HEARTLAND PAYMENT SYSTEMS INC
Form 424B4
August 11, 2005

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**Filed Pursuant to Rule 424(B)(4)**
**File No. 333-118073**

**PROSPECTUS**

# 6,750,000 Shares

# Heartland Payment Systems, Inc.

## Common Stock
## $18.00 per share

We are selling 2,622,046 shares of our common stock and the selling stockholders named in this prospectus are selling 4,127,954 shares. We will not receive any proceeds from the sale of the shares by the selling stockholders. We and the selling stockholders have granted the underwriters an option to purchase up to 1,012,500 additional shares of common stock to cover over-allotments.

This is the initial public offering of our common stock. Our common stock has been approved for listing on the New York Stock Exchange under the symbol "HPY".

**Investing in our common stock involves risks. See "Risk Factors" beginning on page 8.**

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

| | Per Share | Total |
|---|---|---|
| Public Offering Price | $ 18.00 | $ 121,500,000 |
| Underwriting Discount | $ 1.26 | $ 8,505,000 |
| Proceeds to Heartland Payment Systems (before expenses) | $ 16.74 | $ 43,893,050 |
| Proceeds to the selling stockholders (before expenses) | $ 16.74 | $ 69,101,950 |

The underwriters expect to deliver the shares to purchasers on or about August 16, 2005.

**Citigroup**
**Credit Suisse First Boston**
**Robert W. Baird & Co.**

**William Blair & Company**

**KeyBanc Capital Markets**

**SunTrust Robinson Humphrey**

August 10, 2005

**You should rely only on the information contained in this prospectus. We and the selling stockholders have not authorized anyone to provide you with different information. We and the selling stockholders are not making an offer of these securities in any state where the offer is not permitted.**

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Until September 4, 2005 (25 days after the date of this prospectus), all dealers that buy, sell or trade our common stock, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

In this prospectus, we use the terms "Heartland," "we," "us" and "our" to refer to Heartland Payment Systems, Inc.

HEARTLAND PAYMENT SYSTEMS is our registered trademark. We have applied to register HPS Exchange as a trademark. This prospectus also contains trademarks and tradenames of other companies.

**SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS**

We have made forward-looking statements in this prospectus, including the sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business," that are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include the information concerning our possible or assumed future results of operations, business strategies, financing plans, competitive position, industry environment, potential growth opportunities, the effects of future regulation and the effects of competition. Forward-looking statements include all statements that are not historical facts and can be identified by the use of forward-looking terminology such as the words "believe," "expect," "anticipate," "intend," "plan," "estimate" or similar expressions.

Forward-looking statements involve risks, uncertainties and assumptions. Actual results may differ materially from those expressed in the forward-looking statements. We do not have any intention or obligation to update forward-looking statements after we distribute this prospectus.

You should understand that many important factors, in addition to those discussed elsewhere in this prospectus, could cause our results to differ materially from those expressed in the forward-looking statements. These factors include, without limitation, our competitive environment, the business cycles and credit risks of our merchants, chargeback liability, merchant attrition, problems with our bank sponsor, our reliance on other bank card payment processors, our inability to pass increased interchange fees along to our merchants, the unauthorized disclosure of merchant data, economic conditions, system failures and government regulation.

## SUMMARY

*This summary highlights material information about our company and the common stock that we and the selling stockholders are offering. It does not contain all of the information that may be important to you. You should read this entire prospectus carefully, including the "Risk Factors" section and the financial statements and notes to those statements, which are included elsewhere in this prospectus.*

## Heartland Payment Systems, Inc.

### Our Business

We provide bank card-based payment processing services to small-and medium-sized merchants in the United States and, according to The Nilson Report, in 2004 we were the seventh largest card acquirer in the United States ranked by purchase volume, which consists of both credit and debit Visa and MasterCard transactions. This ranking represented 1.8% of the total bank card processing market. As of June 30, 2005, we provided our payment processing services to approximately 101,500 active merchants located across the United States. In 2002, 2003 and 2004, our processing volume was $14.4 billion, $17.9 billion and $25.0 billion, respectively. Our processing volume for the six months ended June 30, 2005 was $15.4 billion, a 36.3% increase from the $11.3 billion processed during the same period in 2004.

