Increase (decrease) in due to sponsor banks	639		12,056		(18,477	)
Increase (decrease) in accounts payable	9,555		(11,434	)	2,136	
Increase in unearned revenue	8,608		1,554		5,010	
Decrease in accrued expenses and other liabilities	(5,822	)	(11,666	)	(6,615	)
Increase (decrease) in processing liabilities	29,903		(21,123	)	32,761	
Payouts of accrued buyout liability	(15,408	)	(11,568	)	(13,651	)
Increase in accrued buyout liability	27,264		20,182		17,620	
Net cash provided by operating activities	189,794		92,997		112,126	
Cash flows from investing activities						
Purchase of investments	(2,283	)	(38,962	)	(5,262	)
Sales of investments	—		25,247		—	
Maturities of investments	2,550	2.55	—		2,000	
(Increase) decrease in funds held for customers	(5,735	)	(35,420	)	4,040	
Increase (decrease) in customer fund deposits	5,467		49,003		(4,030	)
Proceeds from sale of assets	9,973		—		19,343	
Acquisitions of businesses, net of cash acquired	(79,354	)	(392,142	)	(15,182	)
Capital expenditures	(54,345	)	(54,913	)	(52,924	)
Net cash used in investing activities	(123,727	)	(447,187	)	(52,015	)
Cash flows from financing activities						
Proceeds from borrowings, net	230,000		460,392		156,416	
Principal payments on borrowings	(308,250	)	(54,188	)	(161,001	)
Proceeds from exercise of stock options	2,910		6,109		14,174	

Excess tax benefits on employee share-based compensation	9,634	7,524	11,596
Repurchases of common stock	—	(54,455)	(49,625)
Dividends paid on common stock	(14,671)	(12,331)	(10,321)
Net cash (used in) provided by financing activities	(80,377)	353,051	(38,761)
Net (decrease) increase in cash	(14,310)	(1,139)	21,350
Effect of exchange rates on cash	—	—	1
Cash at beginning of year	70,793	71,932	50,581
Cash at end of year	$56,483	$70,793	$71,932
Supplemental cash flow information			
Cash paid during the period for:			
Interest	$12,781	$6,824	$4,598
Income taxes	27,517	30,504	38,827

See accompanying notes to consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries
Notes To Consolidated Financial Statements

1. Organization and Operations

Basis of Financial Statement Presentation— The accompanying consolidated financial statements include those of Heartland Payment Systems, Inc. (the "Company," “we,” “us,” or “our”) and its wholly-owned subsidiaries, Heartland Payroll Solutions, Inc., Heartland Payment Solutions, Inc., Heartland Acquisition LLC, TouchNet Information Systems, Inc. (“TouchNet”) and Heartland Commerce, Inc. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All intercompany balances and transactions with the Company's subsidiaries have been eliminated upon consolidation.

Agreement and Plan of Merger— On December 15, 2015, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Global Payments Inc., a Georgia corporation (“Global”), Data Merger Sub One, Inc., a Delaware corporation and wholly owned subsidiary of Global (“Merger Sub One”) and Data Merger Sub Two, LLC, a Delaware limited liability company and wholly owned subsidiary of Global (“Merger Sub Two”, and together with Merger Sub One, the “Merger Subs”). Pursuant to the terms and subject to the conditions set forth in the Merger Agreement, Global will acquire the Company by way of two mergers (the “Mergers”). First, Merger Sub One will merge with and into the Company, with the Company continuing as a wholly owned subsidiary of Global. Second, the Company will merge with and into Merger Sub Two immediately following the initial merger, with Merger Sub Two surviving the second merger as a wholly owned subsidiary of Global.

As a result of the Mergers, subject to the terms and conditions of the Merger Agreement, each outstanding share of the Company’s common stock, other than shares owned by (i) Global, the Merger Subs or the Company (which will be canceled), (ii) stockholders who have properly exercised and perfected appraisal rights under Delaware law, or (iii) any direct or indirect wholly owned subsidiary of the Company (which will remain outstanding), will be converted into the right to receive (subject to adjustment as set forth in the next sentence) $53.28 in cash (the “Cash Consideration”), without interest, and 0.6687 shares of common stock of Global (the “Stock Consideration”, and together with the Cash Consideration, the “Merger Consideration”). Under the terms of the Merger Agreement, in the event that the number of shares of common stock of Global issuable as a result of the Mergers would exceed 19.9% of the issued and outstanding shares of common stock of Global immediately prior to the closing of the Mergers, the Stock Consideration will be reduced so that no more than 19.9% of the outstanding shares of common stock of Global become issuable in the Mergers and the Cash Consideration will be increased by a corresponding amount, so that the value of the per share Merger Consideration will remain the same.

Out of Period Adjustments Recorded in Prior Year—In the second quarter of 2014, the Company recorded out-of-period adjustments decreasing its revenue and increasing bad debt expense (included in Processing and Servicing in its Consolidated Statements of Income) by $1.4 million and $0.9 million, respectively. These adjustments related to immaterial errors that originated in 2013 in the Company's Heartland School Solutions business. These adjustments included revenue which was incorrectly recorded in prior periods and a reassessment of the collectability of certain customer accounts receivable. These out-of-period adjustments reduced earnings before income taxes and net income in the year ended December 31, 2014 by $2.3 million and $1.4 million, respectively, and reduced diluted earnings per share by $0.04. The Company considered existing guidance in evaluating whether a restatement of prior financial statements was required as a result of these misstatements. The guidance requires corrections of errors to be recorded by restatement of prior periods, if material. The Company quantitatively and qualitatively assessed the materiality of the errors and concluded that the errors were not material to its earnings for the year ended December 31, 2013 and 2014, and accordingly, no restatement of prior period financial statements was warranted.

Business Description—The Company’s primary business is to provide payment processing services to merchants throughout the United States. This involves providing end-to-end electronic payment processing services to merchants by facilitating the exchange of information and funds between them and cardholders' financial institutions. To accomplish this, the Company undertakes merchant set-up and training, transaction authorization and electronic draft capture, clearing and settlement, merchant accounting, merchant assistance and support, and risk management. The Company also provides additional services, including those provided through its subsidiaries, such as:

- Integrated commerce solutions, payment processing, higher education loan services and open and closed-loop payment solutions to higher-education institutions through Campus Solutions,

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Heartland Payment Systems, Inc. and Subsidiaries
Notes To Consolidated Financial Statements—(Continued)

- School nutrition, point-of-sale solutions ("POS"), and associated payment solutions, including online prepayment solutions, to kindergarten through 12th grade ("K-12") schools through Heartland School Solutions,
- Full-service payroll processing and related tax filing services, through Heartland Payroll Solutions, and
- Others including (1) prepaid and stored-value card solutions through Micropayments, (2) POS solutions and other adjacent business service applications through Heartland Commerce, and (3) marketing solutions including loyalty and gift cards which the Company provides through Heartland Marketing Solutions.

