ALLIANCE DATA SYSTEMS CORP
Form 10-Q
November 07, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from to

Commission File Number: 001-15749

ALLIANCE DATA SYSTEMS CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Delaware	31-1429215
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

7500 Dallas Parkway, Suite 700
Plano, Texas 75024
(Address of Principal Executive Office, Including Zip Code)

(214) 494-3000
(Registrant’s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required 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 R No £

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

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

Large accelerated filer R	Accelerated filer £
Non-accelerated filer £ (Do not check if a smaller reporting company)	Smaller reporting company £

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes £ No R

As of November 2, 2011, 49,968,460 shares of common stock were outstanding.

ALLIANCE DATA SYSTEMS CORPORATION

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PART I

Item 1. Financial Statements.

ALLIANCE DATA SYSTEMS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2011	December 31, 2010
	(In thousands)	
ASSETS		
Cash and cash equivalents	$ 239,570	$ 139,114
Trade receivables, less allowance for doubtful accounts ($3,835 and $4,350 at September 30, 2011 and December 31, 2010, respectively)	265,156	260,945
Credit card receivables:		
Credit card receivables – restricted for securitization investors	4,342,167	4,795,753
Other credit card receivables	632,660	560,670
Total credit card receivables	4,974,827	5,356,423
Allowance for loan loss	(448,665)	(518,069)
Credit card receivables, net	4,526,162	4,838,354
Deferred tax asset, net	251,820	279,752
Other current assets	166,125	127,022
Redemption settlement assets, restricted	448,634	472,428
Assets of discontinued operations	3,851	11,920
Total current assets	5,901,318	6,129,535
Property and equipment, net	182,069	170,627
Deferred tax asset, net	44,737	46,218
Cash collateral, restricted	654,705	185,754
Intangible assets, net	403,269	314,391
Goodwill	1,442,696	1,221,823
Other non-current assets	141,126	203,804
Total assets	$ 8,769,920	$ 8,272,152
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$ 122,055	$ 121,856
Accrued expenses	223,449	168,578
Certificates of deposit	752,532	442,600
Asset-backed securities debt – owed to securitization investors	1,769,122	1,743,827
Current debt	19,834	255,679
Other current liabilities	99,836	85,179
Deferred revenue	995,122	1,044,469
Total current liabilities	3,981,950	3,862,188
Deferred revenue	179,195	176,773
Deferred tax liability, net	112,216	82,637
Certificates of deposit	616,473	416,500
Asset-backed securities debt – owed to securitization investors	1,314,165	1,916,315
Long-term and other debt	2,234,386	1,614,093
Other liabilities	185,520	180,552

Total liabilities	8,623,905	8,249,058
Commitments and contingencies (Note 17)		
Stockholders' equity:		
Common stock, $0.01 par value; authorized, 200,000 shares; issued, 93,977 shares and 92,797 shares at September 30, 2011 and December 31, 2010, respectively	940	928
Additional paid-in capital	1,365,235	1,320,767
Treasury stock, at cost, 43,739 shares and 41,426 shares at September 30, 2011 and December 31, 2010, respectively	(2,267,553)	(2,079,819)
Retained earnings	1,065,098	815,718
Accumulated other comprehensive loss	(17,705)	(34,500)
Total stockholders' equity	146,015	23,094
Total liabilities and stockholders' equity	$ 8,769,920	$ 8,272,152

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except per share amounts)			
Revenues				
Transaction	$ 74,712	$ 68,150	$ 221,352	$ 214,092
Redemption	141,152	120,424	424,254	386,810
Finance charges, net	365,925	327,677	1,040,339	953,303
Database marketing fees and direct marketing services	230,350	167,083	565,324	427,246
Other revenue	32,705	19,109	74,469	54,247
Total revenue	844,844	702,443	2,325,738	2,035,698
Operating expenses				
Cost of operations	476,993	385,201	1,312,768	1,104,913
Provision for loan loss	70,697	89,559	198,739	272,259
General and administrative	26,242	19,767	68,202	63,440
Depreciation and other amortization	20,304	17,196	53,908	50,101
Amortization of purchased intangibles	22,929	20,711	60,743	56,398
Total operating expenses	617,165	532,434	1,694,360	1,547,111
Operating income	227,679	170,009	631,378	488,587
Interest expense				
Securitization funding costs	30,233	43,026	96,281	128,251
Interest expense on certificates of deposit	5,645	7,317	16,832	23,519
Interest expense on long-term and other debt, net	38,478	33,776	111,496	98,903
Total interest expense, net	74,356	84,119	224,609	250,673
Income before income tax	$ 153,323	$ 85,890	$ 406,769	$ 237,914
Provision for income taxes	59,342	32,831	157,389	90,881
Net income	$ 93,981	$ 53,059	$ 249,380	$ 147,033
Basic income per share	$ 1.86	$ 1.01	$ 4.89	$ 2.79
Diluted income per share	$ 1.60	$ 0.96	$ 4.35	$ 2.63
Weighted average shares				
Basic	50,644	52,584	50,948	52,743
Diluted	58,579	55,218	57,377	55,820

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 249,380	$ 147,033
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	114,651	106,499
Deferred income taxes	(221)	24,044
Provision for loan loss	198,739	272,259
Non-cash stock compensation	32,471	33,996
Fair value (gain) loss on interest-rate derivatives	(23,146)	5,443
Amortization of discount on convertible senior notes	54,574	48,914
Change in operating assets and liabilities, net of acquisitions:		
Change in trade accounts receivable	1,188	(20,927)
Change in other assets	43,402	36,975
Change in accounts payable and accrued expenses	44,739	33,220
Change in deferred revenue	15,869	9,079
Change in other liabilities	37,411	13,551
Excess tax benefits from stock-based compensation	(12,103)	(12,713)
Other	5,546	(3,869)
Net cash provided by operating activities	762,500	693,504
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in redemption settlement assets	4,353	21,964
Payments for acquired businesses, net of cash	(359,076)	(117,000)
Change in cash collateral, restricted	(468,690)	12,530
Change in credit card receivables	160,592	273,925
Change in restricted cash	98,408	24,064
	(42,696)	—

Purchase of credit card receivables		
Capital expenditures	(48,536)	(48,296)
Investments in marketable securities, net	(68,191)	(4,950)
Investments in the stock of investees	(17,974)	—
Other	—	1,918
Net cash (used in) provided by investing activities	(741,810)	164,155
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under debt agreements	2,858,500	1,205,000
Repayments of borrowings	(2,524,729)	(1,089,549)
Issuances of certificates of deposit	842,505	94,000
Repayments of certificates of deposit	(332,600)	(592,200)
Borrowings from asset-backed securities	1,126,921	833,126
Repayments/maturities of asset-backed securities	(1,703,776)	(1,157,235)
Payment of capital lease obligations	(3,920)	(17,272)
Payment of deferred financing costs	(27,366)	(3,025)
Excess tax benefits from stock-based compensation	12,103	12,713
Proceeds from issuance of common stock	22,942	31,848
Purchase of treasury shares	(186,320)	(76,742)
Net cash provided by (used in) financing activities	84,260	(759,336)
Effect of exchange rate changes on cash and cash equivalents	(4,494)	(2,028)
Change in cash and cash equivalents	100,456	96,295
Cash effect on adoption of ASC 860 and ASC 810	—	81,553
Cash and cash equivalent at beginning of period	139,114	213,378
Cash and cash equivalents at end of period	$ 239,570	$ 391,226
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 177,301	$ 176,335
Income taxes paid, net	$ 87,185	$ 26,497

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements included herein have been prepared by Alliance Data Systems Corporation ("ADSC" or, including its wholly owned subsidiaries and its consolidated variable interest entities, the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report filed on Form 10-K for the year ended December 31, 2010, filed with the SEC on February 28, 2011. With respect to information concerning principal geographic areas, revenues are attributed to respective countries based on the location of the subsidiary, which generally correlates with the location of the customer.