Our revenue is recurring in nature as we typically enter into three-year service contracts that, in order to qualify for the agreed-upon pricing, require the merchant to achieve processing volume minimums. Most of our gross revenue is payment processing fees, which are a combination of a percentage of the dollar amount of each Visa and MasterCard transaction we process plus a flat fee per transaction. On average, our gross revenue from processing transactions equals approximately $2.38 for every $100 we process.

We sell and market our payment processing services through a nationwide direct sales force of approximately 800 sales professionals, known as Relationship Managers. Our sales force is responsible for both the initial sale to, and the ongoing relationship management with, our merchants. Our sales force is compensated solely with commissions, which are directly tied to the performance of the contract signed by the merchant. They are therefore compensated only for adding and retaining profitable processing volume. In 2004, our sales force generated over 42,500 merchant applications and installed over 39,000 new merchants.

We focus our sales efforts on low-risk merchants and have developed systems and procedures designed to minimize our exposure to potential losses. In 2002, 2003 and 2004, we experienced losses of $0.6 million, $0.6 million and $0.9 million, respectively, each of which represented less than 0.4 basis points (0.004%) of payment processing volume. In the first quarter of 2005, we experienced losses of $0.3 million, or 0.44 basis points. We cannot predict our future losses, and any future increases in the loss rate would reduce our income. We have developed expertise in industries that we believe present relatively low risks, as the customers are generally present and the products or services are generally delivered at the time the transaction is processed. These industries include restaurants, brick and mortar retailers, lodging establishments (hotels and motels), automotive repair shops, convenience and liquor stores and professional service providers. As of March 31, 2005, over 33% of our merchants were restaurants. We believe that restaurants represent an attractive merchant base as they typically have unique processing needs and have significant, predictable processing volume.

Our direct sales force and merchant services initiatives are supported by our technology platform. We use a number of proprietary Internet-based systems which allow us to increase our operating efficiencies and distribute our processing and merchant data to our three main constituencies: our sales force, our merchant base and our customer service staff. In 2001, we began using our internally-developed system, HPS Exchange, to provide authorization and data capture services, known as front-end processing, to our merchants. We believe that our proprietary systems provide a superior experience for both our Relationship Managers and merchants, which enhances the overall relationship. We also believe that our front-end processing system allows us to offer superior service at a lower cost to us. During the years ended December 31, 2003 and 2004, and the quarter ended March 31, 2005, approximately 26%, 43% and 51% respectively, of our transactions were processed through HPS Exchange, and we anticipate that as this percentage increases our processing costs per transaction will continue to decline. We rely on third parties, primarily Vital Processing Services, Inc., to provide the remainder of our bank card authorization and data capture services, as well as all of our settlement and merchant accounting services.

Since 2002, our processing volume has increased 31.8% annually from approximately $14.4 billion for the year ended December 31, 2002 to approximately $25.0 billion for the year ended December 31, 2004. During the same period, our total net revenues increased from $340.6 million in 2002 to $602.7 million in 2004. We have achieved this growth entirely through internal expansion rather than through acquisitions or buying merchant contracts from others. In 2000 and 2001 we recorded net losses of $9.4 million and $17.4 million, respectively. In 2002, 2003 and 2004, we recorded net income of $4.9 million, $20.1 million and $8.9 million, respectively. In 2004, our net income declined approximately 55.7% from 2003 primarily as the result of income tax benefits recorded in 2003.

**Our Market Opportunity**

According to The Nilson Report, total expenditures for all card type transactions, which include credit and debit purchases with American Express, Diners Club, Discover, MasterCard and Visa, by U.S. consumers grew from $0.9 trillion in 1998, to $1.9 trillion in 2004, and are expected to grow to $2.8 trillion by 2008, representing a compound annual growth rate of 10% from 2004 levels. We believe that these increases are due to the benefits of bank card payment systems to both merchants and consumers and generational trends that have increased the size of the population that is comfortable with, and accustomed to, using bank cards as a payment medium. By accepting bank cards, merchants can access a broader universe of consumers and enjoy administrative conveniences that are not available with cash and check payments. For example, in recent years, state and local governments have begun accepting bank cards for government payments, such as motor vehicle fees, recreational services, parking fees and taxes, in order to reduce their costs for collecting and processing payments and to expedite the deposit of these payments into their own accounts. Also, we believe more businesses will accept bank card payments from other businesses. By using bank cards, consumers and businesses are able to make purchases more conveniently, while benefiting from loyalty programs, such as frequent flier miles or cash back, which are increasingly being offered by bank card issuers. Given the advantages of bank card payment systems to both merchants and bank card users, favorable generational trends and the resulting growth in bank card usage, we believe that the number of purchases processed using bank card payment systems and the number of merchants accepting bank card payments will continue to increase.