Approximately 72% of the Company's revenue is derived from processing and settling Visa and MasterCard bankcard transactions for its merchant customers. Because the Company is not a "member bank" as defined by Visa and MasterCard, in order to process and settle these bankcard transactions for its merchants, the Company has entered into sponsorship agreements with member banks. Visa and MasterCard rules restrict the Company from performing funds settlement or accessing merchant settlement funds and require that these funds be in the possession of the member bank until the merchant is funded. A sponsorship agreement with a member bank permits the Company to route Visa and MasterCard bankcard transactions under the member bank's control and identification numbers to clear credit and signature debit bankcard transactions through Visa and MasterCard. A sponsorship agreement also enables the Company to settle funds between cardholders and merchants by delivering funding files to the member bank, which in turn transfers settlement funds to the merchants' bank accounts. These restrictions place the settlement assets and obligations under the control of the member bank.

The sponsorship agreements with the member banks require, among other things, that the Company abide by the bylaws and regulations of the Visa and MasterCard networks, and certain sponsor banks require a cash balance in a deposit account. If the Company were to breach a sponsorship agreement and under certain other circumstances, the sponsor banks may terminate the agreement and, under the terms of the agreement, the Company would have six months to identify an alternative sponsor bank. The Company is generally dependent on its sponsor banks, Visa and MasterCard for notification of any compliance breaches. As of December 31, 2015, the Company has not been notified of any such issues by its sponsor banks, Visa or MasterCard.

As of December 31, 2015, the Company is party to three bank sponsorship agreements.

- Processing for the majority of the Company’s small and mid-sized merchants (referred to as "Small and Midsized Enterprises," or “SME merchants”) is performed under a February 8, 2012, sponsorship agreement with Wells Fargo Bank, N.A. ("WFB"). The WFB sponsorship agreement was in effect until February 8, 2016 and would have automatically renewed for three years unless either party provided written notice of non-renewal to the other party. On November 5, 2015, the Company provided written notice of non-renewal to WFB. Under the terms of the WFB sponsorship agreement, the Company has up to six months beyond February 8, 2016 to complete a conversion of its SME merchants to another sponsorship arrangement.

On November 5, 2015, the Company entered into a sponsorship agreement with Deutsche Bank Trust Company Americas ("Deutsche Bank") for its SME merchants. The Company is highly confident it will complete the conversion of its SME merchants to the Deutsche Bank sponsorship arrangement within the six-month conversion period beginning February 8, 2016. The sponsorship agreement with Deutsche Bank involves substantially the same terms as applied in the February 8, 2012 agreement with WFB. The agreement with Deutsche Bank is for a five-year term expiring on November 5, 2020 and will automatically renew for successive one-year periods unless either party provides six months written notice of non-renewal to the other party.

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On November 23, 2009, the Company entered into a sponsorship agreement with The Bancorp Bank ("TBB") to sponsor processing for the Company's Network Services merchants, which are predominantly petroleum industry merchants of all sizes (referred to as "Network Services Merchants"), and since October 2013, certain of the Company's SME merchants. In August 2015, the agreement with TBB automatically renewed until February 2017. The agreement with TBB expires in February 2017 with subsequent one-year auto renewal periods, unless either party provides six months written notice of non-renewal to the other party.

- On March 24, 2011, the Company entered into a sponsorship agreement with Barclays Bank Delaware to sponsor processing for certain of its large national merchants. The original agreement with Barclays Bank Delaware would have expired in March 2016, however, in September 2015, the agreement with Barclays Bank Delaware automatically renewed until March 2017. In January 2016, the Company signed an extension of this agreement, which will now expire in March 2021. The agreement will continue to automatically renew for successive one-year periods thereafter, unless either party provides six months written notice of non-renewal to the other party. The following is a breakout of the Company's total Visa and MasterCard settled card processing volume for the month ending December 31, 2015 by percentage processed under its individual bank sponsorship agreements:

Sponsor Bank	% of December 2015 Bankcard Processing Volume
Wells Fargo Bank, N.A.	75%
The Bancorp Bank	18%
Barclays Bank Delaware	7%

The Company also provides card transaction processing for DFS Services, LLC ("Discover") and is designated as an acquirer by Discover. The agreement with Discover allows the Company to acquire, process and fund transactions directly through Discover's network without the need of a bank sponsor. The Company processes Discover transactions similarly to the way it processes Visa and MasterCard transactions. The Company must comply with Discover's acquirer operating regulations and uses its sponsor banks to assist in funding its merchants' Discover transactions.

Under a prior sales and servicing program agreement with American Express Travel Related Services Company, Inc. ("American Express") the Company: (a) provided solicitation services by signing new-to-American Express merchants directly with American Express; (b) provided transactional support services on behalf of American Express to the Company's American Express accepting merchants; and (c) provided processing, settlement, customer support and reporting to merchants, similar to the services provided for the merchants' Visa, MasterCard and Discover transactions. In May 2014, the Company began offering a new American Express Card Acceptance Program (referred to as "OptBlue") to new merchants. The Company converted a majority of its existing merchants who were processing under the prior sales and servicing agreement with American Express to OptBlue during the third quarter of 2014. As a participant in OptBlue, the Company acquires, contracts, and establishes pricing for, as well as provides customer service to merchants, similar to the transaction processing services the Company provides through Discover, Visa and MasterCard. The Company also uses its sponsor banks to assist in funding its merchants' American Express transactions.

2. Summary of Significant Accounting Policies

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

Cash and Cash Equivalents— At December 31, 2015, cash included approximately $15.1 million of processing-related cash in transit and collateral, compared to approximately $17.8 million of processing-related cash in transit and collateral at December 31, 2014. Processing-related cash in transit and collateral includes merchant deposits, collateral deposits, and funds in transit relating to timing differences for the Company's card and non-card payment processing businesses.

Receivables— The Company's primary receivables are from its bankcard processing merchants. In addition to receivables for transaction fees the Company charges its merchants for processing transactions, these receivables include amounts resulting from the Company's practice of advancing interchange fees to most of its SME merchants during the month and collecting those fees at the beginning of the following month. The Company does not advance interchange fees to its Network Services merchants. Network Services merchants are invoiced monthly, on payment terms of 30 days net from date of invoicing. Receivables from merchants also include receivables from the sale of POS terminal equipment.

The timing for presentment of transaction funding files to the bankcard networks results in the Company's sponsor banks receiving settlement cash one day before payment is made to merchants, thereby increasing funding obligations to its SME merchants, which are carried in processing liabilities. The Company funds interchange advances/receivables to SME merchants first from this settlement cash received from bankcard networks, then from the Company's available cash or by incurring a liability to its sponsor banks. At both December 31, 2015 and 2014, the Company did not use any of its available cash to fund merchant advances. The amount due to sponsor banks for funding advances was $30.5 million at December 31, 2015 and $29.9 million at December 31, 2014. The liability to sponsor banks is repaid at the beginning of the following month out of the fees the Company collects from its merchants.