The unaudited condensed consolidated financial statements included herein reflect all adjustments (consisting of normal, recurring adjustments) which are, in the opinion of management, necessary to state fairly the results for the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for the fiscal year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect (1) the reported amounts of assets; (2) liabilities and disclosure of contingent assets and liabilities at the date of the financial statements; and (3) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. For purposes of comparability, fraud losses of $0.9 million and $2.8 million for the three and nine months ended September 30, 2010, respectively, have been reclassified from provision for loan loss to cost of operations in the prior period financial statements to conform to the current year presentation. Such reclassifications have no impact on previously reported net income.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In October 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2009-13, "Multiple-Deliverable Revenue Arrangements," which supersedes certain guidance in Accounting Standards Codification ("ASC") 605-25, "Revenue Recognition — Multiple-Element Arrangements," and requires an entity to allocate arrangement consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices (the relative-selling-price method). ASU 2009-13 eliminates the use of the residual method of allocation and requires the relative-selling-price method in all circumstances in which an entity recognizes revenue for an arrangement with multiple deliverables subject to ASU 2009-13. ASU 2009-13 is effective for revenue arrangements entered into or materially modified beginning on or after January 1, 2011. The Company elected to adopt this ASU prospectively. Revenue associated with the service element of the Company's AIR MILES® Reward Program has historically been determined using the residual method. Based on the sponsor contracts expected to be signed, renewed or materially modified in 2011, the adoption of ASU 2009-13 did not and is not expected to have a material impact on the Company's unaudited condensed consolidated financial statements for 2011. Should one of the AIR MILES Reward Program's top five sponsors materially modify its agreement with the Company in 2011, it could significantly shift the allocation of deferred revenue between the service element and redemption element. This change in allocation between the deferred revenue elements could impact the timing of revenue recognition, as the redemption element is recognized as AIR MILES reward miles are redeemed while the service element is recognized on a pro-rata basis over the estimated life of an AIR MILES reward mile, or 42 months.

In April 2011, the FASB issued ASU 2011-02, “Receivables (Topic 310): A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring.” ASU 2011-02 provides additional guidance to creditors for evaluating whether a modification or restructuring of a receivable is a Troubled Debt Restructuring (“TDR”) and also requires additional disclosures about TDR activities along with the disclosures required by ASU 2010-20, “Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses,” that were previously deferred. The amendments in ASU 2011-02 were effective for the first interim or annual period beginning on or after June 15, 2011 and are applied retrospectively to the beginning of the annual period of adoption. For purposes of measuring impairment of receivables that are newly considered impaired as a

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

result of ASU 2011-02, the amendments are applied prospectively for the first interim or annual period beginning on or after June 15, 2011. The adoption of ASU 2011-02 did not have a material impact on the Company's financial condition, results of operations or cash flows.

In May 2011, the FASB issued ASU 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ("IFRS")", which amends ASC 820, "Fair Value Measurement." ASU 2011-04 revises the application of the valuation premise of highest and best use of an asset. It also enhances disclosure requirements and will require entities to disclose, for their recurring Level 3 fair value measurements, quantitative information about unobservable inputs used, a description of the valuation processes used by the entity and a qualitative discussion about the sensitivity of the measurements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011 and will require prospective application. The Company does not expect the adoption of ASU 2011-04 to have a material impact on the Company's financial condition, results of operations or cash flows.

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income." ASU 2011-05 eliminates the current option to report other comprehensive income and its components in the statement of changes in equity and requires the presentation of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. ASU 2011-05 is effective for interim and annual periods beginning after December 31, 2011. Early adoption is permitted but full retrospective application is required. ASU 2011-05 only impacts financial statement presentation; accordingly, it will have no impact on the Company's financial condition, results of operations or cash flows.

In September 2011, the FASB issued ASU 2011-08, "Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment," which amends ASC 350, "Intangibles – Goodwill and Other." ASU 2011-08 adds a qualitative assessment to the annual goodwill impairment test, providing the option of first performing a qualitative assessment in testing goodwill for impairment before calculating the fair value of the reporting unit. A company will be required to perform the current quantitative two-step impairment test if, based on the qualitative assessment, it determines that more likely than not, the fair value of the reporting unit is not less than the carrying value. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. ASU 2011-08 only impacts the process of testing goodwill for impairment; accordingly, it will have no impact on the Company's financial condition, results of operations or cash flows.

3. SHARES USED IN COMPUTING NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except per share amounts)			
Numerator:				
Net Income	$ 93,981	$ 53,059	$ 249,380	$ 147,033
Denominator:				
Weighted average shares, basic	50,644	52,584	50,948	52,743
Weighted average effect of dilutive securities:				
	5,138	1,454	4,195	1,785

Shares from assumed conversion of convertible senior notes								
Shares from assumed conversion of convertible note warrants		1,750		—		1,306		—
Net effect of dilutive stock options and unvested restricted stock		1,047		1,180		928		1,292
Denominator for diluted calculations		58,579		55,218		57,377		55,820
Basic net income per share	$	1.86	$	1.01	$	4.89	$	2.79
Diluted net income per share	$	1.60	$	0.96	$	4.35	$	2.63

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company calculates the effect of its convertible senior notes, consisting of $805.0 million aggregate principal amount of convertible senior notes due 2013 (the "Convertible Senior Notes 2013") and $345.0 million aggregate principal amount of convertible senior notes due 2014 (the "Convertible Senior Notes 2014"), which can be settled in cash or shares of common stock, on diluted net income per share as if they will be settled in cash as the Company has the intent to settle the convertible senior notes in cash.

Concurrently with the issuance of the Convertible Senior Notes 2013 and the Convertible Senior Notes 2014, the Company entered into hedge transactions which are generally expected to offset the potential dilution of the shares from assumed conversion of convertible senior notes.

The Company is also party to prepaid forward contracts to purchase 1,857,400 shares of its common stock that are to be delivered over a settlement period in 2014. The number of shares to be delivered under the prepaid forward contracts is used to reduce weighted-average basic and diluted shares outstanding.

For the three and nine months ended September 30, 2011, the Company excluded 10.3 million warrants, respectively, from the calculation of net income per share as the effect was anti-dilutive. For the three and nine months ended September 30, 2010, the Company excluded 17.5 million warrants, respectively, from the calculation of net income per share as the effect was anti-dilutive.

4. ACQUISITION

On May 31, 2011, the Company acquired all of the stock of Aspen Marketing Holdings, Inc. ("Aspen"). Aspen specializes in a full range of digital and direct marketing services, including the use of advanced analytics to perform data-driven customer acquisition and retention campaigns. Aspen is also a leading provider of marketing agency services, with expertise in the automotive and telecommunications industries. The results of Aspen have been included since the date of acquisition and are reflected in the Company's Epsilon® segment. The acquisition enhances Epsilon's core capabilities, strengthens its competitive advantage, expands Epsilon into new industry verticals and adds a strong, talented team of marketing professionals.