**Our Competitive Strengths**

Our principal competitive strengths are:

***Large, experienced, efficient direct sales force.*** We believe that we have the largest direct sales force in the payment processing industry.

***Recurring and predictable revenues.*** Our merchants typically sign three-year service contracts, and many continue their contracts with us for much longer.

***Internal growth.*** All merchants on our platform were originally underwritten by us.

***Strong position and substantial experience in our target markets.*** We believe that we are the largest payment processor that concentrates primarily on small- and medium-sized merchants.

***Industry expertise.*** Our locally-based sales professionals are trained to address the needs of specific industries, in particular the restaurant industry.

***Merchant focused culture.*** Since inception, our corporate culture has focused on offering fully-disclosed pricing and providing superior customer service to our merchants.

***Advanced technology.*** Since our inception, we have consistently invested in our technology and focused on bringing in-house formerly outsourced processes.

***Scalable operating structure.*** The nature of our business, combined with the investment we have made in our technology, allow for lower incremental costs as we grow our processing volume.

***Comprehensive underwriting and risk management system.*** Our underwriting process and experience in assessing risk, combined with our focus on low-risk merchants, has allowed us to maintain low loss levels.

***Proven management team.*** Our senior management team has broad experience within the payment processing industry.

**Challenges We Face**

We face a number of challenges in executing our business strategy. Among the most important we face are:

***Competition.*** The payment processing industry is very competitive, and includes large firms with substantial resources, including First Data Merchant Services Corporation, National Processing, Inc., a subsidiary of Bank of America Corporation, Global Payments, Inc., Fifth Third Bank and Nova Information Systems, Inc., a subsidiary of U.S. Bancorp.

***General Economic Conditions.*** Any changes in economic conditions that adversely affect our customers could reduce the number of merchants or volume of transactions that we process.

***Regulation.*** Our business is subject to numerous bank card association rules and practices that are subject to change and may impose significant costs or limitations on the way we conduct or expand our business.

***Technology.*** We depend on various forms of technology systems to deliver our products and services. The failure of these systems could cause us to lose customers and increase our costs.

***Reliance on Third Parties.*** We rely on third parties, including our bank sponsor, in order to conduct our business. If any of these relationships are terminated, and we cannot find alternate providers quickly, our business will be severely impacted.

***Data Security.*** As a card processor, we must protect cardholder data from unauthorized use. A major compromise of our systems could subject us to significant fines and sanctions from Visa, MasterCard and/or governmental agencies.

Please see the section entitled "Risk Factors" for information on these and other risks related to our business and this offering.

**Our Strategy**

Our growth strategy is to increase our market share in the bank card payment processing services industry for small- and medium-sized merchants in the United States. Key elements of our strategy include:

- Expanding our direct sales force.
- Entering into new markets and further penetrating existing target markets.
- Expanding our product and service offerings.

Leveraging our technology.

Enhancing merchant retention.

Pursuing strategic acquisitions.

## Our History

Heartland Card Services LLC, a Missouri limited liability company and our predecessor, was formed on March 27, 1997, through a contribution of a merchant portfolio from Triad, LLC, a company founded and majority-owned by our chief executive officer, Robert O. Carr, and cash from Heartland Bank, through its subsidiary Heartland Card Company. It began actively processing transactions in July 1997, and in 1999 it changed its name to Heartland Payment Systems LLC. On May 8, 2000, Heartland Payment Systems LLC redeemed the 50% interest owned by Heartland Card Company for cash and part of the merchant portfolio, leaving Triad as the sole member. In connection with such transaction, Heartland Bank and Heartland Card Company acknowledged that we will continue to use the name "Heartland" in connection with our business. On June 16, 2000, we were formed as a Delaware corporation. Triad and Uhle and Associates, LLC were merged into us effective October 1, 2000 and Heartland Payment Systems LLC was merged into us effective January 1, 2001. In addition, on October 1, 2000, Heartland Payroll Company became our wholly-owned subsidiary. In June 2004, we merged Credit Card Software Systems, Inc., our wholly-owned subsidiary, which was acquired by us on December 14, 2000 pursuant to a settlement agreement approved by the United States Bankruptcy Court for the Middle District of North Carolina, into us.

