

ALLIANCE DATA SYSTEMS CORP

Form 10-Q

May 07, 2007

Table of Contents

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

Form 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended March 31, 2007
- 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
*(State or Other Jurisdiction of
Incorporation or Organization)*

31-1429215
*(I.R.S. Employer
Identification No.)*

17655 Waterview Parkway
Dallas, Texas 75252
(Address of Principal Executive Office, Including Zip Code)

(972) 348-5100
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

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 No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of May 1, 2007, 78,699,413 shares of common stock were outstanding.

ALLIANCE DATA SYSTEMS CORPORATION

INDEX

	Page Number
<u>Part I: FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	
<u>Financial Statements (unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of March 31, 2007 and December 31, 2006</u>	3
<u>Condensed Consolidated Statements of Income for the three months ended March 31, 2007 and 2006</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2007 and 2006</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	22
<u>Item 4.</u>	
<u>Controls and Procedures</u>	22
<u>Part II: OTHER INFORMATION</u>	
<u>Item 1.</u>	
<u>Legal Proceedings</u>	23
<u>Item 1A.</u>	
<u>Risk Factors</u>	23
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
<u>Item 3.</u>	
<u>Defaults Upon Senior Securities</u>	24
<u>Item 4.</u>	
<u>Submission of Matters to a Vote of Security Holders</u>	24
<u>Item 5.</u>	
<u>Other Information</u>	24
<u>Item 6.</u>	
<u>Exhibits</u>	25
<u>SIGNATURES</u>	26
<u>Certification of CEO Pursuant to Rule 13a-14(a)</u>	
<u>Certification of CFO Pursuant to Rule 13a-14(a)</u>	
<u>Certification of CEO Pursuant to Rule 13a-14(b)</u>	
<u>Certification of CFO Pursuant to Rule 13a-14(b)</u>	

Table of Contents**PART I****Item 1. Financial Statements****ALLIANCE DATA SYSTEMS CORPORATION****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2007	December 31, 2006
	(In thousands)	
ASSETS		
Cash and cash equivalents	\$ 153,876	\$ 180,075
Due from card associations	63,179	108,671
Trade receivables, less allowance for doubtful accounts (\$4,998 and \$5,325 at March 31, 2007 and December 31, 2006, respectively)	269,850	271,563
Seller's interest and credit card receivables, less allowance for doubtful accounts (\$40,762 and \$45,919 at March 31, 2007 and December 31, 2006, respectively)	455,533	569,389
Deferred tax asset, net	88,709	88,722
Other current assets	115,394	91,555
Total current assets	1,146,541	1,309,975
Redemption settlement assets, restricted	277,587	260,957
Property and equipment, net	241,951	208,327
Due from securitizations	288,297	325,457
Intangible assets, net	416,297	263,934
Goodwill	1,195,040	969,971
Other non-current assets	72,781	65,394
Total assets	\$ 3,638,494	\$ 3,404,015
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	\$ 81,700	\$ 112,582
Accrued expenses	144,315	201,904
Merchant settlement obligations	154,045	188,336
Certificates of deposit	229,900	294,800
Credit facilities and other debt, current	308,040	7,902
Other current liabilities	60,657	72,196
Total current liabilities	978,657	877,720
Deferred tax liability, net	5,143	44,234
Deferred revenue	664,564	651,506
Certificates of deposit	4,200	4,200

Edgar Filing: ALLIANCE DATA SYSTEMS CORP - Form 10-Q

Long-term and other debt	864,625	737,475
Other liabilities	90,732	17,347
Total liabilities	2,607,921	2,332,482
Stockholders' equity:		
Common stock, \$0.01 par value; authorized 200,000 shares; issued 87,614 shares and 86,872 shares at March 31, 2007 and December 31, 2006, respectively	876	869
Additional paid-in capital	854,033	834,680
Treasury stock, at cost (9,024 shares and 7,218 shares at March 31, 2007 and December 31, 2006, respectively)	(409,486)	(300,950)
Retained earnings	575,702	527,686
Accumulated other comprehensive income	9,448	9,248
Total stockholders' equity	1,030,573	1,071,533
Total liabilities and stockholders' equity	\$ 3,638,494	\$ 3,404,015

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**ALLIANCE DATA SYSTEMS CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