The final purchase price for Aspen was $359.1 million, net of $13.5 million of cash and cash equivalents acquired. The purchase was subject to customary working capital adjustments, which were finalized in August 2011, resulting in a $0.9 million increase to goodwill. The goodwill resulting from the acquisition is not deductible for tax purposes. The following table summarizes the allocation of the consideration and the respective fair values of the assets acquired and liabilities assumed in the Aspen acquisition as of the date of purchase:

	As of May 31, 2011 (In thousands)
Current assets	$ 39,924
Property and equipment	4,829
Other assets	1,600
Capitalized software	24,000
Intangible assets	140,000
Goodwill	232,910
Total assets acquired	443,263

Current liabilities		30,099
Other liabilities		3,904
Deferred tax liabilities		50,184
Total liabilities assumed		84,187
Net assets acquired	$	359,076

As part of the acquisition, the Company assumed two interest rate caps with a notional amount of $42.5 million that were to mature November 2012. The derivatives did not qualify for hedge accounting treatment and were terminated in July 2011. The fair value of the derivatives from May 31, 2011 through termination was de minimis.

Additionally, at the date of the acquisition, Aspen had a tax net operating loss carryforward totaling approximately $140 million resulting from a previous merger. This potential tax benefit is contingent on the prior merger qualifying as a reorganization under Internal Revenue Code section 368. At this time, the potential tax benefits from the tax net operating loss carryforward have not been recognized in the Company's unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

5. CREDIT CARD RECEIVABLES

The Company's credit card receivables are the only portfolio segment or class of financing receivables. Quantitative information about the components of total credit card receivables is presented in the table below:

	September 30, 2011	December 31, 2010
	(In thousands)	
Principal receivables	$ 4,741,569	$ 5,116,111
Billed and accrued finance charges	205,412	214,643
Other receivables	27,846	25,669
Total credit card receivables	4,974,827	5,356,423
Less credit card receivables – restricted for securitization investors	4,342,167	4,795,753
Other credit card receivables	$ 632,660	$ 560,670

Allowance for Loan Loss

The Company maintains an allowance for loan loss at a level that is appropriate to absorb probable losses inherent in credit card receivables. The allowance for loan loss covers forecasted uncollectable principal as well as unpaid interest and fees. The allowance for loan loss is evaluated monthly for adequacy.

In estimating the allowance for principal loan losses, management utilizes a migration analysis of delinquent and current credit card receivables. Migration analysis is a technique used to estimate the likelihood that a credit card receivable will progress through the various stages of delinquency and to charge-off. The allowance is maintained through an adjustment to the provision for loan losses. Charge-offs of principal amounts, net of recoveries are deducted from the allowance.

Net charge-offs include the principal amount of losses from credit cardholders unwilling or unable to pay their account balances, as well as bankrupt and deceased credit cardholders, less recoveries and exclude charged-off interest, fees and fraud losses. Charged-off interest and fees reduce finance charges, net while fraud losses are recorded as an expense. Credit card receivables, including unpaid interest and fees, are charged-off at the end of the month during which an account becomes 180 days contractually past due, except in the case of customer bankruptcies or death. Credit card receivables, including unpaid interest and fees, associated with customer bankruptcies or death are charged-off at the end of each month subsequent to 60 days after the receipt of notification of the bankruptcy or death, but in any case, not later than the 180-day contractual time frame.

The Company records the actual charge-offs for unpaid interest and fees as a reduction to finance charges, net. For the three and nine months ended September 30, 2011 and 2010, actual charge-offs for unpaid interest and fees were $43.3 million, $147.8 million and $49.3 million, $163.8 million, respectively. In estimating the allowance for uncollectable unpaid interest and fees, the Company utilizes historical charge-off trends, analyzing actual charge-offs for the prior three months. The allowance is maintained through an adjustment to finance charges, net.

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In evaluating the allowance for loan loss for both principal and unpaid interest and fees, management also considers factors that may impact loan loss experience, including seasoning, loan volume and amounts, payment rates and forecasting uncertainties. The following table presents the Company's allowance for loan loss for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Balance at beginning of period	$ 461,015	$ 526,845	$ 518,069	$ 54,884
Adoption of ASC 860 and ASC 810	—	—	—	523,950
Provision for loan loss	70,697	89,559	198,739	272,259
Change in estimate for uncollectible unpaid interest and fees	(5,000)	—	(5,000)	—
Recoveries	20,858	18,762	68,600	61,546
Principal charge-offs	(93,905)	(120,870)	(326,743)	(398,343)
Other	(5,000)	—	(5,000)	—
Balance at end of period	$ 448,665	$ 514,296	$ 448,665	$ 514,296

Delinquencies

A credit card account is contractually delinquent if the Company does not receive the minimum payment by the specified due date on the cardholder's statement. It is the Company's policy to continue to accrue interest and fee income on all credit card accounts beyond 90 days, except in limited circumstances, until the credit card account balance and all related interest and other fees are paid or charged off, typically at 180 days delinquent. When an account becomes delinquent, a message is printed on the credit cardholder's billing statement requesting payment. After an account becomes 30 days past due, a proprietary collection scoring algorithm automatically scores the risk of the account becoming further delinquent. The collection system then recommends a collection strategy for the past due account based on the collection score and account balance and dictates the contact schedule and collections priority for the account. If the Company is unable to make a collection after exhausting all in-house collection efforts, the Company will engage collection agencies and outside attorneys to continue those efforts.

The following table presents the delinquency trends of the Company's credit card portfolio:

	September 30, 2011	% of Total	December 31, 2010	% of Total
	(In thousands, except percentages)			
Receivables outstanding – principal	$ 4,741,569	100%	$ 5,116,111	100%
Principal receivables balances contractually delinquent:				
31 to 60 days	79,154	1.6%	87,252	1.7%
61 to 90 days	50,624	1.1	59,564	1.2
91 or more days	103,230	2.2	130,538	2.5
Total	$ 233,008	4.9%	$ 277,354	5.4%

Modified Credit Card Receivables

The Company holds certain credit card receivables for which the terms have been modified. Interest income on these modified loans is accounted for in the same manner as other accruing loans. Cash collections on these modified loans are allocated according to the same payment hierarchy methodology applied to loans that are not in such programs. The Company's modified credit card loans include loans for which temporary hardship concessions have been granted and loans in permanent workout programs. These modified loans include concessions consisting primarily of a reduced minimum payment and an interest rate reduction. The temporary programs' concessions remain in place for a period no longer than twelve months, while the permanent programs remain in place through the payoff of the loan if the credit cardholder complies with the terms of the program. These concessions do not include the forgiveness of unpaid principal, but may involve the reversal of certain unpaid interest or fee assessments. In the case of the temporary programs, at the end of the concession period, loan terms revert to standard rates. These arrangements are automatically terminated if the customer fails to make payments in accordance with the terms of the program, at which time their account reverts back to its original terms. In assessing the appropriate allowance for loan loss, these loans are included in the general pool of credit

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cards with the allowance determined under the contingent loss model of ASC 450-20, “Loss Contingencies.” If the Company applied accounting standards under ASC 310-40, “Troubled Debt Restructurings by Creditors,” to loans in these programs, there would not be a significant difference in the allowance for loan loss. Credit card receivables for which temporary and permanent concessions were granted comprised $126.2 million, or less than 3%, of the Company’s total credit card receivables at September 30, 2011.

