HEARTLAND PAYMENT SYSTEMS INC
Form 10-Q
November 06, 2013
Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

OR

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

For the transition period from to

Commission File No. 001-32594

HEARTLAND PAYMENT SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

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

90 Nassau Street, Princeton, New Jersey 08542
(Address of principal executive offices) (Zip Code)
(609) 683-3831
(Registrant's telephone number, including area code)

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

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

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

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

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

As of November 4, 2013, there were 36,875,088 shares of the registrant's Common Stock, $0.001 par value, outstanding.

Table of Contents

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Condensed Financial Statements
Heartland Payment Systems, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(In thousands, except share data)
(unaudited)

	September 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$67,156	$48,440
Funds held for customers	111,895	131,405
Receivables, net	195,678	180,448
Investments	4,650	1,199
Inventory	10,268	9,694
Prepaid expenses	12,957	10,421
Current tax assets	5,588	—
Current deferred tax assets, net	10,382	10,475
Assets held for sale	—	17,044
Total current assets	418,574	409,126
Capitalized customer acquisition costs, net	57,711	56,425
Property and equipment, net	139,160	125,031
Goodwill	191,172	168,062
Intangible assets, net	52,147	53,594
Deposits and other assets, net	449	1,176
Total assets	$859,213	$813,414
Liabilities and Equity		
Current liabilities:		
Due to sponsor banks	$42,633	$37,586
Accounts payable	66,175	64,065
Customer fund deposits	111,895	131,405
Processing liabilities	108,144	95,273
Current portion of borrowings	111,000	102,001
Current portion of accrued buyout liability	13,667	10,478
Accrued expenses and other liabilities	50,280	47,817
Current tax liabilities	—	4,323
Liabilities related to assets held for sale	—	1,672
Total current liabilities	503,794	494,620
Deferred tax liabilities, net	38,830	29,632
Reserve for unrecognized tax benefits	4,267	3,069
Long-term portion of borrowings	35,000	50,000
Long-term portion of accrued buyout liability	23,195	24,932
Total liabilities	605,086	602,253
Commitments and contingencies (Note 11)		
Equity		
	37	38

Common stock, $0.001 par value, 100,000,000 shares authorized, 37,150,990 and 37,571,708 shares issued at September 30, 2013 and December 31, 2012; 36,853,090 and 36,855,908 outstanding at September 30, 2013 and December 31, 2012		
Additional paid-in capital	236,684	222,705
Accumulated other comprehensive loss	(35)	(399)
Retained earnings	21,141	7,629
Treasury stock, at cost (297,900 and 715,800 shares at September 30, 2013 and December 31, 2012)	(10,408)	(20,187)
Total stockholders' equity	247,419	209,786
Noncontrolling interests	6,708	1,375
Total equity	254,127	211,161
Total liabilities and equity	$859,213	$813,414

See accompanying notes to condensed consolidated financial statements.

1

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30	
	2013	2012	2013	2012
Total revenues	$557,129	$530,677	$1,604,992	$1,513,471
Costs of services:				
Interchange	350,734	336,628	1,003,039	965,318
Dues, assessments and fees	53,165	54,121	152,146	150,494
Processing and servicing	60,195	54,344	177,968	165,910
Customer acquisition costs	10,838	10,647	31,554	33,346
Depreciation and amortization	5,454	5,344	14,066	14,168
Total costs of services	480,386	461,084	1,378,773	1,329,236
General and administrative	41,871	36,787	131,242	99,645
Total expenses	522,257	497,871	1,510,015	1,428,881
Income from operations	34,872	32,806	94,977	84,590
Other income (expense):				
Interest income	29	31	95	169
Interest expense	(1,243)	(938)	(3,746)	(2,544)
Provision for processing system intrusion costs	(13)	(290)	(252)	(528)
Other, net	103	(921)	182	(925)
Total other expense	(1,124)	(2,118)	(3,721)	(3,828)
Income from continuing operations before income taxes	33,748	30,688	91,256	80,762
Provision for income taxes	11,857	11,745	34,039	30,893
Net income from continuing operations	21,891	18,943	57,217	49,869
Income from discontinued operations, net of income tax of $—, $229, $2,135 and $555	—	624	3,970	1,512
Net income	21,891	19,567	61,187	51,381
Less: Net income (loss) attributable to noncontrolling interests				
Continuing operations	(90)	—	(90)	—
Discontinued operations	—	187	56	446
Net income attributable to Heartland	$21,981	$19,380	$61,221	$50,935
Amounts Attributable to Heartland:				
Net income from continuing operations, net of noncontrolling interests	21,981	18,943	57,307	49,869
Income from discontinued operations, net of income tax and noncontrolling interests	—	437	3,914	1,066
Net income attributable to Heartland	21,981	19,380	61,221	50,935
Basic earnings per share:				
Income from continuing operations	$0.60	$0.49	$1.56	$1.28
Income from discontinued operations	—	0.01	0.11	0.03
Basic earnings per share	$0.60	$0.50	$1.67	$1.31

Diluted earnings per share:				
Income from continuing operations	$0.58	$0.47	$1.50	$1.23
Income from discontinued operations	—	0.01	0.10	0.03
Diluted earnings per share	$0.58	$0.48	$1.60	$1.26
Weighted average number of common shares outstanding:				
Basic	36,857	38,813	36,752	38,831
Diluted	38,020	40,352	38,079	40,454
Dividends declared per share	$0.07	$0.06	$0.21	$0.18

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30	
	2013	2012	2013	2012
Net income	$21,891	$19,567	$61,187	$51,381
Other comprehensive income (loss):				
Unrealized gains on investments, net of income tax of $—, $10, $4 and $19	—	15	4	30
Unrealized gains (losses) on derivative financial instruments, net of tax of $25, ($12), $121 and ($20)	152	(19)	315	(28)
Foreign currency translation adjustment	—	500	(54)	464
Comprehensive income	22,043	20,063	61,452	51,847
Less: Comprehensive (loss) income attributable to noncontrolling interests	(90)	337	(50)	585
Comprehensive income attributable to Heartland	$22,133	$19,726	$61,502	$51,262