Receivables also include amounts due from Discover and American Express for merchant bankcard transactions. These amounts are recovered the next business day following the date of processing the transaction.

Receivables also include amounts resulting from the sale, installation, training and repair of payment system hardware and software for Campus Solutions, Heartland School Solutions and Other (which includes receivables from Micropayments, Heartland Commerce and Heartland Marketing Solutions). These receivables are mostly invoiced on terms of 30 days net from date of invoicing.

Receivables are stated net of allowance for doubtful accounts. The Company estimates its allowance based on experience with its merchants, customers, and sales force and its judgment as to the likelihood of their ultimate payment. The Company also considers collection experience and makes estimates regarding collectability based on trends in the aging. Historically, the Company has not experienced significant charge offs for its merchant and customer receivables, other than the out-of-period adjustment recorded in the second quarter of 2014 (see Note 1, Organization and Operations for further details).

Investments and Funds Held for Customers— Investments, including those carried on the Consolidated Balance Sheets as Funds held for customers, consist primarily of bond funds, tax-exempt bonds, certificates of deposit and equity investments. Funds held for customers also include overnight bank deposits. The majority of investments carried in Funds held for customers are available-for-sale and recorded at fair value based on quoted market prices. Certificates of deposit are classified as held to maturity and recorded at cost. In the event of a sale, cost is determined on a specific identification basis. At December 31, 2015, Funds held for customers included cash and cash equivalents of $201.4 million and investments available for sale of $26.9 million.

The asset Funds held for customers and the liability Customer fund deposits include: (1) amounts collected from customers prior to funding their payroll liabilities, as well as related tax and fiduciary liabilities for those customers, and (2) amounts collected by Campus Solutions in its capacity as a loan servicer, which will be remitted to the customer/owner of the student loans the following month.

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

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

Management evaluates the capitalized customer acquisition costs for impairment on an annual basis by comparing, on a pooled basis by vintage month of origination, the expected future net cash flows from underlying merchant relationships to the carrying amount of the capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the value of the capitalized customer acquisition costs, the impairment loss will be charged to operations.

The Company believed that no impairment of capitalized customer acquisition costs had occurred as of December 31, 2015 and 2014.

Property and Equipment— Property and equipment are carried at cost, net of accumulated depreciation. Depreciation for the Company's owned service center building in Jeffersonville, Indiana is computed straight-line over 39 years with depreciation on certain building improvements computed over 15 years. Depreciation is computed straight-line over periods ranging from 3 to 10 years for furniture and equipment. Leasehold improvements are amortized over the lesser of the economic useful life of the improvement or the term of the lease.

Equipment held under capitalized lease arrangements is included in property and equipment, and the associated liabilities are included in current and long-term borrowings as appropriate. Amortization of equipment under capitalized leases is included in depreciation and amortization expense.

Fully depreciated property and equipment are retained in property and equipment and accumulated depreciation accounts until their disposal or removal from service. When fully depreciated property and equipment is taken out of service, the original cost basis and matching accumulated depreciation amounts are written off.

Rent expense on operating leases is recorded on a straight-line basis over the term of the lease agreement. Tenant improvement allowances are deferred and amortized on a straight-line basis over the life of the lease agreement as a reduction to rent expense.

The Company capitalizes software development costs and amortizes such costs on a straight-line basis over an estimated useful life of 3 to 7 years. The preliminary project stage consists of the conceptual formation of alternatives, the evaluation of alternatives, the determination of existence of needed technology and the final selection of alternatives. Costs incurred during the preliminary project stage are expensed as incurred. Once the preliminary project stage is complete, costs are capitalized until the software is placed in service.

Long-Lived Assets— The Company evaluates the potential for impairment when changes in circumstances indicate that undiscounted cash flows estimated to be generated by the related assets are less than the carrying amount. In the fourth quarter of 2014, the Company recorded non-cash asset impairments and write-offs relating to assets held and used of $18.9 million relating to internally developed software and intangible assets related to Leaf and a write-off of a capitalized internally developed software project termination (see "Goodwill," below for further detail).

Goodwill— Goodwill represents the excess of acquisition costs over the fair values of net assets acquired in business combinations. At December 31, 2015 and 2014, goodwill of $490.0 million and $425.7 million, respectively, was recorded on the Consolidated Balance Sheets. The Company tests goodwill for impairment at least annually in the fourth quarter and between annual tests if an event occurs or changes in circumstances suggest a potential decline in the fair value of the reporting unit. A significant amount of judgment is involved in determining if an indicator or change in circumstances relating to impairment has occurred. Such changes may include, among others: a significant decline in expected future cash flows; a sustained decline in market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; and slower growth rates.

The Company has the option of performing a qualitative assessment of impairment to determine whether any further quantitative testing for impairment is necessary. The option of whether or not to perform a qualitative assessment is made annually and may vary by reporting unit. Factors the Company considers in the qualitative assessment include general macroeconomic conditions, industry and market conditions, cost factors, overall financial performance of our reporting units, events or changes affecting the composition or carrying amount of the net assets of our reporting units, sustained decrease in our share price, and other relevant entity-specific events. If the Company elects to bypass the qualitative assessment or if it determines, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not less than the carrying value, then the Company performs a two-step quantitative test for that reporting unit. In the first step, the fair value of each reporting unit is compared to the reporting unit's carrying value, including goodwill. If the fair value of a reporting unit is less than its carrying value, the second step of the goodwill impairment test is performed to measure the amount of impairment, if any. In the second step, the fair value of the reporting unit is allocated to the assets and liabilities of the reporting unit as if it had been acquired in a business combination and the purchase price was equivalent to the fair value of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is referred to as the implied fair value of goodwill. The implied fair value of the reporting unit's goodwill is then compared to the actual carrying value of the goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized for the difference.

Significant estimates and assumptions are used in the Company's goodwill impairment review and include the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units and determining the fair value of each reporting unit. The Company's assessment of qualitative factors involves significant judgments about expected future business performance and general market conditions. In a quantitative assessment, the fair value of each reporting unit is determined based on a combination of techniques, including the present value of future cash flows, applicable multiples of competitors and multiples from sales of like businesses, and requires us to make estimates and assumptions regarding discount rates, growth rates and our future long-term business plans. Changes in any of these estimates or assumptions could materially affect the determination of fair value and the associated goodwill impairment charge for each reporting unit.

As of December 31, 2015, the Company performed a qualitative assessment for each of its reporting units, except one, for which the Company performed a quantitative assessment. Based on our annual test as of December 31, 2015, the Company determined on the basis of qualitative factors that the fair values of the reporting units for which it performed a qualitative assessment were not more likely than not less than their respective carrying amounts. Based on the quantitative assessment the Company did for one of its reporting units, it determined that the goodwill for that reporting unit was not impaired.