The following tables indicate the modifications related to troubled debt restructurings within credit card receivables as of the three and nine months ended September 30, 2011:

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Number of Restructurings	Pre-modification Outstanding Principal Balance	Post-modification Outstanding Principal Balance	Number of Restructurings	Pre-modification Outstanding Principal Balance	Post-modification Outstanding Principal Balance
	(Dollars in thousands)					
Troubled debt restructurings – credit card receivables	36,576	$ 32,665	$ 31,398	119,614	$ 104,483	$ 101,019

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011	
	Number of Restructurings	Outstanding Balance	Number of Restructurings	Outstanding Balance
	(Dollars in thousands)			
Troubled debt restructurings that subsequently defaulted – credit card receivables(1)	12,627	$ 11,413	20,899	$ 18,953

(1) Represents those troubled debt restructurings that occurred since January 1, 2011 that have defaulted during the reporting period.

Age of Credit Card Receivables

The following table sets forth, as of September 30, 2011, the number of active credit card accounts with balances and the related principal balances outstanding based upon the age of the active credit card accounts from origination:

Age Since Origination	Number of Active Accounts with Balances	Percentage of Active Accounts with Balances	Principal Receivables Outstanding	Percentage of Receivables Outstanding
	(Dollars in thousands)			
0-12 Months	2,883,748	24.8%	$ 929,383	19.6%

13-24 Months	1,516,285	13.1	603,421	12.7
25-36 Months	1,198,243	10.3	573,477	12.1
37-48 Months	957,825	8.2	427,124	9.0
49-60 Months	793,908	6.8	358,624	7.6
Over 60 Months	4,269,538	36.8	1,849,540	39.0
Total	11,619,547	100.0%	$ 4,741,569	100.0%

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Credit Quality

The Company uses proprietary scoring models developed specifically for the purpose of monitoring the Company's obligor credit quality. The proprietary scoring model is used as a tool in the underwriting process and for making credit decisions. The proprietary scoring model is based on historical data and requires various assumptions about future performance. Information regarding customer performance is factored into these proprietary scoring models to determine the probability of an account becoming 90 or more days past due at any time within the next 12 months. Obligor credit quality is monitored at least monthly during the life of an account. The following table reflects composition by obligor credit quality as of September 30, 2011:

Probability of an Account Becoming 90 or More Days Past Due or Becoming Charged off (within the next 12 months)	Total Principal Receivables Outstanding	Percentage of Principal Receivables Outstanding
	(In thousands, except percentages)	
No Score	$ 80,233	1.7%
27.1% and higher	274,486	5.8
17.1% - 27.0%	467,977	9.9
12.6% - 17.0%	561,270	11.8
3.7% - 12.5%	1,951,653	41.2
1.9% - 3.6%	916,800	19.3
Lower than 1.9%	489,150	10.3
Total	$ 4,741,569	100.0%

Securitized Credit Card Receivables

The Company regularly securitizes its credit card receivables through its credit card securitization trusts, consisting of World Financial Network Credit Card Master Trust, World Financial Network Credit Card Master Note Trust, World Financial Network Credit Card Master Note Trust II and World Financial Network Credit Card Master Trust III (collectively, the "WFN Trusts"), and World Financial Capital Credit Card Master Note Trust (the "WFC Trust"). The Company continues to own and service the accounts that generate credit card receivables held by the WFN Trusts and the WFC Trust. In its capacity as a servicer, each of the respective banks earns a fee from the WFN Trusts and the WFC Trust to service and administer the credit card receivables, collect payments, and charge-off uncollectable receivables. These fees are eliminated and therefore are not reflected in the unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2011 and 2010.

The WFN Trusts and the WFC Trust are variable interest entities ("VIEs") and the assets of these consolidated VIEs include certain credit card receivables that are restricted to settle the obligations of those entities and are not expected to be available to the Company or its creditors. The liabilities of the consolidated VIEs include asset-backed secured borrowings and other liabilities for which creditors or beneficial interest holders do not have recourse to the general credit of the Company.

The tables below present quantitative information about the components of total securitized credit card receivables, delinquencies and net charge-offs:

	September 30, 2011	December 31, 2010

	(In thousands)	
Total credit card receivables – restricted for securitization investors	$ 4,342,167	$ 4,795,753
Principal amount of credit card receivables – restricted for securitization investors, 90 days or more past due	$ 93,820	$ 117,594

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Net charge-offs of securitized principal	$ 65,993	$ 91,467	$ 231,919	$ 297,476

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Portfolio Acquisition

In February 2011, World Financial Capital Bank, one of the Company's wholly-owned subsidiaries, acquired the existing private label credit card portfolio of J.Jill and entered into a multi-year agreement to provide private label credit card services. The total purchase price was approximately $42.7 million, which consisted of $37.9 million of credit card receivables and $4.8 million of intangible assets that are included in the unaudited condensed consolidated balance sheets as of September 30, 2011.

6. REDEMPTION SETTLEMENT ASSETS

Redemption settlement assets consist of cash and cash equivalents and securities available-for-sale and are designated for settling redemptions by collectors of the AIR MILES Reward Program in Canada under certain contractual relationships with sponsors of the AIR MILES Reward Program. These assets are primarily denominated in Canadian dollars. Realized gains and losses from the sale of investment securities were not material. The principal components of redemption settlement assets, which are carried at fair value, are as follows:

	September 30, 2011				December 31, 2010			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)							
Cash and cash equivalents	$ 38,770	$ —	$ —	$ 38,770	$ 74,612	$ —	$ —	$ 74,612
Government bonds	4,858	178	—	5,036	15,235	161	(34)	15,362
Corporate bonds (1)	397,072	8,790	(1,034)	404,828	380,605	3,212	(1,363)	382,454
Total	$ 440,700	$ 8,968	$ (1,034)	$ 448,634	$ 470,452	$ 3,373	$ (1,397)	$ 472,428

(1) As of September 30, 2011 and December 31, 2010, LoyaltyOne® had investments in retained interests in the WFN Trusts with a fair value of $64.9 million in each case. These amounts are eliminated and therefore not reflected in the unaudited condensed consolidated financial statements and notes thereof as of September 30, 2011 and December 31, 2010.

The following tables show the gross unrealized losses and fair value for those investments that were in an unrealized loss position as of September 30, 2011 and December 31, 2010, aggregated by investment category and the length of time that individual securities have been in a continuous loss position:

	September 30, 2011					
	Less than 12 months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Corporate bonds	$ 10,753	$ (1,023)	$ 13,533	$ (11)	$ 24,286	$ (1,034)
Total	$ 10,753	$ (1,023)	$ 13,533	$ (11)	$ 24,286	$ (1,034)

	December 31, 2010					
	Less than 12 months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Government bonds	$ 10,119	$ (34)	$ —	$ —	$ 10,119	$ (34)
Corporate bonds	128,349	(1,363)	—	—	128,349	(1,363)
Total	$ 138,468	$ (1,397)	$ —	$ —	$ 138,468	$ (1,397)

Market values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the security's issuer, and the Company's intent to sell the security and whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. The Company typically invests in highly-rated securities with low probabilities of default and has the ability to hold the investments until maturity. As of September 30, 2011, the Company does not consider the investments to be other-than-temporarily impaired.