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Heartland Stockholders' Equity							
	Common Stock							
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Noncontrolling Interests	Total Equity
Nine Months Ended September 30, 2012								
Balance, January 1, 2012	38,848	$39	$207,643	$ (680)	$29,236	$(16,828)	$ 642	$220,052
Issuance of common stock– options exercised	1,400	2	16,826	—	—	—	—	16,828
Issuance of common stock – RSU's vested	83	—	(1,064)	—	—	—	—	(1,064)
Excess tax benefit on employee share-based compensation	—	—	6,175	—	—	—	—	6,175
Repurchase of common stock	(1,674)	—	—	—	—	(49,216)	—	(49,216)
Share-based compensation	—	—	10,412	—	—	—	—	10,412
Other comprehensive income	—	—	—	327	—	—	139	466
Dividends on common stock ($0.18 per share)	—	—	—	—	(7,012)	—	—	(7,012)
Net income for the period	—	—	—	—	50,935	—	446	51,381
Balance, September 30, 2012	38,657	$41	$239,992	$ (353)	$73,159	$(66,044)	$ 1,227	$248,022
Nine Months Ended September 30, 2013								
Balance, January 1, 2013	36,856	$38	$222,705	$ (399)	$7,629	$(20,187)	$ 1,375	$211,161
Issuance of common stock– options exercised	982	1	10,724	—	—	—	—	10,725
Issuance of common stock – RSU's vested	265	—	(4,866)	—	—	—	—	(4,866)
Excess tax benefit on employee share-based	—	—	8,382	—	—	—	—	8,382

compensation								
Repurchase of common stock	(1,250)	—	—	—	—	(40,221)	—	(40,221)
Retirement of treasury stock	—	(2)	(10,024)	—	(39,974)	50,000	—	—
Share-based compensation	—	—	9,763	—	—	—	—	9,763
Changes in equity from sale of discontinued operation	—	—	—	83	—	—	(1,415)	(1,332)
Other comprehensive income (loss)	—	—	—	281	—	—	(16)	265
Noncontrolling interests in subsidiary acquired	—	—	—	—	—	—	6,798	6,798
Dividends on common stock ($0.21 per share)	—	—	—	—	(7,735)	—	—	(7,735)
Net income (loss) for the period	—	—	—	—	61,221	—	(34)	61,187
Balance, September 30, 2013	36,853	$37	$236,684	$ (35)	$21,141	$(10,408)	$ 6,708	$254,127

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Nine Months Ended September 30, 2013	2012
Cash flows from operating activities		
Net income	$61,187	$51,381
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of capitalized customer acquisition costs	33,936	33,758
Other depreciation and amortization	26,070	20,641
Addition to loss reserves	2,510	1,827
(Recovery) provision for doubtful receivables	(1)	793
Deferred taxes	5,632	3,558
Share-based compensation	9,763	10,412
Gain on sale of business	(3,786)	—
Other	386	964
Changes in operating assets and liabilities:		
Increase in receivables	(15,135)	(8,519)
(Increase) decrease in inventory	(524)	1,685
Payment of signing bonuses, net	(19,546)	(22,446)
Increase in capitalized customer acquisition costs	(15,676)	(12,748)
(Increase) decrease in prepaid expenses	(2,361)	1,329
(Increase) decrease in current tax assets	(1,515)	1,968
Increase in deposits and other assets	(296)	(81)
Excess tax benefits on employee share-based compensation	(8,382)	(6,175)
Increase in reserve for unrecognized tax benefits	1,198	675
Increase (decrease) in due to sponsor banks	5,048	(10,823)
Increase in accounts payable	(1,830)	14,593
(Decrease) increase in accrued expenses and other liabilities	(1,036)	2,423
Increase in processing liabilities	10,310	10,528
Payouts of accrued buyout liability	(11,842)	(9,401)
Increase in accrued buyout liability	13,294	12,336
Net cash provided by operating activities	87,404	98,678
Cash flows from investing activities		
Purchase of investments	(5,241)	(5,225)
Maturities of investments	1,430	3,396
Decrease in funds held for customers	19,519	3,344
Decrease in customer fund deposits	(19,510)	(3,294)
Proceeds from sale of business	19,343	—
Acquisitions of businesses, net of cash acquired	(15,182)	(23,682)
Purchases of property and equipment	(36,929)	(25,029)
Net cash used in investing activities	(36,570)	(50,490)
Cash flows from financing activities		
Proceeds from borrowings	9,000	26,000
Principal payments on borrowings	(15,000)	(37,253)
Proceeds from exercise of stock options	10,725	16,828
Excess tax benefits on employee share-based compensation	8,382	6,175

Repurchases of common stock	(39,632)	(48,202)
Dividends paid on common stock	(7,735)	(7,012)
Net cash used in financing activities	(34,260)	(43,464)
Net increase in cash	16,574	4,724
Effect of exchange rates on cash	1	30
Cash at beginning of year	50,581	40,301
Cash at end of period	$67,156	$45,055
Supplemental cash flow information:		
Cash paid during the period for:		
Interest	$3,173	$2,257
Income taxes	28,917	25,184

See accompanying notes to condensed consolidated financial statements.

5

Heartland Payment Systems, Inc. and Subsidiaries
Notes To Condensed Consolidated Financial Statements
(unaudited)
1. Organization and Operations
Basis of Financial Statement Presentation— The accompanying condensed consolidated financial statements include those of Heartland Payment Systems, Inc. (the “Company,” “we,” “us,” or “our”) and its wholly-owned subsidiaries, Heartland Payroll Company (“HPC”), Ovation Payroll, Inc. ("Ovation"), Educational Computer Systems, Inc. ("ECSI"), Debitek, Inc. (“Debitek”) and Heartland Acquisition LLC (“Network Services”), and as of September 11, 2013, Leaf Acquisition, LLC (which holds 66.67% of the outstanding capital stock of Leaf Holdings, Inc ("Leaf")), as well as its previously 70% owned subsidiary Collective POS Solutions Ltd. (“CPOS”). The Company entered into an agreement during the fourth quarter of 2012 to sell CPOS. The transaction was settled on January 31, 2013 and the Company recorded a gain on the sale in the first quarter of 2013. The Company presents CPOS as a discontinued operation in the accompanying condensed consolidated financial statements. See Note 15, Discontinued Operations for more detail.
The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All intercompany balances and transactions with the Company's subsidiaries have been eliminated upon consolidation.