In the fourth quarter of 2014, the Company considered the overlapping cloud-based POS systems in development at Heartland Commerce businesses (see Note 3, Acquisitions) and decided that it would stop POS development efforts at Leaf, a previous Heartland Commerce business. This decision caused a significant adverse change in the extent or manner in which the long-lived asset group of Leaf would be used, including Prosper, an internally developed POS software technology. Due to these changes in circumstances, the implied fair value of the Leaf reporting unit was determined to be significantly below its carrying value. This led to a Goodwill impairment charge for the full balance of Leaf goodwill as of December 31, 2014. In the fourth quarter of 2014, the Company recorded pre-tax goodwill and asset impairment charges of $18.5 million and $18.9 million, respectively.

Unearned revenue— Unearned revenue of $60.6 million and $49.0 million at December 31, 2015 and 2014, respectively, is primarily related to the Company's Heartland School Solutions, Campus Solutions, Heartland Payroll Solutions and Heartland Commerce businesses. Unearned revenue is derived primarily from the sale and subscription of e-commerce solutions and integration to host computer systems as well as from support and maintenance contracts and professional services. Unearned revenue represents contractual obligations of the Company to provide software, services and support to customers in the future.

Processing Liabilities— Processing liabilities result primarily from the Company's card processing activities. Processing liabilities primarily reflect funds in transit associated with differences arising between the amounts the Company's sponsor banks receive from the bankcard networks and the amounts funded to the Company's merchants. Such differences arise from timing differences, interchange expense, merchant advances, merchant reserves and chargeback processing. These differences result in payables or receivables. If the settlement received from the bankcard networks precedes the funding obligation to the merchant, the Company records a processing liability. Conversely, if funding to the merchant precedes the settlement from the bankcard networks, the Company records a receivable from the bankcard network. The amounts are generally collected or paid the following business day.

Chargebacks arise due to disputes between a cardholder and a merchant resulting from the cardholder's dissatisfaction with merchandise quality or the merchant's service, and the disputes may not always be resolved in the merchant's favor. In some of these cases, the transaction is "charged back" to the merchant and the purchase price is refunded to the cardholder by the credit card-issuing institution. If the merchant is unable to fund the refund, the Company is liable for the full amount of the transaction. The Company's obligation to stand ready to perform is minimal. The Company maintains a deposit or the pledge of a letter of credit from certain merchants as an offset to potential contingent liabilities that are the responsibility of such merchants. The Company evaluates its ultimate risk and records an estimate of potential loss for chargebacks based upon an assessment of actual historical loss rates compared to recent bankcard processing volume levels. The Company believes that the liability recorded as loss reserves approximates fair value.

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

Relationship Managers and sales managers earn portfolio equity on their newly installed payroll and loyalty marketing merchant accounts based on the residual commissions they earn on those accounts. The accrued buyout liability and deferred acquisition cost asset are accrued in the same manner as the SME merchant portfolio equity.

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

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

Revenue— The Company classifies its revenues into five categories: (i) Payment Processing, (ii) Heartland School Solutions, (iii) Heartland Payroll Solutions, (iv) Campus Solutions and (v) Other (including Heartland Commerce). The Company recognizes revenue when (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been performed; (3) the price is fixed or determinable; and (4) collectability is reasonably assured. The Company also evaluates its contractual arrangements for indications that multiple element arrangements may exist, including instances where more-than-incidental software deliverables are included. The following revenue recognition policies define the manner in which the Company accounts for sales transactions by revenue category.

Payment Processing revenue primarily consists of discount, per-transaction and periodic (primarily monthly) fees from the processing of Visa, MasterCard, American Express and Discover transactions for SME merchants and per-transaction fees for the authorization and settlement of transactions for Network Services merchants. Also included in this category are American Express servicing fees, merchant service fees, fees for processing chargebacks and termination fees on terminated contracts. Interchange fees, which are the Company’s most significant expense, are set by the card networks and paid to the card issuing banks. For the majority of SME card processing revenue, the

Company does not offset processing revenues and interchange fees because its business practice is to advance the interchange fees to most SME merchants when settling their daily transactions (thus paying the full amount of the transaction to the merchant), and then to collect the full discount fees from merchants on the first business day of the next month. The Company has merchant portability, credit risk, and the ultimate responsibility to the merchant and, as such, revenue is reported at the time of settlement on a gross basis. Payment processing services are transaction based and priced either as a fixed fee per transaction or as a percentage of the transaction value. The fees are charged for the processing services provided and do not include the gross sales price paid by the ultimate buyer to the merchant. For SME merchants to whom the Company does not advance interchange, it records card processing revenues net of interchange fees. As Network Services does not advance interchange fees to its merchants, the Company records its card processing revenues net of interchange fees.

Heartland Payroll Solutions revenue includes fees charged for payroll processing services, including check printing, direct deposit, related federal, state and local tax deposits and providing accounting documentation, and interest income earned on funds held for customers.
Heartland School Solutions revenue includes fees from sales and maintenance of cafeteria POS solutions and associated payment solutions, including online prepayment solutions, back office management and hardware and technical support.
Campus Solutions revenue includes fees associated with providing integrated commerce solutions to support administrative services for higher education, as well as student loan payment processing, delinquency and default services, refund management, tuition payment plans, electronic billing and payment, tax document services and business outsourcing. Campus Solutions revenue also includes fees from the sale and maintenance of open- and closed-loop payment hardware and software solutions for college or university campuses to process small value electronic transactions.
Heartland Commerce revenue includes sales of POS systems and the associated payment processing and adjacent business service applications.
Campus Solutions, Heartland School Solutions and Heartland Commerce have arrangements that contain multiple elements, such as hardware, software products, including perpetual licenses and Software-as-a-Service (“SaaS”) services, maintenance, and professional installation and training services. The Company allocates revenue to each element based on the selling price hierarchy. The selling price for a deliverable is based on vendor specific objective evidence (“VSOE”) of selling price, if available, third party evidence ("TPE") if VSOE of selling price is not available, or estimated selling price (“ESP”) if neither VSOE or selling price nor TPE is available. The Company establishes ESP based on management judgment, considering internal factors such as margin objectives, pricing practices and controls, customer segment pricing strategies and the product life cycle. In arrangements with multiple elements, the Company determines allocation of the transaction price at inception of the arrangement based on the relative selling price of each unit of accounting.
In multiple element arrangements where more-than-incidental software deliverables are included, the Company has applied the residual method to determine the amount of software license revenues to be recognized. Under the residual method, if fair value exists for undelivered elements in a multiple-element arrangement, such fair value of the undelivered elements is deferred with the remaining portion of the arrangement consideration recognized upon delivery of the software license or services arrangement. The Company allocates the fair value of each element of a software related multiple-element arrangement based upon its fair value as determined by VSOE, with any remaining amount allocated to the software license. If evidence of the fair value cannot be established for the undelivered elements of a software arrangement, then the entire amount of revenue under the arrangement is deferred until these elements have been delivered or objective evidence can be established.
Other revenues include Micropayments fees from selling hardware and software for unattended online wireless credit card based payment systems, and unattended value top up systems for off-line closed-loop smart (chip) card based payment systems. Also included in this category are Heartland Marketing Solutions fees from selling mobile and card-based marketing services, gift cards and rewards services as well as fees from selling, renting and deploying POS devices.