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The net carrying value and estimated fair value of the redemption settlement assets at September 30, 2011 by contractual maturity are as follows:

	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	$ 65,546	$ 65,151
Due after one year through five years	375,154	383,483
Total	$ 440,700	$ 448,634

7. INTANGIBLE ASSETS AND GOODWILL

Intangible Assets

Intangible assets consist of the following:

	September 30, 2011			
	Gross Assets	Accumulated Amortization	Net	Amortization Life and Method
		(In thousands)		
Finite Lived Assets				
Customer contracts and lists	$ 316,245	$ (134,361)	$ 181,884	3-12 years—straight line
Premium on purchased credit card portfolios	156,203	(78,087)	78,116	3-10 years—straight line, accelerated
Collector database	66,664	(59,020)	7,644	30 years—15% declining balance
Customer database	175,391	(91,281)	84,110	4-10 years—straight line
Noncompete agreements	1,024	(911)	113	2-3 years—straight line
Tradenames	38,141	(6,649)	31,492	5-15 years—straight line
Purchased data lists	23,119	(15,559)	7,560	1-5 years—straight line, accelerated
	$ 776,787	$ (385,868)	$ 390,919	
Indefinite Lived Assets				
Tradenames	12,350	—	12,350	Indefinite life
Total intangible assets	$ 789,137	$ (385,868)	$ 403,269	

	December 31, 2010			
	Gross Assets	Accumulated Amortization	Net	Amortization Life and Method
		(In thousands)		
Finite Lived Assets				
Customer contracts and lists	$ 211,413	$ (123,932)	$ 87,481	5-10 years—straight line
Premium on purchased credit card portfolios	151,430	(63,115)	88,315	3-10 years—straight line, accelerated
Collector database	70,211	(61,075)	9,136	30 years—15% declining balance
Customer database	175,397	(76,002)	99,395	4-10 years—straight line
Noncompete agreements	1,062	(668)	394	2-3 years—straight line

Tradenames		14,169		(5,070)		9,099	5-10 years—straight line
Purchased data lists		20,506		(12,285)		8,221	1-5 years—straight line, accelerated
	$	644,188	$	(342,147)	$	302,041	
Indefinite Lived Assets							
Tradenames		12,350		—		12,350	Indefinite life
Total intangible assets	$	656,538	$	(342,147)	$	314,391	

With the J.Jill portfolio acquisition in February 2011, the Company acquired $4.8 million of intangible assets, consisting of a customer relationship of $2.6 million and a marketing relationship of $2.2 million, which are being amortized, in each case, over a weighted average life of 7.0 years. See Note 5, “Credit Card Receivables,” for more information regarding the J.Jill portfolio acquisition.

With the Aspen acquisition on May 31, 2011, the Company acquired $140.0 million of intangible assets, consisting of $116.0 million of customer relationships and $24.0 million of trade names, which are being amortized over a weighted average life of 8.3 years and 15 years, respectively. See Note 4, “Acquisition,” for more information regarding the Aspen acquisition.

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Goodwill

The changes in the carrying amount of goodwill for the nine months ended September 30, 2011 are as follows:

	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Total
			(In thousands)		
December 31, 2010	$ 246,930	$ 713,161	$ 261,732	$ —	$ 1,221,823
Effects of foreign currency translation	(11,902)	(135)	—	—	(12,037)
Goodwill acquired during the year	—	232,910	—	—	232,910
September 30, 2011	$ 235,028	$ 945,936	$ 261,732	$ —	$ 1,442,696

8. DEBT

Debt consists of the following:

Description	September 30, 2011	December 31, 2010	Maturity	Interest Rate
	(Dollars in thousands)			
Certificates of deposit:				
Certificates of deposit	$ 1,369,005	$ 859,100	Three months to five years	0.10% to 5.25%
Less: current portion	(752,532)	(442,600)		
Long-term portion	$ 616,473	$ 416,500		
Asset-backed securities debt – owed to securitization investors:				
Fixed rate asset-backed term note securities	$ 1,772,815	$ 1,772,815	Various - Nov 2011 – Jun 2015	3.79% to 7.00%
Floating rate asset-backed term note securities	703,500	1,153,500	Various - Apr 2012 – Apr 2013	(1)
Conduit asset-backed securities	606,972	733,827	Various - Jun 2012 – Sept 2012	1.26% to 1.97%
Total asset-backed securities – owed to securitization investors	3,083,287	3,660,142		
Less: current portion	(1,769,122)	(1,743,827)		
Long-term portion	$ 1,314,165	$ 1,916,315		
Long-term and other debt:				
2011 credit facility	$ 495,000	$ —	May 2016	(2)
2011 term loan	787,547	—	May 2016	(2)
2006 credit facility	—	300,000	—	—
Series B senior notes	—	250,000	—	—
2009 term loan	—	161,000	—	—

2010 term loan	—	236,000	—	—
Convertible senior notes due 2013	697,977	659,371	August 2013	1.75%
Convertible senior notes due 2014	273,655	257,687	May 2014	4.75%
Capital lease obligations and other debt	41	5,714	July 2013(3)	7.10%(3)
Total long-term and other debt	2,254,220	1,869,772		
Less: current portion	(19,834)	(255,679)		
Long-term portion	$ 2,234,386	$ 1,614,093		

(1) Interest rates include those for certain of the Company's asset-backed securities – owed to securitization investors where floating rate debt is fixed through interest rate swap agreements. The interest rate for the floating rate debt is equal to the London Interbank Offered Rate ("LIBOR") as defined in the respective agreements plus a margin of 0.1% to 2.5% as defined in the respective agreements. The weighted average interest rate of the fixed rate achieved through interest rate swap agreements is 5.75% at September 30, 2011.

(2) At September 30, 2011, the weighted average interest rate for the 2011 Credit Facility and 2011 Term Loan was 2.51% and 2.49%, respectively.

(3) The Company has other minor borrowings, primarily capital leases.

At September 30, 2011, the Company was in compliance with its covenants.

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2011 Credit Agreement

The Company is party to a credit agreement, among the Company as borrower, and ADS Alliance Data Systems, Inc., ADS Foreign Holdings, Inc., Alliance Data Foreign Holdings, Inc., Epsilon Marketing Services, LLC, Epsilon Data Management LLC, Comenity LLC and Alliance Data FHC, Inc., as guarantors, SunTrust Bank and Bank of Montreal, as co-administrative agents, and Bank of Montreal as letter of credit issuer, and various other agents and banks, dated May 24, 2011 (the "2011 Credit Agreement"). The 2011 Credit Agreement provides for a $792.5 million term loan (the "2011 Term Loan") and a $792.5 million revolving line of credit (the "2011 Credit Facility") with a U.S. $65.0 million sublimit for Canadian dollar borrowings and a $65.0 million sublimit for swing line loans. The 2011 Credit Agreement includes an uncommitted accordion feature of up to $415.0 million in the aggregate allowing for future incremental borrowings, subject to certain conditions, for a maximum total facility size of $2.0 billion, both of which were increased by a subsequent amendment.

The loans under the 2011 Credit Agreement are scheduled to mature on May 24, 2016. The 2011 Term Loan provides for aggregate principal payments equal to 2.5% of the initial term loan amount in each of the first and second year and 5% of the initial term loan amount in each of the third, fourth and fifth year of the term loan, payable in equal quarterly installments beginning September 30, 2011. The 2011 Credit Agreement is unsecured.