The accompanying condensed consolidated financial statements are unaudited. In the opinion of the Company's management, the unaudited condensed consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of the Company's financial position at September 30, 2013, and its results of operations, changes in stockholders’ equity and cash flows for the periods ended September 30, 2013 and 2012. Results of operations reported for interim periods are not necessarily indicative of the results to be expected for the year ending December 31, 2013. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2012. The December 31, 2012 condensed consolidated balance sheet was derived from the audited 2012 consolidated financial statements.

Business Description—The Company's principal business is to provide payment processing services related to bankcard transactions for merchants throughout the United States, and until January 31, 2013 in Canada (See Note 15, Discontinued Operations for more detail). In addition, the Company provides certain other card-related services, including the sale and rental of terminal equipment, sale of terminal supplies and loyalty and gift card marketing solutions ("Heartland Marketing Solutions"). The Company provides K to 12 school solutions ("Heartland School Solutions") in the United States including school nutrition and point-of-sale and payment solutions. HPC and Ovation provide payroll and related tax filing services throughout the United States. Debitek provides campus payment solutions ("Campus Solutions"), prepaid card and stored-value card payment solutions ("Prepaid Card") throughout the United States and Canada. ECSI also provides Campus Solutions, including higher education loan servicing, throughout the United States.
Over 72% of the Company's revenue is derived from processing and settling Visa and MasterCard bankcard transactions for its merchant customers. Because the Company is not a "member bank" as defined by Visa and MasterCard, in order to process and settle these bankcard transactions for its merchants, the Company has entered into sponsorship agreements with member banks. Visa and MasterCard rules restrict the Company from performing funds settlement or accessing merchant settlement funds and require that these funds be in the possession of the member bank until the merchant is funded. A sponsorship agreement permits the Company to route Visa and MasterCard bankcard transactions under the member bank's control and identification numbers to clear credit and signature debit bankcard transactions through Visa and MasterCard. A sponsorship agreement also enables the Company to settle funds between cardholders and merchants by delivering funding files to the member bank, which in turn transfers settlement funds to the merchants' bank accounts. These restrictions place the settlement assets and obligations under the control of the member bank.

The sponsorship agreements with the member banks require, among other things, that the Company abide by the bylaws and regulations of the Visa and MasterCard networks, and certain of the sponsor banks require a certificate of deposit or a cash balance in a deposit account. If the Company were to breach a sponsorship agreement and under certain circumstances, the sponsor banks may terminate the agreement and, under the terms of the agreement, the Company would have 180 days to identify an alternative sponsor bank. The Company is generally dependent on its sponsor banks, Visa and MasterCard for notification of any compliance breaches. As of September 30, 2013, the Company has not been notified of any such issues by its sponsor banks, Visa or MasterCard.

Table of Contents

At September 30, 2013, the Company is party to four bank sponsorship agreements.

- On February 8, 2012, the Company entered into a sponsorship agreement with Wells Fargo Bank, N.A. ("WFB"). The WFB sponsorship agreement will be in effect until February 8, 2016 and will automatically renew for successive three year periods unless either party provides six months written notice of non-renewal to the other party. Processing for small and mid-sized merchants (referred to as "Small and Midsized Enterprises," or "SME merchants") under the WFB sponsorship commenced in August 2012, when that activity was transferred from its previous sponsor, KeyBank, National Association.

- In November 2009, the Company entered into a sponsorship agreement with The Bancorp Bank to sponsor processing for the Company's large national and mid-tier merchants. The agreement with The Bancorp Bank expires in February 2015 and will automatically renew for successive one-year periods unless either party provides six months written notice of non-renewal to the other party.

- On March 24, 2011, the Company entered into a sponsorship agreement with Barclays Bank Delaware to sponsor processing for certain of the Company's large national merchants. The agreement with Barclays Bank Delaware expires in March 2016 and will automatically renew for successive one-year periods unless either party provides six months written notice of non-renewal to the other.

- In 2007, the Company entered into a sponsorship agreement with Heartland Bank, an unrelated third party, to sponsor SME merchant processing. In March 2013, the Company notified Heartland Bank of its intention to terminate the sponsorship agreement and made arrangements for continuing sponsorship with The Bancorp Bank under the terms of the November 2009 sponsorship agreement. The transfer of sponsorship and processing from Heartland Bank to The Bancorp Bank was final on October 1, 2013.

Following is a breakout of the Company's total Visa and MasterCard settled bankcard processing volume for the month ending September 30, 2013 by percentage processed under its individual bank sponsorship agreements:

Sponsor Bank	% of September 2013 Bankcard Processing Volume
Wells Fargo Bank, N.A.	64%
The Bancorp Bank	17%
Barclays Bank Delaware	13%
Heartland Bank	6%

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

Under a sales and servicing program agreement with American Express Travel Related Services Company, Inc. ("American Express") the Company: (a) provides solicitation services by signing new-to-American Express merchants directly with American Express; (b) provides transactional support services on behalf of American Express to the Company's American Express accepting merchants; and (c) provides processing, settlement, customer support and reporting to merchants, similar to the services provided for the merchants' Visa, MasterCard and Discover transactions.

Working Capital— The Company's working capital, defined as current assets less current liabilities, was negative by $85.2 million at September 30, 2013 and $85.5 million at December 31, 2012. The negative working capital primarily reflects the Company (a) borrowing $82.0 million under the Revolving Credit Facility (as defined in Note 10, Credit Facilities) which was used to fund the acquisitions of ECSI and Ovation in December 2012, as described above and in Note 3, Acquisitions, (b) using $103.4 million of operating cash to repurchase 3,634,044 shares of the Company's common stock during 2012 and (c) using $40.2 million of operating cash to repurchase 1,250,083 shares during the nine months ended September 30, 2013. See Note 10, Credit Facilities for information on the Company's Revolving Credit Facility. The Company believes that its current cash and investment balances, cash generated from operations and its agreements with its sponsor banks to fund SME merchant advances will provide sufficient liquidity to meet its anticipated needs for operating capital for at least the next twelve months.

