HEARTLAND PAYMENT SYSTEMS INC
Form 10-Q
May 09, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2007

OR

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

Commission File No. 001-32594

HEARTLAND PAYMENT SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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

90 Nassau Street, Princeton, New Jersey 08542

(Address of principal executive offices) (Zip Code)

(609) 683-3831

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant 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 x Non-accelerated filer ¨

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

As of May 2, 2007, there were 37,791,403 shares of the registrant s Common Stock, $0.001 par value, outstanding.

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Heartland Payment Systems, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(In thousands, except share data)

(unaudited)

	March 31, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	**$ 24,759**	$ 16,054
Funds held for payroll customers	**23,210**	16,960
Receivables, net	**111,796**	107,154
Investments	**1,087**	1,082
Inventory	**2,065**	2,252
Prepaid expenses	**2,203**	2,030
Current tax asset	**16,799**	19,227
Current deferred tax assets, net	**670**	757
Total current assets	**182,589**	165,516
Capitalized customer acquisition costs, net	**59,186**	56,705
Deferred tax assets, net	**4,912**	4,562
Property and equipment, net	**26,721**	23,135
Goodwill and intangible assets	**1,747**	1,757
Deposits and other assets	**52**	93
Total assets	**$ 275,207**	$ 251,768
Liabilities and stockholders equity		
Current liabilities:		
Due to sponsor bank	**$ 32,008**	$ 27,253
Accounts payable	**17,885**	16,936
Deposits held for payroll customers	**23,210**	16,960
Current portion of accrued buyout liability	**11,781**	11,519
Merchant deposits and loss reserves	**7,685**	8,210
Accrued expenses and other liabilities	**11,224**	9,649
Current portion of borrowings and financing arrangements	**97**	174
Total current liabilities	**103,890**	90,701
Reserve for unrecognized tax benefits	**789**	
Long-term portion of accrued buyout liability	**22,667**	21,774
Total liabilities	**127,346**	112,475
Commitments and contingencies (Note 9)		
Stockholders equity		
Common Stock, $.001 par value, 100,000,000 shares authorized, 38,808,039 and 38,488,880 shares issued at March 31, 2007 and December 31, 2006; 37,699,839 and 37,405,680 shares outstanding at March 31, 2007 and December 31, 2006	**38**	38
Additional paid-in capital	**158,722**	153,997

Accumulated other comprehensive loss	**(18)**	(21)
Retained earnings	**15,269**	10,804
Treasury stock, at cost (1,108,200 and 1,083,200 shares at March 31, 2007 and December 31, 2006)	**(26,150)**	(25,525)
Total stockholders equity	**147,861**	139,293
Total liabilities and stockholders equity	**$ 275,207**	$ 251,768

See accompanying notes to consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(In thousands, except per share data)

(unaudited)

	Three Months Ended March 31, 2007	2006
Total Revenues	**$ 284,212**	$ 236,919
Costs of Services:		
Interchange	**205,337**	172,229
Dues and assessments	**10,459**	8,586
Processing and servicing	**31,330**	28,151
Customer acquisition costs	**10,391**	8,172
Depreciation and amortization	**1,724**	1,363
Total costs of services	**259,241**	218,501
General and administrative	**14,299**	12,009
Total expenses	**273,540**	230,510
Income from operations	**10,672**	6,409
Other income (expense):		
Interest income	**459**	254
Interest expense	**(112)**	(120)
Other, net	**(95)**	814
Total other income (expense)	**252**	948
Income before income taxes	**10,924**	7,357
Provision for income taxes	**4,072**	2,969
Net income	**$ 6,852**	$ 4,388
Net income	**$ 6,852**	$ 4,388
Other comprehensive income, net of tax: Unrealized gains (losses) on investments	**3**	(3)
Comprehensive income	**$ 6,855**	$ 4,385
Earnings per common share:		
Basic	**$ 0.18**	$ 0.12
Diluted	**$ 0.17**	$ 0.11
Weighted average number of common shares outstanding:		
Basic	**37,507**	35,128
Diluted	**39,971**	39,817