Advances under the 2011 Credit Agreement are in the form of either base rate loans or Eurodollar loans and may be denominated in U.S. dollars or Canadian dollars. The interest rate for base rate loans denominated in U.S. dollars fluctuates and is equal to the highest of (i) the Bank of Montreal's prime rate; (ii) the Federal funds rate plus 0.5% and (iii) the LIBOR rate as defined in the 2011 Credit Agreement plus 1.0%, in each case plus a margin of 0.75% to 1.25% based upon the Company's senior leverage ratio as defined in the 2011 Credit Agreement. The interest rate for base rate loans denominated in Canadian dollars fluctuates and is equal to the higher of (i) the Bank of Montreal's prime rate for Canadian dollar loans and (ii) the Canadian Dollar Offered Rate ("CDOR") plus 1%, in each case plus a margin of 0.75% to 1.25% based upon the Company's senior leverage ratio as defined in the 2011 Credit Agreement. The interest rate for Eurodollar loans denominated in U.S. or Canadian dollars fluctuates based on the rate at which deposits of U.S. dollars or Canadian dollars, respectively, in the London interbank market are quoted plus a margin of 1.75% to 2.25% based upon the Company's senior leverage ratio as defined in the 2011 Credit Agreement.

Concurrently with entering into the 2011 Credit Agreement, the Company terminated the following credit facilities: (i) a credit agreement, dated September 29, 2006, which consisted of a $750.0 million unsecured revolving credit facility (the "2006 Credit Facility"); (ii) a term loan agreement, dated May 15, 2009 (the "2009 Term Loan"); and (iii) a term loan agreement, dated August 6, 2010 (the "2010 Term Loan"). The 2006 Credit Facility, the 2009 Term Loan and the 2010 Term Loan were scheduled to expire on March 30, 2012.

On September 20, 2011, the Company entered into a First Amendment to the 2011 Credit Agreement (the "First Amendment"). The First Amendment, among other things, (a) increases the uncommitted accordion feature to up to $915.0 million in the aggregate to allow a maximum total facility size of $2.5 billion, up from $2.0 billion, (b) permits any incremental term loans to be secured in such collateral as may be agreed to by the Company and the banks advancing the incremental term loans, with the existing loans to be equally and ratably secured in the same collateral, (c) except with respect to terms relating to amortization and pricing of the incremental term loans, requires that the incremental term loans may not otherwise have terms and conditions materially different from those of the existing loans and (d) permits the co-administrative agents, the Company and the banks advancing the incremental term loans to amend the 2011 Credit Agreement, without further consent of any other banks, as necessary to allow the issuance of the incremental term loans.

Total availability under the 2011 Credit Facility at September 30, 2011 was $297.5 million.

Series B Senior Notes

The Company repaid the $250.0 million aggregate principal amount of the 6.14% Series B senior notes at their scheduled maturity of May 16, 2011.

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Convertible Senior Notes

The Company has outstanding $1.15 billion of convertible senior notes, consisting of $805.0 million scheduled to mature on August 1, 2013 and $345.0 million scheduled to mature on May 15, 2014. The table below summarizes the carrying value of the components of the convertible senior notes:

	September 30, 2011	December 31, 2010
	(In thousands)	
Carrying amount of equity component	$ 368,678	$ 368,678
Principal amount of liability component	$ 1,150,000	$ 1,150,000
Unamortized discount	(178,368)	(232,942)
Net carrying value of liability component	$ 971,632	$ 917,058
If-converted value of common stock	$ 1,623,007	$ 1,243,605

The discount on the liability component will be amortized as interest expense over the remaining life of the convertible senior notes which, at September 30, 2011, is a weighted average period of 2.1 years.

Interest expense on the convertible senior notes recognized in the Company's unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2011 and 2010 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except percentages)			
Interest expense calculated on contractual interest rate	$ 7,619	$ 7,619	$ 22,856	$ 22,856
Amortization of discount on liability component	18,692	16,752	54,574	48,914
Total interest expense on convertible senior notes	$ 26,311	$ 24,371	$ 77,430	$ 71,770
Effective interest rate (annualized)	11.0%	11.0%	11.0%	11.0%

Asset-backed Securities – Owed to Securitization Investors

Conduit Facilities

During the second quarter of 2011, the Company renewed its $1.2 billion 2009-VFN conduit facility under World Financial Network Credit Card Master Note Trust and its $275.0 million 2009-VFN conduit facility under World Financial Capital Credit Card Master Note Trust, extending their maturities to June 13, 2012 and June 1, 2012, respectively.

In September 2011, the Company renewed its 2009-VFC1 conduit facility under World Financial Network Credit Card Master Trust III, extending the maturity to September 28, 2012 and reducing the total capacity from $550.0 million to $400.0 million.

Derivative Financial Instruments

As part of its interest rate risk management program, the Company may enter into derivative financial instruments with institutions that are established dealers and manage its exposure to changes in fair value of certain obligations attributable to changes in LIBOR.

The credit card securitization trusts enter into derivative financial instruments, which include both interest rate swaps and an interest rate cap, to mitigate their interest rate risk on a related financial instrument or to lock the interest rate on a portion of their variable asset-backed securities debt.

These interest rate contracts involve the receipt of variable rate amounts from counterparties in exchange for the Company making fixed rate payments over the life of the agreement without the exchange of the underlying notional amount. These interest rate contracts are not designated as hedges. Such contracts are not speculative and are used to manage interest rate risk, but do not meet the specific hedge accounting requirements of ASC 815, “Derivatives and Hedging.”

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The following tables identify the notional amount, fair value and classification of the Company's outstanding interest rate contracts for the credit card securitization trusts at September 30, 2011 and December 31, 2010 in the unaudited condensed consolidated balance sheets:

	September 30, 2011		December 31, 2010	
	Notional Amount	Weighted Average Years to Maturity	Notional Amount	Weighted Average Years to Maturity
	(Dollars in thousands)			
Interest rate contracts not designated as hedging instruments	$ 703,500	1.63	$ 1,153,500	1.72

	September 30, 2011		December 31, 2010	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	(In thousands)			
Interest rate contracts not designated as hedging instruments	Other current liabilities	$ —	Other current liabilities	$ 4,574
Interest rate contracts not designated as hedging instruments	Other liabilities	$ 46,685	Other liabilities	$ 65,257

The following table summarizes activity related to and identifies the location of the Company's outstanding interest rate contracts for the credit card securitization trusts for the three and nine months ended September 30, 2011 and 2010 recognized in the unaudited condensed consolidated statements of income:

	2011		2010	
For the three months ended September 30,	Income Statement Location	Gain on Derivative Contracts	Income Statement Location	Loss on Derivative Contracts
	(In thousands)			
Interest rate contracts not designated as hedging instruments	Securitization funding costs	$ 8,543	Securitization funding costs	$ 59
For the nine months ended September 30,				
Interest rate contracts not designated as hedging instruments	Securitization funding costs	$ 23,146	Securitization funding costs	$ 5,443

The Company limits its exposure on derivatives by entering into contracts with institutions that are established dealers who maintain certain minimum credit criteria established by the Company. At September 30, 2011, the Company does not maintain any derivative contracts subject to master agreements that would require the Company to post collateral or that contain any credit-risk related contingent features. The Company has provisions in certain of the master agreements that require counterparties to post collateral to the Company when their credit ratings fall below certain thresholds. At September 30, 2011, these thresholds were not breached and no amounts were held as collateral by the Company.

9. DEFERRED REVENUE

Because management has determined that the earnings process is not complete at the time an AIR MILES reward mile is issued, the recognition of revenue on all fees received at issuance is deferred. The Company allocates the proceeds from the issuance of AIR MILES reward miles into two components as follows:

- Redemption element. The redemption element is the larger of the two components. Revenue related to the redemption element is based on the estimated fair value. For this component, revenue is recognized at the time an AIR MILES reward mile is redeemed, or for those AIR MILES reward miles that are estimated to go unredeemed by the collector base, known as “breakage,” over the estimated life of an AIR MILES reward mile. The Company’s estimate of breakage is 28%.