Table of Contents
Heartland Payment Systems, Inc. and Subsidiaries
Notes To Condensed Consolidated Financial Statements—(Continued)
(unaudited)

2. Summary of Significant Accounting Policies
Use of Estimates— The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates include, among other things, the accrued buyout liability, capitalized customer acquisition costs, goodwill, loss reserves, certain accounts payable and accrued expenses and certain tax assets and liabilities as well as the related valuation allowances, if any. Actual results could differ from those estimates.
Cash and Cash Equivalents— At September 30, 2013, cash included approximately $39.7 million of processing-related cash in transit and collateral, compared to approximately $31.6 million of processing-related cash in transit and collateral at December 31, 2012.
Receivables—Receivables are stated net of allowance for doubtful accounts. The Company estimates its allowance based on experience with its merchants, customers, and sales force and its judgment as to the likelihood of their ultimate payment. The Company also considers collection experience and makes estimates regarding collectability based on trends in the aging. Historically, the Company has not experienced significant charge offs for its merchant receivables.
The Company's primary receivables are from its bankcard processing merchants. In addition to receivables for transaction fees the Company charges its merchants for processing transactions, these receivables include amounts resulting from the Company's practice of advancing interchange fees to most of its SME merchants during the month and collecting those fees at the beginning of the following month. The Company does not advance interchange fees to its Network Services Merchants. Network Services Merchants are invoiced monthly, on payment terms of 30 days net from date of invoicing. Receivables from merchants also include receivables from the sale of point-of-sale terminal equipment.

Historically, the Company funded interchange advances to its SME merchants first with its available cash, and when that cash had been expended, by directing its sponsor banks to fund advances, thereby incurring a payable to sponsor banks. In the fourth quarter of 2012, the Company accelerated the end-of-day presentment of transaction funding files to the bankcard networks resulting in its sponsor banks receiving settlement cash one day earlier and increasing funding obligations to its SME merchants, which are carried in processing liabilities. As a result of accelerated presentment, the Company funds these merchant interchange advances/receivables first from the accelerated settlement cash received from bankcard networks, then from the Company's available cash or by incurring a payable to its sponsor banks. At September 30, 2013, the Company used $2.4 million of its cash to fund merchant advances and at December 31, 2012, the Company used $3.8 million of its cash to fund merchant advances. The amount due to sponsor banks for funding advances was $41.7 million at September 30, 2013 and $36.3 million at December 31, 2012. The Company pays its sponsor banks the prime rate on these payables. The payable to sponsor banks is repaid at the beginning of the following month out of the fees the Company collects from its merchants.

Receivables also include amounts resulting from the pre-funding of Discover and American Express transactions to the Company's merchants and are due from the related bankcard networks. These amounts are recovered the next business day following the date of processing the transaction.

Receivables also include amounts resulting from the sale, installation, training and repair of payment system hardware and software for prepaid card and stored-value card payment systems, Campus Solutions, and Heartland School Solutions. These receivables are mostly invoiced on terms of 30 days net from date of invoicing.

Investments and Funds Held for Customers— Investments, including those carried on the Condensed Consolidated Balance Sheets as Funds held for customers, consist primarily of equity investments, fixed income bond funds and certificates of deposit. Funds held for customers also include overnight bank deposits. The majority of investments carried in Funds held for customers are available-for-sale and recorded at fair value based on quoted market prices. Certificates of deposit are classified as held to maturity and recorded at cost. In the event of a sale, cost is determined on a specific identification basis. At September 30, 2013, Funds held for customers included cash and cash equivalents of $110.7 million and investments available for sale of $1.2 million.

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

Capitalized Customer Acquisition Costs, net— Capitalized customer acquisition costs consist of (1) up-front signing bonus payments made to Relationship Managers and sales managers (the Company's sales force, which are referred to as "salespersons") for the establishment of new merchant relationships, and (2) a deferred acquisition cost representing the estimated cost of buying out the commissions of vested salespersons. Capitalized customer acquisition costs represent incremental, direct customer acquisition costs that are recoverable through gross margins associated with merchant contracts. The capitalized customer acquisition costs are amortized using a method which approximates a proportional revenue approach over the initial 3-year term of the merchant contract.

The up-front signing bonus paid for new SME bankcard, payroll and loyalty marketing accounts is based on the estimated gross margin for the first year of the merchant contract. The signing bonus, amount capitalized, and related amortization are adjusted after the first year to reflect the actual gross margin generated by the merchant contract during that year. The deferred customer acquisition cost asset is accrued over the first year of SME bankcard merchant processing, consistent with the build-up in the accrued buyout liability, as described below. Beginning in June 2012, Relationship Managers and sales managers earn portfolio equity on their newly installed payroll and loyalty marketing merchant accounts based on the residual commissions they earn on those accounts. The accrued buyout liability and deferred acquisition cost asset are developed in the same manner as the SME bankcard merchant portfolio equity.

Management evaluates the capitalized customer acquisition costs for impairment on an annual basis by comparing, on a pooled basis by vintage month of origination, the expected future net cash flows from underlying merchant relationships to the carrying amount of the capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the value of the capitalized customer acquisition costs, the impairment loss will be charged to operations. The Company believes that no impairment has occurred as of September 30, 2013.

Accrued Expenses and Other Liabilities— Accrued expenses and other liabilities on the Condensed Consolidated Balance Sheets includes deferred revenue of $17.0 million and $13.0 million at September 30, 2013 and December 31, 2012, respectively, which is primarily related to the Company's Heartland School Solutions and Campus Solutions businesses.

Also included in accrued expenses and other liabilities at September 30, 2013 and December 31, 2012 is $4.1 million and $7.3 million, respectively, relating to the allocation of purchase price to an unfavorable processing contract associated with our September 30, 2011 acquisition of School-Link Technologies, Inc. During the nine months ended September 30, 2013 and 2012, we amortized $1.5 million and $2.2 million of this accrued liability against the cash processing costs paid under that contract. During the nine months ended September 30, 2013, we recorded an adjustment to the carrying value of this unfavorable processing contract of $1.6 million to adjust the liability to reflect the latest estimate of the expected cash processing costs to be paid over the remainder of the contract. The amortization and adjustment to the fair value were included in cost of services in our Condensed Consolidated Statements of Income.

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

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

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

Beginning in June 2012, Relationship Managers and sales managers earn portfolio equity on their newly installed payroll and loyalty marketing merchant accounts based on the residual commissions they earn on those accounts. The accrued buyout liability and deferred acquisition cost asset are accrued in the same manner as the SME bankcard merchant portfolio equity.