See accompanying notes to consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries

Condensed Consolidated Statement of Stockholders Equity

(In thousands)

(unaudited)

	Common Stock		Additional Paid-In	Accumulated Other Comprehensive	Retained Earnings	Treasury	Total Stockholders
	Shares	Amount	Capital	Loss	(Accumulated Deficit)	Stock	Equity
Three Months Ended March 31, 2006:							
Balance, January 1, 2006	34,200	$ 34	$ 96,417	$ (26)	$ (15,879)	$ (495)	$ 80,051
Issuance of Common Stock options exercised	2,402	2	15,150				15,152
Excess tax benefit on stock options exercised under SFAS No. 123R			14,517				14,517
Repurchase of Common Stock	(717)					(15,890)	(15,890)
Stock-based compensation under SFAS No. 123R			197				197
Accumulated other comprehensive loss				(3)			(3)
Net income for the period					4,388		4,388
Balance March 31, 2006	35,885	$ 36	$ 126,281	$ (29)	$ (11,491)	$ (16,385)	$ 98,412
Three Months Ended March 31, 2007:							
Balance, January 1, 2007	37,406	$ 38	$ 153,997	$ (21)	$ 10,804	$ (25,525)	$ 139,293
Cumulative effect for change in accounting principal FIN No. 48					(513)		(513)
Issuance of Common Stock options exercised	319		2,385				2,385
Excess tax benefit on stock options exercised under SFAS No. 123R			1,951				1,951
Repurchase of Common Stock	25					(625)	(625)
Stock-based compensation under SFAS No. 123R			389				389
Accumulated other comprehensive income				3			3
Dividends on Common Stock					(1,874)		(1,874)
Net income for the period					6,852		6,852
Balance March 31, 2007	37,700	$ 38	$ 158,722	$ (18)	$ 15,269	$ (26,150)	$ 147,861

See accompanying notes to consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flow

(In thousands)

(unaudited)

	Three Months Ended March 31, 2007	2006
Cash flows from operating activities		
Net income	**$ 6,852**	$ 4,388
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of capitalized customer acquisition costs	**10,062**	8,013
Other depreciation and amortization	**2,131**	1,768
Stock-based compensation	**389**	232
Deferred taxes	**(263)**	1,223
Changes in operating assets and liabilities:		
(Increase) decrease in receivables	**(4,643)**	5,667
Decrease in inventory	**188**	247
Payment of signing bonuses, net	**(9,488)**	(7,091)
Increase in capitalized customer acquisition costs	**(3,055)**	(4,541)
(Increase) decrease in prepaid expenses	**(173)**	230
Decrease in current tax asset	**4,380**	609
Decrease in deposits and other assets	**41**	
Excess tax benefits on options exercised under SFAS No. 123R	**(1,951)**	(14,517)
Increase in reserve for unrecognized tax benefits	**276**	
Increase (decrease) in due to sponsor bank	**4,755**	(10,221)
Increase (decrease) in accounts payable	**948**	(892)
Increase in accrued expenses and other liabilities	**1,574**	2,099
(Decrease) increase in merchant deposits and loss reserves	**(524)**	1,640
Payouts of accrued buyout liability	**(2,229)**	(3,819)
Increase in accrued buyout liability	**3,384**	4,699
Net cash provided by (used in) operating activities	**12,654**	(10,266)
Cash flows from investing activities		
Purchase of investments	**(32)**	(838)
Maturities of investments	**13**	322
Increase in funds held for payroll customers	**(6,233)**	(6,621)
Increase in deposits held for payroll customers	**6,251**	6,630
Acquisition of business, net of cash acquired		(3,452)
Purchases of property and equipment	**(5,708)**	(3,536)
Net cash used in investing activities	**(5,709)**	(7,495)
Cash flows from financing activities		
Principal payments on borrowings and financing arrangements	**(77)**	(57)
Proceeds from exercise of stock options	**2,385**	15,152
Excess tax benefits on options exercised under SFAS No. 123R	**1,951**	14,517
Repurchase of common stock	**(625)**	(15,890)
Dividends paid on common stock	**(1,874)**	