## Corporate Information

Our principal executive offices are located at 47 Hulfish Street, Suite 400, Princeton, New Jersey 08542 and our telephone number is (609) 683-3831. Our website address is www.heartlandpaymentsystems.com. Information contained on our website is not a prospectus and does not constitute part of this prospectus.

**THE OFFERING**

| | |
|---|---|
| Common stock offered by us | 2,622,046 shares |
| Common stock offered by selling stockholders | 4,127,954 shares |
| Common stock outstanding after this offering | 32,406,460 shares |
| Use of proceeds | We intend to use our net proceeds from this offering to repay approximately $2.9 million of outstanding indebtedness and to use the remainder for general corporate purposes, including to fund working capital and potential acquisitions. We will not receive any proceeds from the sale of shares by the selling stockholders. See "Use of Proceeds." |
| New York Stock Exchange symbol | "HPY" |
| Risk factors | See "Risk Factors" for a discussion of factors you should carefully consider before deciding to invest in shares of our common stock. |

Except as otherwise noted, all information in this prospectus assumes:

- a two-for-one split of our outstanding common stock on July 26, 2005;
- the automatic conversion of all outstanding shares of our convertible participating preferred stock into 13,333,334 shares of common stock upon completion of this offering; and
- no exercise of the underwriters' over-allotment option.

As of March 31, 2005, we had 29,784,414 shares of common stock outstanding. The number of shares of common stock to be outstanding after this offering excludes:

- 9,261,002 shares of common stock issuable upon exercise of outstanding stock options as of March 31, 2005 at a weighted average exercise price of $6.43 per share; and
- 168,904 shares of common stock issuable upon exercise of outstanding mandatorily redeemable warrants as of March 31, 2005 at an exercise price of $0.005 per share.

**SUMMARY HISTORICAL CONSOLIDATED FINANCIAL AND OTHER DATA**

The following summary historical consolidated financial and other data should be read in conjunction with "Selected Historical Consolidated Financial Information and Other Data," "Capitalization," "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 prospectus. Our summary balance sheet data as of March 31, 2005 and summary statement of operations data for the years ended December 31, 2002, 2003 and 2004 have been derived from our consolidated financial statements included elsewhere in this prospectus. The summary statement of operations data for the three months ended March 31, 2004 and 2005 are derived from our unaudited consolidated financial statements included elsewhere in this prospectus and include all adjustments that we consider necessary for a fair presentation of the financial position and results of operations for those periods. We have prepared the unaudited information on the same basis as the audited consolidated financial statements and have included all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair presentation of our financial position at those dates and our results of operations for the periods ended.

The following unaudited pro forma balance sheet data give effect to the automatic conversion of all outstanding shares of our convertible participating preferred stock into common stock upon completion of this offering as if it had occurred as of March 31, 2005.

The following unaudited pro forma as adjusted balance sheet data give effect to the pro forma adjustments discussed in the preceding paragraph, our receipt of approximately $39.4 million in net proceeds from our sale of 2,622,046 shares of our common stock in this offering at an initial public offering price of $18.00 per share, after deducting the underwriting discounts and commissions and offering expenses payable by us, as if it had occurred as of March 31, 2005, and the application of our net proceeds from this offering to repay approximately $2.9 million of outstanding indebtedness. The unaudited pro forma and pro forma as adjusted consolidated financial data do not purport to represent what our financial condition would have been if the issuance of the common stock or the automatic conversion of all outstanding shares of our convertible participating preferred stock had occurred as of or on the dates indicated and do not purport to represent a projection of our future results.