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

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

Revenue—Revenues are mainly comprised of gross processing revenue, payroll processing revenue and equipment-related revenue. Gross processing revenue primarily consists of discount fees, per-transaction fees and periodic fees (primarily monthly) from the processing of Visa, MasterCard, American Express and Discover bankcard transactions for merchants. The Company passes through to its customers any changes in interchange or network fees. Gross processing revenue also includes fees for servicing American Express accounts, customer service fees, fees for processing chargebacks, termination fees on terminated contracts, gift and loyalty card fees, fees generated by our Heartland School Solutions business, loan servicing fees and other miscellaneous revenue. Payroll processing revenue includes periodic and annual fees charged by HPC and Ovation for payroll processing services, and interest earned

from investing tax impound funds held for our customers. Revenue is recorded as bankcard and other processing transactions are processed or payroll services are performed.
Equipment-related revenue includes revenues from the sale, rental and deployment of bankcard terminals, and from the sale of hardware, software and associated services for prepaid card and stored-value card payment systems, and from the sale of hardware, software and associated services for Heartland School Solutions and Campus Solutions. Revenues are recorded at the time of shipment, or the provision of service.

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

Table of Contents
Heartland Payment Systems, Inc. and Subsidiaries
Notes To Condensed Consolidated Financial Statements—(Continued)
(unaudited)

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

Other Income (Expense)— Other income (expense) consists of interest income on cash and investments, the interest expense on our borrowings, the gains or losses on the disposal of property and equipment and other non-operating income or expense items. For the nine months ended September 30, 2013, other income (expense) included pre-tax income of approximately $0.2 million reflecting the first two payments relating to the sale of a group of merchant contracts within our Prepaid Card business.

Other income (expense) also includes the pre-tax charges related to the provision for processing system intrusion costs.

Income Taxes—The Company accounts for income taxes by recognizing deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statements and the tax basis of assets and liabilities using enacted tax rates.
The provision for income taxes for the three and nine months ended September 30, 2013 and 2012 and the resulting effective tax rates were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
Provision for income taxes	$11,857	$11,745	$34,039	$30,893
Effective tax rate	35.1 %	38.3 %	37.3 %	38.3 %

The decrease in the effective tax rate for the three and nine months ended September 30, 2013, as compared to the three and nine months ended September 30, 2012, is due to the recognition of research and development credits. On January 2, 2013, the American Taxpayer Relief Act of 2012 ("ATR Act") was enacted which included an extension of the federal research and development credit retroactively to 2012 and prospectively through 2013. The effects of the research and development credits are being recognized by the Company in the three months ended September 30, 2013 in conjunction with filing our 2012 tax return.

The Company's tax provision for interim periods is determined using an estimate of its annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter the Company updates its estimate of the annual effective tax rate, and if the estimated tax rate changes, it makes a cumulative adjustment in that period.

The Company regularly evaluates its tax positions for additional unrecognized tax benefits and associated interest and penalties, if applicable. There are many factors that are considered when evaluating these tax positions including: interpretation of tax laws, recent tax litigation on a position, past audit or examination history, and subjective estimates and assumptions, which have been deemed reasonable by management. However, if management's estimates are not representative of actual outcomes, the Company's results could be materially impacted. The Company does not expect any material changes to unrecognized tax benefits in the next twelve months. At September 30, 2013, the reserve for unrecognized tax benefits related to uncertain tax positions was $4.3 million, of which $2.8 million would, if recognized, impact the effective tax rate. At December 31, 2012, the reserve for unrecognized tax benefits related to uncertain tax positions was $3.1 million, of which $2.0 million would, if recognized, impact the effective tax rate.

The Company has received a final determination letter from the Joint Committee of Taxation for 2010 and such Committee has agreed to the “no change" findings of the IRS audit.

Share–Based Compensation— In the fourth quarters of 2010, 2011, and 2012, the Compensation Committee of the Company's Board of Directors approved grants of performance-based Restricted Share Units with grant-specific vesting and performance target terms as shown in the following table:

Table of Contents
Heartland Payment Systems, Inc. and Subsidiaries
Notes To Condensed Consolidated Financial Statements—(Continued)
(unaudited)

	Performance Awards by Grant Date		
	4th Quarter 2010	4th Quarter 2011	4th Quarter 2012
RSU's Granted	508,800	164,808	72,004
Vested during 2013	50%	—	—
Vesting during 2014	25%	50%	—
Vesting during 2015	25%	50%	50%
Vesting during 2016	—	—	50%
Grant Performance Target	(a)	(b)	(c)

(a) On March 1, 2013 50% vested since the 2012 diluted earnings per share target was achieved. The remaining Restricted Share Units would vest only if, over the term, the following pro forma diluted earnings per share targets for the years ended December 31, 2013, and 2014 are achieved:

	2013	2014
Diluted Earnings Per Share	$1.74	$2.04

Management believes that achieving the performance targets is probable to occur and has recorded share-based compensation expense on these Restricted Share Units.

(b) These Restricted Share Units would vest only if the Company achieves a pro forma diluted earnings per share compound annual growth rate ("CAGR") of seventeen percent (17%) for the two-year period ending December 31, 2013. For each 1% that the CAGR actually achieved by the Company for the two-year period ending on December 31, 2013 is above the 17% target, the number of shares underlying the Restricted Share Units awarded would be increased by 3.09%; provided, however, that the maximum increase in the number of shares that may be awarded is 100%. Likewise, for each 1% that the CAGR actually achieved by the Company for the two-year period ending on December 31, 2013 is below the 17% target, the number of shares underlying the Restricted Share Units awarded would be decreased by 1.13%. If the target CAGR is missed by 80% or more, then the number of shares awarded is zero. Management determined that achieving a CAGR for the two-year period ending December 31, 2013 which would result in earning the maximum 100% increase in the number of shares that may be awarded was probable to occur, and has recorded share-based compensation expense for these Restricted Share Units based on this expectation.

(c) These Restricted Share Units would vest only if the Company achieves a pro forma diluted earnings per share CAGR of fifteen percent (15%) for the two-year period ending December 31, 2014. For each 1% that the CAGR actually achieved for the two year period ending on December 31, 2014 is above the 15% target, the number of shares underlying the Restricted Share Units awarded would be increased by 2.08%; provided, however, that the maximum increase in the number of shares that may be awarded is 125%. Likewise, for each 1% that the CAGR actually achieved for the two-year period ending on December 31, 2014 is below the 15% target, the number of shares underlying the Restricted Share Units awarded would be decreased by 1.31%. If the target CAGR is missed by 67% or more, then the number of shares awarded is zero. The Company has recorded expense on these Restricted Share Units based on achieving the 15% target.