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

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

Other Income (Expense)— Other income (expense) consists of interest income on cash and investments, the interest cost on the Company's borrowings, gains or losses on the disposal of assets, write downs of capitalized information technology development projects, Provision for Processing System Intrusion costs and other non-operating income or expense items.

In 2015, other non-operating income or expense items also include:

- Pre-tax gain of $7.0 million relating to the December 31, 2015 sale of the assets of the SmartLink division ("SmartLink"), which included our secure payment gateways and managed network services technologies, to a third party, for a $10 million cash payment. The Company also entered into a channel partner agreement, whereby Heartland's sales professionals will continue to promote the secure payment gateway and managed network services solutions to merchants. The Company's SmartLink division was included in the Payment Processing Segment. The sale of SmartLink resulted in a $7.0 million pre-tax gain ($4.3 million after-tax, or $0.11 per share) which was included in "Gain on sale of assets" as part of Other income (expense) in the Company's Consolidated Statements of Income for the year ended December 31, 2015.

In 2014, other non-operating income or expense items also include:

- Pre and after-tax gain of $3.6 million relating to a release from a contingent earn-out liability to the noncontrolling shareholders of Leaf. As a result of the Stock Purchase Agreement that the Company entered into on August 6, 2014 with the noncontrolling shareholders of Leaf, the Company was released from a contingent earn-out liability to those noncontrolling shareholders. The non-cash impact of the gain associated with the release of the contingent earn-out liability is recorded in "Other, net" in the Consolidated Statements of Income and "Write-off of fixed assets and other" in the Consolidated Statement of Cash Flows.

- Pre-tax charge of $4.0 million relating to an other than temporary impairment ("OTTI") of an investment in the equity of TabbedOut. See Note 5, Funds Held for Customers and Investments for information on this OTTI.

Income Taxes— The Company accounts for income taxes by recognizing deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statements and the tax basis of assets and liabilities using enacted tax rates. The impact on deferred assets and liabilities of a change in tax rates is recognized in the period that the rate change is enacted. Valuation allowances are recorded when it is determined that it is more likely than not that a deferred tax asset will not be realized.

Share–Based Compensation— The Company expenses employee share-based payments under the fair value method. Share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the requisite service period.

Excess tax benefits are generated when employees exercise non-qualified stock options, make disqualifying dispositions of shares acquired through their exercise of incentive stock options and vest in restricted share units. These excess tax benefits are reported as a financing cash inflow rather than a reduction of taxes paid, which is included within operating cash flows. Accordingly, cash provided by operating activities decreased and cash provided by financing activities increased by $9.6 million in 2015, $7.5 million in 2014 and $11.6 million in 2013 related to excess tax benefits from stock-based awards.

Earnings per Share— Basic earnings per share was computed by dividing net income by weighted average number of common shares outstanding during the period. Diluted earnings per share was computed based on the weighted average outstanding common shares plus equivalent shares assuming exercise of stock options and vesting of RSUs, PRSUs and TRSUs, where dilutive.

Noncontrolling Interests— Noncontrolling interests represent noncontrolling shareholders' share of the equity and after-tax net loss of Leaf until the Company's August 6, 2014 acquisition of Leaf noncontrolling interests.

Noncontrolling shareholders' share of after-tax net loss of Leaf is included in Net income (loss) attributable to noncontrolling interests from continuing operations in the Consolidated Statements of Income as of December 31, 2014 and 2013. On August 6, 2014, the Company entered into a Stock Purchase Agreement with the noncontrolling shareholders of Leaf under which it acquired all shares of Leaf common stock held by the noncontrolling shareholders. Prior to August 6, 2014, the Company owned 66.67% of the outstanding capital stock of Leaf. As a result of this transaction, Leaf became a wholly-owned subsidiary of the Company and there is no noncontrolling interest on the Consolidated Balance Sheet as of December 31, 2014.

Subsequent Events— The Company evaluated subsequent events through the issuance date with respect to the Consolidated Financial Statements as of and for the year ended December 31, 2015.

New Accounting Pronouncements— From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board ("FASB") or other standards setting bodies that are adopted by us as of the specified effective date.

In May 2014, the FASB issued guidance on revenue from contracts with customers, which requires an entity to recognize revenue from 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 guidance addresses in particular contracts with more than one performance obligation as well as the accounting for some costs to obtain or fulfill a contract with a customer and provides for additional disclosures with respect to revenues and cash flows arising from contracts with customers. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. On July 9, 2015, the FASB voted to approve a one-year deferral of the effective date. This made the new guidance effective December 15, 2017 for annual reporting periods beginning after that date. The FASB also approved early adoption of the standard, but not before the original effective date which was for reporting periods beginning after December 15, 2016. The Company has not yet selected a transition method and is currently assessing the impact the adoption of this guidance will have on the Company's consolidated financial statements and disclosures.

In April 2015, the FASB issued guidance on debt issuance costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability instead of being presented as an asset. In August 2015, the FASB issued updated guidance to clarify that an entity may elect to present debt issuance costs related to a line-of-credit arrangement as an asset, regardless of whether or not there are any outstanding borrowings on the line-of-credit arrangement. The new guidance is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The new guidance should be applied on a retrospective basis. The effect of this update is still being evaluated and is not expected to have a material effect on the Company’s consolidated financial statements.

In April 2015, the FASB issued guidance that defines specific criteria entities must apply to determine if a cloud computing arrangement includes an in-substance software license. The new guidance clarifies that software licenses included in a cloud computing software should be accounted for in the same manner as other software licenses. This amendment is effective for annual reporting periods, including interim periods within those periods, beginning after December 15, 2015. Early adoption is permitted. The new guidance can be applied on either a prospective or retrospective basis. The effect of this update is still being evaluated and is not expected to have a material effect on the Company’s consolidated financial statements.

In July 2015, the FASB issued guidance to more clearly articulate the requirements for the subsequent measurement of inventory and related disclosures. The new guidance clarifies the basis for measuring inventory at the lower of cost and net realizable value. This amendment is effective for annual reporting periods, including interim periods within those periods, beginning after December 15, 2016. Early adoption is permitted. The new guidance should be applied on a prospective basis. The effect of this update is still being evaluated and is not expected to have a material effect on the Company’s consolidated financial statements.