| | Year Ended December 31, | | | Three Months Ended March 31, | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2004 | 2005 |
| | (in thousands, except share and per share data) | | | | |
| | | | | (unaudited) | (unaudited) |
| | (Restated*) | (Restated*) | (Restated*) | (Restated*) | |
| **Statement of Operations Data:** | | | | | |
| Revenue: | | | | | |
| Gross processing revenue | $ 330,975 | $ 414,715 | $ 595,524 | $ 119,202 | $ 166,172 |
| Other revenue, net | 9,607 | 7,522 | 7,225 | 2,002 | 3,693 |
| Total net revenue | 340,582 | 422,237 | 602,749 | 121,204 | 169,865 |
| Costs of services: | | | | | |
| Interchange | 242,407 | 302,057 | 438,738 | 86,372 | 122,416 |
| Dues and assessments | 12,616 | 15,945 | 23,348 | 4,785 | 6,415 |
| Processing and servicing | 44,224 | 50,805 | 70,232 | 14,748 | 19,820 |
| Customer acquisition costs | 12,422 | 13,380 | 18,908 | 4,135 | 5,841 |
| Depreciation and amortization | 1,587 | 2,571 | 3,912 | 876 | 1,283 |
| Total costs of services | 313,256 | 384,758 | 555,138 | 110,916 | 155,775 |
| Selling and administrative | 20,786 | 25,751 | 31,501 | 7,233 | 8,989 |
| Total expenses | 334,042 | 410,509 | 586,639 | 118,149 | 164,764 |
| Income from operations | 6,540 | 11,728 | 16,110 | 3,055 | 5,101 |
| Other income (expense): | | | | | |
| Interest income | 171 | 124 | 182 | 38 | 110 |
| Interest expense | (1,182) | (1,188) | (1,385) | (298) | (435) |
| Fair value adjustment for warrants with mandatory redemption provisions | (509) | (893) | (509) | | (90) |
| Other, net | (62) | (740) | 833 | 833 | (3) |
| Total other income (expense) | (1,582) | (2,697) | (879) | 573 | (418) |
| Income before income taxes | 4,958 | 9,031 | 15,231 | 3,628 | 4,683 |
| Provision for (benefit from) income taxes | 51 | (11,102) | 6,376 | 1,482 | 1,989 |
| Net income | $ 4,907 | $ 20,133 | $ 8,855 | $ 2,146 | $ 2,694 |
| Accretion of Series A Senior Convertible Participating Preferred Stock | (6,509) | | | | |
| Income allocated to Series A Senior Convertible Participating Preferred Stock | | (9,843) | (4,263) | (1,037) | (1,295) |
| Net (loss) income attributable to common stock | $ (1,602) | $ 10,290 | $ 4,592 | $ 1,109 | $ 1,399 |
| (Loss) earnings per share: | | | | | |
| Basic | $ (0.10) | $ 0.65 | $ 0.28 | $ 0.07 | $ 0.09 |
| Diluted | $ (0.10) | $ 0.62 | $ 0.26 | $ 0.07 | $ 0.08 |
| Weighted average number of shares outstanding: | | | | | |
| Basic | 15,642,356 | 15,931,626 | 16,407,554 | 16,295,846 | 16,449,452 |

| | Year Ended December 31, | | | Three Months Ended March 31, | |
|---|---|---|---|---|---|
| Diluted | 15,642,356 | 32,230,708 | 33,785,760 | 32,870,764 | 34,671,796 |
| **Other:** | | | | | |
| Number of active merchants (at period end) | 53 | 67 | 89 | 72 | 94 |
| Processing volume for period | $ 14,391,628 | $ 17,914,893 | $ 24,986,790 | $ 5,125,939 | $ 6,877,850 |

| | March 31, 2005 | | |
|---|---|---|---|
| | **Actual** | **Pro Forma** | **Pro Forma As Adjusted** |
| | **(unaudited)** | **(in thousands)** | |
| | **(Restated*)** | | |
| **Balance Sheet Data:** | | | |
| Cash and cash equivalents | $ 12,706 | $ 12,706 | $ 49,280 |
| Receivables | 64,664 | 64,664 | 64,664 |
| Total assets | 136,392 | 136,392 | 172,966 |
| Due to sponsor bank | 45,465 | 45,465 | 45,465 |
| Accounts payable | 26,891 | 26,891 | 26,891 |
| Total liabilities | 127,562 | 127,562 | 124,709 |
| Total stockholders' equity | 8,830 | 8,830** | 48,256 |

* As discussed in Note 21 of the accompanying consolidated financial statements, the consolidated financial statements for 2002, 2003, 2004 and the three months ended March 31, 2004 and the consolidated balance sheet as of March 31, 2005 have been restated.