Pro forma diluted earnings per share for (a), (b) and (c) performance targets will be calculated excluding non-operating gains and losses, if any, and excluding the after-tax impact of share-based compensation expense. The closing price of the Company's common stock on the grant date equals the grant date fair value of these nonvested Restricted Share Units awards and will be recognized as compensation expense over their vesting periods.

In the fourth quarter of 2012, the Compensation Committee of the Company's Board of Directors approved target grants of 72,345 Relative Total Shareholder Return Restricted Share Units (referred to as “TSRs”). These TSRs are nonvested share awards for which vesting percentages and ultimate number of units vesting will be calculated based on the total shareholder return of our common stock as compared to the total shareholder return of 86 peer companies. The payout schedule can produce vesting percentages ranging from 0% to 225%. Total shareholder return will be calculated based upon the average closing price for the 30 calendar day period ending December 9, 2015, divided by the closing price on December 10, 2012. The target number of units is based on achieving a total shareholder return equal to the 65th percentile of the peer group. The Company recorded expense on these TSRs based on achieving the target. A lattice valuation model was applied to measure the grant date fair value of these TSRs.

Diluted earnings per share for the three and nine months ended September 30, 2013 and 2012 were computed based on the weighted average outstanding common shares plus equivalent shares assuming exercise of stock options and vesting of Restricted Share Units, where dilutive.

Common Stock Repurchases. On each of October 21, 2011, July 27, 2012, and November 2, 2012, the Company's Board of Directors authorized the repurchase of up to $50 million worth of the Company's outstanding common stock under each authorization. Repurchases under the October 21, 2011 and July 27, 2012 authorizations were completed during the year ended December 31, 2012 and repurchases under the November 2, 2012 authorization were completed during the second quarter of 2013. Repurchases under these programs were made through the open market from time to time in accordance with applicable laws and regulations. On May 8, 2013, the Company's Board of Directors authorized the repurchase of up to $75 million worth of the Company's outstanding common stock. Repurchases under the May 8, 2013 authorization are ongoing. The Company intends to fund any repurchases with cash flow from operations, existing cash on the balance sheet, and other sources including the Company's Credit Facility and the proceeds of options exercises. The manner, timing and amount of repurchases, if any, will be determined by management and will depend on a variety of factors, including price, corporate and regulatory requirements, market conditions and other corporate liquidity requirements. The repurchase program may be modified or discontinued at any time.

	Repurchase Programs by Authorization Date				
	October 2011	July 2012	November 2012	May 2013	Total
Activity For the Nine Months Ended September 30, 2013					
Shares repurchased	—	—	952,183	297,900	1,250,083
Cost of shares repurchased (in thousands)	—	—	$29,813	$10,407	$40,220
Average cost per share	—	—	$31.31	$34.93	$32.17
Remaining authorization (in thousands)	—	—	—	$64,593	$64,593
Activity For the Nine months Ended September 30, 2012					
Shares repurchased	1,157,440	516,983	—	—	1,674,423
Cost of shares repurchased (in thousands)	$33,172	$16,044	—	—	$49,216
Average cost per share	$28.66	$31.03	—	—	$29.39
Activity For the Year Ended December 31, 2012					
Shares repurchased	1,157,440	1,760,804	715,800	—	3,634,044
Cost of shares repurchased (in thousands)	$33,172	$50,000	$20,187	—	$103,359
Average cost per share	$28.66	$28.40	$28.20	—	$28.44

Derivative Financial Instruments—The Company utilizes derivative instruments to manage interest rate risk on certain borrowings under its Credit Agreement (as defined in Note 10 herein). The Company recognizes the fair value of derivative financial instruments in the Condensed Consolidated Balance Sheets in investments, or accrued expenses and other liabilities. Changes in fair value of derivative instruments are recognized immediately in earnings unless the derivative is designated and qualifies as a hedge of future cash flows. For derivatives that qualify as hedges of future cash flows, the effective portion of changes in fair value is recorded in other comprehensive income and reclassified into interest expense in the same periods during which the hedged item affects earnings. Any ineffectiveness of cash flow hedges would be recognized in other income (expense) in the Condensed Consolidated Statements of Income during the period of change.

In January 2011, the Company entered into fixed-pay amortizing interest rate swaps having an initial notional amount of $50 million as a hedge of future cash flows on the variable rate debt outstanding under its Term Credit Facility (as defined in Note 10 herein). These interest rate swaps convert the related notional amount of variable rate debt to fixed rate. The following table summarizes the components of the interest rate swaps.

	September 30, 2013	December 31, 2012
	(In thousands)	
Remaining notional value	$27,500	$35,000
Fair value (a)	(494)	(817)
Deferred tax benefit	192	313

(a) Recorded as a liability in accrued expenses and other liabilities

Foreign Currency—The Canadian dollar was the functional currency of CPOS, which operated in Canada. CPOS' revenues and expenses were translated at the average exchange rates prevailing during the period. The foreign currency assets and liabilities of CPOS were translated at the period-end rate of exchange. The resulting translation adjustment was allocated between the Company and CPOS' noncontrolling interests and was recorded as a component of other comprehensive income or

Table of Contents
Heartland Payment Systems, Inc. and Subsidiaries
Notes To Condensed Consolidated Financial Statements—(Continued)
(unaudited)

noncontrolling interests in total equity. At September 30, 2012, the cumulative foreign currency translation reflected a gain of $0.1 million. CPOS was sold in a transaction which settled on January 31, 2013. See Note 15, Discontinued Operations for more detail.
Noncontrolling Interests— Noncontrolling interests represent noncontrolling stockholders' share of the equity and after-tax net income or loss of Leaf and CPOS.
Noncontrolling stockholders' share of after-tax net income or loss of Leaf is included in Net income (loss) attributable to noncontrolling interests, continuing operations in the Condensed Consolidated Statements of Income. The minority stockholders' interests included in noncontrolling interests in the September 30, 2013 Condensed Consolidated Balance Sheet is $6.7 million and reflects the original investments by these minority shareholders in Leaf, along with their proportionate share of earnings or losses of Leaf. Noncontrolling stockholders' share of after-tax net income or loss of CPOS is included in Net income (loss) attributable to noncontrolling interests, discontinued operations in the Condensed Consolidated Statements of Income. The minority stockholders' interests included in noncontrolling interests in the December 31, 2012 Condensed Consolidated Balance Sheet was $1.4 million and reflected the original investments by these minority shareholders in CPOS, along with their proportionate share of earnings or losses of CPOS. CPOS was sold in a transaction which settled on January 31, 2013. See Note 15, Discontinued Operations for more detail.
Subsequent Events—The Company evaluated subsequent events with respect to the Condensed Consolidated Financial Statements as of and for the nine months ended September 30, 2013. On October 23, 2013 the Company entered into a new credit facility. See Note 10, Credit Facilities for more detail.
New Accounting Pronouncements— From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (“FASB”) or other standards setting bodies that are adopted by us as of the specified effective date.