Net cash provided by financing activities		**1,760**		13,722
Net increase (decrease) in cash and cash equivalents		**8,705**		(4,039)
Cash and cash equivalents at beginning of year		**16,054**		8,724
Cash and cash equivalents at end of period	**$**	**24,759**	$	4,685
Supplemental cash flow information:				
Cash paid (received) during the period for:				
Interest	**$**	**111**	$	143
Income taxes		**(314)**		1,099
Supplemental schedule of non-cash activities:				
Amortization of other assets	**$**		$	24

See accompanying notes to consolidated financial statements.

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Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

1. Organization and Operations

Basis of Financial Statement Presentation The accompanying condensed consolidated financial statements include those of Heartland Payment Systems, Inc. (the Company) and its subsidiaries, Heartland Payroll Company (HPC) and Debitek, Inc. (Debitek). The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All intercompany balances and transactions with the Company s subsidiaries have been eliminated upon consolidation. The accompanying condensed consolidated financial statements are unaudited. In the opinion of the Company s management, the unaudited condensed consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of the Company s financial position at March 31, 2007, its results of operations, its changes in stockholders equity and its cash flows for the three months ended March 31, 2007 and 2006. Results of operations reported for interim periods are not necessarily indicative of the results to be expected for the year ended December 31, 2007. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the December 31, 2006 Annual Report on Form 10-K. The December 31, 2006 condensed consolidated balance sheet was derived from the audited 2006 consolidated financial statements.

The officers and directors of the Company represent a majority of the outstanding shares, and so control the Company.

Business Description The Company provides payment-processing services related to bank card transactions for merchants throughout the United States. In addition, the Company provides certain other merchant services, including the sale and rental of terminal equipment and the sale of terminal supplies. HPC provides payroll and related tax filing services throughout the United States. Debitek provides prepaid card and stored-value card solutions throughout the United States.

Use of Estimates The preparation of the unaudited condensed 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 unaudited condensed consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates include, among other things, the accrued buyout liability, capitalized customer acquisition costs, loss reserves, certain accounts payable and accrued expenses and certain tax assets and liabilities as well as the related valuation allowances. Actual results could differ from those estimates. Interchange expense for the three months ended March 31, 2006 included $2.0 million of expense for a change in estimate of the amount of on-line debit interchange expense the Company accrues. The change in estimate was based on new information which became available to the Company.

2. Summary of Significant Accounting Policies

Receivables Receivables are stated net of allowance for doubtful accounts. Historically, the Company has not experienced significant charge offs.

The Company carries receivables from its merchants resulting from the practice of advancing interchange fees to most of its merchants during the month and collecting those fees from merchants at the beginning of the following month. The Company uses its available cash to fund a portion of the advances of interchange fees to its merchants, then when available cash has been expended, the Company directs its sponsor bank to make the advances, thus generating a payable to its sponsor bank. At March 31, 2007 and December 31, 2006, the Company used $40.7 million and $44.6 million, respectively, of its available cash to fund merchant advances. The amount due to the sponsor bank for funding advances was $32.0 million at March 31, 2007 and $27.3 million at December 31, 2006. The payable to the sponsor bank is repaid at the beginning of the following month out of the fees the Company collects from its merchants. Receivables from merchants also include receivables from the sale of point of sale terminal equipment.

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

Receivables also include amounts resulting from the sale, installation, training and repair of cashless payment system hardware and software at Debitek. These receivables are mostly invoiced on terms of 30 days net from date of invoicing and are typically funded from working capital.