	Three Months Ended March 31,	
	2007	2006
	(In thousands, except per share amounts)	
Revenues		
Transaction	\$ 164,513	\$ 160,503
Redemption	90,543	78,948
Securitization income and finance charges, net	178,362	160,879
Database marketing fees and direct marketing fees	96,745	57,805
Other revenue	18,995	19,096
Total revenue	549,158	477,231
Operating expenses		
Cost of operations (exclusive of depreciation and amortization disclosed separately below)	377,868	330,319
General and administrative	23,303	19,966
Depreciation and other amortization	20,065	15,217
Amortization of purchased intangibles	19,341	12,321
Total operating expenses	440,577	377,823
Operating income	108,581	99,408
Interest income	(2,861)	(1,752)
Interest expense	18,688	10,289
Income before income taxes	92,754	90,871
Provision for income taxes	35,894	34,450
Net income	\$ 56,860	\$ 56,421
Net income per share basic	\$ 0.72	\$ 0.70
Net income per share diluted	\$ 0.70	\$ 0.69
Weighted average shares basic	79,016	80,065
Weighted average shares diluted	81,109	81,667

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

ALLIANCE DATA SYSTEMS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2007	2006
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 56,860	\$ 56,421
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	39,406	27,538
Deferred income taxes	(2,161)	(3,294)
Provision for doubtful accounts	5,204	3,557
Non-cash stock compensation	12,093	7,304
Fair value gain on interest-only strip	(7,750)	(4,250)
Change in operating assets and liabilities, net of acquisitions:		
Change in trade accounts receivable	14,158	20,057
Change in merchant settlement activity	11,201	14,763
Change in other assets	(30,626)	(12,075)
Change in accounts payable and accrued expenses	(64,781)	(32,334)
Change in deferred revenue	7,338	10,935
Change in other liabilities	(11,816)	(19,664)
Excess tax benefits from stock-based compensation	(2,755)	(4,412)
Other	2,245	6,230
Net cash provided by operating activities	28,616	70,776
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in redemption settlement assets	(15,793)	(6,156)
Payments for acquired businesses, net of cash acquired	(438,712)	(36,124)
Net decrease in seller's interest and credit card receivables	108,478	56,269
Change in due from securitizations	45,345	52,170
Capital expenditures	(21,871)	(20,397)
Other	(329)	404
Net cash (used in) provided by investing activities	(322,882)	46,166
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under debt agreements	859,000	465,323
Repayment of borrowings	(430,000)	(359,000)
Certificate of deposit issuances	60,300	20,000
Repayments of certificates of deposits	(125,200)	(120,900)
Payment of capital lease obligations	(2,059)	(2,093)
Excess tax benefits from stock-based compensation	2,755	4,412
Proceeds from issuance of common stock	13,041	14,544
Purchase of treasury shares	(108,536)	(25,633)
Other	(648)	

Edgar Filing: ALLIANCE DATA SYSTEMS CORP - Form 10-Q

Net cash provided by (used in) financing activities	268,653	(3,347)
Effect of exchange rate changes on cash and cash equivalents	(586)	20
Change in cash and cash equivalents	(26,199)	113,615
Cash and cash equivalents at beginning of period	180,075	143,213
Cash and cash equivalents at end of period	\$ 153,876	\$ 256,828
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 11,001	\$ 8,081
Income taxes paid, net of refunds	\$ 17,661	\$ 32,548

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**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, 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, 2006.

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 the reported amounts of assets and liabilities; and disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

For purposes of comparability, certain prior period amounts, have been reclassified to conform to the current year presentation. Such reclassifications have no impact on previously reported net income.

2. 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 March 31, 2007 2006 (In thousands, except per share amounts)	
Numerator		
Net income available to common stockholders	\$ 56,860	\$ 56,421
Denominator		
Weighted average shares, basic	79,016	80,065
Weighted average effect of dilutive securities:		
Net effect of unvested restricted stock	606	224
Net effect of dilutive stock options	1,487	1,378

Denominator for diluted calculation	81,109	81,667
Basic		
Net income per share	\$ 0.72	\$ 0.70
Diluted		
Net income per share	\$ 0.70	\$ 0.69

Table of Contents

ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. ACQUISITIONS

On February 1, 2007, the Company completed the acquisition of Abacus, a division of DoubleClick Inc. Abacus is a leading provider of data, data management and analytical services for the retail and catalog industry, as well as other sectors. The Abacus acquisition complements, expands and strengthens Epsilon's core offerings and provides additional scale to its data services, strategic database services and analytics offerings.

The acquisition of Abacus included specified assets of DoubleClick's data division (Purchased Assets) and all of the outstanding equity interests of four DoubleClick entities. The consideration consisted of approximately \$435.0 million plus other incremental costs as defined in the agreement for a total of approximately \$439.3 million.

The results of operations for Abacus have been included since the date of acquisition and are reflected in our Marketing Services segment. The goodwill resulting from the acquisition of the Purchased Assets will be deductible for tax purposes.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed in the Abacus acquisition as of the date of purchase. The Company is in the process of finalizing its third-party valuation of certain intangibles, and thus, the final allocation of the purchase price is subject to refinement.

**As of
February 1,
2007**

&nb