- Service element. The service element consists of marketing and administrative services provided to sponsors. Revenue related to the service element has been determined in accordance with ASU 2009-13. It is initially deferred and then amortized pro rata over the estimated life of an AIR MILES reward mile. With the adoption of ASU 2009-13, the residual method will no longer be utilized for new sponsor agreements entered into on or after January 1, 2011 or existing sponsor agreements that are materially modified subsequent to that date; for these agreements, the Company will measure the service element at its estimated selling price.

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Under certain of the Company's contracts, a portion of the proceeds is paid to the Company upon the issuance of an AIR MILES reward mile and a portion is paid at the time of redemption and therefore, the Company does not have a redemption obligation related to these contracts. Revenue is recognized at the time of redemption and is not reflected in the reconciliation of the redemption obligation detailed below. Under such contracts, the proceeds received at issuance are initially deferred as service revenue and revenue is recognized pro rata over the estimated life of an AIR MILES reward mile. Amounts for revenue related to the redemption element and service element are recorded in redemption revenue and transaction revenue, respectively, in the unaudited condensed consolidated statements of income.

A reconciliation of deferred revenue for the AIR MILES Reward Program is as follows:

	Deferred Revenue		
	Service	Redemption	Total
	(In thousands)		
December 31, 2010	$ 339,514	$ 881,728	$ 1,221,242
Cash proceeds	163,534	395,201	558,735
Revenue recognized	(144,610)	(399,437)	(544,047)
Other	—	1,184	1,184
Effects of foreign currency translation	(18,461)	(44,336)	(62,797)
September 30, 2011	$ 339,977	$ 834,340	$ 1,174,317
Amounts recognized in the unaudited condensed consolidated balance sheets:			
Current liabilities	$ 160,782	$ 834,340	$ 995,122
Non-current liabilities	$ 179,195	$ —	$ 179,195

10. STOCKHOLDERS' EQUITY

Stock Repurchase Program

On September 13, 2010, the Company's Board of Directors authorized a stock repurchase program to acquire up to $400.0 million of the Company's outstanding common stock from September 13, 2010 through December 31, 2011, subject to any restrictions pursuant to the terms of the Company's credit agreements or otherwise.

For the nine months ended September 30, 2011, the Company acquired a total of 2,313,078 shares of its common stock for $187.7 million. As of September 30, 2011, the Company has $140.3 million available under the stock repurchase program.

Stock Compensation Expense

Total stock-based compensation expense recognized in the Company's unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2011 and 2010 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Cost of operations	$ 7,762	$ 6,598	$ 19,672	$ 18,801

General and administrative		4,519		4,377		12,799		15,195
Total	$	12,281	$	10,975	$	32,471	$	33,996

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During the nine months ended September 30, 2011, the Company awarded 425,328 performance-based restricted stock units with a weighted average grant date fair value per share of $83.72 as determined on the date of grant. The performance restriction on the awards will lapse upon determination by the Board of Directors or the Compensation Committee of the Board of Directors that the Company's earnings before taxes for the period from January 1, 2011 to December 31, 2011 met certain pre-defined vesting criteria that permit a range from 50% to 150% of such performance-based restricted stock units to vest. Upon such determination, the restrictions will lapse with respect to 33% of the award on February 21, 2012, an additional 33% of the award on February 21, 2013 and the final 34% of the award on February 21, 2014, provided that the participant is employed by the Company on each such vesting date.

During the nine months ended September 30, 2011, the Company awarded 149,324 service-based restricted stock units with a weighted average grant date fair value per share of $85.52 as determined on the date of grant. Service-based restricted stock units typically vest ratably over three years provided that the participant is employed by the Company on each such vesting date.

11. COMPREHENSIVE INCOME

The components of comprehensive income, net of tax effect, are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Net income	$ 93,981	$ 53,059	$ 249,380	$ 147,033
Adoption of ASC 860 and ASC 810 (1)	—	—	—	55,881
Unrealized gain (loss) on securities available-for-sale	13,989	(1,535)	13,045	(3,283)
Foreign currency translation adjustments (2)	7,281	(3,909)	3,750	(5,791)
Total comprehensive income, net of tax	$ 115,251	$ 47,615	$ 266,175	$ 193,840

(1) These amounts related to retained interests in the WFN Trusts and the WFC Trust were previously reflected in accumulated other comprehensive income. Upon the adoption of ASC 860, "Transfers and Servicing," and ASC 810, "Consolidation," which was effective January 1, 2010, these interests and related accumulated other comprehensive income have been reclassified, derecognized or eliminated upon consolidation.

(2) Primarily related to the impact of changes in the Canadian currency exchange rate.

12. FINANCIAL INSTRUMENTS

In accordance with ASC 825, "Financial Instruments," the Company is required to disclose the fair value of financial instruments for which it is practical to estimate fair value. To obtain fair values, observable market prices are used if available. In some instances, observable market prices are not readily available and fair value is determined using present value or other techniques appropriate for a particular financial instrument. These techniques involve judgment and as a result are not necessarily indicative of the amounts the Company would realize in a current market exchange. The use of different assumptions or estimation techniques may have a material effect on the estimated fair value amounts.

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Fair Value of Financial Instruments — The estimated fair values of the Company's financial instruments are as follows:

	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Financial assets				
Cash and cash equivalents	$ 239,570	$ 239,570	$ 139,114	$ 139,114
Trade receivables, net	265,156	265,156	260,945	260,945
Credit card receivables, net	4,526,162	4,526,162	4,838,354	4,838,354
Redemption settlement assets, restricted	448,634	448,634	472,428	472,428
Cash collateral, restricted	654,705	654,705	185,754	185,754
Other investment securities	80,160	80,160	104,916	104,916
Financial liabilities				
Accounts payable	122,055	122,055	121,856	121,856
Certificates of deposit	1,369,005	1,390,828	859,100	883,405
Asset-backed securities debt – owed to securitization investors	3,083,287	3,140,758	3,660,142	3,711,263
Long-term and other debt	2,254,220	2,999,681	1,869,772	2,393,124
Derivative financial instruments	46,685	46,685	69,831	69,831

Fair Value of Assets and Liabilities Held at September 30, 2011 and December 31, 2010

The following techniques and assumptions were used by the Company in estimating fair values of financial instruments as disclosed herein:

Cash and cash equivalents, trade receivables, net and accounts payable — The carrying amount approximates fair value due to the short maturity.

Credit card receivables, net — The carrying amount of credit card receivables, net approximates fair value due to the short maturity, and the average interest rates approximate current market origination rates.

Redemption settlement assets, restricted — The fair value for securities is based on quoted market prices for the same or similar securities.

Cash collateral, restricted — The spread deposits are recorded at their fair value based on discounted cash flow models. The carrying amount of excess funding deposits approximates its fair value due to the relatively short maturity period and average interest rates, which approximate current market rates.

Other investment securities — Other investment securities consist primarily of U.S. Treasury and government securities. The fair value is based on quoted market prices for the same or similar securities.

Certificates of deposit — The fair value is estimated based on the current rates available to the Company for similar certificates of deposit with similar remaining maturities.

Asset-backed securities debt – owed to securitization investors — The fair value is estimated based on the current rates available to the Company for similar debt instruments with similar remaining maturities.

Long-term and other debt — The fair value is estimated based on the current rates available to the Company for similar debt instruments with similar remaining maturities.

Derivative financial instruments —The valuation of these instruments is determined using a discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and option volatility.