Investments and Funds Held for Payroll Customers Investments, including Funds Held for Payroll Customers, consist primarily of fixed income bond funds, corporate and U.S. Government debt securities, certificates of deposit and cost basis equity securities. The Company classifies the majority of its investments, including Funds Held for Payroll Customers, as available-for-sale and records them at the fair value of the investments based on quoted market prices. Certificates of deposit are classified as held to maturity and recorded at cost. Cost basis equity securities are recorded at cost and periodically evaluated for impairment. In the event of a sale, cost is determined on a specific identification basis.

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

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

Management evaluates the capitalized customer acquisition costs for impairment at each balance sheet date by comparing, on a pooled basis by vintage month of origination, the expected future net cash flows from underlying merchant relationships to the carrying amount of the capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the value of the capitalized customer acquisition costs, the impairment loss will be charged to operations. The Company believes that no impairment has occurred as of March 31, 2007 and December 31, 2006.

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

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

Accrued Buyout Liability Relationship Managers and sales managers are paid residual commissions based on the gross margin generated by monthly merchant processing activity. The Company has the right, but is not obligated, to buy out some or all of these commissions, and intends to do so periodically. 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 merchant contract, the Company also records for currently vested Relationship Managers and sales managers a related deferred acquisition cost asset. The accrued buyout liability associated with unvested Relationship Managers and sales managers is not included in the deferred acquisition cost asset since future services are required in order to vest. Subsequent changes in the settlement cost, due to account attrition, same-store sales growth and changes in gross margin, are included in the same income statement caption as customer acquisition cost amortization expense.

The accrued buyout liability is based on the merchants under contract at the balance sheet date, the gross margin generated by those merchants over the prior 12 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 experience that 31% of unvested Relationship Managers and sales managers become vested.

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

Revenue Revenues are mainly comprised of gross processing revenue, payroll processing revenue and equipment-related income. Gross processing revenue primarily consists of discount fees and per-transaction and periodic (primarily monthly) fees from the processing of Visa and MasterCard bank card transactions for merchants. The Company passes through to its customers any changes in interchange or association fees. Gross processing revenue also includes American Express and Discover fees, customer service fees, fees for processing chargebacks, termination fees on terminated contracts, and other miscellaneous revenue. Payroll processing revenue includes periodic and annual fees charged by HPC for payroll processing services, and interest earned through the investment of tax impound funds held for our customers. Revenue is recorded as bank card transactions are processed or payroll services are performed. Equipment-related income includes revenues from the sale, rental and deployment of bank card terminals, and from the sale of hardware, software and associated services for prepaid card and stored-value card payment systems. Revenues are recorded at the time of shipment, or the provision of service.

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

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

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

Diluted earnings per share for the three months ended March 31, 2007 and 2006 were computed based on the weighted average outstanding common shares plus equivalent shares assuming exercise of stock options, where dilutive.

New Accounting Pronouncements The FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN No. 48), in June 2006. FIN No. 48 clarifies the accounting for the recognition and measurement of tax benefits associated with uncertain tax positions and defines criterion that an individual tax position must meet for any part of that position to be recognized or continue to be recognized in the financial statements. FIN No. 48 also adds disclosure requirements for the amounts of unrecognized tax benefits associated with uncertain tax positions. An uncertain tax position exists if it is unclear how a transaction will be treated under tax law. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company has completed its initial evaluation of the impact of adopting FIN No. 48 on January 1, 2007 and recorded a cumulative effect adjustment of $513,000 to Retained Earnings to establish reserves for uncertain tax positions (see Note 8).

The FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), in September 2006. SFAS No. 157 establishes a single authoritative definition of fair value in generally accepted accounting principles (GAAP), sets out a framework for measuring fair value, and requires additional disclosures about fair value measurements. SFAS No. 157 applies only to fair value measurements that are already required or permitted by other accounting standards and is expected to increase the consistency of those measurements. SFAS No. 157 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. The Company does not believe that the application of SFAS No. 157 will have a material effect on its consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities* (SFAS No. 159). SFAS No. 159 provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. SFAS No. 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007 provided that the entity makes that choice in the first 120 days of that fiscal year, has not yet issued financial statements for any interim period of the fiscal year of adoption, and also elects to apply the provisions of Statement No. 157, *Fair Value Measurements*. SFAS No. 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007.The Company does not believe that the application of SFAS No. 159 will have a material effect on its consolidated financial position, results of operations or cash flows.