In July 2012, the FASB issued an accounting standard update on testing indefinite-lived intangible assets for impairment. This guidance will allow an entity to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. Under these amendments, an entity would not be required to calculate the fair value of an indefinite-lived intangible asset unless the entity determines, based on qualitative assessment, that it is not more likely than not the indefinite-lived intangible asset is impaired. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The update is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The implementation of this update did not have a material effect on the Company's Consolidated Financial Statements.

In February 2013, the FASB issued an accounting standard update on improving the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this update seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under generally accepted accounting principles to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures that provide additional detail about those amounts. This update is effective for annual reporting periods beginning after December 15, 2012. The implementation of this update did not have a material effect on the Company's Consolidated Financial Statements.

In July 2013, the FASB issued an accounting standard update which provides guidance on the risks that are permitted to be hedged in a fair value or cash flow hedge. Among those risks for financial assets and financial liabilities is the risk of changes in a hedged item's fair value or a hedged transaction's cash flows attributable to changes in the designated benchmark interest rate (referred to as interest rate risk). This update is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The implementation of this update is not expected to have a material effect on the Company's Consolidated Financial Statements.

In July 2013, the FASB issued an accounting standard update which provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this update are expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryfowards, similar tax losses, or tax credit carryforwards exist. The amendments in this update are effective for fiscal years and interim periods within those years, beginning after December 15, 2013, with early adoption permitted. The amendments would be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The implementation of this update is not expected to have a material effect on the Company's Consolidated Financial Statements.

3. Acquisitions

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

The transaction was accounted for under the purchase method of accounting. Beginning on September 11, 2013, Leaf's results of operations are included in the Company's results of operations. The allocation of the total purchase price was as follows: $20.6 million to goodwill, $6.9 million to intangible assets, $6.2 million to net tangible liabilities and $6.8 million to noncontrolling interest. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is not expected to be deductible for income tax reporting.
The weighted average amortization life for the 2013 acquired finite lived intangible assets related to acquisition of Leaf is as follows:

Weighted-average amortization life	
	(In years)
Software	7.0
Patents	5.0
Overall	6.9

Acquisition transactions in 2012 included:

Lunch Byte Systems, Inc.
On June 29, 2012, the Company expanded its Heartland School Solutions business through its acquisition of the net assets of Lunch Byte Systems, Inc. ("Nutrikids"). The $26.0 million cash payment made on June 29, 2012 for the purchase price was funded through our Revolving Credit Facility and subsequently repaid with cash on hand in July 2012. Beginning July 1, 2012, Nutrikids' results of operations are included in the Company's results of operations. The transaction was accounted for under the purchase method of accounting. The allocation of the total purchase price was as follows: $16.1 million to goodwill, $7.0 million to intangible assets and $2.9 million to net tangible assets. Pro forma results of operations have not been presented because the effect of this acquisition was not material. The entire amount of goodwill is expected to be deductible for income tax reporting.

The weighted average amortization life for the 2012 acquired finite lived intangible assets related to acquisition of Nutrikids is as follows:

Weighted-average amortization life	
	(In years)
Customer relationships	6.0
Software	3.3
Non-compete agreements	5.0
Overall	5.9

Educational Computer Systems, Inc.
On December 14, 2012, the Company purchased for a $37.6 million cash payment, the stock of Educational Computer Systems, Inc. ("ECSI") and net assets of related entities. The cash purchase price was financed under the Company's Revolving Credit Facility. The acquisition expands the Company's Campus Solutions division. ECSI supports the entire life cycle of higher education and post-graduation school/student services, including student loan payment processing, default solutions, refund services, tuition payment plans, electronic billing and payment, tax document services, and business outsourcing to more than 1,800 colleges and universities nationwide. With this acquisition, the Company's Campus Solutions business gained ECSI’s client portfolio, increasing the number of higher education clients to more than 2,000 colleges and universities throughout North America.

The transaction was accounted for under the purchase method of accounting. Beginning December 15, 2012, ECSI results of operations are included in the Company's results of operations. The allocation of the total purchase price was as

Table of Contents
Heartland Payment Systems, Inc. and Subsidiaries
Notes To Condensed Consolidated Financial Statements—(Continued)
(unaudited)

follows: $32.3 million to goodwill, $10.5 million to intangible assets and $5.2 million to net tangible liabilities. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Only a portion of the goodwill is expected to be deductible for income tax reporting.
The weighted average amortization life for the 2012 acquired finite lived intangible assets related to acquisition of ECSI is as follows:

Weighted-average amortization life	
	(In years)
Customer relationships	12.0
Software	5.0
Non-compete agreements	5.0
Overall	9.2

Ovation Payroll, Inc.
On December 31, 2012, the Company purchased for a $44.2 million cash payment, the stock of Ovation Payroll, Inc. ("Ovation"). The cash purchase price was financed under the Company's Revolving Credit Facility. The acquisition expands the Company's existing payroll processing business. Ovation serves over 10,000 clients in 48 states providing payroll processing, payroll tax preparation, Internet payroll reporting, and direct deposit.

