

ALLIANCE DATA SYSTEMS CORP

Form 10-Q

November 06, 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 September 30, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File 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

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

(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:**

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

**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 November 2, 2007, 78,740,781 shares of common stock were outstanding.

---

**Table of Contents**

**ALLIANCE DATA SYSTEMS CORPORATION**

**INDEX**

	<b>Page Number</b>
<b>Part I: FINANCIAL INFORMATION</b>	
Item 1. <u>Financial Statements (unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of September 30, 2007 and December 31, 2006</u>	3
<u>Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2007 and 2006</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2007 and 2006</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	31
Item 4. <u>Controls and Procedures</u>	32
<b>Part II: OTHER INFORMATION</b>	
Item 1. <u>Legal Proceedings</u>	33
Item 1A. <u>Risk Factors</u>	34
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
Item 3. <u>Defaults Upon Senior Securities</u>	35
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	35
Item 5. <u>Other Information</u>	35
Item 6. <u>Exhibits</u>	36
<b><u>SIGNATURES</u></b>	38

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

	September 30, 2007	December 31, 2006
	(In thousands)	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 215,339	\$ 180,075
Due from card associations	138,460	108,671
Trade receivables, less allowance for doubtful accounts (\$6,737 and \$5,325 at September 30, 2007 and December 31, 2006, respectively)	322,453	271,563
Seller's interest and credit card receivables, less allowance for doubtful accounts (\$37,780 and \$45,919 at September 30, 2007 and December 31, 2006, respectively)	537,245	569,389
Deferred tax asset, net	89,670	88,722
Other current assets	117,343	91,555
<b>Total current assets</b>	<b>1,420,510</b>	<b>1,309,975</b>
Redemption settlement assets, restricted	315,601	260,957
Property and equipment, net	241,405	208,327
Due from securitizations	357,185	325,457
Intangible assets, net	382,047	263,934
Goodwill	1,234,299	969,971
Other non-current assets	67,556	65,394
<b>Total assets</b>	<b>\$ 4,018,603</b>	<b>\$ 3,404,015</b>
Accounts payable	\$ 141,886	\$ 112,582
Accrued expenses	197,677	201,904
Merchant settlement obligations	255,465	188,336
Certificates of deposit	309,900	294,800
Credit facilities and other debt, current	309,138	7,902
Other current liabilities	55,097	72,196
<b>Total current liabilities</b>	<b>1,269,163</b>	<b>877,720</b>
Deferred tax liability, net		44,234
Deferred revenue	804,162	651,506
Certificates of deposit	2,100	4,200
Long-term and other debt	693,536	737,475
Other liabilities	97,732	17,347
<b>Total liabilities</b>	<b>2,866,693</b>	<b>2,332,482</b>
<b>Stockholders' equity:</b>		
Common stock, \$0.01 par value; authorized 200,000 shares; issued 87,756 shares and 86,872 shares at September 30, 2007 and December 31, 2006, respectively	878	869
Additional paid-in capital	886,582	834,680
Treasury stock, at cost (9,024 shares and 7,218 shares at September 30, 2007 and December 31, 2006, respectively)	(409,486)	(300,950)

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

Retained earnings	648,963	527,686
Accumulated other comprehensive income	24,973	9,248
<b>Total stockholders' equity</b>	<b>1,151,910</b>	<b>1,071,533</b>
Total liabilities and stockholders' equity	\$ 4,018,603	\$ 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 September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(In thousands, except per share amounts)			
<b>Revenues</b>				
Transaction	\$ 169,390	\$ 167,179	\$ 503,026	\$ 492,572
Redemption	99,151	85,274	290,551	249,092
Securitization income and finance charges, net	164,117	142,611	507,311	444,660
Database marketing and direct marketing fees	120,583	84,473	327,595	219,316
Other revenue	22,284	27,047	59,998	68,622
<b>Total revenue</b>	<b>575,525</b>	<b>506,584</b>	<b>1,688,481</b>	<b>1,474,262</b>
<b>Operating expenses</b>				
Cost of operations (exclusive of depreciation and amortization disclosed separately below)	401,505	357,247	1,181,722	1,041,919
General and administrative	22,488	28,150	67,007	69,117
Depreciation and other amortization	21,823	16,892	63,390	47,958
Amortization of purchased intangibles	21,137	15,086	62,133	43,469
Impairment of long-lived assets	39,961		39,961	
Merger costs	2,134		8,305	
<b>Total operating expenses</b>	<b>509,048</b>	<b>417,375</b>	<b>1,422,518</b>	<b>1,202,463</b>
<b>Operating income</b>	<b>66,477</b>	<b>89,209</b>	<b>265,963</b>	<b>271,799</b>
Interest income	(2,906)	(1,611)	(7,791)	(4,673)
Interest expense	20,716	12,250	60,440	33,908
<b>Income before income taxes</b>	<b>48,667</b>	<b>78,570</b>	<b>213,314</b>	<b>242,564</b>
Provision for income taxes	19,496	29,790	83,194	92,568
<b>Net income</b>	<b>\$ 29,171</b>	<b>\$ 48,780</b>	<b>\$ 130,120</b>	<b>\$ 149,996</b>
<b>Net income per share - basic</b>	<b>\$ 0.37</b>	<b>\$ 0.61</b>	<b>\$ 1.66</b>	<b>\$ 1.88</b>
<b>Net income per share - diluted</b>	<b>\$ 0.36</b>	<b>\$ 0.60</b>	<b>\$ 1.61</b>	<b>\$ 1.84</b>
<b>Weighted average shares - basic</b>	<b>78,201</b>	<b>79,612</b>	<b>78,463</b>	<b>79,885</b>
<b>Weighted average shares - diluted</b>	<b>80,734</b>	<b>81,491</b>	<b>80,770</b>	<b>81,657</b>

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2007	2006
	(In thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 130,120	\$ 149,996
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	125,523	91,427
Deferred income taxes	7,173	(22,642)
Provision for doubtful accounts	24,420	17,306
Fair value gain on interest only strip	(37,857)	(7,970)
Impairment of long-lived assets	39,961	
Stock compensation	41,384	31,476
Change in operating assets and liabilities, net of acquisitions:		
Change in trade accounts receivable	(24,067)	(9,753)
Change in merchant settlement activity	37,341	11,819
Change in other assets	(29,216)	(20,081)
Change in accounts payable and accrued expenses	34,560	4,778
Change in deferred revenue	34,864	40,152
Change in other liabilities	(11,159)	(13,770)
Excess tax benefits from stock-based compensation	(6,820)	(13,784)
Purchase of credit card receivables	(5,780)	(68,398)
Proceeds from the sale of credit card receivable portfolios to the securitization trusts		154,445
Other	5,402	7,899
Net cash provided by operating activities	365,849	352,900
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Change in redemption settlement assets	(11,402)	(16,803)
Payments for acquired businesses, net of cash acquired	(438,166)	(133,118)
Net decrease (increase) in seller's interest and credit card receivables	11,208	(8,906)
Change in due from securitizations	10,095	29,022
Capital expenditures	(78,658)	(72,202)
Other	(13,899)	(42)
Net cash used in investing activities	(520,822)	(202,049)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Borrowings under debt agreements	1,736,000	2,441,907
Repayment of borrowings	(1,477,000)	(2,303,907)
Certificate of deposit issuances	324,500	139,500
Repayments of certificates of deposits	(311,500)	(352,800)
Payment of capital lease obligations	(6,296)	(5,815)
Payment of d		