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Assets and Liabilities Measured on a Recurring Basis

ASC 820, "Fair Value Measurement," establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1, defined as observable inputs such as quoted prices in active markets;
- Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and
- Level 3, defined as unobservable inputs where little or no market data exists, therefore requiring an entity to develop its own assumptions.

Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The use of different techniques to determine fair value of these financial instruments could result in different estimates of fair value at the reporting date.

The following tables provide the assets carried at fair value measured on a recurring basis as of September 30, 2011 and December 31, 2010:

	Balance at September 30, 2011	Fair Value Measurements at September 30, 2011 Using		
		Level 1	Level 2	Level 3
	(In thousands)			
Government bonds (1)	$ 5,036	$ —	$ 5,036	$ —
Corporate bonds (1)	404,828	20,680	384,148	—
Cash collateral, restricted	654,705	—	496,991	157,714
Other investment securities (2)	80,160	61,016	19,144	—
Total assets measured at fair value	$ 1,144,729	$ 81,696	$ 905,319	$ 157,714
Derivative financial instruments (3)	$ 46,685	$ —	$ 46,685	$ —
Total liabilities measured at fair value	$ 46,685	$ —	$ 46,685	$ —

	Balance at December 31, 2010	Fair Value Measurements at December 31, 2010 Using		
		Level 1	Level 2	Level 3
	(In thousands)			
Government bonds (1)	$ 15,362	$ —	$ 15,362	$ —
Corporate bonds (1)	382,454	164,706	217,748	—
Cash collateral, restricted	185,754	—	—	185,754

Other investment securities (2)		104,916		86,881		18,035		—
Total assets measured at fair value	$	688,486	$	251,587	$	251,145	$	185,754
Derivative financial instruments (3)	$	69,831	$	—	$	69,831	$	—
Total liabilities measured at fair value	$	69,831	$	—	$	69,831	$	—

(1) Amounts are included in redemption settlement assets in the unaudited condensed consolidated balance sheets.

(2) Amounts are included in other current assets and other non-current assets in the unaudited condensed consolidated balance sheets.

(3) Amounts are included in other current liabilities and other liabilities in the unaudited condensed consolidated balance sheets.

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The following tables summarize the changes in fair value of the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 825 as of September 30, 2011 and 2010:

	Cash Collateral, Restricted (In thousands)
June 30, 2011	$ 175,826
Total losses (realized or unrealized):	
Included in earnings	(311)
Purchases	11,656
Settlements	(29,457)
Transfers in or out of Level 3	—
September 30, 2011	$ 157,714
Losses for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2011	$ (311)

	Cash Collateral, Restricted (In thousands)
December 31, 2010	$ 185,754
Total gains (realized or unrealized):	
Included in earnings	147
Purchases	13,947
Settlements	(42,134)
Transfers in or out of Level 3	—
September 30, 2011	$ 157,714
Gains for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2011	$ 147

	Cash Collateral, Restricted (In thousands)
June 30, 2010	$ 171,790
Total gains (realized or unrealized):	
Included in earnings	473
Purchases, sales, issuances and settlements	(4,434)

Transfers in or out of Level 3		—
September 30, 2010	$	167,829
Gains for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2010	$	473

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	Corporate Bonds	Seller's Interest	Due from Securitizations	Cash Collateral, Restricted
	(In thousands)			
December 31, 2009	$ 73,866	$ 297,108	$ 775,570	$ 206,678
Adoption of ASC 860 and ASC 810	(73,866)	(297,108)	(775,570)	—
Total gains (realized or unrealized):				
Included in earnings	—	—	—	143
Purchases, sales, issuances and settlements	—	—	—	(38,992)
Transfers in or out of Level 3	—	—	—	—
September 30, 2010	$ —	$ —	$ —	$ 167,829
Gains for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2010	$ —	$ —	$ —	$ 143

Gains and losses included in earnings attributable to cash collateral, restricted are included in interest in the unaudited condensed consolidated statements of income.

Assets and Liabilities Measured on a Non-Recurring Basis

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include those associated with acquired businesses, including goodwill and other intangible assets. For these assets, measurement at fair value in periods subsequent to their initial recognition is applicable if one or more is determined to be impaired. During the three and nine months ended September 30, 2011, the Company had no impairments related to these assets.

13. INCOME TAXES

For the three and nine months ended September 30, 2011, the Company utilized an effective tax rate of 38.7%, in each case, to calculate its provision for income taxes. For the three and nine months ended September 30, 2010, the Company utilized an effective tax rate of 38.2%, in each case, to calculate its provision for income taxes. In accordance with ASC 740-270, "Income taxes — Interim Reporting," the Company's expected annual effective tax rate for calendar year 2011 based on all known variables is 38.7%.

14. SEGMENT INFORMATION

The Company operates in three reportable segments: LoyaltyOne, Epsilon and Private Label Services and Credit.

- LoyaltyOne includes the Company's Canadian AIR MILES Reward Program;
- Epsilon provides integrated direct marketing solutions that combine database marketing technology and analytics with a broad range of direct marketing services; and
- Private Label Services and Credit provides risk management solutions, account origination, funding, transaction processing, customer care and collections services for the Company's private label retail credit card programs.

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Additionally, corporate and all other immaterial businesses are reported collectively as an "all other" category labeled "Corporate/Other." Total interest expense, net and income taxes are not allocated to the segments in the computation of segment operating profit for internal evaluation purposes and are included in "Corporate/Other." Total assets are not allocated to the segments.

Three Months Ended September 30, 2011	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Eliminations	Total
			(In thousands)			
Revenues	$ 209,634	$ 248,405	$ 389,051	$ 211	$ (2,457)	$ 844,844
Adjusted EBITDA (1)	59,920	58,528	187,712	(21,513)	(1,454)	283,193
Depreciation and amortization	5,130	24,899	8,950	4,254	—	43,233
Stock compensation expense	2,047	3,617	2,098	4,519	—	12,281
Operating income (loss)	52,743	30,012	176,664	(30,286)	(1,454)	227,679
Interest expense, net	—	—	—	74,356	—	74,356
Income (loss) before income taxes	52,743	30,012	176,664	(104,642)	(1,454)	153,323

Three Months Ended September 30, 2010	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Eliminations	Total
			(In thousands)			
Revenues	$ 184,411	$ 170,468	$ 349,642	$ 357	$ (2,435)	$ 702,443
Adjusted EBITDA (1)	46,478	44,091	143,894	(13,988)	(1,584)	218,891
Depreciation and amortization	5,827	21,473	8,892	1,715	—	37,907
Stock compensation expense	2,514	2,305	1,779	4,377	—	10,975
Operating income (loss)	38,137	20,313	133,223	(20,080)	(1,584)	170,009
Interest expense, net	—	—	—	84,119	—	84,119
Income (loss) before income taxes	38,137	20,313	133,223	(104,199)	(1,584)	85,890

Nine Months Ended September 30, 2011	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Eliminations	Total
			(In thousands)			
Revenues	$ 630,470	$ 592,545	$ 1,108,679	$ 924	$ (6,880)	$ 2,325,738
Adjusted EBITDA (1)	171,114	131,518	534,713	(54,483)	(4,362)	778,500
Depreciation and amortization	15,564	65,519	26,818	6,750	—	114,651
Stock compensation expense	5,379	8,765	5,528	12,799	—	32,471
Operating income (loss)	150,171	57,234	502,367	(74,032)	(4,362)	631,378
Interest expense, net	—	—	—	224,609	—	224,609
	150,171	57,234	502,367			

Income (loss) before income taxes