** For details of the pro forma stockholder equity accounts, please see "Capitalization."

## RISK FACTORS

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

### Risks Relating to Our Business

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

The market for payment processing services is highly competitive. Other providers of payment processing services have established a sizable market share in the small- and medium-size merchant processing sector. Maintaining our historic growth will depend on a combination of the continued growth in electronic payment transactions and our ability to increase our market share. According to The Nilson Report, in 2004 the eight largest bank card acquirers accounted for approximately $1.4 trillion of purchase volume (which we refer to as processing volume) on bank cards and the total purchase volume of all bank card acquirers was $1.5 trillion. We accounted for approximately 1.8% of this total volume in 2004. This competition may influence the prices we are able to charge. If the competition causes us to reduce the prices we charge, we will have to aggressively control our costs in order to maintain acceptable profit margins. In addition, some of our competitors are financial institutions, subsidiaries of financial institutions or well-established payment processing companies, including First Data Merchant Services Corporation, National Processing, Inc., a subsidiary of Bank of America Corporation, Global Payments, Inc., Fifth Third Bank and Nova Information Systems, Inc., a subsidiary of U.S. Bancorp. Our competitors that are financial institutions or subsidiaries of financial institutions do not incur the costs associated with being sponsored by a bank for registration with the card associations and can settle transactions more quickly for their merchants than we can for ours. Some of these competitors have substantially greater financial, technology, management and marketing resources than we have. This may allow our competitors to offer more attractive fees to our current and prospective merchants, requiring us to keep a tighter control on costs in order to maintain current operating margins. We currently do not anticipate acquiring or merging with a financial institution in order to increase our competitiveness.

**We are subject to the business cycles and credit risk of our merchants, which could negatively impact our financial results.**

A recessionary economic environment could have a negative impact on our merchants, which could, in turn, negatively impact our financial results, particularly if the recessionary environment disproportionately affects some of the market segments that represent a larger portion of our processing volume, like restaurants. If our merchants make fewer sales of their products and services, we will have fewer transactions to process, resulting in lower revenue. In addition, we have a certain amount of fixed and semi-fixed costs, including rent, processing contractual minimums and salaries, which could limit our ability to quickly adjust costs and respond to changes in our business and the economy.

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

While we service a broad range of merchants, restaurants represent a significant portion of our merchant base. The failure rate of restaurants is typically high, which increases our merchant attrition and reject losses. A reduction in consumer spending, particularly at restaurants, would further increase our rate of merchant attrition and reject losses.

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

In the event a billing dispute between a cardholder and a merchant is not resolved in favor of the merchant, the transaction is normally "charged back" to the merchant and the purchase price is credited or otherwise refunded to the cardholder. If we or our clearing banks are unable to collect such amounts from the merchant's account, or if the merchant refuses or is unable, due to closure, bankruptcy or other reasons, to reimburse us for the chargeback, we bear the loss for the amount of the refund paid to the cardholder. The risk of chargebacks is typically greater with those merchants that promise future delivery of goods and services rather than delivering goods or rendering services at the time of payment. There can be no assurance that we will not experience significant losses from chargebacks in the future. Any increase in chargebacks not paid by our merchants may adversely affect our financial condition and results of operations.

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

We incurred charges relating to chargebacks and reject losses of $561,928, $605,256, $939,500 and $299,714 in the years ended December 31, 2002, 2003 and 2004 and the quarter ended March 31, 2005, respectively.

**We have faced, and will in the future face, merchant fraud, which could have an adverse effect on our operating results and financial condition.**

We have potential liability for fraudulent bank card transactions initiated by merchants. Merchant fraud occurs when a merchant knowingly uses a stolen or counterfeit bank card or card number to record a false sales transaction, processes an invalid bank card or intentionally fails to deliver the merchandise or services sold in an otherwise valid transaction. Examples of merchant fraud we have faced include a manager of a franchised motel who applied for a merchant account that proved to be a second account for that motel, and processed duplicate charges in his office, and an antique repair service owner who continued accepting deposits on cards for repairs, but stopped doing the repairs. We have established systems and procedures designed to detect and reduce the impact of merchant fraud, but we cannot assure you that these measures are or will be effective. It is possible that incidents of fraud could increase in the future. Failure to effectively manage risk and prevent fraud would increase our chargeback liability. Increases in chargebacks could have an adverse effect on our operating results and financial condition.

**Increased merchant attrition that we cannot anticipate or offset with increased processing volume or new accounts would cause our revenues to decline.**

We experience attrition in merchant processing volume in the ordinary course of business 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 relating to, and contract breaches by, merchants. During 2003, 2004 and the first quarter of 2005, we experienced average attrition of less than 1% of total processing volume per month. Substantially all of our processing contracts may be terminated by either party on relatively short notice. Increased attrition in merchant processing volume may have an adverse effect on our financial condition and results of operations. We cannot predict the level of attrition in the future. If we are unable to establish accounts with new merchants or otherwise increase our processing volume in order to counter the effect of this attrition, our revenues will decline.