In September 2015, the FASB issued guidance to simplify the accounting for measurement-period adjustments for business combinations. The new guidance eliminates the requirement to retrospectively account for adjustments made to provisional amounts recognized in a business combination. This amendment is effective for annual reporting periods, including interim periods within those periods, beginning after December 15, 2015. Early adoption is permitted. The new guidance should be applied on a prospective basis. The effect of this update is still being evaluated and is not expected to have a material effect on the Company’s consolidated financial statements.

In November 2015, the FASB issued guidance to simplify the balance sheet classification of deferred taxes. The new guidance requires that deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. This amendment is effective for annual reporting periods, including interim periods within those periods, beginning after December 15, 2016. Early adoption is permitted. The new guidance can be applied on either a prospective or retrospective basis. The Company has elected to early adopt this guidance and apply it on a retrospective basis in the fourth quarter of 2015. As of December 31, 2014, the Company reclassified current deferred tax assets of $9.3 million to non-current liabilities, in order to conform to the current-period presentation.

3. Acquisitions

Campus Solutions

TouchNet Information Systems, Inc.
On September 4, 2014, the Company completed the acquisition of TouchNet, for a cash payment of $375 million, less a net working capital deficit, for all outstanding common shares. The purchase was funded primarily through a new five-year $375 million term loan. See Note 10, Credit Facilities for further details.

The transaction was accounted for under the acquisition method of accounting. Beginning September 4, 2014, TouchNet's results of operations are included in the Company's results of operations. The fair values of the TouchNet assets acquired and liabilities assumed were estimated as of their acquisition date. The excess of the purchase price over the net assets, approximately $221.6 million, was recorded as goodwill, which is deductible for income tax reporting. Acquisition-related costs of approximately $2.3 million for advisory, legal and regulatory costs incurred in connection with the TouchNet acquisition have been expensed in general and administrative expenses.
The following table summarizes the purchase price allocation (in thousands):

Cash and cash equivalents	$34,576
Receivables, net	12,243
Inventory	66
Prepaid expenses	601
Property and equipment, net	3,360
Intangible assets, net	144,400
Goodwill	221,575
Total assets acquired	416,821
Accounts payable	2,236
Accrued expenses and other liabilities	2,896
Current portion of unearned revenue	24,014
Current tax liability	13,914
Long-term portion of unearned revenue	2,037
Net assets acquired	$371,724

The weighted average amortization life for the 2014 acquired finite lived intangible assets related to the acquisition of TouchNet is as follows:

Weighted average amortization life	
	(In years)
Customer relationships	20
Software	15
Non-compete agreements	5
Trademark	5
Overall	18

The following pro forma information shows the results of the Company's operations for the year ended December 31, 2014 as if the TouchNet acquisition had occurred on January 1, 2013. The pro forma information is presented for information purposes only and is not necessarily indicative of what would have occurred if the acquisition had been made as of that date. The pro forma information is also not intended to be a projection of future results due to the integration of the acquired business.

	Year Ended December 31,	
	2014	2013
	(In thousands, except share data)	
Total revenues	$2,363,916	$2,192,298
Net income attributable to Heartland	$34,909	$79,585
Basic earnings per share	$0.96	$2.16
Diluted earnings per share	$0.94	$2.09

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Heartland School Solutions

MCS Software Corporation
On April 1, 2014, the Company purchased the net assets of MCS Software Corporation ("MCS Software") for a $17.3 million cash payment. The purchase price was financed under an existing credit facility and from operating cash flows.

The transaction was accounted for under the acquisition method of accounting. Beginning April 1, 2014, MCS Software's results of operations are included in the Company's results of operations. The allocation of the total purchase price was as follows: $11.2 million to goodwill, $6.4 million to intangible assets and $0.3 million to net tangible liabilities. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is expected to be deductible for income tax reporting.
The weighted average amortization life for the 2014 acquired finite lived intangible assets related to the acquisition of MCS Software is as follows:

Weighted average amortization life	
	(In years)
Customer relationships	14
Non-compete agreement	5
Software	5
Overall	11

Heartland Payroll Solutions

Payroll 1, Inc.
On February 27, 2015, the Company purchased the stock of Payroll 1, Inc. ("Payroll 1") for a $30.0 million cash payment, plus net working capital. The purchase price was financed under the 2014 Revolving Credit Facility.

The transaction was accounted for under the acquisition method of accounting. Beginning February 27, 2015, Payroll 1's results of operations were included in the Company's results of operations. The allocation of the total purchase price was as follows: $20.7 million to goodwill, $14.5 million to intangible assets and $4.4 million to net tangible liabilities. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is not expected to be deductible for income tax reporting.
The weighted average amortization life for the 2015 acquired finite lived intangible assets related to the acquisition of Payroll 1 is as follows:

Weighted average amortization life	
	(In years)
Customer relationships	13
Software	6
Non-compete agreement	4
Overall	12

Heartland Commerce

Menusoft Systems Corporation

On October 30, 2015, the Company purchased the stock of Menusoft Systems Corporation (a.k.a. “Digital Dining”) for a $18.7 million cash payment, plus net working capital. The purchase price was funded from a combination of operating cash and financing under the 2014 Revolving Credit Facility.

The transaction was accounted for under the acquisition method of accounting. Beginning on October 30, 2015, Digital Dining's results of operations are included in the Company's results of operations. The allocation of the total purchase price was as follows: $14.7 million to goodwill, $4.7 million to intangible assets, and $0.7 million to net tangible liabilities. The fair values are preliminary, based on estimates, and may be adjusted as the Company analyzes what was known and knowable at the acquisition date, including the finalization of valuations. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is not expected to be deductible for income tax reporting.

The weighted average amortization life for the 2015 acquired finite lived intangible assets related to the acquisition of Digital Dining is as follows:

Weighted average amortization life	
	(In years)
Customer relationships	19
Software	15
Trademark	5
Non-compete agreement	3
Overall	17

Dinerware, LLC

On February 11, 2015, the Company purchased the stock of Dinerware for a $15.0 million cash payment, plus net working capital. The purchase price was funded from a combination of operating cash and financing under the 2014 Revolving Credit Facility.

The transaction was accounted for under the acquisition method of accounting. Beginning on February 11, 2015, Dinerware's results of operations are included in the Company's results of operations. The allocation of the total purchase price was as follows: $12.8 million to goodwill, $2.6 million to intangible assets, and $0.2 million to net tangible liabilities. The fair values are preliminary, based on estimates, and may be adjusted as the Company analyzes what was known and knowable at the acquisition date, including the finalization of valuations. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is not expected to be deductible for income tax reporting.