The transaction was accounted for under the purchase method of accounting. Beginning January 1, 2013, Ovation's results of operations are included in the Company's results of operations. The allocation of the total purchase price was as follows: $31.3 million to goodwill, $6.6 million to intangible assets and $6.3 million to net tangible assets. Pro forma results of operations have not been presented because the effect of this acquisition was not material. Goodwill is not expected to be deductible for income tax reporting.
The weighted average amortization life for the 2012 acquired finite lived intangible assets related to acquisition of Ovation is as follows:

Weighted-average amortization life	
	(In years)
Customer relationships	6.7
Software	1.5
Non-compete agreements	5.0
Overall	5.9

4. Receivables
A summary of receivables by major class was as follows at September 30, 2013 and December 31, 2012:

	September 30, 2013	December 31, 2012
	(In thousands)	
Accounts receivable from merchants	$170,879	$160,702
Accounts receivable from bankcard networks	23,548	19,588
Accounts receivable from others	2,218	1,596
	196,645	181,886
Less allowance for doubtful accounts	(967)	(1,438)
Total receivables, net	$195,678	$180,448

Included in accounts receivable from others are amounts due from employees which are $1.0 million and $0.4 million at September 30, 2013 and December 31, 2012, respectively. Accounts receivable from bankcard networks at

September 30, 2013 and December 31, 2012 include amounts which were pre-funded to merchants for processing Discover and American Express bankcard transactions.

Table of Contents
Heartland Payment Systems, Inc. and Subsidiaries
Notes To Condensed Consolidated Financial Statements—(Continued)
(unaudited)

A summary of the activity in the allowance for doubtful accounts for the three and nine months ended September 30, 2013 and 2012 was as follows:

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
	(In thousands)			
Beginning balance	$915	$1,395	$1,438	$1,407
Additions (reductions) to allowance	186	318	(16)	628
Charges against allowance	(134)	(176)	(455)	(498)
Ending balance	$967	$1,537	$967	$1,537

5. Funds Held for Customers and Investments
A summary of funds held for customers and investments, including the cost, gross unrealized gains (losses) and estimated fair value by major security type and class of security were as follows at September 30, 2013 and December 31, 2012:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In thousands)			
September 30, 2013				
Funds held for customers				
Fixed income bond fund - available for sale	$968	$253	$—	$1,221
Cash held for payroll customers	94,391	—	—	94,391
Cash held for Campus Solutions customers	$16,283	$—	$—	$16,283
Total funds held for customers	$111,642	$253	$—	$111,895
Investments:				
Investments held to maturity - Certificates of deposit (a)	$585	$—	$—	$585
Other investments, at cost	4,065	—	—	4,065
Total Investments	$4,650	$—	$—	$4,650

(a) Certificates of deposit have remaining terms ranging from 1 month to 11 months.

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In thousands)			
December 31, 2012				
Funds held for customers				
Fixed income bond fund - available for sale	$968	$244	$—	$1,212
Cash held for payroll customers	110,334	—	—	110,334
Cash held for Campus Solutions customers	19,859	—	—	19,859
Total funds held for customers	$131,161	$244	$—	$131,405
Investments:				
Investments held to maturity - Certificates of deposit	$1,199	$—	$—	$1,199
Total Investments	$1,199	$—	$—	$1,199

Other investments, at cost, as of September 30, 2013 includes a $4.0 million investment in the equity of ATX Innovation, Inc. ("Tabbedout").

During the nine months ended September 30, 2013 and during the twelve months ended December 31, 2012, the Company did not experience any other-than-temporary losses on its investments.

Table of Contents
Heartland Payment Systems, Inc. and Subsidiaries
Notes To Condensed Consolidated Financial Statements—(Continued)
(unaudited)

The maturity schedule of all available-for-sale debt securities and held to maturity investments along with amortized cost and estimated fair value as of September 30, 2013 is as follows:

	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	$5,618	$5,871
Due after one year through five years	—	—
	$5,618	$5,871

6. Capitalized Customer Acquisition Costs, Net

A summary of net capitalized customer acquisition costs as of September 30, 2013 and December 31, 2012 was as follows:

	September 30, 2013	December 31, 2012
	(In thousands)	
Capitalized signing bonuses	$85,127	$84,728
Less accumulated amortization	(44,541)	(42,941)
	40,586	41,787
Capitalized customer deferred acquisition costs	43,524	37,736
Less accumulated amortization	(26,399)	(23,098)
	17,125	14,638
Capitalized customer acquisition costs, net	$57,711	$56,425

A summary of the activity in capitalized customer acquisition costs, net for the three and nine month periods ended September 30, 2013 and 2012 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
Balance at beginning of period	$56,148	$56,223	$56,425	$55,014
Plus additions to:				
Capitalized signing bonuses, net	7,466	6,985	19,546	22,446
Capitalized customer deferred acquisition costs	5,555	4,491	15,676	12,748
	13,021	11,476	35,222	35,194
Less amortization expense on:				
Capitalized signing bonuses, net	(6,852)	(7,364)	(20,747)	(22,017)
Capitalized customer deferred acquisition costs	(4,606)	(3,885)	(13,189)	(11,741)
	(11,458)	(11,249)	(33,936)	(33,758)
Balance at end of period	$57,711	$56,450	$57,711	$56,450

Net signing bonus adjustments from estimated amounts to actual were $(1.0) million and $(0.9) million, respectively, for the three months ended September 30, 2013 and 2012, and $(2.9) million and $(2.3) million, respectively, for the nine months ended September 30, 2013 and 2012. Net signing bonus adjustments are netted against additions in the table above. Negative signing bonus adjustments occur when the actual gross margin generated by the merchant contract during the first year is less than the estimated gross margin for that year, resulting in the overpayment of the up-front signing bonus and would be recovered from the relevant salesperson. Positive signing bonus adjustments result from the prior underpayment of signing bonuses and would be paid to the relevant salesperson.

Fully amortized signing bonuses of $6.4 million and $7.7 million were written off during the three month periods ended September 30, 2013 and 2012, respectively, and $19.1 million and $24.2 million respectively, were written off during the nine month periods ended September 30, 2013 and 2012. In addition, fully amortized customer deferred acquisition costs of $3.3 million and $4.2 million, respectively, were written off during the three months ended September 30, 2013 and 2012, and $9.9 million and $12.2 million, respectively, were written off during the nine months ended September 30, 2013 and 2012.

The Company believes that no impairment of capitalized customer acquisition costs has occurred as of September 30, 2013 and December 31, 2012.

7. Intangible Assets and Goodwill

Intangible Assets — Intangible assets consisted of the following as of September 30, 2013 and December 31, 2012:

	September 30, 2013			
	Gross Assets	Accumulated Amortization	Net Assets	Amortization Life and Method