**We rely on a bank sponsor, which has substantial discretion with respect to certain elements of our business practices, including sponsorship in the bank card associations, in order to process bank card transactions. If this sponsorship is terminated and we are unable to secure new bank sponsors, we will not be able to conduct our business.**

Substantially all of our revenue is derived from Visa and MasterCard bank card transactions. Because we are not a bank, we are not eligible for membership in the Visa and MasterCard associations and are, therefore, unable to directly access the bank card association networks, which are required to process Visa and MasterCard transactions. Visa and MasterCard operating regulations require us to be sponsored by a bank in order to process bank card transactions. We are currently registered with Visa and MasterCard through KeyBank National Association, which has maintained that registration since 1999. If we or our bank sponsor fail to comply with the applicable requirements of the Visa and MasterCard bank card associations, Visa or MasterCard could suspend or terminate our registration. The bank card associations frequently amend their requirements. If we or our sponsoring bank were unable to comply with any such amended requirements, Visa or MasterCard could suspend or terminate our registration. On occasion, we have received notices of non-compliance, which have typically related to excessive chargebacks for a merchant or data security failures on the part of a merchant.

The termination of our registration, or any changes in the Visa or MasterCard rules that would impair our registration, could require us to stop providing Visa and MasterCard payment processing services, which would make it impossible for us to conduct our business. In addition, if our sponsorship is terminated and we are unable to secure another bank sponsor or sponsors, we will not be able to process Visa and MasterCard transactions. Furthermore, our agreement with KeyBank gives it substantial discretion in approving certain aspects of our business practices, including our solicitation, application and qualification procedures for merchants, the terms of our agreements with merchants and our customer service levels. We cannot guarantee that KeyBank's actions under this agreement will not be detrimental to our operations.

**Current or future bank card association rules and practices could adversely affect our business.**

We are registered with the Visa and MasterCard associations through our bank sponsor as an Independent Sales Organization with Visa and a Member Service Provider with MasterCard. In addition, we are a sales agent for Discover, American Express and Diners Club. The rules of the bank card associations are set by member banks and, in the case of Discover, American Express and Diners Club, by the card issuers, and some of those banks and issuers are our competitors with respect to these processing services. Many banks directly or indirectly sell processing services to merchants in direct competition with us. These banks could attempt, by virtue of their membership in the associations, to alter the associations' rules or policies to the detriment of non-members like us. Discover, American Express and Diners Club also sell processing services for their cardholders to merchants. We cannot assure you that the bank card associations or issuers will maintain our registrations or arrangements or that the current bank card association or issuer rules allowing us to market and provide payment processing services will remain in effect. The termination of our registration or our status as an Independent Sales Organization or Member Service Provider, or any changes in card association or issuer rules that limit our ability to provide payment processing services, could have an adverse effect on our processing volumes, revenues or operating costs. In addition, if we were precluded from processing Visa and MasterCard bank card transactions, we would lose substantially all of our revenues.

**Our systems and our third-party providers' systems may fail due to factors beyond our control, which could interrupt our service, cause us to lose business and increase our costs.**

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

- loss of revenues;
- loss of merchants, although our contracts with merchants do not expressly provide a right to terminate for business interruptions;
- loss of merchant and cardholder data;
- harm to our business or reputation;
- exposure to fraud losses or other liabilities;
- negative publicity;
- additional operating and development costs; and/or
- diversion of technical and other resources.

**We rely on other payment processors and service providers; if they no longer agree to provide their services, our merchant relationships could be adversely affected and we could lose business.**

We rely on agreements with several other large payment processing organizations to enable us to provide bank card authorization, data capture, settlement and merchant accounting services and access to various reporting tools for the merchants we serve. These organizations include First Data Corporation, Paymentech Network Services, Inc. and Global Payments Inc. who also directly or indirectly sell payment processing services to merchants in competition with us. We rely primarily on Vital Processing Services, which provides all of our back-end and the majority of our front-end processing needs under a contract that expires in 2006. We also rely on third parties to whom we outsource specific services, such as organizing and accumulating daily transaction data on a merchant-by-merchant and card issuer-by-card issuer basis and forwarding the accumulated data to the relevant bank card associations. Some of these organizations and service providers are our competitors and, with the exception of Vital, we do not have any long-term contracts with them. Typically, our contracts with these third parties are for one-year terms, have automatic one-year renewals and are subject to cancellation upon limited notice by either party.