The weighted average amortization life for the 2015 acquired finite lived intangible assets related to the acquisition of Dinerware is as follows:

Weighted average amortization life	
	(In years)
Customer relationships	17
Software	5
Trademark	5
Non-compete agreement	3
Overall	13

pcAmerica, LLC

On January 30, 2015, the Company purchased the assets of Automation, Inc. ("pcAmerica") for a $15.0 million cash payment, plus net working capital. The cash purchase price was funded from a combination of operating cash and financing under the 2014 Revolving Credit Facility.

The transaction was accounted for under the acquisition method of accounting. Beginning on January 30, 2015, pcAmerica's results of operations are included in the Company's results of operations. The allocation of the total purchase price was as follows: $14.9 million to goodwill, $1.5 million to intangible assets, and $1.3 million to net tangible liabilities. The fair values are preliminary, based on estimates, and may be adjusted as the Company analyzes what was known and knowable at the acquisition date, including the finalization of valuations. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is expected to be deductible for income tax reporting.

The weighted average amortization life for the 2015 acquired finite lived intangible assets related to the acquisition of pcAmerica is as follows:

Weighted average amortization life	
	(In years)
Customer relationships	20
Software	5
Trademark	5
Non-compete agreement	5
Overall	14

Xpient Solutions, LLC
On October 31, 2014, the Company acquired the net assets of Xpient Solutions, LLC (“Xpient”) for a cash payment of $30.0 million, plus net working capital. The purchase price was funded from a combination of operating cash and financing under the 2014 Revolving Credit Facility.

The transaction was accounted for under the acquisition method of accounting. Beginning October 31, 2014, Xpient's results of operations are included in the Company's results of operations. The allocation of the total purchase price was as follows: $21.5 million to goodwill, $9.5 million to intangible assets and $3.0 million to net tangible assets. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is expected to be deductible for income tax reporting.

The weighted average amortization life for the 2014 acquired finite lived intangible assets related to the acquisition of Xpient is as follows:

Weighted average amortization life	
	(In years)
Customer relationships	21
Software	10
Trademark	5
Non-compete agreement	3
Overall	14

Liquor Point of Sale
On February 14, 2014, the Company purchased the assets of Merchant Software Corporation (referred to as "Liquor POS") for a $3.3 million cash payment. The purchase price was funded from operating cash flows.

The transaction was accounted for under the acquisition method of accounting. Beginning on February 15, 2014, Liquor POS's results of operations are included in the Company's results of operations. The allocation of the total purchase price was as follows: $2.2 million to goodwill, $1.2 million to intangible assets, and $0.1 million to net tangible liabilities. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is expected to be deductible for income tax reporting.
The weighted average amortization life for the 2014 acquired finite lived intangible assets related to the acquisition of Liquor POS is as follows:

Weighted average amortization life	
	(In years)
Customer relationships	10
Software	7
Non-compete agreement	5
Patents	5
Overall	9

Leaf Holdings, Inc.
On September 11, 2013, the Company purchased 66.67% of the outstanding capital stock of Leaf for a $14.5 million cash payment. The purchase price was financed from operating cash flows.

The transaction was accounted for under the acquisition method of accounting. Beginning on September 11, 2013, Leaf's results of operations are included in the Company's results of operations. The allocation of the total purchase price was as follows: $18.5 million to goodwill, $6.9 million to intangible assets, $4.1 million to net tangible liabilities and $6.8 million to noncontrolling interest. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is not expected to be deductible for income tax reporting. See Note 2, Summary of Significant Accounting Policies — Goodwill, for details on the Leaf goodwill and intangible asset impairment in 2014.

On August 6, 2014, the Company entered into a Stock Purchase Agreement with the noncontrolling shareholders of Leaf under which it acquired all shares of Leaf common stock held by the noncontrolling shareholders. As a result of this transaction, Leaf became a wholly-owned subsidiary of the Company. The Company accounted for this transaction as additional paid-in capital on the Consolidated Balance Sheet.

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Notes To Consolidated Financial Statements—(Continued)

4. Receivables

A summary of receivables by major class was as follows at December 31, 2015 and 2014:

	December 31, 2015	2014
	(In thousands)	
Accounts receivable from merchants and customers	$224,222	$200,912
Accounts receivable from bankcard networks	37,621	31,279
Accounts receivable from others	7,155	3,465
	268,998	235,656
Less allowance for doubtful accounts	(1,706)	(1,552)
Total receivables, net	$267,292	$234,104

Included in accounts receivable from others are amounts due from employees (predominantly salespersons), which are $3.5 million and $1.6 million at December 31, 2015 and 2014, respectively. Accounts receivable related to bankcard networks are primarily amounts due from Discover and American Express for bankcard transactions.

A summary of the activity in the allowance for doubtful accounts for the three years ended December 31, 2015, 2014 and 2013 was as follows:

	Year Ended December 31, 2015	2014	2013
	(In thousands)		
Beginning balance	$1,552	$1,032	$1,438
Out-of-Period adjustment (a)	—	875	—
Additions to allowance	6,155	2,405	180
Charges against allowance	(6,064)	(3,426)	(586)
Additions for acquisitions (b)	63	666	—
Ending balance	$1,706	$1,552	$1,032

(a) See Note 1, Organization and Operations for a discussion of the Out-of-Period Adjustment.
(b) Consists of allowances of businesses acquired during the years ended December 31, 2015 and 2014.

5. Funds Held for Customers

A summary of funds held for customers and investments, including the amortized cost, gross unrealized gains (losses) and estimated fair value for investments held to maturity and investments available-for-sale by major security type and class of security were as follows at December 31, 2015 and 2014:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In thousands)			
December 31, 2015				
Funds held for customers:				
Conservative income bond fund - available for sale	$13,012	$—	$(42)	$12,970
Fixed income - municipal bonds - available for sale	13,893	18	(25)	13,886

Cash and cash equivalents held for customers	201,378	—	—	201,378
Total funds held for customers	$228,283	$18	$(67)	$228,234

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Heartland Payment Systems, Inc. and Subsidiaries

Notes To Consolidated Financial Statements—(Continued)

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In thousands)			
December 31, 2014				
Funds held for customers:				
Conservative income bond fund - available for sale	$13,012	$—	$(16)	$12,996
Fixed income - municipal bonds - available for sale	14,688	2	(51)	14,639
Cash and cash equivalents held for customers	148,857	—	—	148,857
Total funds held for customers	$176,557	$2	$(67)	$176,492

Expected maturities of the Fixed income -municipal bonds at December 31, 2015 are as follows:

	Total	Less Than 1 Year	1 To 5 Years	5 To 10 Years
	(In thousands)			
December 31, 2015				
Funds Held for Customers:				
Fixed income - municipal bonds - available for sale cost	$13,893	$2,153	$11,740	$—
Fixed income - municipal bonds - available for sale estimated fair value	$13,886	$2,154	$11,732	$—

During the fourth quarter of 2014, the Company reviewed its investment in the stock of TabbedOut and estimated that the fair value of its investment in TabbedOut was substantially impaired, and therefore, an impairment charge of $4.0 million was recorded as of December 31, 2014 and included in "Other, net" in the Consolidated Statements of Income. Besides this impairment charge, the Company did not experience any other-than-temporary losses on its other investments during the twelve months ended December 31, 2015 and 2014.