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

3. Receivables

A summary of receivables by major class was as follows at March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
	(In thousands)	
Accounts receivable from merchants	**$ 108,483**	$ 103,921
Accounts receivable from others	**3,457**	3,384
	111,940	107,305
Less allowance for doubtful accounts	**(144)**	(151)
Total receivables, net	**$ 111,796**	$ 107,154

Included in accounts receivable from others are $1,882,000 and $1,836,000 which are due from employees at March 31, 2007 and December 31, 2006, respectively.

4. Capitalized Customer Acquisition Costs, Net

A summary of the capitalized customer acquisition costs, net was as follows as of March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
	(In thousands)	
Capitalized signing bonuses	**$ 81,694**	$ 76,037
Less accumulated amortization	**(36,583)**	(33,524)
	45,111	42,513
Capitalized customer deferred acquisition costs	**33,101**	32,909
Less accumulated amortization	**(19,026)**	(18,717)
	14,075	14,192
Capitalized Customer Acquisition Costs, Net	**$ 59,186**	$ 56,705

Heartland Payment Systems, Inc. and Subsidiaries

Notes To Condensed Consolidated Financial Statements

(unaudited)

A summary of the activity in capitalized customer acquisition costs, net for the three month periods ended March 31, 2007 and 2006 was as follows:

	Three Months Ended March 31,	
	2007	**2006**
	(In thousands)	
Balance at beginning of period	**$ 56,705**	$ 42,930
Plus additions to:		
Capitalized signing bonuses, net	**9,488**	7,091
Capitalized customer deferred acquisition costs	**3,055**	4,541
	12,543	11,632
Less amortization expense on:		
Capitalized signing bonuses, net	**(6,890)**	(4,867)
Capitalized customer deferred acquisition costs	**(3,172)**	(3,146)
	(10,062)	(8,013)
Balance at end of period	**$ 59,186**	$ 46,549

Net signing bonus adjustments from estimated amounts to actual were $(0.2) million and $0.2 million, respectively, for the three months ended March 31, 2007 and 2006. Net signing bonus adjustments are netted against additions in the table above.

Fully amortized signing bonuses of $4.9 million and $2.6 million respectively, were written off during the three month periods ended March 31, 2007 and 2006. In addition, fully amortized customer deferred acquisition costs of $2.9 million were written off during the three month period ended March 31, 2007.

The Company believes that no impairment has occurred as of March 31, 2007 and December 31, 2006.

5. Merchant Deposits and Loss Reserves

The Company s merchants have the liability for any charges properly reversed by the cardholder through a mechanism known as a chargeback. If the merchant is unable to pay this amount, the Company will be liable to the Visa and MasterCard networks for the reversed charges. Under FIN 45, the Company determined that the fair value of its obligation to stand ready to perform is minimal. The Company requires personal guarantees, merchant deposits and letters of credit from certain merchants to minimize its obligation. As of March 31, 2007 and December 31, 2006, the Company held merchant deposits totaling $7.2 million and $7.7 million, and letters of credit totaling $228,500 and $380,000, respectively.

The Visa and MasterCard networks generally allow chargebacks up to four months after the later of the date the transaction is processed or the delivery of the product or service to the cardholder. As the majority of the Company s transactions involve the delivery of the product or service at the time of the transaction, a reasonable basis for determining an estimate of the Company s exposure to chargebacks is the last four months processing volume on its portfolio, which was $15.3 billion and $15.1 billion for the four months ended March 31, 2007 and December 31, 2006, respectively. However, for the four months ended March 31, 2007 and December 31, 2006, the Company was presented with $8.9 million

and $8.4 million, respectively, in chargebacks by issuing banks. In the three months ended March 31, 2007 and the year ended December 31, 2006, the Company incurred merchant credit losses of $0.5 million and $1.9 million, respectively, on total dollar volume processed of $11.2 billion and $43.3 billion, respectively. These credit losses are included in processing and servicing costs in the Company s consolidated statements of income.