The termination by our service providers of their arrangements with us or their failure to perform their services efficiently and effectively may adversely affect our relationships with our merchants and, if we cannot find alternate providers quickly, may cause those merchants to terminate their processing agreements with us.

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

Adverse economic or other conditions in California, New York and Florida would negatively affect our revenue and could materially and adversely affect our results of operations. In March 2005, merchants in California represented 15.8%, in New York represented 6.2%, and in Florida represented 6.8% of our total processing volume. As a result of this geographic concentration of our merchants in these markets, we are particularly exposed to the risks of downturns in these local economies and to

other local conditions, which could adverserly affect the operating results of our merchants in these markets.

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

We are dependent upon the ability and experience of a number of our key personnel who have substantial experience with our operations, the rapidly changing payment processing industry and the selected markets in which we offer our services. It is possible that the loss of the services of one or a combination of our senior executives or key managers, particularly Robert O. Carr, our Chief Executive Officer, would have an adverse effect on our operations. None of our senior executives or key managers have entered into employment agreements with us. Our success also depends on our ability to continue to attract, manage and retain other qualified middle management and technical and clerical personnel as we grow. We cannot assure you that we will continue to attract or retain such personnel.

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

Unlike many of our competitors who rely on Independent Sales Organizations or salaried salespeople and telemarketers, we rely on a direct sales force whose compensation is entirely commission-based. Through our direct sales force of approximately 800 Relationship Managers, we seek to increase the number of merchants using our products and services. We intend to significantly increase the size of our sales force. Our success partially depends on the skill and experience of our sales force. If we are unable to retain and attract sufficiently experienced and capable Relationship Managers, our business and financial results may suffer.

**If we cannot pass increases in bank card association interchange fees along to our merchants, our operating margins will be reduced.**

We pay interchange fees set by the bank card associations to the card issuing bank for each transaction we process involving their bank cards. From time to time, the bank card associations increase the interchange fees that they charge payment processors and the sponsoring banks. For example, in 2004, Visa increased its interchange fees for retail transactions by 0.11%. At its sole discretion, our sponsoring bank has the right to pass any increases in interchange fees on to us and it has consistently done so in the past. We are allowed to, and in the past we have been able to, pass these fee increases along to our merchants through corresponding increases in our processing fees. However, if we are unable to do so in the future, our operating margins will be reduced.

**Any acquisitions or portfolio buyouts that we make could disrupt our business and harm our financial condition.**

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

We also regularly buy out the residual commissions of our Relationship Managers and sales managers, at multiples that typically amount to 2 to $2^1/_2$ years of such commissions. If the merchants included in the portfolios we purchase do not generate sufficient incremental margin after the purchase, we will not achieve a positive return on the cash expended.

**Unauthorized disclosure of merchant and cardholder data, whether through breach of our computer systems or otherwise, could expose us to liability and protracted and costly litigation.**

We collect and store sensitive data about merchants, including names, addresses, social security numbers, driver's license numbers and checking account numbers. In addition, we maintain a database of cardholder data relating to specific transactions, including bank card numbers, in order to process the transactions and for fraud prevention. In the last twelve months we have been notified by Visa or MasterCard of six possible compromises of cardholder information retained by our merchants. Two of those incidents resulted in fines to us, each of which was recovered from our merchants. In each of those two incidents, less than 1,400 accounts may have been compromised, and we are unaware of any fraudulent activity resulting from either merchant data compromise. Any significant incidents of loss of cardholder data by us or our merchants could result in significant fines and sanctions by Visa, MasterCard or governmental bodies, which could have a material adverse effect upon our financial position and/or operations. In addition, a significant breach could result in our being prohibited from processing transactions for Visa and MasterCard.

We cannot guarantee that our computer systems will not be penetrated by hackers. If a breach of our system occurs, we may be subject to liability, including claims for unauthorized purchases with misappropriated bank card information, impersonation or other similar fraud claims. We could also be subject to liability for claims relating to misuse of personal information, such as unauthorized marketing purposes. These claims also could result in protracted and costly litigation. In addition, we could be subject to penalties or sanctions from the Visa and MasterCard associations.

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

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

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

**We face uncertainty about additional finan**