During the twelve months ended December 31, 2014, the Company sold available for sale securities for $25.2 million and realized a gain on this sale of $0.3 million which was recognized in the Consolidated Statements of Income.

6. Capitalized Customer Acquisition Costs, Net

A summary of net capitalized customer acquisition costs as of December 31, 2015 and 2014 was as follows:

	December 31, 2015	2014
	(In thousands)	
Capitalized signing bonuses	$118,816	$98,879
Less accumulated amortization	(54,539)	(47,238)
	64,277	51,641
Capitalized customer deferred acquisition costs	64,310	54,583
Less accumulated amortization	(39,592)	(33,117)
	24,718	21,466
Capitalized customer acquisition costs, net	$88,995	$73,107

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A summary of net capitalized customer acquisition costs for the three years ended December 31, 2015, 2014 and 2013 was as follows:

	Year Ended December 31,		
	2015	2014	2013
	(In thousands)		
Balance at beginning of period	$73,107	$61,027	$56,425
Plus additions to:			
Capitalized signing bonuses, net	48,289	38,875	29,091
Capitalized customer deferred acquisition costs	28,562	24,831	21,159
	76,851	63,706	50,250
Less amortization expense on:			
Capitalized signing bonuses, net	(35,653)	(30,345)	(27,767)
Capitalized customer deferred acquisition costs (a)	(25,310)	(21,281)	(17,881)
	(60,963)	(51,626)	(45,648)
Balance at end of period	$88,995	$73,107	$61,027

(a) Includes $0.2 million net charge for the year ended December 31, 2015 related to the sale of SmartLink included in "Gain on sale of assets" in the Consolidated Statements of Income.

Net signing bonus adjustments from estimated amounts to actual were $(5.1) million, $(4.0) million, and $(3.7) million, respectively, for the years ended December 31, 2015, 2014 and 2013. Net signing bonus adjustments are netted against additions in the table above. Negative signing bonus adjustments occur when the actual gross margin generated by the merchant contract during the first year is less than the estimated gross margin for that year, resulting in the overpayment of the up-front signing bonus and would be recovered from the relevant salesperson. Positive signing bonus adjustments result from the prior underpayment of signing bonuses and would be paid to the relevant salesperson.

Fully amortized signing bonuses of $28.0 million, $26.7 million and $27.8 million, respectively, were written off during the three years ended December 31, 2015, 2014, and 2013. In addition, fully amortized customer deferred acquisition costs of $18.8 million, $15.5 million and $13.7 million, respectively, were written off during the three years ended December 31, 2015, 2014 and 2013.

The Company believes that no impairment of capitalized customer acquisition costs has occurred as of December 31, 2015, 2014 and 2013.

7. Property and Equipment, Net

A summary of property and equipment, net as of December 31, 2015 and 2014 is as follows:

	December 31,	
	2015	2014
	(In thousands)	
Computer hardware and software	$225,988	$196,170
Building	55,095	54,998
Furniture, fixtures and equipment	23,836	18,895
Leasehold improvements	17,360	11,966
Land	7,523	7,471

	329,802	289,500
Less accumulated depreciation	(163,110)	(135,197)
	$166,692	$154,303

Depreciation expense for the three years ended December 31, 2015, 2014 and 2013 was $43.4 million, $36.4 million and $30.1 million, respectively.

Total cost of assets not yet placed into service included in property and equipment at December 31, 2015 and 2014 were $20.6 million and $25.8 million, respectively. During the years ended December 31, 2015, 2014, and 2013 the amount of capitalized costs for internally developed projects amounted to $36.9 million, $40.3 million, and $38.4 million, respectively. During the years ended December 31, 2015, 2014, and 2013, the amounts of capitalized costs for internally developed projects placed in service were $39.7 million, $36.5 million, and $25.7 million, respectively.

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As of December 31, 2015 and 2014 there were $61.3 million and $53.0 million, respectively, of net capitalized costs for internally developed projects placed into service.

The estimated depreciation expense related to capitalized costs for internally developed projects placed in service for the next five years is as follows:

For the Years Ended December 31,	
	(In thousands)
2016	$30,297
2017	19,853
2018	8,314
2019	1,602
2020	894
Thereafter	296
	$61,256

8. Intangible Assets and Goodwill

Intangible Assets — Intangible assets consisted of the following as of December 31, 2015 and 2014:

	December 31, 2015			
	Gross Assets	Accumulated Amortization	Net Asset	Amortization Life and Method
	(In thousands)			
Finite Lived Assets:				
Customer relationships	$179,178	$33,896	$145,282	5 to 21 years—proportional cash flow
Merchant portfolios	4,214	3,545	669	7 years—proportional cash flow
Software	52,111	7,737	44,374	3 to 15 years—straight line
Non-compete agreements	4,776	2,549	2,227	3 to 5 years—straight line
Other	6,286	1,615	4,671	5 to 9 years—straight line
	$246,565	$49,342	$197,223	

	December 31, 2014			
	Gross Assets	Accumulated Amortization	Net Asset	Amortization Life and Method
	(In thousands)			
Finite Lived Assets:				
Customer relationships	$159,925	$22,011	$137,914	6 to 21 years—proportional cash flow
Merchant portfolios	4,214	3,161	1,053	7 years—proportional cash flow
Software	58,377	13,300	45,077	1 to 15 years—straight line
Non-compete agreements	5,947	2,830	3,117	5 years—straight line
Other	5,800	408	5,392	5 to 9 years—straight line
	$234,263	$41,710	$192,553	

Amortization expense related to the intangible assets was $20.1 million, $13.3 million and $9.0 million for the years ended December 31, 2015, 2014 and 2013, respectively.

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

For the Years Ended December 31,	
	(In thousands)

2016	$19,323
2017	17,786
2018	15,975
2019	14,528
2020	12,715
Thereafter	116,896
	$197,223

Goodwill — The changes in the carrying amount of goodwill by segment for the years ended December 31, 2015, 2014 and 2013 were as follows:

	Payment Processing	Campus Solutions	Heartland School Solutions	Heartland Payroll Solutions	Leaf	Other (c)	Total
Balance at January 1, 2013	$43,701	$33,679	$53,350	$30,831	$—	$6,501	$168,062
Goodwill acquired during the period	—	—	—	—	20,619	—	20,619
Other (a)	—	2,110	—	187	—	—	2,297
Balance at December 31, 2013	43,701	35,789	53,350	31,018			