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(unaudited)

The loss recorded by the Company for chargebacks associated with any individual merchant is typically small, due both to the relatively small size and the processing profile of the Company s clients. However, from time to time the Company will encounter instances of merchant fraud, and the resulting chargeback losses may be considerably more significant to the Company. The Company has established a contingent reserve for estimated currently existing credit and fraud losses on its consolidated balance sheets, amounting to $510,000 on March 31, 2007 and $475,000 on December 31, 2006. This reserve is determined by performing an analysis of the Company s historical loss experience applied to current processing volume and exposures.

A summary of the activity in the loss reserve for the three month periods ended March 31, 2007 and 2006 was as follows:

	Three Months Ended March 31,	
	2007	**2006**
	(In thousands)	
Beginning balance	**$ 475**	$ 485
Additions to reserve	**527**	468
Charges against reserve	**(492)**	(468)
Ending balance	**$ 510**	$ 485

6. Accrued Buyout Liability

A summary of the accrued buyout liability was as follows as of March 31, 2007 and December 31, 2006:

	March 31, 2007	**December 31, 2006**
	(In thousands)	
Vested Relationship Managers and sales managers	**$ 33,245**	$ 32,001
Unvested Relationship Managers and sales managers	**1,203**	1,292
	34,448	33,293
Less current portion	**(11,781)**	(11,519)
Long-term portion of accrued buyout liability	**$ 22,667**	$ 21,774

A summary of the activity in the accrued buyout liability for the three month periods ended March 31, 2007 and 2006 was as follows:

	Three Months Ended March 31,	
	2007	**2006**
	(In thousands)	
Beginning balance	**$ 33,293**	$ 28,474

Increase in settlement obligation, net	**3,384**	4,699
Buyouts	**(2,229)**	(3,819)
Ending balance	**$ 34,448**	$ 29,354

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

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In calculating the accrued buyout liability for unvested Relationship Managers and sales managers, the Company has assumed that 31% of the unvested Relationship Managers and sales managers will vest in the future, which represents the Company s historical vesting rate. A 5% increase to 36% in the expected vesting rate would have increased the accrued buyout liability for unvested Relationship Managers and sales managers by $0.2 million at March 31, 2007 and $0.2 million at December 31, 2006.

7. Stockholders Equity

Common Stock Repurchases. On January 13, 2006, the Company s Board of Directors authorized management to repurchase up to the lesser of (a) 1,000,000 shares of the Company s common stock or (b) $25,000,000 worth of its common stock in the open market. On August 1, 2006, the Company s Board of Directors authorized management to repurchase up to an additional 1,000,000 shares of its common stock in the open market using the proceeds from the exercise of stock options. Under these authorizations, the Company had repurchased 1,061,200 shares of its common stock during 2006 at a cost of $25.0 million, or $23.59 per share, and an additional 25,000 shares during the three months ended March 31, 2007 at a cost of $0.6 million, or $25.02 per share.

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

Dividends on Common Stock. On August 1, 2006, the Company s Board of Directors declared a quarterly cash dividend of $0.025 per share of common stock, which was paid on September 15, 2006 to stockholders of record as of August 25, 2006. On November 2, 2006, the Company s Board of Directors declared a quarterly cash dividend of $0.025 per share of common stock, which was paid on December 15, 2006 to stockholders of record as of November 24, 2006.

On February 12, 2007, the Company s Board of Directors declared a quarterly cash dividend of $0.05 per share of common stock, which was paid on March 15, 2007 to stockholders of record as of February 23, 2007. On May 3, 2007, the Company s Board of Directors declared a quarterly cash dividend of $0.05 per share of common stock, payable on June 15, 2007 to stockholders of record as of May 25, 2007.

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8. Income Taxes

The provision for income taxes for the three month periods ended March 31, 2007 and 2006 consists of the following: