HEARTLAND PAYMENT SYSTEMS INC
Form 10-K
March 10, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2010

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 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)

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

Title of each class	Name of each exchange on which registered
Common Stock, $0.001 par value	**New York Stock Exchange**

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

NONE

(title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ¨ YES x NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ YES x NO

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 ¨ 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). ¨ YES ¨ NO

Indicate by check mark if disclosure of delinquent filer pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

The aggregate market value of the voting and non-voting common stock held by non-affiliates computed by reference to the price at which the common stock was last sold on the New York Stock Exchange on June 30, 2010 was approximately $532 million.

As of March 2, 2011, there were 38,494,183 shares of the registrant s common stock, $0.001 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Specifically identified portions of the registrant s definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2011 annual meeting of shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K for fiscal year ended December 31, 2010.

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Heartland Payment Systems, Inc.

Annual Report on Form 10-K

For the Year Ended December 31, 2010

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FORWARD LOOKING STATEMENTS

Unless the context requires otherwise, references in this report to the Company, we, us, and our refer to Heartland Payment Systems, Inc. and our subsidiaries.

Some of the information in this Annual Report on Form 10-K may contain forward-looking statements that are based on our management s beliefs and assumptions and on information currently available to our management. Forward-looking statements include the information concerning our possible or assumed future results of operations, the impact of the systems breach of our processing system, business strategies, financing plans, competitive position, industry environment, potential growth opportunities, the effects of future regulation and the effects of competition. Forward-looking statements include all statements that are not historical facts and can be identified by the use of forward-looking terminology such as the words believe, expect, anticipate, intend, plan, estimate or similar expressions.

Forward-looking statements involve risks, uncertainties and assumptions. Actual results may differ materially from those expressed in the forward-looking statements. You should understand that many important factors, in addition to those discussed elsewhere in this report, could cause our results to differ materially from those expressed in the forward-looking statements. Certain of these factors are described in Item 1A. Risk Factors and include, without limitation, the economic conditions in the United States, the results and effects of the systems breach of our processing system, our competitive environment, the business cycles and credit risks of our merchants, chargeback liability, merchant attrition, problems with our bank sponsor, our reliance on third party processors, our inability to pass increased interchange fees along to our merchants, economic conditions, system failures and government regulation.

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PART I

ITEM 1. BUSINESS

Overview of Our Company

Delaware Corporation

We were incorporated in Delaware in June 2000. Our headquarters are located at 90 Nassau Street, Princeton, NJ 08542, and our telephone number is (609) 683-3831.

Our primary business is to provide bankcard payment processing services to merchants in the United States and Canada. This involves facilitating the exchange of information and funds between merchants and cardholders financial institutions, providing end-to-end electronic payment processing services to merchants, including merchant set-up and training, transaction authorization and electronic draft capture, clearing and settlement, merchant accounting, merchant assistance and support and risk management. Our merchant customers primarily fall into two categories; our core small and mid-sized merchants (referred to as Small and Midsized Enterprises, or SME merchants) and Network Services large national and mid-tier merchants, primarily in the petroleum industry (referred to as Network Services Merchants). We also provide additional services to our merchants, such as payroll processing, gift and loyalty programs, prepaid and stored-value solutions, and paper check processing, and we sell and rent point-of-sale devices and supplies.

Bankcard Payment Processing

At December 31, 2010, we provided our bankcard payment processing services to approximately 173,860 active SME bankcard merchants located across the United States. This represents a slight increase over the 173,400 active SME bankcard merchants at December 31, 2009. At December 31, 2010, we provided bankcard payment processing services to approximately 109 Network Services Merchants with approximately 54,244 locations. Our total bankcard processing volume for the year ended December 31, 2010 was $74.9 billion, an 8.2% increase from the $69.3 billion processed during the year ended December 31, 2009. Our 2010 SME bankcard processing volume was $63.1 billion, a 7.0% increase over 2009, and included increases for American Express and Discover card processing, which were initiated in 2009. Our Discover processing volume also benefited from our purchase of an existing merchant portfolio from Discover during the third quarter of 2009. We include American Express volume in our SME bankcard processing volume only where we receive percentage-based residual compensation for that volume. Bankcard processing volume for 2010 includes $11.3 billion of settled volume for Network Services Merchants, compared to $9.9 billion for 2009. In addition to settling Visa and MasterCard transactions, Network Services processes a wide range of payment transactions for its predominantly petroleum customer base, including providing approximately 2.6 billion transaction authorizations through its front-end card processing systems (primarily for Visa and MasterCard) in 2010 and 2.4 billion transactions for the year ended December 31, 2009. We also provided bankcard processing services to over 8,300 merchants in Canada through our majority-owned Canadian subsidiary, Collective Point of Sale Solutions Ltd. (CPOS).

According to The Nilson Report, in 2009 we were the 5th largest card acquirer in the United States ranked by transaction count and the 8th largest acquirer by processed dollar volume, which consists of both credit and debit Visa and MasterCard transactions. These rankings represented 2.4 billion transactions and 4.3% of the total bankcard processing market, respectively. In 2010, 2009 and 2008, our bankcard processing dollar volume was $74.9 billion, $69.3 billion and $66.9 billion, respectively.

Our bankcard processing revenue is recurring in nature. We typically enter into three-year service contracts with our SME merchants that, in order to qualify for the agreed-upon pricing, require the achievement of agreed bankcard processing volume minimums from our merchants. Our SME gross bankcard processing revenue is driven by cardholders making purchases at our SME merchants using mostly Visa and MasterCard credit and signature-debit cards, but also pin-debit cards, American Express and Discover cards. We generally benefit from consumers increasing use of bankcards in place of cash and checks, and sales growth (if any) experienced by our retained SME merchants. Most of our SME revenue is from gross processing fees, which are primarily a combination of a percentage of the dollar amount of each card transaction we process plus a flat fee per transaction. We make mandatory payments of interchange fees to card issuing banks through card networks and dues, assessments and transaction authorization fees to Visa, MasterCard and Discover, and we retain the remainder of the revenue. For example, in a transaction using a Visa or MasterCard credit card, the allocation of funds resulting from a $100 transaction is depicted below.

Our bankcard processing revenue from our Network Services Merchants is also recurring in nature. We typically enter into five-year contracts with our large national merchants and three year contracts with our mid-tier merchants. However, in contrast to SME merchants, our processing revenues from Network Services Merchants generally consist of a flat fee per transaction and thus revenues are driven primarily by the number of transactions we process (whether settled, or only authorized), not bankcard processing volume.

In December 2007, we signed a sales and servicing program agreement (OnePoint) with American Express Travel Related Services Company, Inc. (referred to as American Express in this document) under which we sign up and service new merchants on behalf of American Express. Under the terms of the program, we act as American Express s agent in: (a) providing solicitation services by signing new-to-American Express merchants directly with American Express; and (b) providing transactional support services on behalf of American Express to a larger group of existing American Express acceptors in our portfolio. Under OnePoint, we provide processing, settlement, customer support and reporting to merchants, in effect consolidating a merchant s American Express card acceptance into the services we currently provide for their Visa, MasterCard and Discover transactions. OnePoint became available to our sales organization effective January 1, 2009. The terms of the new American Express agreement have a compensation model which provides us a percentage-based residual on the American Express volume generated under (a) above, plus fees for every transaction we process for both new and existing acceptors.

In June 2008, we signed an agreement with DFS Services, LLC (referred to as Discover in this document) to offer bankcard merchants a streamlined process that enables them to accept Discover Network cards on our processing platform. We offer our merchants an integrated processing solution that includes card acceptance pricing, funding, statement processing and customer service on one platform. This program became available to new merchants that boarded with Heartland in the second quarter of 2009. Additionally, in July 2009 we purchased the existing Discover merchant portfolio we were already processing and converted them to the streamlined process described above. Under our new agreement with Discover, our revenue model is similar to Visa and MasterCard.

We sell and market our bankcard payment processing services through a nationwide direct sales force of 1,188 sales professionals. We focus our sales efforts on low-risk bankcard merchants and have developed systems and procedures designed to minimize our exposure to potential merchant losses. In 2010, 2009 and 2008, we experienced such losses in amounts equal to 1.51 basis points (0.0151%), 1.01 basis points (0.0101%) and 0.88 basis points (0.0088%) of SME merchant Visa and MasterCard bankcard processing volume, respectively. The year-over-year increases in our merchant losses track with the overall deteriorating economic conditions in those years, which contributed to increased incidences of merchant fraud. We have developed significant expertise in industries that we believe present relatively low risks as the customers are generally present and the products or services are generally delivered at the time the transaction is processed. These industries include restaurants, brick and mortar retailers, convenience and liquor stores, automotive sales, repair shops and gas stations, professional service providers, lodging establishments and others. As of December 31, 2010, approximately 26.9% of our SME bankcard merchants were restaurants, approximately 19.2% were brick and mortar retailers, approximately 11.4% were convenience and liquor stores, approximately 7.7% were automotive sales and repair shops, approximately 9.9% were professional service providers, approximately 3.4% were lodging establishments, and approximately 1.6% were gas stations.

We have developed a number of proprietary payment processing systems to increase our operating efficiencies and distribute our processing and merchant data to our three main constituencies: our merchant base, our sales force and our customer service staff. We provide authorization and data capture services to our SME merchants through our own front-end processing system, which we call HPS Exchange. We provide clearing, settlement and merchant accounting services through our own internally developed back-end processing system, which we call Passport. Our control over our front-end and back-end systems enables us to more effectively customize these services to the needs of our Relationship Managers and merchants. In the fourth quarter of 2010, the clearing, settlement and merchant accounting services for Network Services settled transactions were converted onto Passport. During the years ended December 31, 2010, 2009 and 2008, we processed approximately 90%, 88% and 83%, respectively, of our SME merchant transactions through HPS Exchange, which has decreased our operating costs per transaction. At December 31, 2010 and 2009, approximately 99% of total SME merchants were processing on Passport. At December 31, 2010, our internally developed systems have been providing substantially all aspects of a merchant s processing needs for most of our SME merchants. At December 31, 2010, our internal systems are providing all aspects of our Network Services Merchants processing needs.

In 2009, we partnered with Voltage Security to develop end-to-end encryption (which we refer to as E3) software specifically suited to payments processing. Voltage is a global leader in information encryption. In May 2010, we launched the E3 technology making it available to merchants and business owners nationwide. Since its launch, approximately 10,000 small and mid-sized business owners across the country have purchased and deployed approximately 12,000 E3 terminals to protect their businesses and their consumers. E3 is a complete end-to-end encryption solution designed to protect cardholder data at all stages of a transaction from card swipe through delivery to the card brands, helping our merchants improve data security and reduce the cost of PCI compliance. The Voltage SecureData product line, based on its Format-Preserving Encryption and Identity-Based Encryption approaches, power the software component of E3. We also employ Voltage SecureMail and Voltage SecureFile to protect personal information throughout our corporate and extended business network.

Payroll Processing Services

Through our wholly-owned subsidiary, Heartland Payroll Company, we operate a full-service nationwide payroll processing service, including check printing, direct deposit, related federal, state and local tax deposits and providing accounting documentation. We developed a new comprehensive payroll management system, which we refer to as PlusOne Payroll, that streamlines all aspects of the payroll process to enable time and cost savings. PlusOne Payroll was made available to new and existing customers beginning in 2010. We expect to fully convert our existing payroll customers to PlusOne Payroll by mid-2011.

At December 31, 2010, 2009 and 2008, we processed payroll for 11,131, 9,382 and 7,738 customers, respectively. Our nationwide direct sales force sells our payroll processing services solely on a commission basis. In 2010, 2009 and 2008, we installed 4,858, 4,303 and 4,406 new payroll processing customers, respectively.

Other Products and Services

Other products and services which we offer, such as Electronic Check Processing Services, Micropayment, Campus Solutions, Loyalty and Heartland Gift Marketing, Prepaid Calling Services, and K to 12 School Services are discussed in Our Services and Products.

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Processing System Intrusion

On January 20, 2009, we publicly announced the discovery of a criminal breach of our payment systems environment (the Processing System Intrusion). The Processing System Intrusion involved malicious software that appears to have been used to collect in-transit, unencrypted payment card data while it was being processed during the transaction authorization process. We believe the breach has been contained and did not extend beyond 2008. See Item 3. Legal Proceedings and Management s Discussion and Analysis of Financial Condition and Results of Operations Legal and Regulatory Considerations for further detail and related events.

Since our announcement of the Processing System Intrusion on January 20, 2009 and through December 31, 2010, we have expensed a total of $146.1 million, before reducing those charges by $31.2 million of total insurance recoveries. The majority of the total charges, or approximately $114.7 million, related to settlements of claims. Approximately $31.4 million of the total charges were for legal fees and costs we incurred for investigations, defending various claims and actions, remedial actions and crisis management services.

During the year ended December 31, 2010, we recovered from our insurance providers approximately $27.2 million of the costs incurred for the Processing System Intrusion and expensed approximately $13.1 million for accruals, legal fees and costs incurred for defending various claims and actions, resulting in a net recovery of $14.1 million, or $0.22 per share.

For the year ended December 31, 2009, we expensed a total of $132.9 million for settlement accruals, legal fees and costs we incurred for defending various claims and actions associated with the Processing System Intrusion, and recovered from our insurance providers approximately $4.0 million of the costs incurred resulting in net expenses of $128.9 million, or about $2.16 per share.

At December 31, 2010 and 2009, we carried a Reserve for Processing System Intrusion on our Consolidated Balance Sheet of $1.6 million and $99.9 million, respectively. During the years ended December 31, 2010 and 2009, we settled the following claims and disputes with the bankcard networks related to the Processing System Intrusion:

- On December 17, 2009, we entered into a settlement agreement and release with American Express and paid approximately $3.5 million in full and final satisfaction of any and all claims of American Express and its issuers arising from or relating to the Processing System Intrusion. We paid this settlement from our available cash.

- On January 7, 2010, we entered into a settlement agreement with Heartland Bank, KeyBank National Association (KeyBank, and, together with Heartland Bank, the Sponsor Banks), and Visa U.S.A. Inc., Visa International Service Association and Visa Inc. (collectively, Visa), to resolve potential claims and other disputes related to the Processing System Intrusion (the Visa Settlement Agreement) and on February 18, 2010 we paid $59.3 million for that settlement. We obtained loans totaling $53.0 million from Sponsor Banks, the proceeds of which were used to partially fund the settlement amount. See Management s Discussion and Analysis of Financial Condition and Results of Operations Credit Facilities for a discussion of our $28.0 million Bridge Loan and our $25.0 million Increased Credit Commitment, both entered into on February 18, 2010.

- On May 19, 2010, we entered into a settlement agreement with MasterCard Worldwide to resolve potential claims and other disputes related to the Processing System Intrusion (the MasterCard Settlement Agreement) and in September 2010 we paid $34.8 million for that settlement. We paid this settlement from our available cash.

- On August 31, 2010, we entered into an agreement of settlement and release with Discover to resolve potential claims and other disputes with respect to the Processing System Intrusion (the Discover Settlement Agreement) and on September 2, 2010, we paid Discover $5.0 million in full and final satisfaction of any and all claims of Discover, its affiliates and certain of its issuers. We paid this settlement from our available cash.

These settlement amounts were previously provided for in our Provision for Processing System Intrusion. We are prepared to vigorously defend ourselves against any unsettled claims relating to the Processing System Intrusion that have been asserted against us to date. We feel we have strong defenses to all the claims that have been asserted against us relating to the Processing System Intrusion.

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Additional costs that we may incur for legal fees and costs for defending various claims and actions associated with the Processing System Intrusion will be recognized as incurred. Such costs could be material and could adversely impact our results of operations, financial condition and cash flow.

Payment Processing Industry Overview

The payment processing industry provides merchants with credit, debit, gift and loyalty card and other payment processing services, along with related information services. The industry continues to grow as a result of wider merchant acceptance, increased consumer use of bankcards and advances in payment processing and telecommunications technology. According to The Nilson Report, total expenditures for all card type transactions by U.S. consumers were $3.4 trillion in 2009, and are expected to grow to $5.8 trillion by 2015. The proliferation of bankcards has made the acceptance of bankcard payments a virtual necessity for many businesses, regardless of size, in order to remain competitive. This use of bankcards, enhanced technology initiatives, efficiencies derived from economies of scale and the availability of more sophisticated products and services to all market segments has led to a highly competitive and specialized industry.

Segmentation of Merchant Service Providers

The payment processing industry is dominated by a small number of large, fully-integrated payment processors that sell directly to, and handle the processing needs of, the nation s largest merchants. Large national merchants (i.e., those with multiple locations and high volumes of bankcard transactions) typically demand and receive the full range of payment processing services at low per-transaction costs.

Payment processing services are generally sold to the SME merchant market segment through banks and Independent Sales Organizations that generally procure most of the payment processing services they offer from large payment processors. It is difficult, however, for banks and Independent Sales Organizations to customize payment processing services for the SME merchant on a cost-effective basis or to provide sophisticated value-added services. Accordingly, services to the SME merchant market segment historically have been characterized by basic payment processing without the availability of the more customized and sophisticated processing, information-based services or customer service that is offered to large merchants. The continued growth in bankcard transactions is expected to cause SME merchants to increasingly value sophisticated payment processing and information services similar to those provided to large merchants.

The following table sets forth the typical range of services provided directly (in contrast to using outsourced providers) by fully integrated transaction processors, traditional Independent Sales Organizations and us.

(a) HPS Exchange: 90% of our SME merchant bankcard transactions
Passport: 99% of our SME merchants

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We believe that the card-based payment processing industry will continue to benefit from the following trends:

Growth in Card Transactions

The proliferation in the uses and types of cards, including in particular debit and prepaid cards, the rapid growth of the Internet, significant technological advances in payment processing and financial incentives offered by issuers have contributed greatly to wider merchant acceptance and increased consumer use of such cards. The following chart illustrates the growth in card volume for the periods indicated.

Source: The Nilson Report. Card purchase volume includes VISA / MasterCard (debit and credit), American Express, Discover and Diners Club.

Note: Percentages inside bar represent year-over-year growth.

According to The Nilson Report and the New York State Forum for Information Resource Management, sources of increased bankcard payment volume include:

- increasing acceptance of electronic payments by merchants who previously did not do so, such as quick service restaurants, government agencies and businesses that provide goods and services to other businesses;
- increasing consumer acceptance of alternative forms of electronic payments, as demonstrated by the dramatic growth of debit cards, electronic benefit transfer, and prepaid and gift cards; and
- continued displacement of checks with the use of cards and other methods of payment, including electronic, at the point of sale, as shown below.

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Source: The Nilson Report

Technology

At present, many large payment processors provide customer service and applications via legacy systems that are difficult and costly to alter or otherwise customize. In contrast to these systems, recent advances in scalable and networked computer systems, and relational database management systems, provide payment processors with the opportunity to deploy less costly technology that has improved flexibility and responsiveness. In addition, the use of fiber optic cables and advanced switching technology in telecommunications networks and competition among long-distance carriers, and the dramatic increase in merchants use of the Internet to process their transactions, further enhance the ability of payment processors to provide faster and more reliable service at lower per-transaction costs than previously possible.

Advances in personal computers and point-of-sale terminal technology, including integrated cash registers and networked systems, have increasingly allowed access to a greater array of sophisticated services at the point of sale and have contributed to the demand for such services. These trends have created the opportunity for payment processors to leverage technology by developing business management and other software application products and services.

Consolidation

The payment processing industry has undergone significant consolidation. Merchant requirements for improved customer service, the risk of merchant fraud, and the demand for additional customer applications have made it difficult for community and regional banks to remain competitive in the merchant acquiring industry. Many of these providers are unwilling or unable to invest the capital required to meet these evolving demands, and have steadily exited the payment processing business or otherwise found partners to provide payment processing for their customers. Despite this consolidation, the industry remains fragmented with respect to the number of entities selling payment processing services, particularly to SME merchants.

Our Competitive Strengths

We believe our competitive strengths related to Bankcard Payment Processing include the following:

Large, Experienced, Efficient, Direct Sales Force

We sell and market our SME bankcard payment processing services through a nationwide direct sales force of 1,188 sales professionals who work exclusively for us. Many of our competitors rely on Independent

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Sales Organizations that often generate merchant accounts for multiple payment processing companies simultaneously. Our sales professionals have local merchant relationships and industry-specific knowledge that allow them to effectively compete for merchants; these relationships are also supported by our 134 Account Managers, who are focused on installing new merchants and responding to any ongoing servicing needs. We compensate our sales force primarily through commissions, which are based upon the performance of their merchant accounts. Our sales professionals have considerable latitude in pricing a new account, but we believe that the shared economics motivate them to sign attractively priced contracts with merchants generating significant bankcard processing volume. The residual commissions our sales force receives from their merchant accounts give them an incentive to maintain a continuing dialogue and servicing presence with their merchants. We believe that our compensation structure is atypical in our industry and contributes to building profitable, long-term relationships with our merchants.

In 2010, our sales force generated over 50,500 SME bankcard merchant applications and installed over 42,800 new SME bankcard merchants. In 2009, our sales force generated over 55,700 SME bankcard merchant applications and installed over 47,900 new SME bankcard merchants.

Recurring and Predictable Revenue

We generate recurring revenue through our payment processing services. Our revenue is recurring in nature because we typically enter into multi-year service contracts with our SME and Network Services Merchants. Our recurring revenue grows as the number of transactions or dollar volume processed for a merchant increases or as we add new merchants. In 2010, approximately 92% of our SME bankcard processing volume came from merchants we installed in 2009 and earlier.

Internal Growth

We grew our SME payment processing business primarily through internal expansion by generating new merchant contracts submitted by our own direct sales force. Substantially all of the SME merchants we process were originally underwritten by our staff, and we have substantial experience responding to the merchants processing needs and the risks associated with them. We believe this practice both enhances our merchant retention and reduces our risks. We believe that internally generated merchant contracts generally are of a higher quality and are more predictable than contracts acquired from third parties, and the costs associated with such contracts generally are lower than the costs associated with contracts acquired from third parties.

While we continue to pursue internal growth, we have selectively taken advantage of acquisition opportunities, for example Network Services in 2008, and to expand into other markets that we previously did not have the technical capabilities to support. See Our Strategy Pursue Strategic Acquisitions and Our Services and Products later in this section for descriptions of these acquisitions.

Strong Position and Substantial Experience in Our Target Markets

As of December 31, 2010, we were providing payment processing services to approximately 173,860 active SME merchants located across the United States. We believe our understanding of the needs of SME merchants and the risks inherent in doing business with them, combined with our efficient direct sales force, provides us with a competitive advantage over larger service providers that access this market segment indirectly. We also believe that we have a competitive advantage over service providers of a similar or smaller size that may lack our extensive experience and resources and which do not benefit from the economies of scale that we have achieved.

Also at December 31, 2010, Network Services provided bankcard payment processing services to approximately 109 large national and mid-tier merchants with approximately 54,244 locations. These Network Services Merchants are primarily in the petroleum industry. We believe that our understanding of the processing needs of petroleum merchants and the products we offer them provides us with a competitive advantage.

Industry Expertise

Historically, we have focused our sales efforts on SME merchants who have certain key attributes and on industries in which we believe our direct sales model is most effective and the risks associated with bankcard processing are relatively low. These attributes include owners who are typically on location, interact with customers in person, value a local sales and servicing presence and often consult with trade associations and other civic groups to help make purchasing decisions.

To further promote our products and services, we have entered into sponsoring arrangements with various trade associations, with an emphasis on state restaurant and hospitality groups. We believe that these sponsorships have enabled us to gain exposure and credibility within the restaurant industry and have provided us with opportunities to market our products to new merchants. On January 19, 2010, we formed a strategic partnership with The National Restaurant Association which will deliver a unified payments processing platform to the restaurant industry. This alliance is expected to provide restaurateurs nationwide with effective tools, solutions and resources that will help them reduce their expenses, improve operations and increase profitability all from one source with integrated technology product platforms.

In December 2010, the restaurant industry represented approximately 34.1% of our SME bankcard processing volume and 49.8% of our SME transactions. In December 2009 and December 2008, the restaurant industry represented approximately 34.8% and 37.5% of our bankcard processing volume and 50.3% and 52.1% of our transactions, respectively. We believe that the restaurant industry will remain an area of focus, though its growth will likely approximate the growth in the overall portfolio. Restaurants represent an attractive segment for us: according to a report by the National Restaurant Association, restaurant industry sales are expected to reach approximately $604 billion in 2011, which would represent a 3.6% increase over projected industry sales for 2010 and the twentieth consecutive year of growth. The projected restaurant industry growth for 2011 is in spite of a challenging economy and this steady growth profile, combined with the industry s low seasonality, makes restaurant merchant bankcard processing volume very stable and predictable. In addition, the incidence of chargebacks is very low among restaurants, as the service typically is provided before the card is used. Our industry focus not only differentiates us from other payment processors, but also allows us to forge relationships with key trade associations that attract merchants to our business. Our industry focus also allows us to better understand a merchant s needs and tailor our services accordingly.

Although we have historically focused significant sales and marketing efforts on the restaurant industry, our SME merchant base also includes a broad range of brick and mortar retailers, lodging establishments, automotive repair shops, convenience and liquor stores, professional service providers, and gas stations. See Our Merchant Base for detail on December 2010 bankcard processing volume by merchant category.

Our historical focus on SME merchants has diversified our merchant portfolio and we believe has reduced the risks associated with revenue concentration. In 2010, no single SME merchant represented more than 1.01% of our total bankcard processing volume. In 2009 and 2008, no single SME merchant represented more than 0.87% and 0.56% of our total bankcard processing volume, respectively.

Our Network Services business has further diversified our total merchant portfolio adding a substantial base of large national merchants, primarily in the petroleum industry.

Merchant Focused Culture

We have built a corporate culture and established practices that we believe improve the quality of services and products we provide to our merchants. We developed and endorsed The Merchant Bill of Rights, an advocacy initiative that details ten principles we believe should characterize all merchants processing relationships. The Merchant Bill of Rights allows our sales team to differentiate our approach to bankcard processing from alternative approaches, and we believe that a focus on these principles by our merchants will enhance our merchant relationships. We believe that our culture and practices allow us to maintain strong merchant relationships and differentiate ourselves from our competitors in obtaining new merchants.

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Our merchant-focused culture spans from our sales force, which maintains a local market presence to provide rapid, personalized customer service, through our service center which is segmented into regionalized teams to optimize responsiveness, and to our technology organization, which has developed a customer management interface and information system that alerts our Relationship Managers to any problems a merchant has reported and provides them with detailed information on the merchants in their portfolio. Additionally, we believe that we are one of the few companies that discloses, and does not unilaterally change, our pricing to merchants. We think this is the best approach to building long-term merchant relationships.

Scalable Operating Structure

Our scalable operating structure generally allows us to expand our operations without proportionally increasing our fixed and semi-fixed support costs. In addition, our technology platform, including both HPS Exchange and Passport, was designed with the flexibility to support significant growth and drive economies of scale with relatively low incremental costs. Most of our operating costs are related to the number of individuals we employ. We have in the past used, and expect in the future to use, technology to leverage our personnel, which should cause our personnel costs to increase at a slower rate than our bankcard processing volume.

Advanced Technology

We employ information technology systems which use the Internet to improve management reporting, enrollment processes, customer service, sales management, productivity, merchant reporting and problem resolution.

We provide authorization and data capture services to our SME merchants through our internally-developed front-end processing system, HPS Exchange. This system incorporates real time reporting tools through interactive point-of-sale database maintenance via the Internet. These tools enable merchants, and our employees, to change the messages on credit card receipts and to view sale and return transactions entered into the point-of-sale device with a few second delay on any computer linked to the Internet. During the years ended December 31, 2010, 2009 and 2008, approximately 90%, 88% and 83%, respectively, of our SME transactions were processed through HPS Exchange.

We provide clearing, settlement and merchant accounting services through our own internally developed back-end processing system, Passport. Passport enables us to customize these services to the needs of our Relationship Managers and merchants. At both December 31, 2010 and 2009, approximately 99% of total SME bankcard merchants were processing on Passport. In the fourth quarter of 2010, the clearing, settlement and merchant accounting services for Network Services settled transactions were converted onto Passport. At December 31, 2010 and 2009, our internally developed systems have been providing substantially all aspects of a merchant s processing needs for most of our SME merchants. At December 31, 2010, our internal systems are providing all aspects of our Network Services Merchants processing needs.

HPS Exchange, Passport and our other technology efforts have contributed to efficiency gains in our transaction processing costs. Our Internet-based systems allow all of our merchant relationships to be documented and monitored in real time, which maximizes management information and customer service responsiveness. We believe that these systems help attract both new merchants and Relationship Managers and provide us with a competitive advantage over many of our competitors who rely on less flexible legacy systems.

Comprehensive Underwriting and Risk Management System

Through our experience in assessing risks associated with providing payment processing services to small- and medium-size merchants, we have developed procedures and systems that provide risk management and fraud prevention solutions designed to minimize losses. Our underwriting processes help us to evaluate merchant applications and balance the risks of accepting a merchant against the benefit of the bankcard processing volume we anticipate the merchant will generate. We believe our systems and procedures enable us to identify potentially fraudulent activity and other questionable business practices quickly, thereby minimizing both our losses and those of our merchants. As evidence of our ability to manage these risks, notwithstanding the challenging economic environment faced by our SME merchants in recent years, we experienced losses of no more than 1.51 basis points of SME Visa and MasterCard bankcard processing volume for each of the years ended December 31, 2010, 2009 and 2008, which we believe is lower than industry norms. The risks discussed in this paragraph are merchant fraudulent card activity that is not related to the Processing System Intrusion.

Proven Management Team

We have a strong senior management team, each with at least a decade of financial services and payment processing experience. Our Chief Executive Officer, Robert O. Carr, was a founding member of the Electronic Transactions Association, the leading trade association of the bankcard acquiring industry. Our management team has developed extensive contacts in the industry and with banks and value-added resellers. Our sales leaders have all sold merchant services for us prior to assuming management roles, and many have been with us throughout most of our first decade of existence. We believe that the strength and experience of our management team has helped us to attract additional sales professionals and add additional merchants, thereby contributing significantly to our growth.

Our Strategy

Our current growth strategy is to increase our market share as a provider of payment processing services to merchants in the United States and Canada. We believe that the forecasted increase in the use of bankcards as a payment method, combined with our sales and marketing approaches, will continue to present us with significant growth opportunities. Additionally, we intend to continue growing our payroll processing business, and enhance our other products such as Electronic Check Processing, Micro Payments, Campus Solutions, and Gift Marketing. Key elements of our strategy include:

Expand Our Direct Sales Force

Unlike many of our competitors who rely on Independent Sales Organizations or salaried salespeople and telemarketers, we have built a direct, commission-only sales force. Our sales model divides the United States into 15 primary geographic regions overseen by Regional Directors. The Regional Directors are primarily responsible for hiring Relationship Managers and increasing the number of installed merchants in their territory. Historically, we compensated our sales managers based on their success in growing the sales force and increasing the total SME merchant base in their regions. Past increases in our direct sales force, including our Relationship Managers, had led to significant growth in the total SME merchants for which we process and the gross margin generated by those merchants.

In the third quarter of 2010, we focused on accelerating new gross margin install growth by improving the productivity of our sales organization. We have leveraged the best and most effective practices of our most productive sales divisions and implemented their sales process and management techniques across the country. Since then we have seen a significant reduction in headcount of our Relationship Managers, but have improved our individual sales productivity to historical highs. We have also more fully engaged our Territory Managers in the sales process by requiring them to achieve individual minimum monthly gross margin install targets. We anticipate renewed growth in our sales force in the next few years in order to increase our share of our target markets.

Further Penetrate Existing SME Bankcard Target Markets and Enter Into New Markets

We believe that we have an opportunity to grow our business by further penetrating the SME market through our direct sales force and alliances with local trade organizations, banks and value-added resellers. During 2009, according to The Nilson Report, we processed approximately 2.9% of the dollar volume of all Visa and MasterCard transactions in the United States, down from approximately 3.0% in 2008, and up from approximately 2.4% in 2007, 2.3% in 2006 and 2.2% in 2005. We believe that our sales model, combined with our community-based strategy that involves our Relationship Managers building relationships with various trade groups and other associations in their territory, will enable our Relationship Managers to continuously add new merchants. We intend to further expand our bankcard processing sales efforts into new target markets with relatively low risk characteristics, including markets that have not traditionally accepted electronic payment methods. These markets include governments, schools and the business-to-business market.

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Expand Our Services and Product Offerings

We have focused on offering a broad set of payment-related products to our customers. Our current product offerings include payroll processing, check processing services, Micropayments, Campus Solutions, prepaid, loyalty and gift card. See Our Services and Products for descriptions of these services. In 2008, we added Collective Point of Sale Solutions Ltd., Network Services and Chockstone, Inc. expanding our bankcard processing services into Canada and large national merchants, and adding gift card and loyalty solutions to our product set (see Our Services and Products Large National Merchant Bankcard Processing , Our Services and Products Collective Point of Sale Solutions Ltd. and Our Services and Products Loyalty and Heartland Gift Marketing for more information).

We also distribute products that will help our merchants reduce their costs and grow their businesses, such as age verification services that track driver s license data to verify an individual s age and identity. We may develop new products and services internally, enter into arrangements with third-party providers of these products or selectively acquire new technology and products. Many of these new service offerings are designed to work on the same point-of-sale devices that are currently in use, enabling merchants to purchase a greater volume of their services from us and eliminating their need to purchase additional hardware. We believe that these new products and services will enable us to leverage our existing infrastructure and create opportunities to cross-sell our products and services among our various merchant bases, as well as enhance merchant retention and increase processing revenue.

Leverage Our Technology

We intend to continue leveraging our technology platforms to increase operating efficiencies and provide real-time processing and data to our merchants, sales force and customer service staff. Since our inception, we have been developing Internet-based systems to improve and streamline our information systems, including customer-use reporting, management reporting, enrollment, customer service, sales management and risk management reporting tools. We continually develop enriched back office solutions which allow merchants to integrate their payment processing data into any of the major small business accounting software packages, and remain on the leading edge of the merchant marketplace. We continue to make material investments in our payment processing capabilities, which allows us to offer a differentiated payment processing product that is faster, less expensive, and more comprehensive than competing products.

Enhance Merchant Retention

By providing our merchants with a consistently high level of service and support, we strive to enhance merchant retention. We recognize that our ability to maintain strong merchant relationships is important to not only maintaining our recurring revenues, but to our growth. We believe that our practice of fully disclosing our pricing policies to our merchants creates goodwill. We developed and endorsed The Merchant Bill of Rights, an advocacy initiative that details ten principles we believe should characterize all merchants processing relationships. The Merchant Bill of Rights allows our sales force to differentiate our approach to bankcard processing from alternative approaches, and we believe that a focus on these principles by our merchants will enhance our merchant relationships.

We have developed a customer management interface that alerts our Relationship Managers and Account Managers to any problems an SME merchant has reported and provides them with detailed information on the merchants in their portfolio. In addition, we believe that our flexible back-end processing platform, Passport, allows us to tailor our services to the needs of our sales force and merchants, which we believe will further enhance merchant retention. Passport s flexibility allows us to enhance the information available to our merchants, and to offer new services to them.

Pursue Strategic Acquisitions

Although we intend to continue to pursue growth through the efforts of our direct sales force, we may also expand our merchant base or gain access to other target markets by acquiring complementary businesses, products or technologies, including other providers of payment processing. Our 2006 acquisition of Debitek, Inc. and 2007 acquisition of General Meters Corp, are examples of expanding by acquiring complementary businesses. In 2008, we acquired Collective Point of Sale Solutions Ltd., a Canadian provider of payment processing services and secure point-of-sale solutions that provided us with an entrance into the Canadian credit and debit card processing market. We are now able to service merchants that have locations in both the United States and Canada. In 2008, we also acquired Network Services which handles a wide range of payment transactions for its predominantly petroleum customer base. Our acquisition of Chockstone in 2008 provided for expansion into the loyalty marketing and gift card solutions market.

On December 30, 2010, we initiated our K to 12 School Services product through the acquisition of the K to 12 School Services business operated by Lunchbox. We followed this acquisition with the January 12, 2011 and February 4, 2011 acquisitions of the K to 12 School Services businesses of Comalex, Inc. and mySchoolBucks, LLC. Combined, these three acquisitions provide us with approximately 9,000 schools as the base to build our K to 12 School Services business.

On July 31, 2009, we purchased the existing Discover merchant portfolio for $3.2 million, which we were already processing. This purchase related to our 2008 agreement with Discover, which enables us to offer bankcard merchants a streamlined process that enables them to accept Discover Network cards on our processing platform.

Our Services and Products

SME Merchant Bankcard Payment Processing

We derive the majority of our SME processing revenues from fee income relating to Visa and MasterCard payment processing, which is primarily comprised of a percentage of the dollar amount of each transaction we process, as well as a flat fee per transaction. The percentage we charge is typically a fixed margin over interchange, which is the percentage set by Visa and MasterCard depending on the type of card used and the way the transaction is handled by the merchant. On average, the gross revenue we generate from processing a Visa or MasterCard transaction equals approximately $2.50 for every $100 we process. We also receive fees from American Express, Discover, and JCB for facilitating their transactions with our SME merchants. The terms of our new American Express agreement have a compensation model which provides us percentage-based residual on the American Express volume we process, plus fees for every transaction we process. Under our new agreement with Discover, which made this program available to our merchants in the second quarter of 2009, our revenue model is similar to Visa and MasterCard.

We receive revenues as compensation for providing bankcard payment processing services to merchants, including merchant set-up and training, transaction authorization and electronic draft capture, clearing and settlement, merchant accounting, merchant support and chargeback resolution. In 2005, we began providing clearing, settlement and accounting services through Passport, our own internally developed back-end processing system. Passport enables us to customize these services to the needs of our Relationship Managers and merchants. At December 31, 2010 and 2009, approximately 99% of our SME bankcard merchants were processing on Passport. In addition, we sell and rent point-of-sale devices and supplies and provide additional services to our merchants, such as gift and loyalty programs, paper check authorization and chargeback processing. These payment-related services and products are described in more detail below:

Merchant Set-up and Training After we establish a contract with a merchant, we create the software configuration that is downloaded to the merchant s existing, newly purchased or rented point-of-sale terminal, cash register or computer. This configuration includes the merchant identification number, which allows the merchant to accept Visa and MasterCard as well as any other cards, such as American Express, Discover and JCB, provided for in the contract. The configuration might also accommodate check verification, gift and loyalty programs and allow the terminal or computer to communicate with a pin-pad or other device. Once the download has been completed by the Relationship Manager or Account Manager, we conduct a training session on use of the system. We also offer our merchants flexible low-cost financing options for point-of-sale terminals, including installment sale and monthly rental programs.

Authorization and Draft Capture We provide electronic payment authorization and draft capture services for all major bankcards. Authorization generally involves approving a cardholder s purchase at the point of sale after

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verifying that the bankcard is not lost or stolen and that the purchase amount is within the cardholder s credit or account limit. The electronic authorization process for a bankcard transaction begins when the merchant swipes the card through its point-of-sale terminal and enters the dollar amount of the purchase. After capturing the data, the point-of-sale terminal transmits the authorization request through HPS Exchange or the third-party processor to the card-issuing bank for authorization. The transaction is approved or declined by the card-issuing bank and the response is transmitted back through HPS Exchange or the third-party processor to the merchant. At the end of each day, and, in certain cases, more frequently, the merchant will batch out a group of authorized transactions, transmitting them through us to the bankcard networks for payment.

We introduced HPS Exchange, our internally developed front-end processing system, in August 2001. During the years ended December 31, 2010, 2009 and 2008, approximately 90%, 88% and 83%, respectively, of our SME transactions were processed through HPS Exchange. The remainder of our front-end processing is outsourced to third-party processors, primarily TSYS Acquiring Solutions. Although we will continue to install new SME merchants on TSYS systems, we anticipate that the percentage of SME transactions that are outsourced will continue to decline as we install a high percentage of new merchants on HPS Exchange. Additionally, in the fourth quarter of 2010 we sold many of our remaining merchant accounts that had not been converted onto HPS Exchange and were still processing on third party front-end platforms. The sale s purpose was to eliminate servicing inefficiencies associated with these merchant accounts.

Clearing and Settlement Clearing and settlement processes, along with Merchant Accounting, represent the back-end of a transaction. Once a transaction has been batched out for payment, the payment processor transfers the merchant data to Visa or MasterCard who then collect funds from the card issuing banks. This is typically referred to as clearing. After a transaction has been cleared, the transaction is settled by Visa or MasterCard by payment of funds to the payment processor s sponsor bank the next day. The payment processor creates an electronic payment file in ACH format for that day s cleared activity and sends the ACH file to its sponsor bank. The ACH payments system generates a credit to the merchants bank accounts for the value of the file. The merchant thereby receives payment for the value of the purchased goods or services, generally two business days after the sale. Under the terms of the new Agreement with American Express and Discover, the process is substantially similar to the Visa and MasterCard process, and the merchant receives one deposit for all cards accepted, in contrast to the previously existing arrangement, where an acceptor of Visa and MasterCard, American Express and Discover would have received three deposits.

Passport, our internally developed back-end system, enables us to customize these services to the needs of our merchants and Relationship Managers. For example, Passport enables us to provide Next Day Funding to our SME merchants who have banking relationships with certain banks. Under Next Day Funding, these merchants are paid for their transactions one day earlier than possible when we were processing on a third party back-end platform.

Merchant Accounting Utilizing Passport, we organize our SME merchants transaction data into various files for merchant accounting and billing purposes. We send our SME merchants detailed monthly statements itemizing daily deposits and fees, and summarizing activity by bankcard type. These detailed statements allow our SME merchants to monitor sales performance, control expenses, disseminate information and track profitability. We also provide information related to exception item processing and various other items of information, such as volume, discounts, chargebacks, interchange qualification levels and funds held for reserves to help them track their account activity. SME merchants may access this archived information through our customer service representatives or online through our Internet-based customer service reporting system.

Merchant Support Services We provide merchants with ongoing service and support for their processing needs. Customer service and support includes answering billing questions, responding to requests for supplies, resolving failed payment transactions, troubleshooting and repair of equipment, educating merchants on Visa and MasterCard compliance and assisting merchants with pricing changes and purchases of additional products and services. We maintain a toll-free help-line 24 hours a day, seven days a week, which is staffed by our customer service representatives and during 2010 answered an average of approximately 138,000 customer calls per month. The information access and retrieval capabilities of our intranet-based systems provide our customer service representatives prompt access to merchant account information and call history. This data allows them to quickly respond to inquiries relating to fees, charges and funding of accounts, as well as technical issues.

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Chargeback Services In the event of a billing dispute between a cardholder and a merchant, we assist the merchant in investigating and resolving the dispute as quickly and accurately as possible with card issuers or the bankcard networks, which determine the outcome of the dispute. In most cases, before we process a debit to a merchant s account for the chargeback, we offer the merchant the opportunity to demonstrate to the bankcard network or the card issuer that the transaction was valid. If the merchant is unable to demonstrate that the transaction was valid and the dispute is resolved by the bankcard network or the card issuer in favor of the cardholder, the transaction is charged back to the merchant. After a merchant incurs three chargebacks in a year, we typically charge our merchants a $25 fee for each subsequent chargeback they incur.

Network Services Merchant Bankcard Payment Processing

Network Services is a provider of payment processing solutions, serving large national merchants in a variety of industries such as petroleum, convenience store, parking and retail. More recently, we have added mid-tier petroleum merchants to Network Services merchant base. Services include payment processing, prepaid services, POS terminals, helpdesk services and merchant bankcard services. In addition to Visa and MasterCard transactions, Network Services handles a wide range of payment transactions for its predominantly petroleum customer base.

Our bankcard processing revenue from Network Services Merchants is recurring in nature. In contrast to SME merchants, our processing revenues from Network Services Merchants generally consist of a flat fee per transaction and thus are primarily driven by the number of transactions we process (whether settled, or only authorized), not processing volume.

Authorization and Draft Capture Network Services provides electronic payment authorization and draft capture for all major bankcards, client private label cards and fleet cards. Authorization generally involves approving a cardholder s purchase at the point of sale after verifying that the card is not lost or stolen and that the purchase amount is within the cardholder s credit or account limit. The electronic authorization process for a card transaction begins when the merchant swipes the card through its point-of-sale terminal and enters the dollar amount of the purchase. Network Services offers two front-end processing hosts, VAPS and NWS. After capturing the data, the point-of-sale terminal transmits the authorization request through the VAPS or NWS host or the third-party processor to the card-issuing entity for authorization. The transaction is approved or declined by the card-issuing entity and the response is transmitted back through the VAPS/NWS host or the third-party processor to the merchant. At the end of each day, and, in certain cases, more frequently, the merchant will batch out a group of authorized transactions, transmitting them through us to the bankcard networks for payment.

VAPS and NWS provide distinct functionality and processing options for our large corporate customers. These hosts provide efficient transaction payment processing and real-time authorizations using fully redundant routing paths. Our merchants can rely on quick response times and high availability. We maintain two redundant data centers for our Network Services Merchant transaction processing. If one site fails, the other site is capable of supporting 100% of the workload so this assures uninterrupted transaction processing. Each data center maintains direct connections to Visa, MasterCard, Discover, Fiserv and American Express. The Fiserv connection is our gateway for debit and EBT processing.

Clearing and Settlement Clearing and settlement processes represent the back-end of a transaction. Once a transaction has been batched out for payment, we transfer the completed transaction detail file to our Passport back-end processing system for clearing and settlement. During the clearing process, the transaction detail is split out and sent to Visa or MasterCard who then collect funds from the card issuing banks. After a transaction has been cleared, the transaction is settled by Visa or MasterCard by payment of funds to our sponsor bank the next day. We then create either electronic payment files for wire or ACH for that day s cleared activity and send the files to our sponsor bank. The payments system generates a wire or credit to the merchants bank accounts for the value of the file.

We provide deposit information to our Network Services Merchants each day via our Internet-based settlement reporting system. Deposits are broken out by card type and show gross sales, less chargebacks, interchange, and miscellaneous adjustments.

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Merchant Boarding The Merchant Support area supports new site setup requests, changes to existing locations, and any deletions. In addition, we provide Network Services Merchants with a web-based system, Prometheus, that allows merchants to manage their sites data in the mainframe database after their initial setup has been completed. The benefits of Prometheus include reducing complexity, decreasing delay in boarding, allowing merchants to control their data entry, and minimizing the learning curve and data entry. The only requirements are Windows and a user ID. Boarding merchants using Prometheus access allows direct connect into Prometheus through a TCP/IP connection.

Merchant Reporting We provide three types of reporting options to Network Services Merchants:

- Data Warehouse Merchants interested in flexible reporting alternatives have been satisfied with our Data Warehouse. A data warehouse is an architecture that consists of various technologies, which include relational and multi-dimensional databases, file servers, extraction and transformation programs, user query and reporting tools, and more. Other than a suitable web browser, no additional software is required to access Data Warehouse. Users can access Data Warehouse from any location anywhere and at any time from any PC that has access to the Internet.

- Doc Web Provides multiple reports with multiple filtering options. There is no investment in new hardware or software required to view reports only a web browser that supports HTML. Availability for filtered reports for quick adaptation to changing market conditions is available to merchants 24 hours a day, seven days a week.

- Direct Settlement Reporting Direct is a java based application that links the merchant directly with the settlement processing systems for viewing transaction and chargeback data.

Help Desk Services The large national merchant Help Desk manages merchant trouble ticket initiation, escalation and resolution. The Help Desk also provides vendor and technician support, password resets, completes supply orders, and special projects.

Our Help Desk s operating philosophy focuses on providing the highest level of quality support to our customers. To provide this high level of support, we train our Help Desk agents to focus on resolving the caller s issue or concern during the first call. As a result, our agents are not limited by restrictive and unproductive talk time limits so that they can focus on delivering a working solution to the caller. Our merchant Help Desk is open 24 hours a day, seven days a week with full Help Desk support.

The Help Desk provides three possible levels of support on all point-of-sale (POS) solutions that are certified to process on our network:

- 1st level support includes full support of all of the POS functions, downloading of the POS, and replacement of the POS (when applicable), as well as all of the support functions provided at 2nd and 3rd level.

- 2nd level support includes full support of the communication between the POS and our network and minor support of the POS functions, mostly limited to those functions related to communication or network identification, as well as any support provided at 3rd level.

- 3rd level support includes research and analysis of data being sent by the POS to our network.

Chargeback Services We provide direct settlement reporting to help our Network Services Merchants manage chargebacks received from Visa, MasterCard and Discover. Merchants are notified of chargebacks and requested to submit any information regarding the transaction within 15 days to facilitate resolution of the chargeback. During this time, the merchant is not debited for a chargeback. If we do not receive the required information within the timeframe allowed, the merchant will be debited for the chargeback.

Collective Point of Sale Solutions Ltd.

In March 2008, we acquired a majority interest in Collective Point of Sale Solutions Ltd. (CPOS), a Canadian provider of bankcard payment processing services and secure point-of-sale solutions. This acquisition provides us with an entrance into the Canadian credit and debit bankcard processing market. We are now able to service merchants that have locations in both the United States and Canada. CPOS employs call center and field sales personnel to sign new processing relationships. As of December 31, 2010 and 2009, we provided bankcard processing services to over 8,300 and 6,600 merchants, respectively, in Canada. Revenues for our CPOS services were $8.5 million, $6.0 million and $4.1 million, respectively, in 2010, 2009 and 2008.

Payroll Processing Services

Through our wholly-owned subsidiary, Heartland Payroll Company, we operate a full-service nationwide payroll processing service. Revenues for our Payroll Processing Services were $17.3 million, $15.0 million and $12.8 million, respectively, in 2010, 2009 and 2008. Our payroll services include check printing, direct deposit, related federal, state and local tax deposits and providing accounting documentation. In addition, we offer a PayAdvantage card, which provides employees the opportunity to have all, or a portion, of their payroll deposited to a Visa debit card account. In order to improve operating efficiencies and ease-of-use for our customers and to decrease our own processing costs, we offer electronic and paperless payroll processing that allows an employer to submit its periodic payroll information to us via the Internet or through a personal computer-based, direct-connect option. If a customer chooses either of these online options, all reports and interactions between the employer and us can be managed electronically, eliminating the need for cumbersome paperwork. Approximately 45% of our payroll customers currently submit their information electronically. However, if a customer chooses not to submit their payroll data online, they may submit such information via phone or facsimile. Regardless of input method, clients can choose to have Heartland print and ship their payroll package or to receive this information electronically. As of December 31, 2010, 2009 and 2008, we provided payroll processing services to 11,131, 9,382 and 7,738 customers, respectively. In 2010, 2009 and 2008, we installed 4,858, 4,303 and 4,406 new payroll processing customers, respectively.

We developed a new comprehensive payroll management system, which we refer to as PlusOne Payroll, that streamlines all aspects of the payroll process to enable time and cost savings. PlusOne Payroll was made available to new and existing customers beginning in 2010. At December 31, 2010, 883 of our payroll processing customers were processing on PlusOne Payroll. We expect to fully convert our existing payroll customers to PlusOne payroll by mid-2011. We consider our PlusOne Payroll platform to be state-of-the art, enabling us to process payroll on a large scale and provide customizable solutions for businesses of all sizes. PlusOne Payroll enables faster processing and continuous updates to help businesses remain compliant with payroll, tax and human resources regulations. The platform features web-hosted access, enabling businesses and their accountants to securely access all payroll data from virtually anywhere with SSL-encryption protection. It also provides robust, easy-to-use reporting for better business analysis. PlusOne Payroll is equipped to interface with the leading providers of accounting and time and attendance applications, as well as restaurant and retail point-of-sale systems.

Electronic Check Processing Services

We offer electronic check processing services, which we refer to as Express Funds, to merchants. Revenues for our Electronic Check Processing Services were $1.9 million, $1.5 million and $0.8 million, respectively, in 2010, 2009 and 2008. Express Funds allows our merchants to quickly and easily scan all of their checks at their place of business, using a scanner sold or rented by us, to capture the image of the front and back of the check, store those images, and transmit the image to us for clearing through existing banking channels. Our merchants do not have to change their local banking arrangements. We clear checks on their behalf, and deposit collected funds at their own bank as soon as the next banking day. Express Funds also performs security checks and ensures that the image file is balanced before it is sent to us. Merchants often benefit from checks clearing faster and receiving a return notification earlier. We also offer a late deposit deadline and comprehensive reporting on the status of all checks and deposits.

The product has additional value-added functionality, ease of use, and support to our check processing merchants. The Express Funds platform is capable of automatically posting check activity to many popular accounting packages, has been directly embedded in industry specific enterprise applications, and has been expanded to include remittance processing capabilities. The platform continues to drive efficiency for our check processing merchants. In addition, our platform now offers a Service Oriented Architecture that allows a software partner or enterprise business the ability to embed our check management platform into the merchant s programs giving them a direct interface. We have also created a new interface referred to as Express Funds Online Lockbox that assists with remittance processing, complex data management, full page document scanning and the ability to manage split allocations.

Micropayments

We began providing payment solutions within the small value transaction market in 2006. Revenues for Micropayments were $6.8 million, $4.8 million and $6.3 million, respectively, in 2010, 2009 and 2008. We manufacture and sell solutions comprising unattended online wireless credit card based payment systems, and unattended value top up systems for off-line closed loop smart (chip) card based payment systems. Our electronic cash systems provide small value transaction processing for laundromat machines, vending machines, and cash registers, in apartment laundries, cruise ships, corporate and university campuses, and penitentiaries. These systems offer consumers convenient ways to use their credit cards in laundromats with our new Waverider system, purchase and reload electronic cash cards, and spend the value on the card for small value purchases in both attended and unattended point of sale locations. In addition, we provide merchants financial settlement between the value (electronic cash card) issuer and the vendor/merchant who accepts the card as payment. We believe that there is increasing consumer demand for, and merchant interest in, card-based solutions for small denomination transactions, and expect to make additional investments in the future in developing solutions in this area.

Campus Solutions

Our campus solutions product provides an open or closed networked payments solution for a campus to efficiently process small value electronic transactions. Revenues for Campus Solutions were $5.7 million, $4.8 million, and $4.4 million, respectively, in 2010, 2009, and 2008. Besides payment processing, our solutions enable personal identification, door access, cashless vending transactions, cashless laundry, meal plans and cashless printing. Our innovative Give Something Back Network adds Internet and phone accessible debit card based financial services to the students, faculty, staff and local community merchants of an educational institution. In addition, our new Acceluraid program addresses a major operational need for campuses by providing a debit card based platform for reimbursing financial aid refunds. We currently have 150 OneCard college and university accounts.

Loyalty and Heartland Gift Marketing

We continue to leverage our November 2008 acquisition of Chockstone, Inc., to provide gift card programs and loyalty solutions. Revenues for Loyalty and Gift Marketing were $9.2 million, $6.4 million and $0.8 million, respectively, in 2010, 2009 and 2008. Through our Loyalty Group, we deliver processing services to merchant locations through real-time communications with the merchant point-of-sale, enabling us to leverage existing installations across our merchant base. In addition to servicing the SME market, the Loyalty Group also provides gift and loyalty services to national brands.

In September 2009, we initiated a gift card program called Heartland Gift Marketing, which strengthens an SME merchant s marketing initiatives by combining traditional, loyalty and promotional gift card features into one integrated gift card program. Merchants are using Heartland Gift Marketing to increase customer loyalty and acquire new customers through the use of real-time offers and rewards delivered at the merchant point-of-sale. As of December 31, 2010, Heartland Gift Marketing has signed 5,300 merchant locations and loaded $22 million onto approximately 620,000 activated consumer gift cards, compared to 1,300 merchant locations and $1.8 million loaded onto approximately 80,000 cards in 2009.

Prepaid Calling Services

In August of 2009, we began reselling top-up minutes from the major prepaid wireless and long distance providers across the nation through our e-PIN It! Program. E-PIN It! Prepaid Services enables one of our merchants to dispense electronic products and services through their existing point-of-sale terminal, using our proprietary application. Business owners can download the program directly to their terminal and sell a large assortment of products and services without the need to carry inventory. Customers access the minutes by calling a toll-free number and inputting the Personal Identification Number (PIN) printed on the terminal generated receipt.

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K to 12 School Services

On December 30, 2010, we initiated our K to 12 School Services product through the acquisition of the K to 12 School Services business operated by Lunchbox. Lunchbox serves approximately 4,400 schools. Lunchbox develops, manufactures, sells, services and maintains computer software designed to facilitate accounting and management functions of food service operations of K to 12 schools.

School districts use Lunchbox for point-of-sale (POS) platforms for their cafeteria serving line, free and reduced meal application processing, inventory, menu planning, nutritional analysis and online payments. These platforms are web-based software which provides real-time communication and interaction between the District s central office and schools. LunchBox uses touch screen technology and offers optional biometrics, reimbursable meal vending, meal application scanning and on-line application processing.

On January 12, 2011 and February 4, 2011, we acquired the K to 12 School Services businesses of Comalex, Inc. and mySchoolBucks, LLC. Comalex and mySchoolBucks added approximately 3,700 and 900 schools, respectively, to our K to 12 School Services customer base. These acquisitions will enable us also to offer Internet payment capability, which enables on-line deposits of funds into student accounts and enables schools to operate more efficiently. We plan to consolidate the individual platforms and products of Lunchbox, Comalex and mySchoolBucks to optimize synergies, cost efficencies and product offerings to our customers.

Sales

We sell and market our products and services to our SME merchants exclusively through our sales force. As of December 31, 2010, we employed 1,188 Relationship Managers, Account Managers and sales managers in 50 states plus the District of Columbia. We employ a geographic sales model that divides the United States into 15 regions overseen by Regional Directors, who are responsible for sales and service in their region and ultimately responsible for increasing the number of installed merchants. Regional Directors manage their territories through Division Managers and Territory Managers. Division Managers do not sell our products and services. Instead, their sole responsibility is to hire, train and manage Territory and Relationship Managers in their assigned geography. In contrast, Territory Managers are Relationship Managers who are also responsible for hiring and training a small number of Relationship Managers in their territory. Our Relationship Managers employ a community-based strategy that involves cold calling, obtaining referrals from existing merchants and building relationships with various trade groups, banks and value-added resellers to create sales opportunities.

We designed our sales force compensation structure to motivate our Relationship Managers to establish profitable long-term relationships with low-risk merchants and create a predictable and recurring revenue stream. Compensation for Relationship Managers is entirely commission-based, as a percentage of the financial value of new merchant accounts installed, which is measured in terms of the annual gross margin we estimate we will receive from the merchant accounts installed. Gross Margin is calculated by deducting interchange fees, dues, assessments and fees and all of our costs incurred in underwriting, processing and servicing an account from expected gross processing revenues. Relationship Managers are permitted to price accounts as they deem appropriate, subject to minimum and maximum gross margin guidelines.

We pay our Relationship Managers, Territory Managers, Division Managers, and Regional Directors a percentage of the gross margin we derive from the payments we process for the SME merchant accounts they generate and service. Typically, when a new merchant account is signed at an acceptable estimated gross margin level, the Relationship Manager will be paid a signing bonus equal to 50% of the first 12 months estimated gross margin. The Relationship Manager will also receive 15% of the gross margin generated from the merchant each month as residual commissions for as long as the merchant remains our customer, and in situations where there is no Account Manager assigned to the merchant account, 5% of gross margin is paid for the Relationship Manager s continued servicing of the account. In addition, the Division Manager will receive an amount equal to 25% of the amount paid to the Relationship Manager (split with a Territory Manager, if one exists for the account), and the Regional Director will receive an amount equal to 25% of the amount paid to the Division Manager. For example, if a merchant account has $1,000 of estimated annual gross margin for the first twelve months and estimated monthly gross margin of $83.33, our sales force would be compensated as follows:

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Signing Bonus:		
Estimated Gross Margin for first 12 months	$ 1,000	
Signing bonus paid to:		
Relationship Manager	$ 500	50.0%
Division Manager (plus Territory Manager)	$ 125	12.5%
Regional Director	$ 31	3.125%
Residual Commission:		
Estimated monthly Gross Margin	$ 83.33	
Monthly residual commission paid to:		
Relationship Manager	$ 12.50	15.00%
Division Manager	$ 3.12	3.75%
Regional Director	$ 0.78	0.94%

In certain cases, no signing bonus will be paid to a Relationship Manager, but the residual commission is 30% (excluding the 5% servicing fee) of the ongoing monthly gross margin generated by such merchant.

When a Relationship Manager has established merchant relationships that generate the equivalent of $10,000 of monthly gross margin, he or she will be deemed to have a vested equity interest (known as portfolio equity), and will be guaranteed the owned portion (all but the 5% servicing portion) of the ongoing monthly gross margin generated by such merchants for as long as the merchant processes with us. See Management s Discussion And Analysis of Financial Condition And Results of Operations Critical Accounting Policies Accrued Buyout Liability for more information regarding portfolio equity. At the end of the first 12 months of processing for a new merchant, we compare the actual gross margin generated from that merchant with the estimated gross margin used to calculate the signing bonus. If the merchant was more profitable than expected, we increase the signing bonus amount paid to the Relationship Manager. However, if the merchant was less profitable than anticipated, the Relationship Manager must return a pro-rata portion of his or her signing bonus to us. See Management s Discussion And Analysis of Financial Condition And Results of Operations Critical Accounting Policies Capitalized Customer Acquisition Costs for more information regarding signing bonuses.

We maintain a team of Account Managers who are assigned a specific geographic territory for which they are responsible for servicing and completing installation activities. We believe that the Account Manager role allows our Relationship Managers and Territory Managers to leverage their sales efforts, while allowing us to offer merchants two local relationship contacts including an Account Manager who is more attuned to the merchants service needs. The majority of Account Managers compensation represents a shift of the 5% servicing portion associated with the merchants he or she is servicing. The 5% is distributed in compensation to the Account Manager in the form of a weekly salary, a monthly expense allotment and monthly bonus. Compensation for these activities is deducted from Relationship Manager and Territory Manager compensation. At December 31, 2010 and 2009, we had 134 and 331 Account Managers, respectively. The decline in the number of Account Managers at 2010 year end reflects the impacts of eliminating selling capabilities from the Account Manager role, and our focus on improving the productivity of Relationship Managers and Territory Managers.

In late 2008, we established a small team of sales professionals to directly solicit mid-market and large national accounts. This team consists of one Senior Director of National Accounts and four national account sales representatives. All members of the National Account team are on draw against a commission plan that includes Signing Bonus compensation and relationship management compensation. Signing Bonuses are determined after calculating the cost and internal support requirements to support each large national account s custom needs, which is then deducted from the traditional gross margin calculations before commissions are paid.

In addition to our commission-based compensation structure, we use various sales contests to reward strong sales performance. Sales compensation in connection with these contests includes stock options, trips and incentive points. The incentive points are redeemable for custom rewards, such as travel, personal goods, and business tools.

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Marketing

Our marketing efforts have historically focused on industry verticals and marketing partnerships. We focus our marketing efforts on industries in which we believe our direct sales model is most effective and on merchants with certain key attributes. These attributes include owners who are typically on location, interact with customers, value a local sales presence, and consult with trade associations and other civic groups to make purchasing decisions. We also determine which additional markets to enter into based on the following criteria:

- average potential customer revenue;
- number of locations to be serviced;
- underwriting risk; and
- required technological upgrades.

We have focused significantly on the hospitality industry and, in particular, independent restaurants. The number of independent restaurants to which we provide our products and services were 46,700 as of December 31, 2010 and 47,500 as of December 31, 2009. In December 2010, the restaurant industry represented approximately 34.1% of our SME bankcard processing volume and 49.8% of our SME transactions. In December 2009 and December 2008, the restaurant industry represented approximately 34.8% and 37.5% of our bankcard processing volume and 50.3% and 52.1% of our transactions, respectively. In addition to restaurants, our merchant base includes brick and mortar retailers, lodging establishments, automotive repair shops, convenience and liquor stores, and professional service providers.

We have historically had success in marketing our products and services through relationships with key trade associations, agent banks and value-added resellers.

Trade Associations

On January 19, 2010, we formed a strategic partnership with The National Restaurant Association which will deliver a unified payments processing platform to the restaurant industry. This alliance is expected to provide restaurateurs nationwide with effective tools, solutions and resources that will help them reduce their expenses, improve operations and increase profitability all from one source with integrated technology product platforms. Referred to as Full Course Business Solutions[SM], the partnership s offering was launched in early 2010 with an exclusively endorsed suite of payments products, including card processing, check management, payroll and tip management, reporting and compliance services. This suite of solutions is supported by our national sales and servicing organization of 1,188 professionals located in communities across America and our 1,200 service, information technology and administrative employees. Founded in 1919, The National Restaurant Association is the leading business association for the restaurant industry, which is comprised of 945,000 restaurant and foodservice outlets and a work force of 13 million employees.

As of December 31, 2010, we also had preferred partner agreements with more than 200 trade associations, approximately 50% of which are in the hospitality industry. Of these partnerships, 43 are state restaurant associations and another 39 are state lodging associations. In addition, we are the American Hotel & Lodging Association s endorsed provider of card processing, check management, payroll and tip management services. Our agreements with trade associations typically include our commitment to be a member of the association, a sponsor of the association s events and an advertiser in the association s publications. In exchange for an association s recommendation of our products and services to their members, upon the installation of a new merchant that is a member of the association we pay to the trade association a portion of the signing bonus or residual payment that otherwise would be paid to the Relationship Manager responsible for that merchant.

Agent Banks

Many community banks find it difficult to provide their merchant servicing personnel with the training and support they need to serve their customer base, and are unwilling to assume transaction risk. As a result, some of these banks enter into arrangements with payment processors to service their banking customers. As of December 31, 2010, we provided these services to over 300 community banks in the United States. In exchange

for a bank s endorsement of our products and services, upon the installation of a new merchant referred by the bank we typically pay the bank a portion of the signing bonus or residual payment that otherwise would be paid to the Relationship Manager responsible for that merchant.

Additionally, we have entered into arrangements with TD Bank (Marlton, NJ), Bremer Bank (St. Paul, MN), Central Pacific Bank (Honolulu, HI), Gateway Bank (Elizabeth, NC) and Commerce Bank Harrisburg (Harrisburg, PA) providing for the conversion, in some cases, of their existing merchant processing customers onto our processing systems. In most arrangements, these relationships are cross-referral, so that we and the banks benefit from these arrangements by gaining access to each other s customers.

Value-Added Resellers and Third-Party Software Providers

In order to further market our products and services, we enter into arrangements with value-added resellers and third-party software developers. Value-added resellers typically sell complementary products and services such as hardware and software applications and point-of-sale hardware, software and communication network services to merchants in markets similar to ours. Our agreements with value-added resellers provide that, in exchange for their endorsement of our products and services and upon the installation of a new merchant referred by them we will pay the value-added reseller a portion of the sales commission from the Relationship Manager responsible for that merchant and/or a transaction fee. As we continue to expand our product offerings, we intend to introduce capabilities that will allow our systems to be compatible with third-party software developers while working to reduce merchants third-party up-front costs for processing with us. We are committed to passing along our cost efficiencies to our merchants and their point-of-sale providers to encourage joint technology partnerships. In addition we will continue to consult with industry groups such as The National Restaurant Association to advocate for fair treatment to merchants from point-of-sale software providers and their dealers. As of December 31, 2010, we had arrangements with over 1,784 value-added resellers and referral services providers, including agreements with many third-party developers in the hospitality industry. From time to time, we have also entered into direct alliances with original equipment manufacturers and vendors.

Relationships with Sponsor Banks and Processors

In order to provide payment processing services for Visa and MasterCard transactions, we must be sponsored by a financial institution that is a principal member of the Visa and MasterCard networks. The sponsor bank must register us with Visa as an Independent Sales Organization and with MasterCard as a Member Service Provider. We also contract with third-party processors to provide critical payment processing services.

Sponsor Banks

Because we are not a member bank as defined by Visa and MasterCard we have entered into sponsorship agreements with member banks. Visa and MasterCard rules restrict us from performing funds settlement or accessing merchant settlement funds and require that these funds be in the possession of a member bank until the merchant is funded. A sponsorship agreement enables us to route Visa and MasterCard bankcard transactions under the member bank s control and identification numbers to clear credit bankcard transactions through Visa and MasterCard. A sponsorship agreement also enables us 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.

The sponsorship agreements with the member banks require, among other things, that we abide by the by-laws and regulations of the Visa and MasterCard networks, and certain of the bank sponsors require a certificate of deposit or a cash balance in a deposit account. If we breach a sponsorship agreement, the sponsor bank may terminate the agreement and, under the terms of the agreement, we would have 180 days to identify an alternative sponsor bank. We are dependent on our sponsor banks, Visa and MasterCard for notification of any compliance breaches. As of December 31, 2010, we have not been notified of any such issues by our sponsor banks, Visa or MasterCard.

We are currently party to three bank sponsorship agreements. Our primary sponsor bank for SME merchant processing is KeyBank, National Association, referred to as KeyBank in this document. Either KeyBank or we can terminate the agreement if the other party materially breaches the agreement, including non-payment of fees due for processing our monthly settlement of transactions. The agreement may also be terminated if the other party enters bankruptcy or files for bankruptcy, if either party is required to discontinue performing its services under the agreement based upon a final order of a state or federal court or regulatory body or if there is a change in the majority ownership of the other party. KeyBank may terminate the agreement with us if we breach the by-laws and regulations of Visa or MasterCard, if either our registration or KeyBank s membership with Visa or MasterCard terminates, if any federal or state regulatory authority requests that the agreement be terminated or that KeyBank terminate its services or if applicable laws or regulations change to prevent KeyBank from performing its services under the agreement. Upon termination of the agreement for any reason, we will have 180 days to convert to another sponsor bank. Although we expect that we would be able to secure a new sponsor bank, the cost of entering into a new sponsorship agreement may be different than under our current agreement with KeyBank. The agreement, which we entered into with KeyBank on April 1, 1999, expires in March 2012.

In 2007, we entered into a second sponsor bank agreement, this one with Heartland Bank, which is based in Saint Louis, Missouri. Heartland Bank is not related to, or associated with Heartland Payment Systems. Our agreement with Heartland Bank involves substantially the same terms as apply with KeyBank and it has been renewed through September 2013.

In November 2009, we entered into a sponsorship agreement with The Bancorp Bank to sponsor our Network Services Merchants and transferred sponsorship from SunTrust Bank, its previous sponsor, to the Bancorp Bank in February 2010. The agreement with The Bancorp Bank expires in November 2014 and involves substantially the same terms as apply with KeyBank.

Following is a breakout of our total Visa and MasterCard settled bankcard processing volume for the month of December 2010 by percentage processed under our individual sponsorship agreements:

Sponsor Bank	% of December 2010 Bankcard Processing Volume
KeyBank, National Association	72%
Heartland Bank	13%
The Bancorp Bank	15%

Third-Party Processors

We have agreements with several third-party processors to provide to us on a non-exclusive basis payment processing and transmittal, transaction authorization and data capture services, and access to various reporting tools. These third-party processors include Fujitsu America, TSYS, and Global Payments, Inc. Certain agreements with third-party processors may be terminated by the third-party processors if we materially breach certain sections of the agreements, including our failure to pay fees due, and we do not cure the breach within 30 days, if our registration with Visa or MasterCard terminates, or if we enter bankruptcy or file for bankruptcy.

In the fourth quarter of 2010, we sold many of our remaining merchant accounts that had not been converted onto HPS Exchange and were processing on third party front-end platforms. The sale s purpose was to eliminate servicing inefficiencies associated with these merchant accounts.

Our Merchant Base

Our merchant customers primarily fall into two categories: our core small and mid-sized merchants (referred to as Small and Midsized Enterprises, or SME) and Network Services large national and mid-tier merchants, primarily in the petroleum industry. At December 31, 2010, we provided our bankcard payment processing services to approximately 173,860 active SME bankcard merchants located across the United States. This represents a slight increase over the 173,400 active SME bankcard merchants at December 31, 2009. At December 31, 2010, we provided bankcard payment processing services to approximately 109 Network Services Merchants with approximately 54,244 locations.

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SME Merchant Base

While restaurants represent a significant portion of our SME merchant base, we also provide payment processing services to a wide variety of merchants, with a focus on those merchants whose typical customer is present when using a bankcard to pay for products or services. We define SME merchants as generating annual Visa and MasterCard bankcard processing volume between $50,000 and $5,000,000. With the added functionality and cost benefits that our back-end processing system, Passport, affords us, we market to merchants with annual processing volume above $5,000,000.

The following chart summarizes our SME processing volume by merchant category for the month of December 2010, compared to the months of December 2009 and December 2008.

Processing Volume by Merchant Category

December 2010

No single SME merchant accounted for more than 1.01% of our total SME Visa and MasterCard bankcard processing volume in 2010, and during 2010, our top 25 merchants represented only 3.00% of our Visa and MasterCard bankcard processing volume and 2.54% of our gross processing revenue. In 2009 and 2008, no single merchant represented more than 0.87% and 0.56% of our total bankcard processing volume, respectively. In both 2009 and 2008 our top 25 merchants represented only 3.0% and 3.1%, respectively, of our bankcard processing volume and 2.4% and 2.5%, respectively, of our gross processing revenue.

In December 2010, SME merchants in California represented 11.4%, in New York represented 5.9%, in Texas represented 5.5%, in Florida represented 4.7%, and in New Jersey represented 4.3% of our SME bankcard processing volume. No other state represented more than 4% of our total bankcard processing volume. Our geographic concentration tends to reflect the states with the highest economic activity, as well as certain states where we have historically maintained a stronger sales force. This merchant and geographic diversification makes us less sensitive to changing economic conditions in any particular industry or region. We believe that the loss of any single merchant would not have a material adverse effect on our financial condition or results of operations.

Generally, our agreements with SME merchants are for three years and automatically renew for additional one-year periods unless otherwise terminated. Our sponsor bank is also a party to these agreements. The merchants are obligated to pay for all chargebacks, fines, assessments, and fees associated with their account, and in some cases, annual fees. Our sponsor bank may terminate a merchant agreement for any reason on 30 days notice, and the merchant may terminate the agreement at any time without notice, subject to the payment of any applicable early termination fees. Typically, the agreement may also be terminated immediately upon a breach by the merchant of any of its terms. The agreement may not be assigned by the merchant without the prior written consent of the sponsor bank and us.

Network Services Merchants

At December 31, 2010, we provided bankcard payment processing services to approximately 109 Network Services Merchants with approximately 54,244 locations. Network Services provides processing of credit and debit cards to large national and mid-tier merchants, primarily in the petroleum industry. For the month of December 2010, approximately 95% of Network Services Merchant processing volume was in the petroleum industry. In addition to settling Visa and MasterCard transactions, Network Services processes a wide range of payment transactions, including providing approximately 2.6 billion transaction authorizations through our Network Services front-end card processing systems (primarily for Visa and MasterCard) in 2010. Network Services added $11.3 billion to our bankcard processing volume on 488 million settled transactions in 2010. In the fourth quarter of 2010, the clearing, settlement and merchant accounting services for Network Services settled transactions were converted onto Passport.

Risk Management

We believe that we have significant experience in assessing the risks associated with providing payment processing services to small- and medium-sized merchants. These risks include the limited operating history of many of the small- and medium-sized merchants we serve and the risk that these merchants could be subject to a higher rate of insolvency, which could adversely affect us financially. We apply varying levels of scrutiny in our application evaluation and underwriting of prospective merchant accounts, ranging from basic due diligence for merchants with a low risk profile to a more thorough and detailed review for higher risk merchants. In addition, through Network Services, we are also one of the leading providers of payment processing to the petroleum industry.

Merchant attrition is expected in the payment processing industry in the ordinary course of business. During 2010, 2009, and 2008, we experienced average annual attrition of 15.3%, 22.6%, and 17.3% respectively of our SME bankcard processing volume. Much of our attrition is related to business closures, which accelerated in 2008 and 2009 due to weak economic conditions, and in 2008 and 2009 our volume attrition was significantly impacted by overall contraction in same stores sales. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview General for a discussion of same stores sales.

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As a result of our exposure to potential liability for merchant fraud, chargebacks, reject and other losses created by our merchant services business, we view our risk management and fraud avoidance practices as integral to our operations and overall success. We believe that the risks associated with our merchant base are generally not significant as our merchants consist primarily of companies conducting card-present transactions and whose chargeback levels are generally not significant as a percentage of their sales volume. As a result of their low risk profile, we can employ underwriting and set-up procedures that are less extensive than if these merchants had higher risk profiles and can typically ensure that these merchants will be approved and set up on our systems within 24 hours of our receiving their application.

However, for our merchants conducting card-not-present transactions, which we view as having a higher risk profile, we employ an extended underwriting and due diligence period and special account monitoring procedures. The underwriting process for these merchants applications may take three to five days while we evaluate the applicants financials, previous processing history and credit reports/OFAC (Office of Foreign Assets Control).

Effective risk management helps us minimize merchant losses for the mutual benefit of our merchants and ourselves. Our risk management procedures also help protect us from fraud perpetrated by our merchants. We believe our knowledge and experience in dealing with attempted fraud has resulted in our development and implementation of effective risk management and fraud prevention systems and procedures for the types of fraud discussed in this section. In 2010, 2009 and 2008, we experienced losses of 1.51 basis points, 1.01 basis points and 0.88 basis points, respectively, of our Visa and MasterCard SME bankcard processing volume. The year-over-year increases in our merchant losses track with the overall deteriorating economic conditions in those years, which contributed to increased incidences of merchant fraud.

We employ the following systems and procedures to minimize our exposure to merchant and transaction fraud:

Underwriting

Our Relationship Managers send new applications for low-risk merchants to their regional service team for scoring and account set up. Higher-risk applications are routed to our underwriting department for review and screening. Our underwriting department s review of these applications serves as the basis for our decision whether to accept or reject a merchant account. The review also provides the criteria for establishing cash deposit or letter of credit requirements, processing limits, average transaction amounts and pricing, which assists us in monitoring merchant transactions for those accounts that exceed those pre-determined thresholds. The criteria set by our underwriting department also assist our risk management staff in advising merchants with respect to identifying and avoiding fraudulent transactions. Depending upon their experience level, our underwriting staff has the authority to render judgment on new applications or to take additional actions such as adjusting processing limits supported by prior processing history, analyzing average charge per transaction information or establishing cash deposits/letter of credits, reserves, and delayed funding requirements for new and existing merchants. Our underwriting department prepares accounts that are risk sensitive for our credit committee review. The Credit Committee consists of a Manager of Underwriting, Manager of Risk Review and Executive Director of Core Support Group. Merchant accounts that exceed certain committee thresholds are reviewed by either our CEO, President or Chief of Operations. Our sponsor bank also reviews and approves our merchant underwriting policies and procedures to ensure compliance with Visa and MasterCard operating rules and regulations.

Merchant Monitoring

We employ several levels of merchant account monitoring to help us identify suspicious transactions and trends. Daily merchant activity is obtained from two sources: HPS Exchange (where the information is downloaded from HPS Exchange to our monitoring systems) and TSYS (where the information is downloaded from our third-party processors onto TSYS risk system and then accessed by us on the Internet), and is sorted into a number of customized reports by our systems. Our risk management team reviews any unusual activity highlighted by these reports, such as larger than normal transactions or credits, and monitors other parameters that are helpful in identifying suspicious activity. We have a daily window of 10:00 a.m. to 7:30 p.m. Eastern time to decide if any transactions should be held for further review, which provides us time to interview a merchant or issuing bank to determine the validity of suspicious transactions. We have also developed a fraud management system for HPS Exchange that is fully integrated with our internal customer relationship management software and has detailed review capabilities to further streamline our monitoring of those transactions. We also place merchants who require special monitoring on alert status and have engaged a web crawling solution that scans all merchant websites for content and integrity.

Investigation and Loss Prevention

If a merchant exceeds any parameters established by our underwriting and/or risk management staff or violates regulations established by the applicable bankcard network or the terms of our merchant agreement, one of our investigators will identify the incident and take appropriate action to reduce our exposure to loss and the exposure of our merchant. This action may include requesting additional transaction information, withholding or diverting funds, verifying delivery of merchandise or even deactivating the merchant account. Additionally, Account Managers or Relationship Managers may be instructed to retrieve equipment.

Collateral

We require some of our merchants to establish cash deposits or letters of credit that we use to offset against liabilities we may incur. We hold such cash deposits or letters of credit for as long as we are exposed to a loss resulting from a merchant s payment processing activity. In addition, we maintain a 5-day delayed deposit policy on transactions processed by our Internet merchants and newly established merchants who have not previously processed bankcards to allow for additional risk monitoring. We also place a hold on batches containing questionable transactions, diverting the funds to a separate account pending review. As of December 31, 2010, these cash deposits, delayed and held batches, and letters of credit totaled approximately $9.1 million.

Servicing and Processing Technology

We have developed a number of systems that are designed to improve the effectiveness of our sales force, customer service and the management of our business. In 2010, 2009 and 2008 we spent $15.3 million, $12.2 million and $5.9 million, respectively, on capitalized software development costs to make electronic payments easier for our sales force and merchants. Many of the following systems are accessible over the Internet through www.e-hps.com.

Our Servicing Technology platforms include:

Portfolio Manager

Portfolio Manager is designed to allow each of our Relationship, Territory and Division Managers and Regional Directors to manage many aspects of his or her business, including portfolio monitoring and management, compensation review, training and professional development and the ability to communicate with others within our company. Portfolio Manager consists of a set of merchant relationship management tools. These tools include detailed merchant data, such as historical bankcard processing volume, updates on merchant contracts that will soon expire, losses, merchants who may have attrited and data that can be used by our Relationship Managers to assist merchants in understanding interchange fee structures and the risks associated with certain types of transactions. Portfolio Manager also includes an estimated gross margin calculator and a merchant profitability analysis that allows Relationship Managers to optimize gross margin generated from a new SME merchant account. In addition, Portfolio Manager provides our Relationship Managers with the ability to view their residual commission stream from their merchant portfolio, track their productivity and compare their sales statistics with those of other Relationship Managers.

Merchant Center

Merchant Center is designed to improve our merchants efficiency, cash management and dispute resolution by providing them with real-time access to their transaction data, including clearinghouse records, deposits and transactions. Merchant Center can replace paper merchant statements and provide automated customer self-service. Approximately 60.3% of our SME merchants, as of December 31, 2010, had signed up for this product. Affiliate Manager also provides similar information tools to our strategic relationships, such as trade associations, banks and value-added resellers.

Client Manager

Information regarding all of our interactions with our SME merchants and all of their documents and transaction records are immediately available to our customer service department and management through Client Manager. Each new account is entered into this database during the initial application and underwriting process, and all documents regarding a merchant are scanned into the database. Subsequently, all of a merchant s transactions and statements, and records of all calls to our customer service representatives as well as their resolution, are maintained in the database. Client Manager is also the tool by which we make any pricing adjustments and manage any equipment-related transactions. Integrating many of our customer management tools into one database provides service center employees with the same information regarding a merchant, which enables us to provide consistent, rapid problem resolution and optimal customer service. We believe that reliance on the system has allowed considerable productivity gains in recent years.

Our Processing Technology platforms include:

HPS Exchange

Our front-end system, HPS Exchange, provides us greater control of the electronic transaction process, allows us to offer our merchants (through our Relationship Managers) a differentiated product offering, and offers economies of scale that we expect will increase our long-term profitability.

On January 20, 2009, we publicly announced the discovery of the Processing System Intrusion, which apparently had occurred during some portion of 2008. The Processing System Intrusion involved malicious software that appears to have been used to collect in-transit, unencrypted payment card data while it was being processed by us during the transaction authorization process. We believe the breach has been contained and did not extend beyond 2008. See Management s Discussion and Analysis of Financial Condition and Results of Operations Overview Processing System Intrusion and Management s Discussion and Analysis of Financial Condition and Results of Operations Legal and Regulatory Considerations for further detail and related events. We have taken a number of steps since discovering the Processing System Intrusion to further enhance the security of our computer system.

During 2010, approximately 90% of the transactions of our SME merchants were processed on HPS Exchange, and 94% of all merchant accounts established in 2010 were placed on the system. When a merchant uses HPS Exchange on certain hardware platforms, the resulting authorization speed for dial-up transactions can be six seconds or less and IP transactions can be two seconds or less, which we believe is faster than industry norms for comparable terminals. This increased speed not only benefits the merchant but also reduces the telecommunications costs we incur in connection with a transaction.

HPS Exchange enables us to provide more customized solutions to SME merchants, target larger merchants that demand customized front-end solutions and take advantage of new terminal hardware platforms and technology like End-to-End Encryption as they become available. HPS Exchange is customized for each merchant and will allow us to provide our merchants with differentiated value-added features, including the following:

Merchant/Cardholder Selected Debit or Credit. Merchants have the ability to convert a Visa Check or Master Money card to a pin-based debit transaction, which is typically less expensive for the merchant.

Real-Time Transaction Monitoring. Using their personal computers, merchants using Merchant Manager can observe open batches of payment transactions at any of their locations, allowing early detection of problem transactions, such as abnormally large tickets or credits, and changes in business volume.

Cash Back on Debit. Merchants have the ability to offer a cash-back option to their customers for pin-based debit transactions.

On-line Download Maintenance. On-line Download Maintenance is an Internet interface to a merchant s point-of-sale terminal download system that allows a merchant to change the

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parameters that control how its point-of-sale terminal functions as opposed to having to call the service center to request such changes. This enables a merchant to more easily change its receipt message each day and assists a merchant in preventing employee fraud by setting parameters that restrict the actions that can be taken by various employees.

While we will continue to utilize third-party front-end systems, we plan to continue incorporating additional functionality into HPS Exchange and to install an increasing percentage of new merchants onto HPS Exchange.

We believe that we are one of the first payment processors to develop all of our systems to take advantage of recent technological advancements in network and distributed computing, such as relational databases and Internet technologies. This offers significant benefits to us in terms of cost, data manipulation and distribution, flexibility and scalability. We further believe that these systems help attract both new merchants and Relationship Managers and provide us with a competitive advantage over many of our competitors who rely on less flexible legacy systems. With more widespread availability and usage of the Internet, increasing numbers of merchants are using the web as a transport medium. In December 2010, 48% of all transactions processed through HPS Exchange were transmitted through the Internet. These transactions represent a significantly lower overall cost to HPS, since no dial-up costs are incurred.

Passport

Our internally-designed back-end processing system, Passport, provides us with significant cost savings and results in greater economies of scale, by replacing third party processors per-transaction charges with more of a fixed-cost structure. This structure allows per-transaction savings as increasing numbers of transactions are processed on Passport. In addition, Passport provides us with the opportunity to offer our merchants significantly greater amounts of information regarding their processing characteristics, in more usable formats and to offer our services to larger merchants. At December 31, 2010 and 2009, approximately 99% of our SME merchants were processing on Passport.

Network Services Technology

We operate Network Services platforms in two geographically dispersed outsourced data centers that are the focal point for hosting all Network Services front-end transaction processing and network activity. We establish system service level thresholds based on our large national merchants requirements. System availability of 99.5% uptime is our standard large national merchant metric, which Network Services exceeded in 2010. To achieve this standard, transactions are mirrored between data centers, and each center has the capacity to handle our full merchant transaction load. This ensures uninterrupted transaction processing during maintenance windows and other times processing may not be available.

Authorization We route authorization and capture transactions through Access Engine, where it is assigned to one of two payment engines: VAPS and NWS. After routing a transaction to the appropriate payment engine, it is then sent to Auth Engine which passes the transaction to the card networks for authorization.

Settlement We provide both authorization and settlement services to 53 Network Services Merchants, representing 15.7% of Network Services transactions in 2010. In the fourth quarter of 2010, the clearing, settlement and merchant accounting services for Network Services settled transactions were converted onto Passport. Prior to then, these settlement transactions were processed by a third party.

Network Security

In the course of our operations, we compile and maintain a large database of information relating to our merchants and their transactions, and large amounts of card information crosses our network as we authorize transactions. We have placed significant emphasis on maintaining a high level of security in order to attempt to protect the information of our merchants and their customers. We maintain current updates of network and operating system security releases and virus definitions, and have engaged a third party to regularly test our systems for vulnerability to unauthorized access. Further, we encrypt the cardholder numbers and merchant data that are stored in our databases using the highest commercially available encryption methods.

Our internal network configuration provides multiple layers of security to isolate our databases from unauthorized access and implements detailed security rules to limit access to all critical systems. In November 2003, we were certified by Visa as having successfully completed their Cardholder Information

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Security Program (CISP) review of our payment processing and Internet-based reporting systems. In 2004, the Visa CISP requirements were combined with security guidelines of the other card networks into a comprehensive Payment Card Industry Data Security Standard (PCI-DSS). We received confirmation of our compliance with PCI-DSS from a third party assessor in April 2008. Notwithstanding our implementation and utilization of the network security measures described in this section, we suffered the Processing System Intrusion described elsewhere in this annual report. Subsequent to the discovery of the Processing System Intrusion, we were advised by Visa that based on Visa s investigation of the Processing System Intrusion, Visa had removed us from Visa s published list of PCI-DSS compliant service providers. We were similarly advised by MasterCard that, based on MasterCard s investigation of the Processing System Intrusion MasterCard believed we were in violation of the MasterCard Standards and that, based on that belief, MasterCard removed us from MasterCard s published list of Compliant Service Providers. In April 2009, we were re-certified as PCI-DSS compliant and the assessor s report attesting to such re-certification was reviewed and approved by Visa. Visa placed us in a probationary status for the two years following our re-certification as being PCI-DSS compliant, during which time our failure to comply with the probationary requirements set forth by Visa or with the Visa operating regulations may result in Visa seeking to impose further risk conditions on us, including but not limited to our disconnection from VisaNet or our disqualification from the Visa payment system. In April 2009, MasterCard returned us to its published list of Compliant Service Providers.

Visa, Star, NYCE and other debit card networks have established security guidelines for PIN-based debit transaction processing that is based upon ANSI standards that are published as the ASC X9 TG-3 PIN Security Compliance Guideline. We have regularly scheduled Security Review of our Key Management Procedures against this standard that is performed by an external auditor.

We also have engaged external auditors to perform an annual SAS-70 review and publish our Report on Controls Placed in Operation and Tests of Operating Effectiveness.

Disaster Recovery and Back-up Systems

We have implemented an alternative data center and disaster recovery plan for HPS Exchange and Passport systems to ensure business continuity in the event of a system failure. As part of this plan, we have established a passive processing site in Houston, Texas that has the same functionality as our primary data center in Allen, Texas. In the event of a failure at our Allen data center, we would switch our processing immediately to the Houston data center. This scenario was successfully tested during a full Disaster Recovery test in January 2010.

We also rely on connections to the systems of our third-party front-end and back-end processing providers. In many cases, they have installed or developed communications circuits with backup connectivity to overcome telecommunications problems. In addition, our service center has installed redundant power sources and our administrative systems are backed up and archived daily.

Competition

The payment processing industry is highly competitive. We compete with other providers of payment processing services on the basis of the following factors:

- quality of service;
- reliability of service;
- Professional Association endorsements;
- ability to evaluate, undertake and manage risk;
- speed in approving merchant applications; and

price.

We compete with both small and large companies in providing payment processing and related services to a wide range of merchants. Our competitors sell their services either through a direct sales force, generally concentrating on larger accounts, or through Independent Sales Organizations, telemarketers or banks, generally concentrating on smaller accounts.

There are a number of large payment processors, including First Data Corporation, Global Payments Inc., Fifth Third Processing Solutions, Chase Paymentech Solutions and Elavon, Inc., a subsidiary of U.S. Bancorp, that serve a broad market spectrum from large to small merchants; further, certain of these provide banking, ATM and other payment-related services and systems in addition to bankcard payment processing. There are also a large number of smaller payment processors that provide various services to small- and medium-sized merchants.

Some of our competitors have substantially greater capital resources than we have and operate as subsidiaries of financial institutions or bank holding companies, which may allow them on a consolidated basis to own and conduct depository and other banking activities that we do not have the regulatory authority to own or conduct. Since they are affiliated with financial institutions or banks, these competitors do not incur the costs associated with being sponsored by a bank for registration with card networks and they can settle transactions quickly for their own merchants. We do not, however, currently contemplate acquiring or merging with a financial institution in order to increase our competitiveness. We believe that our direct sales focus on SME merchants, our competitive payments product set, and our understanding of the needs and risks associated with providing payment processing services to those merchants, gives us a competitive advantage over larger competitors, which do not have our focus, and over competitors of a similar or smaller size that may lack our experience and sales resources.

Intellectual Property

We own and are pursuing several patents with the United States Patent and Trademark Office. In addition, we own various trademarks and have applied for numerous others. Most of our services and products are based on proprietary software or processes that are updated to meet merchant needs and remain competitive. Protecting our rights to our proprietary software is critical, as it allows us to offer distinctive services and products to merchants, which differentiates us from our competitors.

Employees

As of December 31, 2010, we employed 2,612 full- and part-time personnel, including 713 customer service, risk management, financial and operations support and underwriting employees, 345 systems and technology employees, 123 payroll services employees, 66 prepaid and stored-value solutions employees, 35 K to 12 School Services employees, 142 accounting and administration employees and 1,188 sales professionals. None of our employees are represented by a labor union, and we have experienced no work stoppages. We consider our employee relations to be good.

WHERE YOU CAN GET ADDITIONAL INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy our reports or other filings made with the SEC at the SEC s Public Reference Room, located at 100 F Street, N.E., Washington, DC 20549. You can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You can also access these reports and other filings electronically on the SEC s web site, www.sec.gov.

In addition, certain of our SEC filings, including our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, can be viewed and printed from the investor information section of our website at www.heartlandpaymentsystems.com, as soon as reasonably practicable after filing with the SEC. Certain materials relating to our corporate governance, including our senior financial officers code of ethics, are also available in the investor relations section of our website.

The information on the websites listed above, is not and should not be considered part of this Annual Report on Form 10-K and is not incorporated by reference in this document. These websites are, and are only intended to be, inactive textual references.

In August 2010, we submitted to the New York Stock Exchange the CEO certification required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual without qualification.

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ITEM 1A. RISK FACTORS

An investment in our common stock involves a high degree of risk. You should consider carefully the following risks and other information contained in this Annual Report on Form 10-K and other SEC filings before you decide whether to buy our common stock. If any of the events contemplated by the following discussion of risks should occur, our business, results of operations and financial condition could suffer significantly. As a result, the market price of our common stock could decline, and you may lose all or part of the money you paid to buy our common stock.

Risks Relating to Our Business

Unauthorized disclosure of merchant and cardholder data, whether through breach of our computer systems (such as the Processing System Intrusion) or otherwise, could expose us to liability and protracted and costly litigation.

On January 20, 2009, we publicly announced the Processing System Intrusion. The Processing System Intrusion involved malicious software that appears to have been used to collect in-transit, unencrypted payment card data while it was being processed by us during the transaction authorization process. We believe the breach has been contained and did not extend beyond 2008. We have taken a number of steps to contain the Processing System Intrusion and to further enhance the security of our computer system. Nevertheless, there can be no assurance that we will not suffer an additional security breach in the future.

To date, we have had several claims and lawsuits filed against us, settled several claims and lawsuits, and additional lawsuits may be filed against us in the future. Several government agencies have either made inquiries to us or initiated investigations of us related to Processing System Intrusion. The amounts of the claims and the amounts we have paid as a result of, or in order to defend, the claims, lawsuits and government investigations and inquiries described above have been material. For more information concerning these claims, lawsuits and government inquiries and investigations, and settlements we paid see Item 3. Legal Proceedings.

We collect and store sensitive data about merchants, including names, addresses, social security numbers, driver s license numbers and checking account numbers. In addition, we maintain a database of cardholder data relating to specific transactions, including bankcard numbers, in order to process the transactions and for fraud prevention. Any loss of cardholder data by us or our merchants could result in significant fines and sanctions by the card networks or governmental bodies, which could have a material adverse effect upon our financial position and/or results of operations. In addition, a significant breach could result in our being prohibited from processing transactions for card networks.

Our computer systems have been, and could be in the future, subject to penetration by hackers and our encryption of data may not prevent unauthorized use. In this event, we may be subject to liability, including claims for unauthorized purchases with misappropriated bankcard information, impersonation or other similar fraud claims. We could also be subject to liability for claims relating to misuse of personal information, such as unauthorized marketing purposes. These claims also could result in protracted and costly litigation. In addition, we could be subject to penalties or sanctions from the card networks.

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

If we fail to comply with the applicable requirements of the Visa and MasterCard bankcard networks, Visa or MasterCard could seek to fine us, suspend us or terminate our registrations. Fines could have an adverse effect on our operating results and financial condition, and if these registrations are terminated, we will not be able to conduct our business.

If we are unable to comply with Visa and MasterCard bankcard network requirements, Visa or MasterCard could seek to fine us, suspend us or terminate our registrations. On occasion, we have received notices of non-compliance and fines, which have typically related to excessive chargebacks by a merchant or data security failures on the part of a merchant. If we are unable to recover fines from our merchants, we would experience a financial loss. The termination of our registration, or any changes in the Visa or MasterCard rules that would impair our registration, could require us to stop providing Visa and MasterCard payment processing services, which would make it impossible for us to conduct our business.

Subsequent to the discovery of the Processing System Intrusion, we were advised by Visa that based on Visa s investigation of the Processing System Intrusion, Visa had removed us from Visa published list of PCI-DSS compliant service providers. We were similarly advised by MasterCard that, based on MasterCard s investigation of the Processing System Intrusion MasterCard believed we were in violation of the MasterCard Standards and that, based on that belief, MasterCard removed us from MasterCard s published list of Compliant Service Providers. In April 2009, we were re-certified as PCI-DSS compliant and the assessor s report attesting to such re-certification was reviewed and approved by Visa. Visa placed us in a probationary status for the two years following our re-certification as being PCI-DSS compliant, during which time our failure to comply with the probationary requirements set forth by Visa or with the Visa operating regulations may result in Visa seeking to impose further risk conditions on us, including but not limited to our disconnection from VisaNet or our disqualification from the Visa payment system. In April 2009, MasterCard returned us to its published list of Compliant Service Providers.

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

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

In a recessionary environment our merchants could also experience a higher rate of business closures, which could adversely affect our business and financial condition. During prior recessions, including the 2008-2009 recession, we experienced a slowdown in the rate of same-store sales growth and an increase in business closures. In the event of a closure of a merchant, we are unlikely to receive our fees for any transactions processed by that merchant in its final month of operation.

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

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

The market for payment processing services is highly competitive. Other providers of payment processing services have established a sizable market share in the small- and medium-size merchant processing sector. Maintaining our historic growth will depend on a combination of the continued growth in electronic payment transactions and our ability to increase our market share. The weakness of the current economic recovery could cause future growth in electronic payment transactions to slow compared to historical rates of growth and the Processing System Intrusion could negatively impact our ability to increase our market share. According to The Nilson Report, we accounted for approximately 2.9% of the $2.4 trillion of total dollar volume (which we refer to as bankcard processing volume) processed by all bankcard acquirers in 2009. This competition may influence the prices we are able to charge. If the competition causes us to reduce the prices we charge, we will have to aggressively control our costs in order to maintain acceptable profit margins. In addition, some of our competitors are financial institutions, subsidiaries of financial institutions or well-established payment processing companies, including First Data Corporation, Global Payments, Inc., Fifth Third Processing Solutions, Chase Paymentech Solutions and Elavon, Inc., a subsidiary of U.S. Bancorp. Our competitors that are financial institutions or subsidiaries of financial institutions do not incur the costs associated with being sponsored by a bank for registration with the card networks and can settle transactions more quickly for their merchants than we can for ours. These competitors have substantially greater financial, technological, management and marketing resources than we have. This may allow our competitors to offer more attractive fees to our current and prospective merchants, or other products or services that we do not offer. This could result in a loss of customers, greater difficulty attracting new customers, and a reduction in the price we can charge for our services.

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

In the event a billing dispute between a cardholder and a merchant is not resolved in favor of the merchant, the transaction is normally charged back to the merchant and the purchase price is credited or otherwise refunded to the cardholder. If we or our clearing banks are unable to collect such amounts from the merchant s account, or if the merchant refuses or is unable, due to closure, bankruptcy or other reasons, to reimburse us for the chargeback, we bear the loss for the amount of the refund paid to the cardholder. The risk of chargebacks is typically greater with those merchants that promise future delivery of goods and services rather than delivering goods or rendering services at the time of payment. We may experience significant losses from chargebacks in the future. Any increase in chargebacks not paid by our merchants may adversely affect our financial condition and results of operations.

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

We have potential liability for fraudulent bankcard transactions initiated by merchants. Merchant fraud occurs when a merchant knowingly uses a stolen or counterfeit bankcard or card number to record a false sales transaction, processes an invalid bankcard or intentionally fails to deliver the merchandise or services sold in an otherwise valid transaction. We have established systems and procedures designed to detect and reduce the impact of merchant fraud, but we cannot assure you that these measures are or will be effective. It is possible that incidents of fraud could increase in the future. Failure to effectively manage risk and prevent fraud would increase our chargeback liability. Increases in chargebacks could have an adverse effect on our operating results and financial condition.

We incurred charges relating to chargebacks, reject losses and merchant fraud of $9.1 million, $5.9 million and $5.3 million in the years ended December 31, 2010, 2009 and 2008, respectively. The year-over-year increases in our merchant losses track with the overall deteriorating economic conditions in those years which contributed to increased incidences of merchant fraud.

Increased merchant attrition that we cannot offset with increased bankcard processing volume from same store sales growth or new accounts would cause our revenues to decline.

We experience attrition in merchant bankcard processing volume resulting from several factors, including business closures, transfers of merchants accounts to our competitors and account closures that we initiate due to heightened credit risks relating to, or contract breaches by, merchants, and when applicable same store sales contraction. During 2010, 2009, and 2008, we experienced average annual attrition of 15.3%, 22.6%, and 17.3% respectively. Substantially all of our SME processing contracts may be terminated by either party on relatively short notice. We cannot predict the level of attrition in the future, and it could increase. Increased attrition in merchant bankcard processing volume may have an adverse effect on our financial condition and results of operations. If we are unable to establish accounts with new merchants or otherwise increase our bankcard processing volume in order to counter the effect of this attrition, our revenues will decline.

We rely on sponsor banks, which have substantial discretion with respect to certain elements of our business practices, in order to process bankcard transactions. If these sponsorships are terminated and we are unable to secure new bank sponsors, we will not be able to conduct our business.

Over 90% of our revenue is derived from processing Visa and MasterCard bankcard transactions. Because we are not a bank, we are not eligible for membership in the Visa and MasterCard networks and are, therefore, unable to directly access the bankcard networks, which are required to process Visa and MasterCard transactions. Visa and MasterCard operating regulations require us to be sponsored by a member bank in order to process bankcard transactions. We are currently registered with Visa and MasterCard through KeyBank, which has maintained that registration since 1999, Heartland Bank, which has been a sponsor since December 2007, and The Bancorp Bank, which has been a sponsor since February 2010. Our agreements with KeyBank, Heartland Bank and The Bancorp Bank expire March 2012, September 2013 and November 2014, respectively. If our sponsorships are terminated and we are unable to secure another bank sponsor or sponsors, we will not be able to process Visa and MasterCard transactions. Furthermore, our agreements with KeyBank and Heartland Bank give them substantial discretion in approving certain aspects of our business practices, including our solicitation, application and qualification procedures for merchants, the terms of our agreements with merchants and our customer service levels. Our sponsor banks discretionary actions under these agreements could be detrimental to our operations.

If we cannot pass increases in bankcard network interchange fees, assessments and transaction fees along to our merchants, our operating margins will be reduced.

We pay interchange fees and other network fees set by the bankcard networks to the card issuing bank and the bankcard networks for each transaction we process. From time to time, the bankcard networks increase the interchange fees and other network fees that they charge payment processors and the sponsor banks. At its sole discretion, our sponsor bank has the right to pass any increases in interchange fees on to us and it has consistently done so in the past. We are allowed to, and in the past we have been able to, pass these fee increases along to our merchants through corresponding increases in our processing fees. However, if we are unable to do so in the future, our operating margins will be reduced.

Current or future bankcard network rules and practices could adversely affect our business.

We are registered with the Visa and MasterCard networks through our bank sponsors as an Independent Sales Organization with Visa and a Member Service Provider with MasterCard. We are currently a sales agent for American Express and a registered Acquirer with Discover. The rules of the bankcard networks are set by their boards, which may be strongly influenced by card issuers, and some of those card issuers are our competitors with respect to these processing services. Many banks directly or indirectly sell processing services to merchants in direct competition with us. These banks could attempt, by virtue of their influence on the networks, to alter the networks rules or policies to the detriment of non-members like us. The bankcard networks or issuers who maintain our registrations or arrangements or the current bankcard network or issuer rules allowing us to market and provide payment processing services may not remain in effect. The termination of our registration or our status as an Independent Sales Organization or Member Service Provider, or any changes in card network or issuer rules that limit our ability to provide payment processing services, could have an adverse effect on our bankcard processing volumes, revenues or operating costs. In addition, if we were precluded from processing Visa and MasterCard bankcard transactions, we would lose substantially all of our revenues.

Any new laws and regulations, or revisions made to existing laws, regulations, or other industry standards affecting our business may have an unfavorable impact on our operating results and financial condition.

Our business is impacted by laws and regulations that affect the bankcard industry. The number of new and proposed regulations has increased significantly, particularly pertaining to interchange fees on bankcard transactions, which are paid to the bank card issuer. In July 2010, Congress passed The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which significantly changes financial regulation. Changes include restricting amounts of debit card fees that certain issuer banks can charge merchants and allowing merchants to offer discounts for different payment methods. The impact which the Dodd-Frank Act will have on our operating results is difficult to determine, as the changes are not directed at us and final regulations on interchange fees are still to be set by the Federal Reserve Board. When final, these regulations could adversely affect our operating results and financial condition.

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

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

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

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

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

additional operating and development costs; and/or

diversion of technical and other resources.

If we fail to protect our intellectual property rights and defend ourselves from potential patent infringement claims, our competitive advantages may diminish or our ability to offer services to our customers could be restricted.

Our patents, trademarks, proprietary software and other intellectual property are critical to our future success. We rely on proprietary technology. It is possible that others will independently develop the same or similar technologies. Assurance of protecting our rights and proprietary information cannot be guaranteed. Our

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patents could be challenged, invalidated or circumvented by others and may not be of sufficient scope or strength to provide any meaningful protection or advantage. If we are unable to maintain the proprietary nature of our technologies, we could lose competitive advantages and be materially adversely affected. Adverse determinations in judicial or administrative proceedings could prevent us from selling our services or prevent us from precluding others from selling competing services, and thereby may have a material adverse affect on the business and results of operations. Additionally, claims have been made, are currently pending, and other claims may be made in the future, with regard to our technology infringing on a patent or other intellectual property rights of others. Unfavorable resolution of these claims could either result in our being restricted from delivering the related service or result in an unfavorable settlement that could be material to our operating results, financial condition and cash flow.

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

Adverse economic or other conditions in California, New York, Texas, Florida, and New Jersey would negatively affect our revenue and could materially and adversely affect our results of operations. In December 2010, SME merchants in California represented 11.4%, in New York represented 5.9%, in Texas represented 5.5%, in Florida represented 4.7%, and in New Jersey represented 4.3% of our SME bankcard processing volume. As a result of this geographic concentration of our merchants in these markets, we are exposed to the risks of downturns in these local economies and to other local conditions, which could adversely affect the operating results of our merchants in these markets. No other state represented more than 4% of our SME bankcard processing volume in December 2010.

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

We are dependent upon the ability and experience of a number of our key personnel who have substantial experience with our operations, the rapidly changing payment processing industry and the selected markets in which we offer our services. It is possible that the loss of the services of one or a combination of our senior executives or key managers, particularly Robert O. Carr, our Chief Executive Officer, would have an adverse effect on our operations. Our success also depends on our ability to continue to attract, manage and retain other qualified middle management and technical and clerical personnel as we grow. We may not continue to attract or retain such personnel.

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

Unlike many of our competitors who rely on Independent Sales Organizations or salaried salespeople and telemarketers, we rely on a direct sales force whose compensation is entirely commission-based. Through our direct sales force of approximately 917 Relationship Managers and Territory Managers, we seek to increase the number of merchants using our products and services. We intend to significantly increase the size of our sales force. Our success partially depends on the skill and experience of our sales force. If we are unable to retain and attract sufficiently experienced and capable Relationship Managers, our business and financial results may suffer.

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

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

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

Our operating results are subject to seasonality, which could result in fluctuations in our quarterly net income.

We have experienced in the past, and expect to continue to experience, seasonal fluctuations in our revenues as a result of consumer spending patterns. Historically our revenues have been strongest in our second and third quarters, and weakest in our first quarter.

We may become subject to additional U.S., state or local taxes that cannot be passed through to our merchants, which could negatively affect our results of operations.

Companies in the payment processing industry, including us, may become subject to taxation in various tax jurisdictions on our net income or revenues. Application of these taxes is an emerging issue in our industry and taxing jurisdictions have not yet adopted uniform positions on this topic. If we are required to pay additional taxes and are unable to pass the tax expense through to our merchants, our costs would increase and our net income would be reduced.

We may need to raise additional funds to finance our future capital needs, which may prevent us from growing our business.

We may need to raise additional funds to finance our future capital needs, including developing new products and technologies, and operating expenses. We may need additional financing earlier than we anticipate if we:

- experience material costs to mitigate the impacts of, and resolve remaining claims originating from, the Processing System Intrusion;
- expand faster than our internally generated cash flow can support;
- purchase portfolio equity (the portion of our commissions that we have committed to our sales force for as long as the merchant processes with us, which we may buy out at an agreed multiple) from a large number of Relationship Managers or sales managers;
- add new merchant accounts faster than expected;
- need to reduce pricing in response to competition;
- repurchase our common stock; or
- acquire complementary products, businesses or technologies.

If we raise additional funds through the sale of equity securities, these transactions may dilute the value of our outstanding common stock. We may also decide to issue securities, including debt securities that have rights, preferences and privileges senior to our common stock. We may be unable to raise additional funds on terms favorable to us or at all. If financing is not available or is not available on acceptable terms, we may be unable to fund our future needs. This may prevent us from increasing our market share, capitalizing on new business opportunities or remaining competitive in our industry.

Risks Related to Our Company

Borrowings under our Second Amended and Restated Credit Agreement could adversely affect our financial condition, and the related debt service obligations may adversely affect our cash flow and ability to invest in and grow our businesses.

The interest rates on debt outstanding under our Second Amended and Restated Credit Agreement are floating based on the LIBOR rate; accordingly, if the LIBOR rate increases, our interest expense would be higher. At December 31, 2010, there was $23.2 million outstanding under the Revolving Credit Facility and $100.0 million outstanding under the Term Credit Facility. The Term Credit Facility requires amortization payments in the amount of $3.75 million for each fiscal quarter during the fiscal years ended December 31, 2011 and 2012, $5.0 million for each fiscal quarter during the fiscal years ended December 31, 2013 and 2014, and $7.5 million for each fiscal quarter during the period commencing on January 1, 2015 through the maturity date on November 24, 2015. In January 2011, we entered into fixed-pay amortizing interest rate swaps having an initial notional amount of $50 million on the variable rate debt outstanding under the Term Credit Facility. These interest rate swaps convert that initial notional amount to fixed rate.

We intend to fulfill our total debt service obligations primarily from cash generated by our operations. Such funds will not be available to use in future operations, or investing in our businesses. This may adversely impact our ability to expand our businesses or make other investments. If we are unable to meet our debt obligations, we could be forced to restructure or refinance our obligations, to seek additional equity financing or to sell assets, which we may not be able to do on satisfactory terms or at all. As a result, we could default on those obligations and in the event of such default, our lenders could accelerate our debt or take other actions that could restrict our operations.

Our borrowing agreements contain restrictions which may limit our flexibility in operating and growing our business.

Our borrowing agreements contain covenants, including the maintenance of certain leverage and fixed charge coverage ratios, limitations on the amount of our indebtedness, liens on our properties and assets, investments in, and loans to, other business units, our ability to enter into business combinations and asset sales, and certain other financial and non-financial covenants. We were in compliance with these covenants as of December 31, 2010.

These covenants limit our ability to engage in specified types of transactions, including among other things:

- incur additional indebtedness or issue equity;
- pay dividends on, repurchase or make distributions in respect of our common stock;
- make certain investments;
- sell certain assets;
- create liens;
- consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; and
- enter into certain transactions with respect to our subsidiaries.

Future sales of our common stock, or the perception in the public markets that these sales may occur, could depress our stock price.

Sales of substantial amounts of our common stock in the public market, or the perception in the public markets that these sales may occur, could cause the market price of our common stock to decline. This could also impair our ability to raise additional capital through the sale of our equity securities. At December 31, 2010, we had 38,415,199 shares of our common stock outstanding. In addition, as of December 31, 2010, we had outstanding stock options and restricted share units totaling 8,334,276 shares issued under our 2008 Incentive Stock Option Plan and our 2000 Incentive Stock Option Plan, of which 1,782,475 were vested. Assuming the exercise of all outstanding options to acquire our common stock and the vesting of all restricted share units, our current stockholders would own on a fully-diluted basis 82% of the outstanding shares of our common stock, and the number of shares of our common stock available to trade could cause the market price of our common stock to decline. In addition to the adverse effect a price decline could have on holders of our common stock, such a decline could impede our ability to raise capital or to make acquisitions through the issuance of additional shares of our common stock or other equity securities.

Provisions in our charter documents and Delaware law could discourage a takeover that our shareholders may consider favorable or could cause current management to become entrenched and difficult to replace.

Provisions in our amended and restated certificate of incorporation, in our bylaws and under Delaware law could make it more difficult for other companies to acquire us, even if doing so would benefit our stockholders. Our amended and restated certificate of incorporation and bylaws contain the following provisions, among others, which may inhibit an acquisition of our company by a third party:

advance notification procedures for matters to be brought before stockholder meetings;

a limitation on who may call stockholder meetings;

a prohibition on stockholder action by written consent; and

the ability of our Board of Directors to issue up to 10 million shares of preferred stock without a stockholder vote.

If any shares of preferred stock are issued that contain an extraordinary dividend or special voting power, a change in control could be impeded.

We are also subject to provisions of Delaware law that prohibit us from engaging in any business combination with any interested stockholder, meaning, generally, that a stockholder who beneficially owns more than 15% of our stock cannot acquire us for a period of three years from the date this person became an interested stockholder unless various conditions are met, such as approval of the transaction by our Board of Directors. Any of these restrictions could have the effect of delaying or preventing a change in control.

We may be unable or we may decide not to pay dividends on our common stock at a level anticipated by shareholders, which could depress our stock price.

The payment of dividends on our common stock in the future will be at the discretion of our Board of Directors and will depend on, among other factors, our earnings, stockholders equity, cash position and financial condition. No assurance can be given that we will be able to or will choose to pay any dividends in the foreseeable future.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable.

ITEM 2. PROPERTIES

At December 31, 2010, we owned one facility and leased eleven facilities which we use for operational, sales and administrative purposes.

Our principal executive offices are located in approximately 9,300 square feet of leased office space on Nassau Street in Princeton, New Jersey. The Nassau Street lease expires in May 2013.

We own 35 acres of land in Jeffersonville, Indiana, on which we have completed constructing our credit card operations and service center. The state-of-the-art facility is comprised of 238,000 square feet of space supporting customer service, operations, deployment, day care, fitness, cafeteria, and large company meetings.

We also leased the following facilities as of December 31, 2010:

Location	Square Feet	Expiration
Alpharetta, Georgia	150	October 31, 2011
Chattanooga, Tennessee	9,461	September 30, 2014
Cleveland, Ohio	24,229	June 30, 2012
Colorado Springs, Colorado	9,920	March 1, 2014
Johnson City, Tennessee	45,000	May 1, 2011
Phoenix, Arizona	1,284	March 31, 2011
Plano, Texas	53,976	May 31, 2015 for 26,988 square feet.
		January 14, 2019 for 26,988 square feet.
Portland, Oregon	11,564	September 30, 2013
Toronto, Ontario, Canada	14,094	July 31, 2020

West Windsor Township, New Jersey	5,288	May 31, 2013

We believe that our facilities are suitable and adequate for our current business operations and, if necessary, could be replaced with little disruption to our company. We periodically review our space requirements and may acquire new space to meet our business needs or consolidate and dispose of or sublet facilities which are no longer required.

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ITEM 3. LEGAL PROCEEDINGS

Processing System Intrusion Legal Proceedings

To date, we have had several lawsuits filed against us and additional lawsuits may be filed. These include lawsuits which assert claims against us by cardholders (including various putative class actions seeking in the aggregate to represent all cardholders in the United States whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion) and banks that issued payment cards to cardholders whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion (including various putative class actions seeking to represent all financial institutions that issued payment cards to cardholders whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion), seeking damages allegedly arising out of the Processing System Intrusion and other related relief. The actions generally assert various common-law claims such as claims for negligence and breach of contract, as well as, in some cases, statutory claims such as violation of the Fair Credit Reporting Act, state data breach notification statutes, and state unfair and deceptive practices statutes. The putative cardholder class actions seek various forms of relief including damages, injunctive relief, multiple or punitive damages, attorneys fees and costs. The putative financial institution class actions seek compensatory damages, including recovery of the cost of issuance of replacement cards and losses by reason of unauthorized transactions, as well as injunctive relief, attorneys fees and costs.

The putative consumer class actions and putative financial institution class actions filed against us through March 4, 2011 are described below.

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Putative Consumer Class Actions

Name of the Court	Date Filed	Principal Parties
United States District Court for the District of New Jersey	January 23, 2009	*Sansom and Engel v. Heartland Payment Systems, Inc. et al.*, 3:09-cv-00335
United States District Court for the Northern District of Florida	January 26, 2009	*Read v. Heartland Payment Systems, Inc. et al.*, 3:09-cv-00035
United States District Court for the District of Arizona	January 29, 2009	*Swenka v. Heartland Payment Systems, Inc. et al.*, 2:09-cv-00179
United States District Court for the District of Kansas	January 29, 2009	*Barrett v. Heartland Payment Systems, Inc. et al.*, 09-cv-2053
United States District Court for the District of New Jersey	January 29, 2009	*Merino v. Heartland Payment Systems, Inc. et al.*, 3:09-cv-00439
United States District Court for the Middle District of Alabama	February 2, 2009	*Brown, Latham and Spencer v. Heartland Payment Systems, Inc. et al.*, 2:09-cv-00086
United States District Court for the Eastern District of California	February 2, 2009	*Hilliard v. Heartland Payment Systems, Inc. et al.*, 1:09-cv-00179
United States District Court for the District of New Jersey	February 2, 2009	*Kaissi v. Heartland Payment Systems, Inc. et al.*, 3:09-cv-00540
United States District Court for the Northern District of Ohio	February 3, 2009	*McGinty and Carr v. Heartland Payment Systems, Inc. et al.*, 1:09-cv-00244
United States District Court for the Southern District of Texas	February 4, 2009	*Watson v. Heartland Payment Systems, Inc. et al.*, 4:09-cv-00325
United States District Court for the Eastern District of Wisconsin	February 4, 2009	*Anderson and Hoven v. Heartland Payment Systems, Inc. et al.*, 2:09-cv-00113
United States District Court for the Southern District of Florida	February 6, 2009	*Balloveras v. Heartland Payment Systems, Inc. et al.*, 1:09-cv-20326
United States District Court for the Southern District of California	February 25, 2009	*Mata v. Heartland Payment Systems, Inc. et al.*, 3:09-cv-00376
United States District Court for the Western District of Missouri	February 26, 2009	*McLaughlin v. Heartland Payment Systems, Inc. et al.*, 6:09-cv-3069
United States District Court for the District of New Jersey	February 27, 2009	*Rose v. Heartland Payment Systems, Inc. et al.*, 3:09-cv-00917
United States District Court for the Southern District of Illinois	April 21, 2009	*Leavell v. Heartland Payment Systems, Inc. et al.,* 3:09-cv-00270
United States District Court for the Eastern District of Arkansas	April 30, 2009	*Brown v. Heartland Payment Systems, Inc. et al.,* 4:09-cv-00384

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Putative Financial Institution Class Actions

Name of the Court	Date Filed	Principal Parties
United States District Court for the District of New Jersey	February 6, 2009	*Lone Summit Bank v. Heartland Payment Systems, Inc. et al., 3:09- cv-00581*
United States District Court for the District of New Jersey	February 13, 2009	*TriCentury Bank et al. v. Heartland Payment Systems, Inc. et al., 3:09-cv-00697*
United States District Court for the Southern District of Texas	February 16, 2009	*Lone Star National Bank v. Heartland Payment Systems, Inc. et al., 7:09-cv-00064*
United States District Court for the District of New Jersey	February 20, 2009	*Amalgamated Bank et al. v. Heartland Payment Systems, Inc. et al., 3:09-cv-00776*
United States District Court for the Southern District of Florida	March 19, 2009	*First Bankers Trust Co., N.A. v. Heartland Payment Systems, Inc. et al., 4:09-cv-00825*
United States District Court for the Southern District of Florida	March 31, 2009	*PBC Credit Union et al. v. Heartland Payment Systems, Inc. et al., 9:09-cv-80481*
United States District Court for the Southern District of Texas	April 22, 2009	*Community West Credit Union, et al. v. Heartland Payment Systems, Inc. et al., 4:09-cv-01201*
United States District Court for the Southern District of Texas	April 22, 2009	*Eden Financial Corp. v. Heartland Payment Systems, Inc. et al., 4:09-cv-01203*
United States District Court for the Southern District of Texas	April 28, 2009	*Heritage Trust Federal Credit Union v. Heartland Payment Systems, Inc. et al., 4:09-cv-01284*
United States District Court for the Southern District of Texas	May 1, 2009	*Pennsylvania State Employees Credit Union v. Heartland Payment Systems, Inc. et al., 4:09-cv-01330*

On June 10, 2009, the Judicial Panel on Multidistrict Litigation (the JPML) entered an order centralizing the class action cases for pre-trial proceedings before the United States District Court for the Southern District of Texas, under the caption *In re Heartland Payment Systems, Inc. Customer Data Security Breach Litigation*, MDL No. 2046, 4:09-md-2046. On August 24, 2009, the court appointed interim co-lead and liaison counsel for the financial institution and consumer plaintiffs. On September 23, 2009, the financial institution plaintiffs filed a Master Complaint in the MDL proceedings, which we moved to dismiss on October 23, 2009. Briefing on that motion to dismiss concluded on February 1, 2010 and the motion remains pending. On December 18, 2009, the Company and interim counsel for the consumer plaintiffs filed with the Court a proposed settlement agreement, subject to court approval, of the consumer class action claims. On May 3, 2010, the Court entered an order preliminarily certifying the settlement class, authorizing notice to the class to proceed, and scheduling a fairness hearing for December 10, 2010, which was later adjourned to December 13, 2010. The Company and interim consumer plaintiffs counsel provided additional information requested by the Court following the hearing, and the Court has taken the proposed settlement under advisement.

Other actions have been filed against us seeking damages allegedly arising out of the Processing System Intrusion and other related relief on an individual basis. On October 14, 2009, the Clark County Indiana Teachers Federal Credit Union filed a complaint in the Clark Circuit Superior Court of the State of Indiana. This action is captioned *Clark County Indiana Teachers Federal Credit Union v. Heartland Payment Systems, Inc.*, Civ. No. 10D02-0910-LL-1209, and asserts claims for negligence and breach of contract. On April 12, 2010, we filed an answer to the complaint. On July 30, 2010, the court entered an order staying the action until the MDL court rules on our motion to dismiss or until September 30, 2010, whichever occurs first. On October 25, 2010, the court granted our motion to extend the stay until the MDL court rules on our motion to dismiss or until December 31, 2010, whichever occurs first. On December 27, 2010, we filed a motion to extend the stay until the MDL court rules on our motion to dismiss, and this motion remains pending. On December 28, 2009, Putnam Bank of Putnam, Connecticut filed a complaint in Connecticut Superior Court, *Putnam Bank v. Heartland Payment Systems, Inc.*, case no. WWM-CV-10-6001208-S. On January 20, 2010, we removed the action to the United States District Court for the District of Connecticut, case no. 3:10-cv-0061 (JBA), and, on January 27, 2010, filed a Notice of Potential Tag-Along Action, requesting centralization of the action with the MDL proceedings. On March 17, 2010, the action was centralized with the MDL proceedings. On February 9, 2010, OmniAmerican Bank filed a complaint in the District Court for Collin County, Texas, Civ. No. 380-00563-2012. The complaint identifies as a party in interest the Federal Insurance

Company, which is alleged to have insured plaintiff and reimbursed it for $1,005,077.50, less a $100,000 deductible. On March 15, 2010, we filed an answer to the complaint and removed the action to the United States District Court for the Eastern District of Texas, case no. 4:10-cv-114, and, on March 16, 2010, filed a Notice of Potential Tag-Along Action, requesting centralization of the action with the MDL proceedings. On April 29, 2010, the action was centralized with the MDL proceedings. On February 18, 2010, Quad City Bank and Trust filed a complaint in the District Court for Collin County, Texas, Civ. No. 380-00721-2010. The complaint identifies as a party in interest the Federal Insurance Company, which is alleged to have insured plaintiff and reimbursed it for $432,420.32, less a $100,000 deductible. On March 15, 2010, we filed an answer to the complaint and removed the action to the United States District Court for the Eastern District of Texas, case no. 4:10-cv-115 and, on March 16, 2010, filed a Notice of Potential Tag-Along Action, requesting centralization of the action with the MDL proceedings. On April 29, 2010, the action was centralized with the MDL proceedings. On May 5, 2010, Napus Federal Credit Union filed a complaint in the United States District Court for the Southern District of Texas, case no. 4:10-cv-1616, and the action was consolidated with the MDL proceedings on June 9, 2010.

On January 19, 2010, financial institution plaintiffs, including certain of the named plaintiffs in the MDL proceedings, commenced an action against our sponsor banks in the United States District Court for the Southern District of Texas, captioned *Lonestar National Bank, N.A. et al. v. KeyBank NA, et al.*, Civ. No. 4:10-cv-00171. This action against our sponsor banks asserts common-law claims similar to those asserted against us, and likewise seeks to represent all financial institutions that issued payment cards to cardholders whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion. On March 4, 2010, this action was transferred to the judge overseeing the MDL proceedings. On April 9, 2010, our sponsor banks moved to dismiss the complaint. Briefing on that motion to dismiss concluded on June 7, 2010 and the motion remains pending. The sponsor banks could seek indemnification from us in regard to the claims asserted in this action.

We have been advised by the SEC that it has commenced an informal inquiry and we have been advised by the United States Attorney for the District of New Jersey that it has commenced an investigation, in each case to determine whether there have been any violations of the federal securities laws in connection with our disclosure of the Processing Systems Intrusion and the alleged trading in our securities by certain of our employees, including certain executive officers. We are cooperating with these inquiries.

We were contacted by the Federal Financial Institutions Examination Council and informed that it would make inquiries into the Processing System Intrusion, and the Federal Trade Commission, by letters dated February 19, 2009, August 4, 2009, and March 10, 2010, has requested that we provide information about our payment processing services and information security practices. Additionally, we have received written or telephonic inquiries relating to the Processing System Intrusion from a number of state Attorneys General s offices, including a Civil Investigative Demand from the Louisiana Department of Justice Office of the Attorney General, the Canadian Privacy Commission, and other government officials. We are cooperating with the

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government officials in response to each of these inquiries. Additional lawsuits may be filed against us relating to the Processing System Intrusion and that additional inquiries from governmental agencies may be received or investigations may be commenced.

Although we intend to defend the lawsuits, investigations and inquiries described above vigorously, we cannot predict the outcome of such lawsuits, investigations and inquiries. Apart from damages claimed in such lawsuits and in other lawsuits relating to the Processing System Intrusion that may be filed, we may be subject to fines or other obligations as a result of the government inquiries and investigations described above and additional governmental inquiries or investigations relating to the Processing System Intrusion that may be commenced.

Since our announcement of the Processing System Intrusion on January 20, 2009 and through December 31, 2010, we have expensed a total of $146.1 million, before reducing those charges by $31.2 million of total insurance recoveries. The majority of the total charges, or approximately $114.7 million, related to settlements of claims. Approximately $31.4 million of the total charges were for legal fees and costs we incurred for investigations, defending various claims and actions, remedial actions and crisis management services.

During the year ended December 31, 2010, we recovered from our insurance providers approximately $27.2 million of the costs we incurred for the Processing System Intrusion and expensed approximately $13.1 million for accruals, legal fees and costs it incurred for defending various claims and actions, resulting in a net recovery of $14.1 million, or $0.22 per share.

For the year ended December 31, 2009, we expensed a total of $132.9 million for settlement accruals, legal fees and costs we incurred for defending various claims and actions associated with the Processing System Intrusion, and recovered from our insurance providers approximately $4.0 million of the costs we incurred resulting in net expenses of $128.9 million, or about $2.16 per share.

At December 31, 2010 and 2009, we carried a Reserve for Processing System Intrusion on our Consolidated Balance Sheet of $1.6 million and $99.9 million, respectively. During the year ended December 31, 2010, we settled the following claims and disputes related to the Processing System Intrusion:

On January 7, 2010, we entered into a settlement agreement with Heartland Bank, KeyBank National Association (KeyBank, and, together with Heartland Bank, the Sponsor Banks), and Visa U.S.A. Inc., Visa International Service Association and Visa Inc. (collectively, Visa) to resolve potential claims and other disputes among us, the Sponsor Banks and Visa with respect to the potential rights and claims of Visa and certain issuers of Visa-branded credit and debit cards related to the Processing System Intrusion (the Visa Settlement Agreement). After including a $780,000 credit for fines previously collected by Visa during 2009, the amount we paid under the Visa Settlement Agreement was $59.3 million. The costs of this settlement were included in our Provision for Processing System Intrusion on our Consolidated Statement of Operations for the year ended December 31, 2009 and in on Reserve for Processing System Intrusion on our Consolidated Balance Sheet as of December 31, 2009. Financial institutions representing more than 97 percent of eligible Visa-branded credit and debit cards have accepted the offers they received pursuant to the settlement entered into between and among us, Visa, and our sponsoring acquirers.

On February 18, 2010, we entered into a bridge loan agreement (the Bridge Loan Agreement) with KeyBank, as administrative agent, and KeyBank and Heartland Bank as bridge lenders. On that date, KeyBank made a bridge loan to us in the amount of $20.0 million and Heartland Bank made a bridge loan in the amount of $8.0 million (collectively, the Bridge Loan). See Note 11, Credit Facilities for additional terms of the Bridge Loan.

On February 18, 2010, we also entered into a Commitment Increase Agreement pursuant to the Amended and Restated Credit Agreement dated as of May 30, 2008 (the Commitment Increase Agreement) whereby KeyBank, as one of the lenders under the Amended and Restated Credit Agreement, agreed to increase its revolving credit commitment to us under the Amended and Restated Credit Agreement by $25.0 million (the Increased Credit Commitment). See Note 11, Credit Facilities for additional terms of the Commitment Increase Agreement.

The proceeds of the Bridge Loan and the Increased Credit Commitment, together with a portion of our cash reserves, were used to fund the settlement with Visa. The Visa Settlement Agreement was consummated on February 18, 2010, with a payment of $58.6 million.

On May 19, 2010, we entered into a settlement agreement with MasterCard Worldwide (MasterCard) to resolve potential claims and other disputes among us, the Sponsor Banks and MasterCard related to the Processing System Intrusion (the MasterCard Settlement Agreement). Under the MasterCard Settlement Agreement, alternative recovery offers totaling $41.4 million were made to eligible MasterCard issuers with respect to losses alleged to have been incurred by them as a result of the Processing System Intrusion. The $41.4 million included a $6.6 million credit for fines previously collected by MasterCard during 2009, so the maximum amount payable under the settlement was $34.8 million if all MasterCard issuers had accepted the settlement. On September 3, 2010 and September 14, 2010, we paid approximately $34.4 million because certain issuers did not accept settlement. Those issuers, who represent less than 1% of the accounts eligible for the settlement, had been preliminarily awarded $367,172 by MasterCard, and we are contesting that award.

On August 31, 2010, we entered into an agreement of settlement and release with DFS Services, LLC (Discover) to resolve potential claims and other disputes among us and Discover (and its affiliates and certain of its issuers) with respect to the Processing System Intrusion (the Discover Settlement Agreement). On September 2, 2010, we paid Discover $5.0 million in full and final satisfaction of any and all claims of Discover, its affiliates and certain of its issuers arising from or relating to the Processing System Intrusion. The Discover Settlement Agreement contains mutual releases by and between us and Discover (on behalf of itself and its affiliates) relating to the Processing System Intrusion.

During the year ended December 31, 2009, we settled the following claims and disputes related to the Processing System Intrusion:

On December 17, 2009, we entered into a settlement agreement and release with American Express to resolve potential claims and other disputes among us and American Express (and its issuers) with respect to the Processing System Intrusion, and subsequently we paid approximately $3.5 million in full and final satisfaction of any and all claims of American Express and its issuers arising from or relating to the Processing System Intrusion. Such settlement agreement and release contains mutual releases by and between us and American Express (on behalf of itself and its issuers) relating to the Processing System Intrusion.

These settlement amounts were previously provided for in our Provision for Processing System Intrusion and carried in our Reserve for Processing System Intrusion. We are prepared to vigorously defend our company against any unsettled claims relating to the Processing System Intrusion that have been asserted against us and our sponsor banks to date. We feel we have strong defenses to all the claims that have been asserted against us and our sponsor banks relating to the Processing System Intrusion.

Additional costs we expect to incur for legal fees and costs for defending various claims and actions associated with the Processing System Intrusion will be recognized as incurred. Such costs could be material and could adversely impact our results of operations, financial condition and cash flow.

Other Legal Proceedings

On December 16, 2008, a putative class action was filed against us in the Superior Court of California, County of San Diego, *Ryan McInerney, Hossein Vazir Zand v. Heartland Payment Systems, Inc*. The plaintiffs purport to represent a putative class of individuals who allegedly were not reimbursed by us for business expenses and whose compensation was allegedly reduced for their costs of doing business. We and the plaintiffs have agreed to a tentative settlement to resolve the claims and are working towards providing notice to the putative class members and obtaining approval by the Court.

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On September 9, 2009, VeriFone Israel Ltd. filed a lawsuit in the Northern District of California alleging patent infringement of U.S. Patent No. 6,853,093 (the 093 patent) by our NP3000 payment terminals. VeriFone Israel seeks injunctive relief against the alleged infringement and damages, including enhanced damages for willfulness and reasonable attorneys fees. On October 13, 2009, VeriFone Israel Ltd. amended its complaint to add an additional plaintiff, VeriFone Holdings, Inc., and seeking Declaratory Judgment that VeriFone Holdings was not involved in certain unfair business activity including Tortious Interference with Contract and Prospective Economic Advantage, Tortious Refusal to Deal, Breach of Contract, Breach of Implied Duty of Good Faith and Fair Dealing, Unfair Competition and Defamation. These declaratory judgment counts regarding VeriFone s unfair business activities correspond to affirmative claims we brought against VeriFone Holdings in New Jersey State Court, previously. We have has not yet answered the complaint. This case was assigned to Hon. Charles R. Breyer. VeriFone Israel filed a notice of voluntary dismissal on February 15, 2010. On February 16, 2010, we filed a Declaratory Judgment action in the Northern District of California seeking a judgment that we have not infringed the 093 patent and that the 093 patent is not valid. On February 16, 2010, VeriFone Israel filed counterclaims in our New Jersey Lanham Act case mirroring those it voluntarily dismissed in the Northern District of California. On April 22, 2010, our Declaratory Judgment action was transferred to the District of New Jersey, where it has been assigned to Judge Mary L. Cooper. On June 8, 2010, Magistrate Judge Douglas E. Arpert entered an Order staying all discovery in the case until September 7, 2010. The Order staying all discovery has been subsequently extended until March 31, 2011.

On November 6, 2009, VeriFone Holdings, Inc. filed a lawsuit in the Northern District of California alleging violations of the Lanham Act (False Advertising) and California Laws (Unfair Business Practices). VeriFone Holdings sought a preliminary and permanent injunction against us and unspecified damages. The case was assigned to Hon. Phyllis Hamilton. VeriFone Holdings filed a notice of voluntary dismissal on February 15, 2010. On February 16, 2010, VeriFone Holdings filed counterclaims in our New Jersey Lanham Act case mirroring those it voluntarily dismissed in the Northern District of California.

In the ordinary course of our business, we are party to various legal actions, which we believe are incidental to the operation of our business. We believe that the outcome of the proceedings to which we are currently a party will not have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 4. (REMOVED AND RESERVED)

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock trades on the New York Stock Exchange under the ticker symbol HPY. The following table sets forth the high and low sales prices of our common stock and dividend paid per share for the four quarters during the years ended December 31, 2010 and 2009:

	High	Low	Dividend Per Share
2009			
Quarter Ended:			
March 31, 2009	$ 18.93	$ 3.57	$ 0.025
June 30, 2009	$ 9.62	$ 6.34	$ 0.01
September 30, 2009	$ 15.17	$ 8.88	$ 0.01
December 31, 2009	$ 14.59	$ 10.45	$ 0.01
2010			
Quarter Ended:			
March 31, 2010	$ 19.03	$ 12.95	$ 0.01
June 30, 2010	$ 19.51	$ 14.78	$ 0.01
September 30, 2010	$ 16.81	$ 13.48	$ 0.01
December 31, 2010	$ 16.82	$ 13.57	$ 0.01

Holders of Common Stock

The number of shareholders of record of our common stock as of March 2, 2011 was 26.

Dividends

Until the third quarter of 2006, we had not paid any cash dividends on our common stock. On August 1, 2006, our Board of Directors declared the first quarterly cash dividend on our common stock. The payment of dividends on our common stock in the future will be at the discretion of our Board of Directors and will depend on, among other factors, our earnings, stockholders equity, cash position and financial condition. On February 16, 2011, the Company s Board of Directors declared a quarterly cash dividend of $0.04 per share of common stock, payable on March 15, 2011 to stockholders of record as of March 4, 2011.

Securities Authorized For Issuance Under Equity Compensation Plans

We maintain the Heartland Payment Systems, Inc. Amended and Restated 2008 Equity Incentive Plan under which shares of our common stock are authorized for issuance. For more information on this plan, see Note 15, Stock Incentive Plan. Information regarding the common stock issuable under this plan as of December 31, 2010 is set forth in the following table:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities

	rights		reflected in the first column)
Equity compensation plans approved by security holders	8,334,276	$ 15.09	8,334,276
Equity compensation plans not approved by security holders	None	N/A	None
Total	8,334,276	$ 15.09	8,334,276

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Purchases of Equity Securities by the Issuer

On January 13, 2006, our Board of Directors authorized management to repurchase up to the lesser of (a) 1,000,000 shares of our common stock or (b) $25,000,000 worth of our common stock in the open market. On August 1, 2006, our Board of Directors authorized management to repurchase up to 1,000,000 shares of our common stock in the open market using the proceeds from the exercise of stock options. On May 3, 2007, our Board of Directors eliminated the restriction in the August 1, 2006 repurchase authorization which required management to use only proceeds from the issuance of stock options for repurchases, and increased the total remaining authorized number of shares to be repurchased to 2,000,000. Under these authorizations, we repurchased an aggregate of 2,924,684 shares of our common stock at a cost of $65.1 million, or an average cost of $22.25 per share. This includes 350,400 shares repurchased at a cost of $3.2 million, or $9.14 per share during 2009 and 781,584 shares repurchased at a cost of $18.0 million, or $23.02 per share during 2008. No common stock was repurchased in 2010.

Performance Graph

The following graph compares the percentage change in cumulative total stockholder return on our common stock for the past five years with the cumulative total returns over the same period of (i) the S&P 500 Index and (ii) the S&P Information Technology Index.

The below comparison assumes $100 was invested on December 31, 2005 in our common stock and in the S&P 500 Index and the S&P Information Technology Index, and assumes reinvestment of dividends, if any. Historical stock prices are not indicative of future stock price performance.

	Base Period	Period Ended				
	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09	12/31/10
Heartland Payment Systems, Inc.	100.00	130.66	125.05	83.04	62.73	73.85
S&P 500	100.00	115.79	122.16	76.96	97.33	111.99
S&P Information Technology Index	100.00	108.42	126.10	71.70	115.95	127.77

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected historical consolidated financial information and other data for the years ended December 31, 2010, 2009, 2008, 2007 and 2006 which are derived from our consolidated financial statements included elsewhere in this report. Historical consolidated financial information for 2007 and 2006 are derived from our consolidated financial statements for those years (not included herein). The information in the following table should be read together with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the related notes included elsewhere in this report.

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(in thousands, except per share data)				
Statement of Operations Data:					
Total revenues	$ 1,864,337	$ 1,652,139	$ 1,544,902	$ 1,313,846	$ 1,097,041
Costs of services:					
Interchange	1,299,631	1,142,112	1,093,546	962,025	804,267
Dues, assessments and fees	119,834	89,844	67,648	57,050	47,122
Processing and servicing	228,953	199,934	179,106	131,944	117,112
Customer acquisition costs	50,415	50,362	48,522	44,193	35,451
Depreciation and amortization	15,201	15,786	11,006	6,806	6,042
Total costs of services	1,714,034	1,498,038	1,399,828	1,202,018	1,009,994
General and administrative	104,088	104,154	74,434	52,059	42,229
Total expenses	1,818,122	1,602,192	1,474,262	1,254,077	1,052,223
Income from operations	46,215	49,947	70,640	59,769	44,818
Other income (expense):					
Interest income	148	117	755	1,934	1,225
Interest expense	(4,778)	(2,698)	(3,206)	(785)	(753)
Gain (loss) on investments	25	(31)	(395)	(1,650)	
Exit costs for service center	(493)			(1,267)	
(Provision for) recovery of processing system intrusion	14,138	(128,943)			
Other, net	540	(41)	(5)	(841)	(669)
Total other income (expense)	9,580	(131,596)	(2,851)	(2,609)	(197)
Income (loss) before income taxes	55,795	(81,649)	67,789	57,160	44,621
Provision for income taxes	21,135	(29,919)	25,918	21,290	16,077
Net income (loss)	34,660	(51,730)	41,871	35,870	28,544
Less: Net income attributable to noncontrolling interests	123	66	31		
Net income (loss) attributable to Heartland	$ 34,537	$ (51,796)	$ 41,840	$ 35,870	$ 28,544
Earnings (loss) per common share:					
Basic	$ 0.91	$ (1.38)	$ 1.12	$ 0.95	$ 0.78
Diluted	$ 0.88	$ (1.38)	$ 1.08	$ 0.90	$ 0.71
Weighted average number of common shares outstanding:					
Basic	37,994	37,483	37,521	37,686	36,394
Diluted	39,310	38,028	38,698	39,980	39,943

Cash dividends declared per common share	$ 0.04	$ 0.055	$ 0.36	$ 0.25	$ 0.05
Other Data:					
Number of active bankcard merchants serviced (at period end - in thousands)	236	234	230	155	133
Bankcard processing volume for the period (in millions)	74,939	69,262	66,925	51,936	43,294

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	As of December 31,				
	2010	2009	2008	2007	2006
			(in thousands)		
Balance Sheet Data:					
Cash and cash equivalents	$ 41,729	$ 32,113	$ 27,589	$ 35,508	$ 16,054
Receivables, net	175,530	149,403	140,145	122,613	107,154
Total assets	561,464	562,206	463,619	329,189	251,768
Due to sponsor banks	72,573	80,007	68,212	49,798	27,253
Accounts payable	42,126	32,305	25,864	20,495	16,936
Current portion of borrowings	38,286	58,547	58,522		174
Long term portion of borrowings	85,000	8,419	16,984		
Total liabilities	383,870	432,251	284,256	163,520	112,475
Total Stockholders Equity	177,293	129,741	179,244	165,669	139,293

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and the accompanying notes to consolidated financial statements and the risk factors included elsewhere in this report.

Overview

General

Our primary business is to provide bankcard payment processing services to merchants in the United States and Canada. This involves facilitating the exchange of information and funds between merchants and cardholders financial institutions, providing end-to-end electronic payment processing services to merchants, including merchant set-up and training, transaction authorization and electronic draft capture, clearing and settlement, merchant accounting, merchant assistance and support, and risk management. Our merchant customers primarily fall into two categories: our core small and midsized merchants (referred to as Small and Midsized Enterprises, or SME) and Network Services large national and mid-tier merchants, primarily in the petroleum industry (referred to as Network Services Merchants). We also provide additional services to our merchants, such as payroll processing, gift and loyalty programs, paper check processing, and we sell and rent point-of-sale devices and supplies.

On January 20, 2009, we publicly announced the Processing System Intrusion, which apparently occurred during some portion of 2008. See Processing System Intrusion for more detail.

At December 31, 2010, we provided our bankcard payment processing services to approximately 173,860 active SME bankcard merchants located across the United States. This represents a slight increase over the 173,400 active SME bankcard merchants at December 31, 2009. At December 31, 2010, we provided bankcard payment processing services to approximately 109 Network Services Merchants with approximately 54,244 locations. Additionally, at December 31, 2010, we provided bankcard payment processing services to over 8,300 merchants in Canada.

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Our total bankcard processing volume for the years ended December 31, 2010 was $74.9 billion, an 8.2% increase from the $69.3 billion processed during the year ended December 31, 2009. Our SME bankcard processing volume for the year ended December 31, 2010 was $63.1 billion, a 7.0% increase over 2009, and included increases for American Express and Discover card processing, which were initiated in 2009. Our Discover processing volume also benefited from our purchase of an existing merchant portfolio from Discover during the third quarter of 2009. We include American Express volume in our SME bankcard processing volume only where we receive percentage-based residual compensation for that volume. Our bankcard processing volume for 2010 also includes $11.3 billion of settled volume for Network Services Merchants, compared to $9.9 billion for 2009. Bankcard processing volume for the years ended December 31, 2010, 2009 and 2008 was as follows:

	Year Ended December 31,		
	2010	**2009**	**2008**
		(in millions)	
SME merchants	**$ 63,058**	$ 58,952	$ 57,939
Network Services Merchants	**11,319**	9,850	8,653
Canada	**562**	460	334
Total bankcard processing volume (a)	**$ 74,939**	$ 69,262	$ 66,926

(a) Bankcard processing volume includes volume for credit and signature debit transactions.

Merchant attrition is expected in the card payment processing industry in the ordinary course of business. We experience attrition in merchant bankcard processing volume resulting from several factors, including business closures, transfers of merchants accounts to our competitors and account closures that we initiate due to heightened credit risks relating to, or contract breaches by, merchants, and (when applicable) same store sales contraction. We measure SME processing volume attrition against all SME merchants that were processing with us in the same month a year earlier. During the year ended December 31, 2010, we experienced an improved 15.3% average annualized attrition in our SME bankcard processing volume compared to an average attrition of 22.6% and 17.3% for the years ended December 31, 2009 and 2008, respectively. Much of our attrition is related to business closures, which accelerated in 2009 and 2008 due to weak economic conditions, and in 2009 and 2008 our volume attrition was also significantly impacted by overall contraction in same stores sales.

In our SME business, we measure same store sales growth, or contraction, as the change in bankcard processing volume for all bankcard merchants that were processing with us in the same month a year earlier. In 2010, same store sales grew 1.3% on average, compared to a 7.8% and 2.1% contraction in 2009 and 2008, respectively. Same store sales growth or contraction results from the combination of the increasing or decreasing use by consumers of bankcards for the purchase of goods and services at the point of sale, and sales growth or contraction experienced by our retained SME bankcard merchants. The following table compares our same store sales growth or contraction during 2010, 2009, 2008 and 2007:

Same Store Sales Growth (Contraction)	**2010**	**2009**	**2008**	**2007**
First Quarter	(1.5)%	(7.6)%	0.6%	3.4%
Second Quarter	1.1%	(9.7)%	(0.1)%	3.3%
Third Quarter	2.0%	(8.6)%	(2.0)%	3.6%
Fourth Quarter	3.8%	(5.2)%	(6.8)%	2.1%
Full Year	1.3%	(7.8)%	(2.1)%	3.0%

We attribute the deterioration in same store sales percentages that we experienced in our SME business from the first quarter of 2008 through the first quarter of 2010 to declining economic conditions including impacts from severely contracted credit markets, a weak housing market, historically low consumer and investor confidence and high unemployment rates. Our same store sales contraction experience tracked the overall economic downturn. The improvement we experienced in same store sales percentages in 2010 also tracks the general economy, as well as benefiting from year-over-year comparison to weaker processing volumes. Management believes that the challenging economic conditions may continue to result in modest, if any, near-term improvements in our existing SME merchants businesses.

In September 2010, we refocused the efforts of our sales force by applying historically productive sales and motivation techniques and relying less on the Industry Specialization Model (ISM) we developed and had attempted to implement earlier in the year. The ISM model had focused the sales force on specific industry verticals, whereby Relationship Managers were assigned protected merchant verticals (e.g., restaurants, healthcare and lodging) within their territories. In order to retain their protected merchant lists, a Relationship Manager was required to meet a minimum level of documented daily merchant visits within the protected vertical, and to report on their progress. Management determined that the daily reporting and weekly tracking processes required under the ISM model slowed down the Relationship Managers and their sales managers, distracted them from their overall selling efforts and adversely affected sales results.

We measure the overall production of our sales force by gross margin installed, which reflects the expected annual gross profit from a merchant contract after deducting processing and servicing costs associated with that revenue. Our newly installed gross margin for the year ended December 31, 2010 decreased 14.2% from the gross margin we installed during the year ended December 31, 2009. We attribute this decline in newly installed gross margin to the weak economy, the disruption in our sales efforts caused by our attempt to transition to the ISM model, and the related focus on increasing the size and training of our sales force during the first nine months of 2010.

Historically, we compensated our sales managers based on their success in growing the sales force and increasing the total SME merchant base in their regions. Past increases in our direct sales force, including our Relationship Managers, had led to significant growth in the total SME merchants for which we process and the gross margin generated by those merchants and for the first half of 2010, our sales managers were focused on increasing our number of Relationship Managers. During the six months ended June 30, 2010, we grew the number of Relationship Managers by 30.0% to 1,393, from 1,069 at December 31, 2009. However, during the third quarter of 2010 as we refocused our sales organization toward improving individual sales persons productivity, we reduced our Relationship Manager count, but at the same time more fully engaged our Territory Managers in the sales process by requiring them to achieve individual minimum monthly gross margin install targets. Combining our Relationship Managers and Territory Managers gives us a count of 917 at December 31, 2010. The focus on productivity resulted in year-over-year growth of 6.4% in our installed gross margin for the fourth quarter 2010.

The bankcard revenue we earn in our SME business is recurring in nature, as we typically enter into three-year service contracts with our card processing merchants that, in order to qualify for the agreed-upon pricing, require the merchant to achieve bankcard processing volume minimums. Most of our SME revenue is from payment processing fees, which are a combination of a fee equal to a percentage of the dollar amount of each transaction we process plus a flat fee per transaction. We make mandatory payments of interchange fees to card-issuing banks through the card networks and dues, assessments and other network fees to Visa, MasterCard and Discover. Our SME gross bankcard processing revenue is largely driven by Visa and MasterCard volume processed by our merchants. More recently, we have experienced growth in card processing revenues by processing transaction for SME merchants new to accepting American Express and from processing Discover transactions.

In contrast to SME card processing revenues, revenues from our Network Services Merchants are largely driven by the number of transactions we process (whether settled, or only authorized), not our processing volume, as the merchants which comprise Network Services customer base pay on a per transaction basis for processing services. Additionally, we acquire and settle transactions on our front and back end systems for American Express transactions for which we receive compensation from American Express on a per transaction basis. The number of transactions we processed for Network Services Merchants and American Express for the years ended December 31, 2010, 2009 and 2008 were as follows:

	2010	2009	2008
		(in thousands)	
Network Services Merchants:			
Settled	**487,972**	462,342	316,679
Authorized	**2,611,830**	2,374,735	1,392,421
American Express	**20,703**		
Total	**3,120,505**	2,837,077	1,709,100

We have developed a number of proprietary payment processing systems to increase our operating efficiencies and distribute our processing and merchant data to our three main constituencies: our merchant base, our sales force and our customer service staff. We provide authorization and data capture services to our SME merchants through our internally-developed front-end processing system, HPS Exchange. This system incorporates real time reporting tools through interactive point-of-sale database maintenance via the Internet. These tools enable merchants, and our employees, to change the messages on credit card receipts and to view sale and return transactions entered into the point-of-sale device with a few second delay on any computer linked to the Internet. During the years ended December 31, 2010, 2009 and 2008, approximately 90%, 88% and 83%, respectively, of our SME transactions were processed through HPS Exchange.

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We provide clearing, settlement and merchant accounting services through our own internally developed back-end processing system, Passport. Passport enables us to customize these services to the needs of our Relationship Managers and merchants. At both December 31, 2010 and 2009, approximately 99% of total SME bankcard merchants were processing on Passport. In the fourth quarter of 2010, the clearing, settlement and merchant accounting services for Network Services settled transactions were converted onto Passport, so that at December 31, 2010, our internal systems are providing all aspects of our Network Services Merchants processing needs.

We also provide payroll processing services throughout the United States. At December 31, 2010, we processed payroll for 11,131 customers, an increase of 18.6% from 9,382 payroll customers at December 31, 2009. Our nationwide direct sales force sells our payroll processing services solely on a commission basis. In 2010, 2009 and 2008, we installed 4,858, 4,303 and 4,406 new payroll processing customers, respectively. We developed a new comprehensive payroll management system, which we refer to as PlusOne Payroll, that streamlines all aspects of the payroll process to enable time and cost savings. PlusOne Payroll was made available to new and existing customers beginning in 2010. We expect to fully convert our existing payroll customers to PlusOne Payroll by mid-2011. The PlusOne Payroll platform enables us to process payroll on a large scale and provide customizable solutions for businesses of all sizes.

Processing System Intrusion

On January 20, 2009, we publicly announced the discovery of a criminal breach of our payment systems environment (the Processing System Intrusion). The Processing System Intrusion involved malicious software that appears to have been used to collect in-transit, unencrypted payment card data while it was being processed by us during the transaction authorization process. We believe the breach has been contained and did not extend beyond 2008. See Legal and Regulatory Considerations for further detail and related events.

Since our announcement of the Processing System Intrusion on January 20, 2009 and through December 31, 2010, we have expensed a total of $146.1 million, before reducing those charges by $31.2 million of total insurance recoveries. The majority of the total charges, or approximately $114.7 million, related to settlements of claims. Approximately $31.4 million of the total charges were for legal fees and costs we incurred for investigations, defending various claims and actions, remedial actions and crisis management services.

During the year ended December 31, 2010, we recovered from our insurance providers approximately $27.2 million of the costs we incurred for the Processing System Intrusion and expensed approximately $13.1 million for accruals, legal fees and costs we incurred for defending various claims and actions, resulting in a net recovery of $14.1 million, or $0.22 per share.

For the year ended December 31, 2009, we expensed a total of $132.9 million for settlement accruals, legal fees and costs we incurred for defending various claims and actions associated with the Processing System Intrusion, and recovered from our insurance providers approximately $4.0 million of the costs we incurred resulting in net expenses of $128.9 million, or about $2.16 per share.

At December 31, 2010 and 2009, we carried a Reserve for Processing System Intrusion on our Consolidated Balance Sheet of $1.6 million and $99.9 million, respectively. During the year ended December 31, 2010, we settled the following claims and disputes related to the Processing System Intrusion:

On January 7, 2010, we entered into a settlement agreement with Heartland Bank, KeyBank National Association (KeyBank, and, together with Heartland Bank, the Sponsor Banks), and Visa U.S.A. Inc., Visa International Service Association and Visa Inc. (collectively, Visa) to resolve potential claims and other disputes among us, the Sponsor Banks and Visa with respect to the potential rights and claims of Visa and certain issuers of Visa-branded credit and debit cards related to the Processing System Intrusion (the Visa Settlement Agreement). After including a $780,000 credit for fines previously collected by Visa during 2009, the amount we paid under the Visa Settlement Agreement was $59.3 million. The costs of this settlement were included in our Provision for Processing System Intrusion on our Consolidated Statement of Operations for the year ended December 31, 2009 and in our Reserve for Processing System Intrusion on our Consolidated Balance Sheet as of December 31, 2009. Financial institutions representing more than 97 percent of eligible Visa-branded credit and debit cards have accepted the offers they received pursuant to the settlement entered into between and among us, Visa, and our sponsoring acquirers.

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On February 18, 2010, we entered into a bridge loan agreement (the Bridge Loan Agreement) with KeyBank, as administrative agent, and KeyBank and Heartland Bank as bridge lenders. On that date, KeyBank made a bridge loan to us in the amount of $20.0 million and Heartland Bank made a bridge loan in the amount of $8.0 million (collectively, the Bridge Loan). See Note 11, Credit Facilities for additional terms of the Bridge Loan.

On February 18, 2010, we also entered into a Commitment Increase Agreement pursuant to the Amended and Restated Credit Agreement dated as of May 30, 2008 (the Commitment Increase Agreement) whereby KeyBank, as one of the lenders under the Amended and Restated Credit Agreement, agreed to increase its revolving credit commitment to us under the Amended and Restated Credit Agreement by $25.0 million (the Increased Credit Commitment). See Note 11, Credit Facilities for additional terms of the Commitment Increase Agreement.

The proceeds of the Bridge Loan and the Increased Credit Commitment, together with a portion of our cash reserves, were used to fund the settlement with Visa. The Visa Settlement Agreement was consummated on February 18, 2010, with a payment of $58.6 million.

On May 19, 2010, we entered into a settlement agreement with MasterCard Worldwide (MasterCard) to resolve potential claims and other disputes among us, the Sponsor Banks and MasterCard related to the Processing System Intrusion (the MasterCard Settlement Agreement). Under the MasterCard Settlement Agreement, alternative recovery offers totaling $41.4 million were made to eligible MasterCard issuers with respect to losses alleged to have been incurred by them as a result of the Processing System Intrusion. The $41.4 million included a $6.6 million credit for fines previously collected by MasterCard during 2009, so the maximum amount payable under the settlement was $34.8 million if all MasterCard issuers had accepted the settlement. On September 3, 2010 and September 14, 2010, we paid approximately $34.4 million because certain issuers did not accept settlement. Those issuers, who represent less than 1% of the accounts eligible for the settlement, have been preliminarily awarded $367,172 by MasterCard, and we are contesting that award.

On August 31, 2010, we entered into an agreement of settlement and release with DFS Services, LLC (Discover) to resolve potential claims and other disputes among us and Discover (and its affiliates and certain of its issuers) with respect to the Processing System Intrusion (the Discover Settlement Agreement). On September 2, 2010, we paid Discover $5.0 million in full and final satisfaction of any and all claims of Discover, its affiliates and certain of its issuers arising from or relating to the Processing System Intrusion. The Discover Settlement Agreement contains mutual releases by and between us and Discover (on behalf of itself and its affiliates) relating to the Processing System Intrusion.

During the year ended December 31, 2009, we settled the following claims and disputes related to the Processing System Intrusion:

On December 17, 2009, we entered into a settlement agreement and release with American Express to resolve potential claims and other disputes among us and American Express (and its issuers) with respect to the Processing System Intrusion, and subsequently we paid approximately $3.5 million in full and final satisfaction of any and all claims of American Express and its issuers arising from or relating to the Processing System Intrusion. Such settlement agreement and release contains mutual releases by and between us and American Express (on behalf of itself and its issuers) relating to the Processing System Intrusion.

These settlement amounts were previously provided for in our Provision for Processing System Intrusion and carried in our Reserve for Processing System Intrusion. We are prepared to vigorously defend our company against any unsettled claims relating to the Processing System Intrusion that have been asserted against us and our sponsor banks to date. We feel we have strong defenses to all the claims that have been asserted against us and our sponsor banks relating to the Processing System Intrusion.

Additional costs we expect to incur for legal fees and costs for defending various claims and actions associated with the Processing System Intrusion will be recognized as incurred. Such costs could be material and could adversely impact our results of operations, financial condition and cash flow.

2010 Financial Highlights

Our financial results for the year ended December 31, 2010 reflect the impact of a slow economic recovery for our SME merchant base and the two-year financial impacts of the Processing System Intrusion (a net recovery of costs in 2010 and net charges in 2009). For 2010, we recorded net income of $34.5 million, or $0.88 per share compared to a net loss of $51.8 million, or $1.38 per share, in 2009. During the year ended December 31, 2010, we recovered from our insurance providers approximately $27.2 million of the costs we incurred for the Processing System Intrusion and expensed approximately $13.1 million for accruals, legal fees and costs we incurred for defending various claims and actions, resulting in a net recovery of $14.1 million, or $0.22 per share. This compares to total charges of $132.9 million for settlement accruals, legal fees and costs incurred for defending various claims and actions associated with the Processing System Intrusion, and recoveries from our insurance providers of approximately $4.0 million resulting in net expenses of $128.9 million, or about $2.16 per share for the year ended December 31, 2009. See Processing System Intrusion for more detail.

Both the levels of new SME merchant gross margin installs and processing volume at existing SME merchants for the year ended December 31, 2010 were unfavorably impacted by the weak economy. However, in the fourth quarter of 2010, we experienced year-over-year growth in gross margin installed for the first quarter in two years and the fastest same store sales growth rate for a quarter in over three years. The following is a summary of our financial results for the year ended December 31, 2010:

- Our SME bankcard processing volume increased 7.0% to $63.1 billion, compared to $59.0 billion in 2009. This increase in SME bankcard processing volume was primarily attributable to the American Express and Discover processing volume we added in 2009, and same store sales growth combined with reduced merchant attrition in 2010.

- Net revenue, which we define as total revenues less interchange fees and dues, assessments and fees, increased 5.9% to $444.9 million during 2010 from $420.2 million during 2009. The increase in net revenue was driven by the increase in SME merchant processing revenues and growth in payroll revenues and equipment-related revenues.

- Our general and administrative expenses were relatively flat for the year ended December 31, 2010, decreasing 0.1% from $104.2 million in 2009 to $104.1 million in 2010. This reflects management s focus on cost containment including wages, bonuses, fringe benefits, consulting and legal expenses, as well as an increase in the amount of personnel expense capitalized for work on system development in 2010.

- Our income from operations, which we also refer to as operating income, contracted to $46.2 million for 2010 from $49.9 million in 2009 primarily due to the unfavorable impact which challenging economic conditions had on growth of our net revenues and to increases in processing and servicing expense. Our operating margin, which is measured as operating income divided by net revenue, was 10.4% for 2010, compared to 11.9% for 2009.

See Results of Operations Year Ended December 31, 2010 Compared to Year Ended December 31, 2009 for a more detailed discussion of our full year operating results.

Components of Revenues and Expenses

Revenues. Our revenues fall into three categories: gross processing revenue, payroll processing revenue and equipment-related income. Our gross processing revenue primarily consists of discount, per-transaction (Network Services prices its card processing fees entirely on a per transaction basis) and periodic (primarily monthly) fees from the processing of Visa, MasterCard, American Express and Discover transactions, for merchants and authorization of transactions by Network Services. These fees are negotiated by our Relationship Managers with each merchant. Gross processing revenue also includes American Express and Discover servicing fees, customer service fees, fees for processing chargebacks, termination fees on terminated contracts, check processing fees, gift and loyalty card fees and other miscellaneous revenue. Revenues are recorded at the time service is provided.

Payroll processing revenue includes fees charged by our subsidiary, Heartland Payroll Company, for payroll processing services, including check printing, direct deposit, related federal, state and local tax deposits and providing accounting documentation and interest income earned on funds held for customers. Revenues are recorded at the time service is provided.

Equipment-related income includes revenues from the sale, rental and deployment of bankcard and check processing terminals. Our equipment-related income also includes revenues 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 campus payment solutions to our equipment-related income. Equipment revenues are recorded at the time of shipment, or the provision of service. Most of these revenue items will tend to grow with our merchant growth.

Expenses. Our most significant expense is interchange fees, which are set by the card networks, and are paid to the card issuing banks. For our SME bankcard processing, we do not offset bankcard processing revenues and interchange fees because our business practice is to advance the interchange fees to most of our merchants when settling their daily transactions (thus paying the full amount of the transaction to the merchant), and then to collect our full discount fees from our merchants on the first business day of the next month. As Network Services does not advance interchange fees to its merchants, we record its portion of our processing revenues net of interchange fees. Interchange fees are calculated as a percentage of the dollar volume processed plus a per transaction fee. We also pay Visa, MasterCard and Discover network dues, assessments and fees, which are a combination of a percentage of the dollar volume processed and per-transaction fees. Interchange fees and dues, assessments and fees are recognized at the time transactions are processed. It is our policy to pass along to our merchants any changes in interchange fees and card network dues, assessments and fees. Since the card networks regularly adjust those rates, our gross processing revenue will increase or decrease, but all the impact of such changes will be paid to the card issuing banks and our income from operations will not be affected.

Costs of services also include processing and servicing costs, customer acquisition costs, and depreciation and amortization. Processing and servicing costs include:

- processing costs, which are either paid to third parties, including our bank sponsors, or represent the cost of our own authorization/capture and accounting/settlement systems. During 2010, third party costs represented about 64% of our processing costs. During 2009, third party costs represented about 76% of our processing costs, compared to 74% during 2008. Approximately 22% and 13%, respectively, of our third-party processing costs in 2010 and 2009 were paid to Fujitsu for processing Network Services Transactions. Approximately 30%, 29% and 35%, respectively, of our third-party processing costs in 2010, 2009 and 2008 were paid to TSYS Acquiring Solutions;

- residual commission payments to our Relationship Managers, sales managers, trade associations, agent banks and value-added resellers, which are a percentage of the gross margin we generated from our merchant contracts during the accounting period;

- the costs of operating our service centers, including telecommunications costs, personnel costs, occupancy costs, losses due to merchant defaults, depreciation and amortization, and other direct merchant servicing costs; and

- the costs of bankcard terminals, prepaid card and stored value hardware deployed, and merchant supplies.

Customer acquisition costs reflect the amortization over the initial three-year contract term of the cash signing bonus paid and the deferred acquisition costs for vested Relationship Managers and sales managers, as well as changes in the accrued buyout liability, which reflect the impact of buying out residual commissions (see Critical Accounting Estimates Accrued Buyout Liability) and volume attrition.

Depreciation and amortization expenses are primarily recognized on a straight-line basis over the estimated useful life of the asset. We have made significant capital expenditures for computer hardware and software and such costs are generally depreciated over three to five years.

General and administrative expenses include personnel and other administrative expenses related to our information technology infrastructure costs, our marketing expenses and other administrative functions.

Other income (expense) consists of interest income on cash and investments, the interest cost on our borrowings, gain from the sale of merchant bankcard processing contracts, legal settlements accrued or received, an impairment charge of an acquisition asset, service center exit costs, and other non-operating income or expense items.

Critical Accounting Estimates

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results could differ from those estimates. Our significant accounting policies are more fully described in Note 2 to our consolidated financial statements included elsewhere in this report. The critical accounting estimates described here are those that are most important to the depiction of our financial condition and results of operations, including those whose application requires management s most subjective judgment in making estimates about the effect of matters that are inherently uncertain. The line items on our income statement and balance sheet impacted by management s estimates are described below.

Revenues

Our bank card processing revenue is derived from processing and settling Visa, MasterCard, American Express and Discover bank card transactions for our merchant customers. Our most significant expense related to the generation of those revenues is interchange fees, which are set by the card networks, and paid to the card issuing banks. For our SME merchant bank card processing, we do not offset bank card processing revenues and interchange fees because our business practice is to advance the interchange fees to most of our merchants when settling their daily transactions (thus paying the full amount of the transaction to the merchant), and then to collect our full discount fees from our merchants on the first business day of the next month. We believe this policy aids in new business generation, as our merchants benefit from bookkeeping simplicity. However, this results in our carrying a large receivable from our merchants at each period-end, and a corresponding but smaller payable to our sponsor banks, which are settled on the first business day after the period-end. As we are at risk for the receivables, we record the associated revenues on a gross processing revenue basis in our consolidated income statements. Certain of our competitors report their processing revenue net of interchange fees. This is because the card issuing banks make their payments to these competitors net of those interchange fees, and these acquirers pay this reduced amount to their merchants. Since the acquisition of Network Services, we also record a portion of our processing revenues net of interchange fees because the daily cash settlement with Network Services merchants is net of interchange fees.

Capitalized Customer Acquisition Costs

Capitalized customer acquisition costs consist of (1) up-front signing bonuses paid to Relationship Managers and sales managers, referred to as the salesperson or salespersons, for the establishment of new merchant relationships, and (2) deferred acquisition cost representing the estimated cost of buying out the commissions of vested salespersons at some point in the future. Capitalized customer acquisition costs represent incremental, direct customer acquisition costs that are recoverable through gross margins associated with SME merchant contracts. The capitalized customer acquisition costs are amortized using a method which approximates a proportional revenue approach over the initial three-year term of the merchant contract.

The amount of the up-front signing bonus paid for new SME bankcard, payroll and check processing accounts is based on the estimated gross margin for the first year of the merchant contract. The gross signing bonuses paid during 2010, 2009 and 2008 were $28.6 million, $34.7 million and $43.8 million, respectively. The signing bonus paid, amount capitalized, and related amortization are adjusted at the end of the first year to reflect the actual gross margin generated by the merchant contract during that year. The net signing bonus adjustments made during 2010, 2009 and 2008 were $(2.1) million, $(1.5) million and $1.7 million, respectively. Positive signing bonus adjustments occur when the actual gross margin generated by the merchant contract during the first year exceeds the estimated gross margin for that year, resulting in the underpayment of the up-front signing bonus and would be paid to the relevant sales person. Negative signing bonus adjustments result from prior overpayments of up-front signing bonuses, and would be recovered from the relevant salesperson. The amount of signing bonuses paid which remained subject to adjustment at December 31, 2010 and 2009 was $26.5 million and $32.8 million, respectively.

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The deferred acquisition cost component is accrued for vested salespersons over the first year of SME bankcard merchant processing, consistent with the build-up in the accrued buyout liability, which is described below.

Management evaluates the capitalized customer acquisition costs for impairment at each balance sheet date 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. We have not recognized an impairment loss in 2010, 2009 or 2008.

Accrued Buyout Liability

We pay our salespersons residual commissions based on the gross margin generated from the monthly processing activity of SME merchants signed by them. We refer to these residual commissions as the owned portion of such commissions, or portfolio equity. The salesperson has no obligation to perform additional services for the merchant for so long as the merchant continues processing with us. We accrue the buyout liability, which represents the estimated current settlement cost of buying out all vested and expected-to-vest salespersons for the owned portion of such commissions. We also record a deferred acquisition cost asset related to those buyouts, and amortize that asset as an expense over the initial 3-year contract term.

We consider a salesperson to be vested once they have established merchant relationships that generate the equivalent of $10,000 of monthly gross margin. Vested status entitles the salesperson to his or her residual commissions for as long as the merchant processes with us, even if the salesperson is no longer employed by us.

The accrued buyout liability is based on the SME merchants we have under contract at the balance sheet date, the gross margin we generated from those accounts in the prior twelve months, the owned commission rate, and the fixed buyout multiple of 2.5 times the commissions. 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.

For unvested salespersons, the accrued buyout liability is accrued over the expected vesting period; however, no deferred acquisition cost is capitalized as future services are required in order to vest. In calculating the accrued buyout liability for unvested salespersons, we have assumed that 31% of unvested salespersons will vest in the future, which represents our historical vesting rate. A 5% increase to 36% in the expected vesting rate would have increased the accrued buyout liability for unvested salespersons by $0.2 million and $0.3 million respectively, at December 31, 2010 and 2009.

Buyout payments made to salespersons reduce the outstanding accrued buyout liability. Given our view of the duration of the cash flows associated with a pool of merchant contracts, we believe that the benefits of such buyouts significantly exceed the cost, which typically represents 2 to 2 $^{1}/2$ years of commissions. If the cash flows associated with a pool of bought out contracts does not exceed this cost, we will incur an economic loss on our decision to buyout the contracts. During 2010, 2009, and 2008, we made buyout payments of approximately $25.2 million, $8.1 million and $7.0 million, respectively.

During the third quarter of 2010, we exercised our rights to buy out a substantial amount of portfolio equity owned by our Relationship Managers and sales managers. As a result of these buyouts, we reduced our Accrued Buyout Liability recorded on the Consolidated Balance Sheet by the approximately $17.7 million of cash payments we made. We realized a reduction of approximately $0.6 million in monthly residual commission expense beginning in the fourth quarter of 2010, and expect to realize a lesser reduction in ensuing years. The amount of future annual reductions in residual commission expense will be impacted by merchant attrition. We expect to make significant buyout payments in the future, subject to available cash, as such buyouts reduce the monthly payments we will have to make to our salespersons for such merchants in the future.

Reserve for Processing System Intrusion

The Processing System Intrusion requires us to make assumptions and estimates concerning the outcomes and related costs and losses in connection with various lawsuits, claims, and investigations. We make our estimates of costs based on our best judgments and anticipated outcomes of these lawsuits, claims, and investigations. See Overview Processing System Intrusion for a discussion of the Processing System Intrusion.

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Since our announcement of the Processing System Intrusion on January 20, 2009 and through December 31, 2010, we have expensed a total of $146.1 million, before reducing those charges by $31.2 million of total insurance recoveries. The majority of the total charges, or approximately $114.7 million, related to settlements of claims. Approximately $31.4 million of the total charges were for legal fees and costs we incurred for investigations, defending various claims and actions, remedial actions and crisis management services.

During the year ended December 31, 2010, we recovered from our insurance providers approximately $27.2 million of the costs we incurred for the Processing System Intrusion and expensed approximately $13.1 million for accruals, legal fees and costs it incurred for defending various claims and actions, resulting in a net recovery of $14.1 million, or $0.22 per share.

For the year ended December 31, 2009, we expensed a total of $132.9 million for settlement accruals, legal fees and costs we incurred for defending various claims and actions associated with the Processing System Intrusion, and recovered from our insurance providers approximately $4.0 million of the costs we incurred resulting in net expenses of $128.9 million, or about $2.16 per share.

At December 31, 2010 and 2009, we carried a Reserve for Processing System Intrusion on our Consolidated Balance Sheet of $1.6 million and $99.9 million, respectively. See Overview Processing System Intrusion for a discussion of settlements paid and charged to this Reserve for Processing System Intrusion during 2010 and 2009.

We are prepared to vigorously defend our company against any unsettled claims relating to the Processing System Intrusion that have been asserted against us and our sponsor banks to date. We feel we have strong defenses to all the claims that have been asserted against us and our sponsor banks relating to the Processing System Intrusion.

Additional costs we expect to incur for legal fees and settlements related to the Processing System Intrusion will be recognized as incurred. Such costs could be material and could adversely impact our results of operations, financial condition and cash flow.

Processing Liabilities and Loss Reserves

The majority of our processing liabilities include funds in transit associated with bankcard and check processing. At December 31, 2010 and 2009, these funds in transit totaled $17.9 million and $16.6 million, respectively. In addition, we maintain merchant deposits to offset potential liabilities from merchant chargeback processing.

Disputes between a cardholder and a merchant periodically arise as a result of, among other things, the cardholder s dissatisfaction with merchandise quality or merchant services. Such disputes may not be resolved in the merchant s favor. In these cases, the transaction is charged back to the merchant, which means the purchase price is refunded to the customer by the card-issuing bank and charged to the merchant. If the merchant is unable to fund the refund, we must do so. We also bear the risk of reject losses arising from the fact that we collect our fees from our merchants on the first day after the monthly billing period. If the merchant has gone out of business during such period, we may be unable to collect such fees. We maintain cash deposits or require the pledge of a letter of credit from certain merchants, generally those with higher average transaction size where the card is not present when the charge is made or the product or service is delivered after the charge is made, in order to offset potential contingent liabilities such as chargebacks and reject losses that would arise if the merchant went out of business. At December 31, 2010 and 2009, we held SME merchant deposits totaling $9.2 million and $9.3 million, respectively. Most chargeback and reject losses are charged to processing and servicing as they are incurred. However, we also maintain a loss reserve against losses including major fraud losses, which are both less predictable and involve larger amounts. The loss reserve was established using historical loss rates, applied to recent bankcard processing volume. At December 31, 2010 and 2009, our loss reserve totaled $1.7 million and $1.3 million, respectively. Aggregate SME bankcard merchant losses, including losses charged to operations and the loss reserve, were $9.1 million, $5.9 million and $5.1 million for 2010, 2009 and 2008, respectively. As percentages of SME Visa and MasterCard processing volume, in 2010, 2009 and 2008, we experienced losses of 0.0151%, 0.0101% and 0.0088%, respectively.

During the fourth quarter of 2010, we converted Network Services settled transaction from a third party processor and began settling large national merchant accounts, and processing chargebacks originating from these merchants, on Passport. Prior to this, these chargebacks were processed and carried by Fifth Third Processing Solutions, which was our third-party outsourced processor for settling Network Services Merchant accounts. Chargeback losses originating from Network Services bankcard processing on Passport during the year ended December 31, 2010 were insignificant.

Stock-based Compensation

We expense employee share-based payments under the fair value method. Share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the requisite service period. Under the modified-prospective-transition method, we are required to record compensation expense for all awards granted after the date of adoption using grant-date fair value estimate and for the unvested portion of previously granted awards using the grant-date fair value estimate.

We estimate the grant date fair value of the stock options we issue using a Black-Scholes valuation model for plain-vanilla stock options and performance-based stock options, and we use a lattice valuation model to measure grant date fair value for stock options containing market vesting conditions. Our assumption for expected volatility is based on our historical volatility for those option grants whose expected life fall within a period we have sufficient historical volatility data related to market trading of our own Common Stock. For those option grants whose expected life is longer than we have sufficient historical volatility data related to market trading of our own Common Stock, we determine an expected volatility assumption by referencing the average volatility experienced by a group of our public company peers. For plain-vanilla stock options, we estimate the expected life of a stock option based on the simplified method as provided by the staff of the SEC. The simplified method is used because, at this point, we do not have sufficient historical information to develop reasonable expectations about future exercise patterns. For the performance-based options, the expected life is estimated based on the average of three possible performance condition outcomes. Our dividend yield assumption is based on dividends expected to be paid over the expected life of the stock option. Our risk-free interest rate assumption for stock options granted is determined by using U.S. treasury rates of the same period as the expected option term of each stock option.

The weighted-average fair value of options we granted during 2010, 2009 and 2008 were $6.12, $3.12 and $6.11, respectively. The fair value of options granted during 2010, 2009 and 2008 was estimated at the grant date using the following weighted average assumptions:

	Year Ended December 31,		
	2010	**2009**	**2008**
Expected volatility	54%	48%	35%
Expected life	3.75 years	3.75 to 4.0 years	2.5 to 4.0 years
Expected Dividends	0.40%	0.47%	1.36%
Risk-free interest rate	1.21%	1.76%	2.98%

In the second quarter of 2009, our Board of Directors approved grants of 930,000 stock options subject to multiple vesting conditions. Under these stock options, the employee must provide continuous service over four years and a market price condition must be satisfied within those four years. These stock options have a five-year term and could vest in equal amounts in 2010, 2011, 2012 and 2013 only if during the four-year service period, the price of our common stock as reported by the New York Stock Exchange exceeds two or three times the exercise price for 30 consecutive trading days. The grant date fair values of these multiple vesting condition options are recognized as compensation expense over their four-year service periods. At December 31, 2010, none of the 930,000 stock options have vested.

In the third quarter of 2008, our Board of Directors approved a performance-based stock option program. Under this program, we granted 2.5 million performance-based stock options to our employees. These stock options were granted to those employees who the Board of Directors determined could have significant impact on successfully integrating the recently acquired Network Services business and effectively executing our growth plan. These stock options have a five-year term and will vest in equal amounts in 2011, 2012 and 2013 only if over the term of the stock options, both of the following performance conditions are achieved:

- Consolidated net revenue grows at a compound annual rate of at least 15%; and

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Fully diluted EPS grows at a compound annual rate of at least 25%.

As of December 31, 2010, 2009 and 2008, management believed that achieving these performance conditions was not more likely than not to occur; therefore, no share-based compensation expense was recorded for these stock options for these years. The evaluation of the likelihood of achieving these performance conditions will be repeated quarterly, and if vesting of some or all of the options becomes more likely than not, share-based compensation expense will be recorded.

In the fourth quarter of 2010, our Board of Directors approved grants of 508,800 performance-based Restricted Share Units. These Restricted Share Units are nonvested share awards which would vest 50% in 2013, 25% in 2014, and 25% in 2015 only if over the term of these Restricted Share Units, the following diluted earnings per share targets for the years ended December 31, 2012, 2013 and 2014 are achieved:

	2012	2013	2014
Diluted Earnings Per Share [a]	$ 1.48	$ 1.74	$ 2.04

[a] Calculated on a Pro Forma basis to exclude non-operating gains and losses, if any, and excluding the after-tax impact of Stock Compensation Expense.

As of December 31, 2010, management believed that achieving these performance targets was not more likely than not to occur; therefore, no share-based compensation expense was recorded for these Restricted Share Units. The evaluation of the likelihood of achieving these performance targets will be repeated quarterly, and if vesting of some or all of the Restricted Share Units becomes more likely than not, share-based compensation expense will be recorded. The closing price of our common stock on the grant date equals the grant date fair value of these nonvested Restricted Share Units awards and would be recognized as compensation expense over their vesting periods.

In 2010 and 2009, our Board of Directors approved grants of 102,240 and 362,360 Restricted Share Units, respectively. These Restricted Share Units are nonvested share awards which will vest over a four-year service period as employees perform service. The closing price of our common stock on the grant date equals the grant date fair value of these nonvested share awards and will be recognized as compensation expense over their four-year service periods.

Amounts we recognized in our financial statements during the years ended December 31, 2010, 2009 and 2008 with respect to share-based compensation plans were as follows (in thousands):

	Year Ended December 31,		
	2010	**2009**	**2008**
Compensation expense recognized on share-based plans before income tax benefit	**$ 6,295**	$ 4,526	$ 1,517
Related income tax benefit recognized in the income statement	**2,379**	1,723	572
Cash received from stock option exercises	**6,303**	1,045	3,075
Excess tax benefit recorded for tax deductions resulting from the exercise of stock options	**1,910**	384	710
Tax benefit realized as reductions of estimated tax payments during the period		250	1,400

Goodwill

Goodwill represents the excess of acquisition costs over the fair values of net assets acquired in business combinations. We recorded goodwill in connection with our acquisitions of Debitek, Inc., E-Secure Peripherals, Inc., General Meters Corp., Collective Point of Sales Solutions Ltd., Network Services, Chockstone, Inc. and Lunchbox. Goodwill is tested for impairment at least annually and between annual tests if an event occurs or changes in circumstances suggest a potential decline in the fair value of the reporting unit. A significant amount of judgment is involved in determining if an indicator or change in circumstances relating to impairment has occurred. Such changes may include, among others: a significant decline in expected future cash flows; a sustained decline in market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; and slower growth rates. We perform annual goodwill impairment testing in the fourth quarter. Our evaluation indicated that no impairment existed as of December 31, 2010 or 2009. At December 31, 2010 and 2009, goodwill of $68.3 million and $61.0 million, respectively, was recorded on our

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Consolidated Balance Sheet. We may be required to record goodwill impairment losses in future periods, whether in connection with our next annual impairment testing in the fourth quarter of 2011 or subsequent to that, if any such indicators constitute a triggering event in other than the quarter in which the annual goodwill impairment test is performed. It is not possible at this time to determine if any such future impairment loss would result or, if it does, whether such charge would be material.

Income Taxes

We account for income taxes by recognizing deferred tax assets and liabilities, which are recorded to reflect the future tax consequences attributable to the effects of differences between the carrying amounts of existing assets and liabilities for financial reporting and for income tax purposes. Judgments are required in determining the amount and probability of future taxable income, which in turn is critical to a determination of whether a valuation reserve against the deferred tax asset is appropriate.

We also account for the recognition and measurement of tax benefits associated with uncertain tax positions. This requires evaluations of individual tax positions to determine whether any part of that position can be recognized or continue to be recognized in the financial statements. An uncertain tax position exists if it is unclear how a transaction will be treated under tax law. We had approximately $1.3 million of total gross unrecognized tax benefits as of December 31, 2010, approximately $0.9 million of which would impact the effective tax rate.

Results of Operations

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009

The following table shows certain income statement data as a percentage of revenue for the year ended December 31, 2010 compared to the year ended December 31, 2009 (in thousands of dollars):

					Change	
	2010	**% of Total Revenue**	2009	% of Total Revenue	Amount	%
Total revenues	**$ 1,864,337**	**100.0%**	$ 1,652,139	100.0%	$ 212,198	12.8%
Costs of services:						
Interchange	**1,299,631**	**69.7%**	1,142,112	69.1%	157,519	13.8%
Dues, assessments and fees	**119,834**	**6.4%**	89,844	5.4%	29,990	33.4%
Processing and servicing	**228,953**	**12.3%**	199,934	12.1%	29,019	14.5%
Customer acquisition costs	**50,415**	**2.7%**	50,362	3.0%	53	0.1%
Depreciation and amortization	**15,201**	**0.8%**	15,786	1.0%	(585)	(3.7)%
Total costs of services	**1,714,034**	**91.9%**	1,498,038	90.7%	215,996	14.4%
General and administrative	**104,088**	**5.6%**	104,154	6.3%	(66)	(0.1)%
Total expenses	**1,818,122**	**97.5%**	1,602,192	97.0%	215,930	13.5%
Income from operations	**46,215**	**2.5%**	49,947	3.0%	(3,732)	(7.5)%
Other income (expense):						
Interest income	**148**		117		31	26.5%
Interest expense	**(4,778)**	**(0.3)%**	(2,698)	(0.2)%	(2,080)	77.1%
Provision for processing system intrusion	**14,138**	**0.8%**	(128,943)	(7.8)%	143,081	(111.0)%
Other, net	**72**		(72)		144	(200.0)%
Total other income (expense)	**9,580**	**0.5%**	(131,596)	(8.0)%	141,176	(107.3)%
Income (loss) before income taxes	**55,795**	**3.0%**	(81,649)	(4.9)%	137,444	(168.3)%
Provision for income taxes	**21,135**	**1.1%**	(29,919)	(1.8)%	51,054	(170.6)%

Net income (loss)		**34,660**	**1.9%**		(51,730)	(3.1)%		86,390	(167.0)%
Less: Net Income attributable to noncontrolling interests		**123**			66			57	86.4%
Net income (loss) attributable to Heartland	**$**	**34,537**	**1.9%**	$	(51,796)	(3.1)%	$	86,333	(166.7)%

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Total Revenues. Total revenues increased by 12.8%, from $1,652.1 million in 2009 to $1,864.3 million in 2010, primarily as a result of a $204.5 million, or 12.7%, increase in our bankcard processing revenues. The breakout of our total revenues for the years ended December 31, 2010 and 2009 was as follows (in thousands of dollars):

	Year Ended December 31,		Change from Prior Year	
	2010	2009	Amount	%
Processing revenues, gross (a)	**$ 1,814,655**	$ 1,610,108	$ 204,547	12.7%
Payroll processing revenues	**17,344**	15,046	2,298	15.3%
Equipment-related income	**32,338**	26,985	5,353	19.8%
Total Revenues	**$ 1,864,337**	$ 1,652,139	$ 212,198	12.8%

(a) Includes Visa, MasterCard, AMEX and Discover bankcard processing revenues, AMEX fees, Discover fees, check processing fees, customer service fees, gift card, loyalty and other miscellaneous revenue.

The increase in our gross processing revenues from $1,610.1 million in 2009 to $1,814.7 million in 2010 was primarily due to higher SME merchant card processing revenues. Revenues from our SME bankcard processing are primarily earned as a percentage of processing volume. Our SME bankcard processing volume increased 7.0% to $63.1 billion, compared to $59.0 billion in 2009. American Express and Discover processing volume contributed over 40% of this year-over-year increase. Network Services increased its bankcard processing revenues on the 488 million transactions it settled, representing $11.3 billion in processing volume, and the 2.6 billion transactions it authorized through its front-end card processing systems during the year ended December 31, 2010, compared to 462 million transactions it settled, representing $9.9 billion in processing volume, and the 2.4 billion transactions it authorized through its front-end card processing systems during the year ended December 31, 2009. The increase in Network Services bankcard processing revenues was primarily due to increases in Visa and MasterCard bankcard transaction authorization fees, which we pass through to our merchants, partially offset by reductions in gross processing revenues due to renegotiations of customer contracts. We report Network Services settled bankcard processing revenues net of credit interchange and dues and assessments because the daily cash settlement with Network Services merchants is on a net basis.

Payroll processing revenues, which include fees earned on payroll processing services and interest income earned on funds held for customers, increased by 15.3%, from $15.0 million in 2009 to $17.3 million in 2010, primarily due to the 18.6% increase in the number of payroll processing customers from 9,382 at December 31, 2009 to 11,131 at December 31, 2010, partially offset by the impact of a reduction in the average number of employees at our customers.

Equipment-related income increased by 19.8% from $27.0 million in 2009 to $32.3 million in 2010, primarily due to increases in revenues from the laundry vertical in our prepaid and stored-value card business as well as increases in revenues from our campus solutions business, both at our Debitek subsidiary. We also experienced an increase in equipment-related revenues from the sale of SME card terminals, including our proprietary terminals, referred to as E3 Terminals, which encrypt cardholder data as the card is being swiped.

Costs of services. Costs of services increased 14.4% from $1.5 billion in 2009 to $1.7 billion in 2010, due primarily to increases in interchange fees, dues, assessments and fees, and processing and servicing expense. Costs of services represented 91.9% of total revenues in 2010, up slightly from 90.7% in 2009.

Interchange fees increased 13.8% from $1,142.1 million in 2009 to $1,299.6 million in 2010, and represented 69.7% of total revenues in 2010 compared to 69.1% in 2009. The increase in interchange fees was primarily due to higher SME bankcard processing volume in the year ended December 31, 2010, especially for American Express and Discover which generally have higher interchange rates than Visa and MasterCard.

Dues, assessments and fees increased 33.4% from $89.8 million in 2009 to $119.8 million in 2010, primarily as a result of increases in MasterCard and Visa bankcard transaction authorization fees during 2009, as well as increases in MasterCard and Visa assessments during 2010, and also due to higher SME bankcard processing volume. Dues, assessments and fees were 6.4% of total revenues in 2010, compared to 5.4% in 2009.

Net revenue, which we define as total revenues less interchange fees and dues, assessments and fees, increased 5.9% from $420.2 million in 2009, to $444.9 million in 2010. The increase in net revenue was driven primarily by increases in SME bankcard processing volume and equipment-related revenues. Net revenue for Network Services merchants declined in 2010 primarily due to renegotiations of customer contracts. Excluding Network Services net revenue decline from consideration, our aggregate net revenue would have grown by 8.8% in the year ended December 31, 2010.

Processing and servicing expense for 2010 increased by $29.0 million, or 14.5%, compared with 2009. The increase in processing and servicing expense was due to costs associated with processing the higher SME bankcard processing volume, increased costs of sales related to the higher payroll and equipment-related revenues as well as phone card and loyalty and gift related revenues, costs of investments we have made in enhancing our processing systems, an increase in the amount of merchant losses and increases in the costs of operating our service centers, particularly the costs of support personnel, including account managers and depreciation and amortization. As a percentage of total revenue, processing and servicing expense increased slightly to 12.3% in 2010 compared with 12.1% in 2009.

Included in processing and servicing expense was $6.2 million of payroll processing costs in the year ended December 31, 2010, an increase of 43.9% from $4.3 million recorded in the year ended December 31, 2009. This increase was primarily due to increased costs associated with our new PlusOne Payroll system, particularly depreciation and amortization, as well as the 18.6% increase in the number of payroll processing customers from 9,382 at December 31, 2009 to 11,131 at December 31, 2010.

Customer acquisition costs remained flat at $50.4 million in 2010 and in 2009. Customer acquisition costs for the years ended 2010 and 2009 included the following components (in thousands of dollars):

	Year Ended December 31,	
	2010	**2009**
Amortization of signing bonuses, net	**$ 37,990**	$ 40,897
Amortization of capitalized customer deferred acquisition costs	**16,007**	15,941
Increase in accrued buyout liability	**11,133**	9,973
Capitalized customer deferred acquisition costs	**(14,715)**	(16,449)
Total Customer Acquisition Costs	**$ 50,415**	$ 50,362

Depreciation and amortization expenses decreased 3.7%, from $15.8 million in 2009 to $15.2 million in 2010. Most of our investments in information technology have been for security-related enhancements and in support of the continuing development of HPS Exchange, Passport and other processing-related initiatives. Depreciation and amortization expense recorded on these investments is included in processing and servicing expense. Additionally, we capitalized salaries, fringe benefits and other expenses incurred by our employees that worked on internally developed software projects and outsourced programming. Amortization does not begin on the internally developed software until the project is complete and placed in service, at which time we begin to amortize the asset over expected lives of three to five years. The amount capitalized increased from $12.3 million in 2009 to $15.6 million in 2010. The total amount of capitalized costs for projects placed in service in 2010 and 2009 was $15.7 million and $8.7 million, respectively.

General and administrative. General and administrative expenses decreased slightly from $104.2 million in 2009 to $104.1 million in 2010. This decrease was primarily due to cost containment measures instituted mid-year, resulting in a reduction in legal, consulting and personnel costs. Personnel cost reductions included decreases in bonus and medical benefit costs, as well as an increase in the amount of capitalized salaries, partially offset by higher stock compensation expense. Our payroll operation s general and administrative expenses increased 17.8%, from $6.3 million in 2009 to $7.4 million in 2010. General and administrative expenses as a percentage of total revenue were 5.6% for 2010, a decrease from 6.3% for 2009.

Income from operations. Our income from operations, which we also refer to as operating income, declined to $46.2 million for 2010, from $50.0 million for 2009. This decline was primarily due to the continuing limiting effect which economic conditions had on growth in our net revenues, and to increases in processing and servicing expenses. Our operating margin, which is measured as operating income divided by net revenue, was 10.4% for 2010, compared to 11.9% for 2009.

Interest expense. Interest expense of $4.8 million was recorded in 2010, a 77.1% increase from the $2.7 million recorded in 2009. The increase in interest expense for 2010 was due to higher interest rates incurred on our borrowings under our Credit Facilities, increased borrowings under our Credit Facilities and Bridge Loan, and higher average payables to our sponsor banks. Interest expense for 2010 included approximately $1.7 million related to borrowings we incurred to fund the settlement with Visa in February 2010 (see Overview Processing System Intrusion for more detail). See Liquidity and Capital Resources Credit Facilities for more detail on our borrowings. Interest expense which we recorded as payables to our sponsor banks resulted from our practice of having our sponsor banks advance interchange fees to most of our SME merchants. Generally, when we have cash available for investment we fund these advances to our SME merchants first with our cash, then by incurring a payable to our sponsor banks when that cash has been expended. We pay our sponsor banks the prime rate on these payables.

Provision for processing system intrusion. See Overview Processing System Intrusion and Critical Accounting Estimates Reserve for Processing System Intrusion for more details on the Processing System Intrusion.

During 2010, we recovered from our insurance providers approximately $27.2 million of the costs we incurred for the Processing System Intrusion and expensed approximately $13.1 million for accruals, legal fees and costs we incurred for remediation and defending various claims and actions, for a net recovery of $14.1 million, or $0.22 per share. For 2009, we recorded total expenses of $128.9 million, or $2.16 per share, associated with the Processing System Intrusion.

Other, net. Other, net for 2010 also includes:

- A pre-tax gain of $3.1 million from the sale of SME merchant bankcard processing contracts. During the fourth quarter of 2010, we sold 636 SME merchant accounts that had not been converted onto HPS Exchange and which were still processing on third-party platforms. This was a strategic sale undertaken to eliminate administrative and servicing inefficiencies associated with random merchant accounts processing on third party platforms.

- Net pre-tax charges of $1.7 million for legal settlements accrued or received during 2010. These legal settlements were unrelated to the Processing System Intrusion.

- A pre-tax charge of $0.8 million for the impairment of an acquisition intangible asset.

- Pre-tax charges of $0.5 million reflecting the estimated liability for costs (primarily accrued staff termination costs and fixed asset write downs) associated with the announced closing of our Johnson City, Tennessee service center.

Other, net for 2009 included the write down of a debt security and a reduction of Canadian tax rebates.

Income tax. Our income tax expense for 2010 was $21.1 million, reflecting an effective tax rate of 37.9%. This compares to an effective tax rate of 36.6% for 2009, which resulted in income tax benefit of $29.9 million. The increase in the effective tax rate for 2010 primarily reflects the impacts of minimum income tax obligations in certain states. In 2009 the company also recognized a one-time tax benefit of $18 million related to a change in the tax treatment of accrued buyout liabilities. Absent this change the Company s effective tax rate for fiscal 2007 would have been 37.6%.

Net income (loss) attributable to Heartland. As a result of the above factors, we recorded net income of $34.5 million for the year ended December 31, 2010. This compares to a net loss of $51.8 million for the year ended December 31, 2009, primarily due to the Provision for Processing System Intrusion.

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Year Ended December 31, 2009 Compared to Year Ended December 31, 2008

The following table shows certain income statement data as a percentage of revenue for the year ended December 31, 2009 compared to the year ended December 31, 2008 (in thousands of dollars):

	2009	% of Total Revenue	2008	% of Total Revenue	Change Amount	Change %
Total revenues	**$ 1,652,139**	**100.0%**	$ 1,544,902	100.0%	$ 107,237	6.9%
Costs of services:						
Interchange	**1,142,112**	**69.1%**	1,093,546	70.8%	48,566	4.4%
Dues, assessments and fees	**89,844**	**5.4%**	67,648	4.4%	22,196	32.8%
Processing and servicing	**199,934**	**12.1%**	179,106	11.6%	20,828	11.6%
Customer acquisition costs	**50,362**	**3.0%**	48,522	3.1%	1,840	3.8%
Depreciation and amortization	**15,786**	**1.0%**	11,006	0.7%	4,780	43.4%
Total costs of services	**1,498,038**	**90.7%**	1,399,828	90.6%	98,210	7.0%
General and administrative	**104,154**	**6.3%**	74,434	4.8%	29,720	39.9%
Total expenses	**1,602,192**	**97.0%**	1,474,262	95.4%	127,930	8.7%
Income from operations	**49,947**	**3.0%**	70,640	4.6%	(20,693)	(29.3)%
Other income (expense):						
Interest income	**117**		755		(638)	(84.5)%
Interest expense	**(2,698)**	**(0.2)%**	(3,206)	(0.2)%	508	(15.8)%
Provision for processing system intrusion	**(128,943)**	**(7.8)%**			(128,943)	
Other, net	**(72)**		(400)		328	(82.0%)
Total other (expense) income	**(131,596)**	**(8.0)%**	(2,851)	(0.2)%	(128,745)	
Income before income taxes	**(81,649)**	**(4.9)%**	67,789	4.4%	(149,438)	(220.4)%
Provision for income taxes	**(29,919)**	**(1.8)%**	25,918	1.7%	(55,837)	(215.4)%
Net Income (loss)	**(51,730)**	**(3.1)%**	41,871	2.7%	(93,601)	(223.5)%
Less: Net Income attributable to noncontrolling interests	**66**		31		35	
Net income (loss) attributable to Heartland	**$ (51,796)**	**(3.1)%**	$ 41,840	2.7%	$ (93,636)	(223.8)%

Total Revenues. Total revenues increased by 6.9%, from $1,544.9 million in 2008 to $1,652.1 million in 2009, primarily as a result of a $105.7 million, or 7.0%, increase in our bankcard processing revenues. The breakout of our total revenues for the years ended December 31, 2009 and 2008 was as follows (in thousands of dollars):

	Year Ended December 31, 2009	Year Ended December 31, 2008	Change from Prior Year Amount	Change from Prior Year %
Processing revenues, gross (a)	**$ 1,610,108**	$ 1,504,381	$ 105,727	7.0%
Payroll processing revenues	**15,046**	12,790	2,256	17.6%
Equipment-related income	**26,985**	27,731	(746)	(2.7)%

Total Revenues	**$ 1,652,139**	$ 1,544,902	$ 107,237	6.9%

(a) Includes Visa, MasterCard, AMEX and Discover bankcard processing revenues, AMEX fees, Discover fees, check processing fees, customer service fees, gift card, loyalty and other miscellaneous revenue.

The increase in our gross processing revenues from $1,504.4 million in 2008 to $1,610.1 million in 2009 was primarily due to the acquisition in May 2008 of Network Services, which recorded $86.6 million of transaction-based processing revenues in the current year, higher net revenue margin earned on SME bankcard processing and higher SME bankcard processing volume. Revenues from our SME bankcard processing are earned as a percentage of processing volume. Our SME bankcard processing volume increased 1.7% to $59.0 billion, compared to $57.9 billion in 2008. This increase in SME bankcard processing volume was primarily attributable to the American Express and Discover processing volume we added in 2009 as well as a net increase in SME bankcard merchant accounts. The number of SME bankcard merchant accounts grew by approximately 2.7% from 168,850 at December 31, 2008 to 173,400 at December 31, 2009. Network Services recorded bankcard processing revenues on the 462 million transactions it settled, representing $9.9 billion in processing volume, and the 2.4 billion transactions it authorized through its front-end card processing systems during 2009, compared to 317 million transactions it settled, representing $8.7 billion in processing volume, and the 1.4 billion transactions it authorized through its front end processing systems during the period from its acquisition in May through December 31, 2008. We report Network Services settled bankcard processing revenues net of credit interchange and dues and assessments because the daily cash settlement with Network Services merchants is on a net basis.

Payroll processing revenues, which include fees earned on payroll processing services and interest income earned on funds held for customers, increased by 17.6%, from $12.8 million in 2008 to $15.0 million in 2009, primarily due to the 21.2% increase in the number of payroll processing customers from 7,738 at December 31, 2008 to 9,382 at December 31, 2009. Payroll processing fees increased by 20.7% from $12.4 million in 2008 to $15.0 million in 2009, while interest income earned on funds held for customers decreased from $370,000 in 2008 to $59,000 in 2009 primarily due to lower interest rates in the current period and the application of available interest earning balances to offset bank fees and payables to sponsor banks.

Equipment-related income decreased by 2.7%, from $27.7 million in 2008 to $27.0 million in 2009, due to declines in the number of new bankcard merchants installed and in revenues from prepaid card and stored-value card systems at our Debitek, Inc. subsidiary during 2009. Both of these declines were attributable to the weak economy in the current year. The addition of revenues from our May 2008 acquisition of Network Services and our March 2008 acquisition of CPOS partially offset these declines.

Costs of services. Costs of services increased 7.0% from $1.4 billion in 2008 to $1.5 billion in 2009, due primarily to an increase in interchange fees, dues, assessments and fees as well as processing and servicing costs. Costs of services represented 90.7% of total revenues in 2009, up slightly from 90.6% in 2008.

Interchange fees increased 4.4% from $1,093.5 million in 2008 to $1,142.1 million in 2009, and represented 69.1% of total revenues in 2009, compared to 70.8% of total revenues in the prior year period. The increase in interchange fees was primarily due to the result of including Network Services debit interchange for the full 2009 year and only seven months in 2008 since its acquisition, and higher SME bankcard processing volume in 2009. However, interchange fees as a percentage of total revenues declined due to the nature of Network Services bankcard processing settlement practices. We report Network Services bankcard processing revenues net of interchange fees because our daily cash settlement with Network Services merchants is on a net basis.

Dues, assessments and fees increased 32.8% from $67.6 million in 2008 to $89.8 million in 2009, as a result of increases in Visa and MasterCard bankcard transaction authorization fees during 2009 as well as including Network Services transaction authorization fees for the full 2009 year and only seven months in 2008 since its acquisition. Dues, assessments and fees were 5.4% of total revenues in 2009, compared to 4.4% in 2008.

Net revenue, which we define as total revenues less interchange fees and dues, assessments and fees, increased 9.5% from $383.7 million in 2008 to $420.2 million in 2009. The increase in net revenue was driven by the addition of revenues from Network Services and by the year-over-year increases in SME merchant processing revenues. Excluding Network Services net revenue addition, our net revenue would have grown by 5.2% in the year ended December 31, 2009.

Processing and servicing expense for 2009 increased by $20.8 million, or 11.6%, compared with 2008. The increase in processing and servicing expense primarily resulted from including Network Services processing and servicing for the full 2009 year and only seven months in 2008 since its acquisition, and costs related to our emphasis on merchant retention after our announcement of the Processing System Intrusion. The increase in processing and servicing expense was also due to costs associated with the increased SME bankcard processing volume and increases in the costs of operating our Jeffersonville, Indiana service center, particularly the costs of support personnel, including account managers and depreciation and amortization.

Included in processing and servicing expense was $4.3 million of payroll processing costs in the year ended December 31, 2009, an increase of 14.0% from $3.8 million recorded in the year ended December 31, 2008. This increase was primarily due to the 21.2% increase in the number of payroll processing customers from 7,738 at December 31, 2008 to 9,382 at December 31, 2009.

As a percentage of total revenue, processing and servicing expense increased to 12.1% in 2009 compared with 11.6% in 2008. The increase in processing and servicing as a percentage of total revenue for 2009 reflects the addition of Network Services processing and servicing costs, partially offset by continued leveraging of our lower cost internally developed front-end processing system, HPS Exchange, and cost savings associated with our back-end processing system, Passport. Transactions processed on HPS Exchange represented approximately 88% of our total SME processing transactions during 2009, compared to 83% during 2008. We expect the increasing share of HPS Exchange in our SME merchant base to continue in the future, and over time we expect the Network Services transactions will be converted over to our platforms.

Customer acquisition costs increased 3.8% from $48.5 million in 2008 to $50.4 million in 2009. Increases in amortization of signing bonuses and capitalized customer deferred acquisition costs were primarily responsible for the increase in the customer acquisition costs. The increase in the accrued buyout liability for 2009 was lower than the prior year due to a contraction in same store sales and higher merchant attrition, including merchants who have gone out of business. Customer acquisition costs for the years ended 2009 and 2008 included the following components (in thousands of dollars):

	Year Ended December 31,	
	2009	**2008**
Amortization of signing bonuses, net	**$ 40,897**	$ 38,749
Amortization of capitalized customer deferred acquisition costs	**15,941**	14,983
Increase in accrued buyout liability	**9,973**	10,307
Capitalized customer deferred acquisition costs	**(16,449)**	(15,517)
Total Customer Acquisition Costs	**$ 50,362**	$ 48,522

Depreciation and amortization expenses increased 43.4%, from $11.0 million in 2008 to $15.8 million in 2009. The increase was primarily due to amortization recorded on the intangible assets acquired in the acquisitions of the Discover merchant portfolio, Chockstone, Network Services and CPOS and depreciation expense recorded on information technology equipment to support the network and the continuing development of HPS Exchange and Passport. Additionally, we capitalized salaries and fringe benefits and other expenses incurred by employees that worked on internally developed software projects and outsourced programming. Amortization does not begin on the internally developed software until the project is complete and placed in service, at which time we begin to amortize the asset over expected lives of three to five years. The amount capitalized increased from $5.9 million in 2008 to $12.3 million in 2009. The total amount of capitalized costs for projects placed in service in 2009 and 2008 was $8.7 million and $5.4 million, respectively.

General and administrative. General and administrative expenses increased 39.9%, from $74.4 million in 2008 to $104.2 million in 2009. The increase was primarily due to the addition of Network Services general and administrative expenses, and growth in personnel costs including increases in wages and bonuses, medical benefits and a $3.0 million increase in stock-based compensation expense, and legal, consulting and other expenses which are related to the Processing System Intrusion, but that cannot be separated from ongoing expenses. Additionally, 2009 included $3.1 million for costs of our periodic sales and servicing organization summit, which focuses on the training and development of our organization. Our payroll operation s general and administrative expenses increased by 23.7%, from $5.1 million in 2008 to $6.3 million in 2009.

General and administrative expenses as a percentage of total revenue were 6.3% for 2009, an increase from 4.8% for 2008.

Income from operations. Primarily due to the unfavorable impact which challenging economic conditions had on our revenues and the increase in general and administrative expenses, our income from operations, which we also refer to as operating income, decreased from $70.6 million for 2008 to $50.0 million for 2009. Our operating margin, which is measured as operating income divided by net revenue, was 11.9% for 2009, compared to 18.4% for 2008. In addition to the impact of the economy, the year-over-year decline in our operating margin was also due to the addition of Network Services whose operating margin is significantly lower than that of our historic business.

Interest income. Interest income decreased from $755,000 in 2008 to $117,000 in 2009, due primarily to the use of cash for acquisitions, Processing System Intrusion fines and other costs related to the Processing System Intrusion, as well as lower interest rates. (see Liquidity and Capital Resources for more detail).

Interest expense. Interest expense of $2.7 million was recorded in 2009, a decrease from $3.2 million in 2008. The decrease in interest expense for 2009 was the result of lower interest rates incurred on our borrowings under our credit facility and payables to our sponsor banks, and a lower average balance outstanding under our Term Credit Facility. Interest expense which we recorded on payables to our sponsor banks resulted from our practice of having our sponsor banks advance interchange fees to most of our merchants. Generally, when we have cash available for investment, we fund these advances to our merchants first with our cash, then by incurring a payable to our sponsor banks when that cash has been expended. We pay our sponsor banks the prime rate on these payables. See Liquidity and Capital Resources Credit Facilities for more detail on the borrowings.

Provision for processing system intrusion. During the year ended December 31, 2009, we recorded a pre-tax charge of $128.9 million, or about $2.16 per share, for costs we incurred for investigations, remedial actions, legal fees, crisis management services, and accruals for settlement offers and expected costs of settling with certain claimants with whom settlement discussions are underway. See Overview Processing System Intrusion and Critical Accounting Estimates Reserve for Processing System Intrusion for more details on the Processing System Intrusion.

Other, net. Other, net for 2009 included the write down of a debt security and a reduction of Canadian tax rebates. For 2008, Other, net included a loss on the sale of a debt security as well as write downs on a fixed income bond fund.

Income tax. Our income tax benefit for 2009 was $29.9 million, reflecting an effective tax rate of 36.6%. This compares to an effective tax rate of 38.3% for 2008, which resulted in income tax expense of $25.9 million. Minimum state tax income tax expenses recorded in 2009 resulted in the relatively lower effective tax rate benefit on our 2009 loss. The Company recognized a one-time tax benefit of $18 million related to a change in the tax treatment of accrued buyout liabilities. Absent this change the Company s effective tax rate for fiscal 2009 would have been 37.6%.

Net income (loss) attributable to Heartland. As a result of the above factors, and primarily due to the Provision for Processing System Intrusion, we recorded a net loss of $51.8 million for the year ended December 31, 2009. This compares to net income of $41.8 million for the year ended December 31, 2008.

Balance Sheet Information

	December 31, 2010	December 31, 2009
	(in thousands)	
Selected Balance Sheet Data		
Cash	**$ 41,729**	$ 32,113
Funds held for payroll customers	**36,523**	29,667
Receivables, net	**175,530**	149,403
Current tax asset	**18,652**	16,266
Current deferred tax asset	**7,250**	42,760
Capitalized customer acquisition costs, net	**59,251**	72,038
Property and equipment, net	**102,248**	99,989
Goodwill	**68,319**	60,962
Intangible assets	**31,160**	34,637
Total assets	**561,464**	562,206
Due to sponsor banks	**72,573**	80,007
Accounts payable	**42,126**	32,305
Deposits held for payroll customers	**36,523**	29,667
Borrowings:		
Current portion	**38,286**	58,547
Long term portion	**85,000**	8,419
Accrued buyout liability:		
Current portion	**5,560**	9,306
Long term portion	**23,250**	33,580
Reserve for Processing System Intrusion	**1,618**	99,911
Total liabilities	**383,870**	432,251
Total stockholders equity	**177,293**	129,741

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December 31, 2010 Compared to December 31, 2009

Total assets at December 31, 2010 of $561.5 million were 0.1% below our total assets at December 31, 2009. We experienced increases in receivables, cash and funds held for payroll customers, offset by decreases in current deferred tax assets and capitalized customer acquisition costs. Our cash increased primarily as the result of our operating activities augmented by borrowings to fund the settlement with Visa (see Liquidity and Capital Resources for discussion of cash flow from operating and financing activities). The $6.9 million increase in funds held for payroll customers was offset by an equal increase in deposits held for payroll customers.

Our receivables, which in the aggregate increased $26.1 million or 17.5% from December 31, 2009, are primarily due from our bankcard processing merchants and result in large part from our practice of advancing interchange fees to most of our SME merchants during the month and collecting those fees from our merchants at the beginning of the following month, as well as from transaction fees we charge merchants for processing transactions. Generally, these advances to our SME merchants are funded first with our cash available for investment, then by incurring a payable to our sponsor banks when that cash has been expended. Our receivables from bankcard processing merchants increased $15.5 million from December 31, 2009. At December 31, 2010, we used $29.5 million of available cash to fund merchant advances and at December 31, 2009, we used $7.0 million of cash to fund merchant advances. The amount due to sponsor banks for funding advances was $63.2 million at December 31, 2010 and $73.2 million at December 31, 2009. The payable to sponsor banks is repaid at the beginning of the following month out of the fees we collect from our merchants. Receivables from bankcard merchants also include receivables from the sale of point of sale terminal equipment and check processing terminals.

Receivables also include amounts due from bankcard networks, primarily for amounts we have pre-funded to our merchants for processing Discover and American Express transactions (these receivables increased $10.7 million over December 31, 2009), and receivables resulting from the sale, installation, training and repair of payment system hardware and software for prepaid card and stored-value card payment systems and campus payment solutions.

Current deferred tax assets decreased $35.5 million to $7.3 million at December 31, 2010. The reduction in current deferred tax assets primarily resulted from the payment of the settlements with Visa, MasterCard and Discover during 2010 (see Overview Processing System Intrusion for more detail). The payment of these settlements was also the primary reason for the $98.3 million decrease in our Reserve for Processing System Intrusion.

Capitalized customer acquisition costs decreased by $12.8 million, or 17.8%, primarily reflecting a decline in the amount of signing bonuses paid due to the decrease in gross margin installed.

Total borrowings increased $56.3 million, or 84.1%, to $123.3 million at December 31, 2010 from $67.0 million at December 31, 2009, primarily due to our February 18, 2010 settlement with Visa and that settlement s condition that we obtain loans of at least $53.0 million from our Sponsor Banks to fund the settlement amount. On November 24, 2010, we refinanced our previous credit facility and the $53.0 million of borrowings from our Sponsor Banks used to fund the Visa settlement. See Overview Provision for Processing System Intrusion and Liquidity and Capital Resources for discussion of the Visa Settlement Agreement, the Bridge Loan, the Increased Credit Commitment and our Second Amended and Restated Credit Agreement.

During the third quarter of 2010, we exercised our rights to buy out a substantial amount of residual commissions owned by our Relationship Managers and sales managers (also referred to as portfolio equity). As a result of these buyouts, we reduced our Accrued Buyout Liability recorded on the Consolidated Balance Sheet by the approximately $17.7 million of cash payments we made. We realized a reduction of approximately $0.6 million in monthly residual commission expense beginning in the fourth quarter of 2010, and expect to realize a lesser reduction in ensuing years. The amount of future annual reductions in residual commission expense will be impacted by merchant attrition. See Critical Accounting Estimates Accrued Buyout liability for the accounting treatment of our Accrued Buyout Liability.

Total stockholders equity increased $47.5 million from December 31, 2009 primarily due to recording net income of $34.5 million for 2010, including net pre-tax insurance recoveries of $14.1 million related to the

Processing System Intrusion. Other increases in total stockholders equity for 2010 included proceeds received from the exercise of stock options, stock compensation expense and tax benefits related to those stock option exercises.

Liquidity and Capital Resources

General. Liquidity and capital resource management is a process focused on providing the funding we need to meet our short and long-term cash and working capital needs. We have used our funding sources to build our merchant portfolio, our servicing technology platforms, and our Jeffersonville, Indiana service center with the expectation that these investments will generate cash flows sufficient to cover our working capital needs and other anticipated needs for capital.

Our cash requirements include funding payments to salespersons for signing bonuses, residual commissions and residual buyouts, paying interest expense and other operating expenses, including taxes, constructing our primary service center, investing in building our technology infrastructure, and making acquisitions of businesses or assets. We expect that our future cash requirements will continue to include amounts required to defend against claims arising from the Processing System Intrusion; such costs could be material. At times, we have used cash to repurchase our common stock.

Other than borrowings we used to fund certain acquisitions and settlements of claims related to the Processing System Intrusion, we fund our cash needs primarily with cash flow from our operating activities and through our agreements with our sponsor banks to fund SME merchant advances. We believe that our current cash and investment balances, cash generated from operations and our agreements with our sponsor banks to fund SME merchant advances will provide sufficient liquidity to meet our anticipated needs for operating capital for at least the next twelve months.

Working Capital. Our working capital, defined as current assets less current liabilities, was positive by $ 47.4 million at December 31, 2010. Prior to refinancing of our credit facility in November 2010, our net working capital position was negative, reflecting (i) our previous revolving credit facility with its $75.0 million in borrowings classified as a current liability, and (ii) a $28.0 million Bridge Loan, which was due on February 17, 2011. See Credit Facilities for discussion of our refinancing.

At December 31, 2010, we had cash on our Balance Sheet totaling $41.7 million compared to cash of $32.1 million at December 31, 2009 and $27.6 million at December 31, 2008. Our December 31, 2010 cash balance included approximately $25.6 million of processing-related cash in transit and collateral, compared to approximately $25.5 million of cash in transit and collateral at December 31, 2009. As of December 31, 2010, the Company had used $29.5 million of its available cash to fund merchant advances and at December 31, 2009, the Company had used $7.0 million of its cash to fund merchant advances.

On December 31, 2010, we had borrowed $23.2 million of the total $50.0 million available to us under our Revolving Credit Facility. See Credit Facilities for more details.

Settlements of Claims Related to the Processing System Intrusion. See Overview Processing System Intrusion for a more detailed discussion of each claim and settlement. Settlements with the bankcard networks which we have entered into and paid are summarized below:

- On December 17, 2009, we entered into a settlement agreement and release with American Express and paid approximately $3.5 million in full and final satisfaction of any and all claims of American Express and its issuers arising from or relating to the Processing System Intrusion. We paid this settlement from our available cash.

- On January 7, 2010, we entered into the Visa Settlement Agreement to resolve potential claims and other disputes related to the Processing System Intrusion and on February 18, 2010 we paid $59.3 million for that settlement. We obtained loans totaling $53.0 million from Sponsor Banks, the proceeds of which were used to partially fund the settlement amount. See Credit Facilities for a discussion of our $28.0 million Bridge Loan and our $25.0 million Increased Credit Commitment, both entered into on February 18, 2010.

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On May 19, 2010, we entered into the MasterCard Settlement Agreement to resolve potential claims and other disputes related to the Processing System Intrusion and in September 2010 we paid $34.8 million for that settlement. We paid this settlement from our available cash.

On August 31, 2010, we entered into the Discover Settlement Agreement to resolve potential claims and other disputes with respect to the Processing System Intrusion and on September 2, 2010, we paid Discover $5.0 million in full and final satisfaction of any and all claims of Discover, its affiliates and certain of its issuers. We paid this settlement from our available cash.

2010 Acquisition. On December 30, 2010, we purchased for a $7.7 million cash payment the net assets of the K to 12 School Services business operated by Lunchbox. The acquisition was financed through a combination of cash on hand and our credit facilities. Lunchbox serves approximately 4,400 schools. Lunchbox develops, manufactures, sells and services and maintains computer software designed to facilitate accounting and management functions of food service operations of K to 12 schools.

School Districts use Lunchbox for point-of-sale platforms for their cafeteria serving line, free and reduced meal application processing, inventory, menu planning, nutritional analysis and online payments. These platforms are Web-based software which provide real-time communication and interaction between the District s central office and schools. LunchBox uses touch screen technology and offers optional biometrics, reimbursable meal vending, meal application scanning and on-line application processing.

On January 12, 2011 and February 4, 2011, we acquired the K to 12 School Services businesses of Comalex, Inc. and mySchoolBucks, LLC. We made cash payments of $6.2 million and $1.5 million, respectively, for the net assets of Comalex and mySchoolBucks. Comalex and mySchoolBucks added approximately 3,700 and 900 schools, respectively, to our K to 12 School Services product. These acquisitions will enable us to offer Internet payment capability, which enables on-line deposits of funds into student accounts and enables schools to operate more efficiently. We plan to consolidate the individual platforms and products of Lunchbox, Comalex and mySchoolBucks to optimize synergies, cost efficencies and product offerings to our customers.

The acquisitions of Lunchbox, Comalex and mySchoolBucks are not expected to have a material impact on earnings in the near term.

2009 Acquisition. On July 31, 2009, we purchased for $3.2 million the existing Discover merchant portfolio, which we were already processing. This purchase related to our 2008 agreement with DFS Services, LLC, which enables us to offer bankcard merchants a streamlined process that enables them to accept Discover Network cards on our processing platforms. This asset is being amortized over the next 73 months in proportion to estimated future cash flows.

2008 Acquisitions. As of May 31, 2008, we acquired the net assets of the Network Services business unit of Alliance Data Network Services LLC, for a cash payment of $77.5 million plus the net working capital of Network Services on the closing date, for a total purchase price of $92.5 million. The acquisition was financed through a combination of cash on hand and our credit facilities. Network Services provides processing of credit and debit cards to large national merchants, primarily in the petroleum industry. On March 3, 2008, we acquired a majority interest in Collective Point of Sale Solutions Ltd. (CPOS) for a net cash payment of $10.1 million. CPOS is a Canadian provider of payment processing services and secure point-of-sale solutions. On November 14, 2008, we acquired Chockstone, Inc. (Chockstone) for a net cash payment of $4.0 million. Chockstone provides loyalty marketing and gift card solutions to restaurant, convenience store, and other retail locations in North America. The acquisitions of CPOS and Chockstone are not expected to have a material impact on earnings in the near term.

The Chockstone Purchase Agreement contains provisions for contingent earnout payments to the former shareholders of Chockstone. These contingent earnout payments are based on the acquired business achieving certain pre-established levels of gross profits during the first three years after acquisition. For the year ended December 31, 2009, the first contingent earnout period, the contingent earnout paid and charged to goodwill was $1.4 million. For the year ended December 31, 2010, the second contingent earnout period, the contingent earnout payment was estimated at $1.4 million and we accrued this amount as payable and charged it to goodwill in the consolidated balance sheet as of December 31, 2010.

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Cash Flow Provided by (Used in) Operating Activities. We reported net cash used in operating activities of $22.3 million in 2010, compared to net cash provided by operating activities of $61.5 million in 2009.

The primary reason for negative operating cash flow for 2010 were payments of $98.5 million, which are reflected in the reduction of our Reserve for Processing System Intrusion, that we made for the settlements with Visa, MasterCard and Discover. The Visa Settlement Agreement required us to obtain a loan of $53.0 million from our Sponsor Banks, the proceeds of which were to be used to fund the settlement amount (see Overview Processing System Intrusion for more detail). The $53.0 million of proceeds from the loans we obtained from our Sponsor Banks are included in Cash Flow Provided by Financing Activities (See Cash Flow Provided By (Used In) Financing Activities). The settlements with MasterCard and Discover were funded from our cash reserves. Partially offsetting the impact these settlements had on our operating cash flow for 2010 was approximately $27.2 million of cash we recovered from our insurance providers against certain costs we incurred for the Processing System Intrusion. Other Processing System Intrusion settlements we paid in 2010 totaled $2.5 million. For 2010, we paid an additional $10.9 million for Processing System Intrusion costs we incurred for legal fees incurred in defending various claims and actions. For 2009, we paid $27.6 million for Processing System Intrusion costs we incurred for legal fees, certain settlements, investigations, defending various claims and actions, and crisis management services.

Other major determinants of operating cash flow are net signing bonus payments, which consume operating cash as we install new merchants, and payouts on the accrued buyout liability, which represent the costs of buying out residual commissions owned by our salespersons. See Critical Accounting Estimates Capitalized Customer Acquisition Costs and Critical Accounting Estimates Accrued Buyout Liability for more information. We paid net signing bonuses of $26.5 million, $34.7 million and $45.5 million, respectively, in 2010, 2009 and 2008. The reductions in net signing bonuses paid in 2010 and 2009 reflect two year-over-year declines in newly installed gross margin. In 2010, 2009 and 2008, we reduced our accrued buyout liability by making buyout payments of $25.2 million, $8.1 million and $7.0 million, respectively. See Balance Sheet Information for a discussion of buyouts initiated in the third quarter of 2010.

Cash Flow Used in Investing Activities. Net cash used in investing activities was $31.1 million for 2010, compared to $44.7 million for 2009 and 142.5 million in 2008. The amount of cash used in investing activities was lower in 2010 as we made capital expenditures of $23.3 million, compared to $41.6 million in 2009 and $35.1 million in 2008. Capital expenditures include costs of $1.9 million, $18.6 and $16.7 million in 2010, 2009 and 2008, respectively, related to the construction and continued build out of our primary service center facility in Jeffersonville, Indiana. See Contractual Obligations for more detail regarding cumulative cash outlays and expected future funding requirements related to our primary service center. We also continued building our technology infrastructure, primarily for hardware and software needed for the expansion of HPS Exchange and Passport. To further develop our technology, we anticipate that these expenditures will continue near current levels. Additionally, our technology expenditures in 2010 and 2009 were increased by measures we implemented after the Processing System Intrusion to further enhance the security of our computer systems.

During the years ended December 31, 2010, 2009 and 2008, we invested in the following acquisitions: in December 2010, we acquired Lunchbox for a net cash payment of $7.7 million; in July 2009, we purchased a Discover merchant portfolio for $3.2 million; in March 2008, we acquired CPOS for a net cash payment of $10.1 million; in May 2008, we acquired Network Services for a cash payment of $92.5 million; and in November 2008, we acquired Chockstone, Inc. for a net cash payment of $4.0 million. Additionally, in 2010 we made a $1.4 million payment for a contingent earnout due to the former shareholders of Chockstone.

Cash Flow Provided By (Used in) Financing Activities. Net cash provided by financing activities was $63.0 million for 2010, compared to net cash used in financing activities of $12.4 million in 2009 and net cash provided by financing activities of $47.3 million in 2008. Cash flow from financing activities in 2010 included the $53.0 million of proceeds from the loans we obtained from our Sponsor Banks to use in funding the February 18, 2010 settlement with Visa (see Overview Processing System Intrusion for more detail) and the impacts of refinancing our credit facility in November 2010 (see Credit Facilities for more detail).

During 2010 and 2009, we made term loan amortization payments of $6.2 million and $8.3 million, respectively, due under a term credit facility. See Credit Facilities for more details.

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Cash dividends paid in 2010 were $1.5 million, compared to dividends paid of $2.1 million and $13.5 million, respectively, in 2009 and 2008. See Dividends on Common Stock for more information on our common stock dividends. During 2010, 2009 and 2008, employees exercised stock options generating cash proceeds in the aggregate of $6.3 million, $1.0 million and $3.1 million, respectively.

Cash used in financing activities in 2009 and 2008 included cash for common stock repurchases. See Common Stock Repurchases for more information on our common stock repurchases authorization. We used $3.2 million of cash to repurchase 350,400 shares of our common stock during 2009 and $18.0 million of cash in 2008 to repurchase 781,584 shares. No common stock was repurchased during 2010.

Credit Facilities. On November 24, 2010, we entered into a Second Amended and Restated Credit Agreement (the Credit Agreement) with JPMorgan Chase Bank, N.A., as administrative agent, and certain lenders who are a party to the Credit Agreement. Credit extended under the Credit Agreement is guaranteed by our subsidiaries and is secured by substantially all of our assets and the assets of our subsidiaries. The Credit Agreement amended and restated in its entirety our previous amended and restated credit agreement entered into on May 30, 2008, as amended (the Previous Credit Agreement), between us and certain of the parties to the Credit Agreement.

On August 3, 2009, we amended the Previous Credit Agreement to exclude a certain amount of charges related to the Processing System Intrusion in determining our compliance with the financial covenants of the Previous Credit Agreement, provide the lenders with a security interest in our assets, and increase the interest margin charged on borrowings. On May 30, 2008, we borrowed $50 million under the Previous Credit Agreement s revolving credit facility and $25 million under the Previous Credit Agreement s term credit facility. All of the proceeds of both borrowings were applied to finance and pay expenses related to our acquisition of Network Services. On February 18, 2010, we entered into the Commitment Increase Agreement with KeyBank as one of the lenders under the Previous Credit Agreement to increase the total commitment under that facility s revolving credit facility by $25 million.

The Credit Agreement provides for a revolving credit facility in the aggregate amount of up to $50 million (the Revolving Credit Facility), of which up to $10 million may be used for the issuance of letters of credit and up to $5 million is available for swing line loans. Upon the prior approval of the administrative agent, we may increase the total revolving commitments by $50 million for a total commitment under the Revolving Credit Facility of $100 million. The Revolving Credit Facility is available to us on a revolving basis until November 24, 2015. All principal and interest not previously paid on the Revolving Credit Facility will mature and be due and payable on November 24, 2015.

The Credit Agreement also provides for a term credit facility in the aggregate amount of up to $100 million (the Term Credit Facility). The Term Credit Facility requires amortization payments in the amount of $3.75 million for each fiscal quarter during the fiscal years ended December 31, 2011 and 2012, $5.0 million for each fiscal quarter during the fiscal years ended December 31, 2013 and 2014, and $7.5 million for each fiscal quarter during the period commencing on January 1, 2015 through the maturity date on November 24, 2015. All principal and interest not previously paid on the Term Credit Facility will mature and be due and payable on November 24, 2015. Amounts borrowed and repaid under the Term Credit Facility may not be re-borrowed.

The Credit Agreement contains covenants, which include our maintenance of certain leverage and fixed charge coverage ratios, limitations on our indebtedness, liens on our properties and assets, our investments in, and loans to, other business units, our ability to enter into business combinations and asset sales, and certain other financial and non-financial covenants. These covenants also apply to certain of our subsidiaries. We were in compliance with these covenants as of December 31, 2010. Under the terms of the Credit Agreement, we may borrow, at our option, at interest rates equal to one, two, three or six month adjusted LIBOR rates, or equal to the greater of the prime rate, the federal funds rate plus 0.50% and the adjusted LIBOR rate plus 1%, in each case plus a margin determined by our current leverage ratio.

On February 18, 2010, we entered into the Bridge Loan Agreement with KeyBank, as administrative agent, and KeyBank and Heartland Bank as bridge lenders. On that date, KeyBank made a bridge loan to us in the amount of $20.0 million and Heartland Bank made a bridge loan to us in the amount of $8.0 million. The maturity date of the Bridge Loan was scheduled for February 17, 2011. We had the option to prepay the Bridge Loan at any time in whole or in part. The proceeds of the Bridge Loan ($28.0 million) and the Increased Credit Commitment ($25.0 million), together with a portion of our cash reserves, were used to fund the settlement with Visa, which was consummated on February 18, 2010 for $58.6 million.

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At December 31, 2010, we had $23.2 million outstanding under the Revolving Credit Facility and $100.0 million outstanding under the Term Credit Facility. Amounts previously borrowed and outstanding under the Previous Credit Agreement, the Increased Credit Commitment, and the Bridge Loan were all repaid on November 24, 2010 from the amounts we borrowed under the Revolving Credit Facility and the Term Credit Facility. Additionally, $7.7 million of the total amount outstanding under the Revolving Credit Facility at December 31, 2010 was used in the acquisition of Lunchbox.

At December 31, 2009, there was $50.0 million outstanding under the revolving credit facility of the Previous Credit Agreement and $16.7 million outstanding under the term credit facility of the Previous Credit Agreement.

Common Stock Repurchases. Under authorizations from our Board of Directors, we repurchased an aggregate of 2,924,684 shares of our common stock at a cost of $65.1 million, or an average cost of $22.25 per share. At December 31, 2010, we have remaining authorization to repurchase up to 175,316 additional shares of our common stock. During the years ended December 31, 2009, 2008 and 2007, we repurchased 350,400, 781,584 and 731,500 shares, respectively, of our common stock at average per share costs of $9.14, $23.02 and $25.78. No common stock was repurchased in 2010.

Dividends on Common Stock. The following table summarizes quarterly cash dividends declared and paid on our common stock:

Date Declared	Record Date	Date Paid	Amount Paid Per Common Share
Twelve Months Ended December 31, 2008:			
February 13, 2008	February 28, 2008	March 15, 2008	$ 0.09
April 30, 2008	May 23, 2008	June 15, 2008	$ 0.09
August 5, 2008	August 22, 2008	September 15, 2008	$ 0.09
November 4, 2008	November 24, 2008	December 15, 2008	$ 0.09
Twelve Months Ended December 31, 2009:			
February 20, 2009	March 9, 2009	March 16, 2009	$ 0.025
May 7, 2009	May 25, 2009	June 15, 2009	$ 0.01
August 3, 2009	August 25, 2009	September 15, 2009	$ 0.01
November 3, 2009	November 23, 2009	December 15, 2009	$ 0.01
Twelve Months Ended December 31, 2010:			
February 18, 2010	March 5, 2010	March 15, 2010	$ 0.01
May 4, 2010	May 25, 2010	June 15, 2010	$ 0.01
August 3, 2010	August 25, 2010	September 15, 2010	$ 0.01
November 2, 2010	November 23, 2010	December 15, 2010	$ 0.01

On February 16, 2011, our Board of Directors declared a quarterly cash dividend of $0.04 per share of common stock, payable on March 15, 2011 to stockholders of record as of March 4, 2011.

Contractual Obligations. The card brand networks generally allow chargebacks up to four months after the later of the date the transaction is processed or the delivery of the product or service to the cardholder. If the merchant incurring the chargeback is unable to fund the refund to the card issuing bank, we must do so. As the majority of our SME transactions involve the delivery of the product or service at the time of the transaction, a good basis to estimate our exposure to chargebacks is the last four months bankcard processing volume on our SME portfolio, which was $21.7 billion, $19.6 billion and $18.7 billion for the four months ended December 31, 2010, 2009 and 2008, respectively. However, during the four months ended December 31, 2010, 2009, and 2008, we were presented with $10.1 million, $11.1 million, and $10.2 million, respectively, of chargebacks by issuing banks. In 2010, 2009 and 2008, we incurred merchant credit losses of $9.1 million, $5.9 million and $5.1 million, respectively, on total SME bankcard dollar volumes processed of $64.5 billion, $59.0 billion, and $57.9 billion, respectively. These credit losses are included in processing and servicing expense in our Consolidated Statement of Operations.

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During the fourth quarter of 2010, we converted Network Services settled transaction from a third party processor and began settling large national merchant accounts, and processing chargebacks originating from these merchants, on Passport. Prior to this, these chargebacks were processed and carried by Fifth Third Processing Solutions, which was our third-party outsourced processor for settling Network Services Merchants. Chargeback losses originating from Network Services bankcard processing on Passport during the year ended December 31, 2010 were insignificant.

The following table reflects our significant contractual obligations as of December 31, 2010:

	Payments Due by Period				
Contractual Obligations	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
			(in thousands)		
Processing providers (a)	$ 24,793	$ 13,330	$ 7,780	$ 3,683	$
Telecommunications providers	8,151	4,073	4,078		
Office and equipment leases	20,952	5,988	7,757	3,395	3,812
Term Credit Facility (b)	100,000	15,000	35,000	50,000	
Construction and Equipment (c)	1,753	1,753			
Capital lease obligations	86	86			
	$ 155,735	$ 40,230	$ 54,615	$ 57,078	$ 3,812

(a) We have agreements with several third-party processors to provide us on a non-exclusive basis payment processing and transmittal, transaction authorization and data capture services, and access to various reporting tools. Our agreements with third-party processors require us to submit a minimum monthly number of transactions or volume for processing. If we submit a number of transactions or volume that is lower than the minimum, we are required to pay the third party processors the fees that they would have received if we had submitted the required minimum number or volume of transactions.

(b) Interest rates on the Term Credit Facility are variable in nature, however, in January 2011 we entered into fixed-pay amortizing interest rate swaps having an initial notional amount of $50.0 million. If interest rates were to remain at the December 31, 2010 level, we would make interest payments of $3.3 million in the next 1 year, $5.0 million in the next 1 to 3 years and $2.1 million in the next 3 to 5 years or a total of $10.4 million including net settlements on the fixed-pay amortizing interest rate swaps. In addition, we had $23.2 million outstanding under our Revolving Credit Facility at December 31, 2010. The Revolving Credit Facility is available on a revolving basis until November 24, 2015.

(c) These amounts relate to contractual commitments we have for outfitting and constructing additions to our service center in Jeffersonville, Indiana. Additional contractual commitments will be entered into as we progress with this development. Through December 31, 2010, we have spent approximately $70.6 million of our cash on our new service center, including $1.7 million to acquire land.

In addition, we record a payable to our sponsor banks each month in conjunction with our monthly processing activities. This amount was $72.6 million and $80.0 million as of December 31, 2010 and 2009, respectively. This amount is repaid on the first business day of the following month out of the fees collected from our merchants.

Unrecognized Tax Benefits. At December 31, 2010, we had gross tax effected unrecognized tax benefits of approximately $1.3 million. See Critical Accounting Estimates Income Taxes. As of December 31, 2010, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority, hence the unrecognized tax benefits have been excluded from the above commitment and contractual obligations table.

Off-Balance Sheet Arrangements

We have not entered into any transactions with third parties or unconsolidated entities whereby we have financial guarantees, subordinated retained interest, derivative instruments, or other contingent arrangements that expose us to material continuing risks, contingent liabilities, or other obligations other than for chargebacks and reject losses described under Critical Accounting Estimates.

Legal and Regulatory Considerations

Processing System Intrusion Legal Proceedings

To date, we have had several lawsuits filed against us and additional lawsuits may be filed. These include lawsuits which assert claims against us by cardholders (including various putative class actions seeking in the aggregate to represent all cardholders in the United States whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion), and banks that issued payment cards to cardholders whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion (including various putative class actions seeking to represent all financial institutions that issued payment cards to cardholders whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion), seeking damages allegedly arising out of the Processing System Intrusion and other related relief. The actions generally assert various common-law claims such as claims for negligence and breach of contract, as well as, in some cases, statutory claims such as violation of the Fair Credit Reporting Act, state data breach notification statutes, and state unfair and deceptive practices statutes. The putative cardholder class actions seek various forms of relief including damages, injunctive relief, multiple or punitive damages, attorneys fees and costs. The putative financial institution class actions seek compensatory damages, including recovery of the cost of issuance of replacement cards and losses by reason of unauthorized transactions, as well as injunctive relief, attorneys fees and costs.

On June 10, 2009, the Judicial Panel on Multidistrict Litigation (the JPML) entered an order centralizing the class action cases for pre-trial proceedings before the United States District Court for the Southern District of Texas, under the caption *In re Heartland Payment Systems, Inc. Customer Data Security Breach Litigation*, MDL No. 2046, 4:09-md-2046. On August 24, 2009, the court appointed interim co-lead and liaison counsel for the financial institution and consumer plaintiffs. On September 23, 2009, the financial institution plaintiffs filed a Master Complaint in the MDL proceedings, which we moved to dismiss on October 23, 2009. Briefing on that motion to dismiss concluded on February 1, 2010 and the motion remains pending. On December 18, 2009, we and interim counsel for the consumer plaintiffs filed with the Court a proposed settlement agreement, subject to court approval, of the consumer class action claims. On May 3, 2010, the Court entered an order preliminarily certifying the settlement class, authorizing notice to the class to proceed, and scheduling a fairness hearing for December 10, 2010. The putative consumer class actions and putative financial institution class actions filed against us and pending through September 30, 2010 are described in Legal Proceedings Processing System Intrusion Legal Proceedings.

Other actions have been filed against us seeking damages allegedly arising out of the Processing System Intrusion and other related relief on an individual basis. On October 14, 2009, the Clark County Indiana Teachers Federal Credit Union filed a complaint in the Clark Circuit Superior Court of the State of Indiana. This action is captioned *Clark County Indiana Teachers Federal Credit Union v. Heartland Payment Systems, Inc.*, Civ. No. 10D02-0910-LL-1209, and asserts claims for negligence and breach of contract. On April 12, 2010, we filed an answer to the complaint. On July 30, 2010, the court entered an order staying the action until the MDL court rules on our motion to dismiss or until September 30, 2010, whichever occurs first. On October 25, 2010, the court granted our motion to extend the stay until the MDL court rules on our motion to dismiss or until December 31, 2010, whichever occurs first. On December 27, 2010, we filed a motion to extend the stay until the MDL court rules on our motion to dismiss, and this motion remains pending. On December 28, 2009, Putnam Bank of Putnam, Connecticut filed a complaint in Connecticut Superior Court, *Putnam Bank v. Heartland Payment Systems, Inc.*, case no. WWM-CV-10-6001208-S. On January 20, 2010, we removed the action to the United States District Court for the District of Connecticut, case no. 3:10-cv-0061 (JBA), and, on January 27, 2010, filed a Notice of Potential Tag-Along Action, requesting centralization of the action with the MDL proceedings. On March 17, 2010, the action was centralized with the MDL proceedings. On February 9, 2010, OmniAmerican Bank filed a complaint in the District Court for Collin County, Texas, Civ. No. 380-00563-2012. The complaint identifies as a party in interest the Federal Insurance Company, which is alleged to have insured plaintiff and reimbursed it for $1,005,077.50, less a $100,000 deductible. On March 15, 2010, we filed an answer to the complaint and removed the action to the United States District Court for the Eastern District of Texas, case no. 4:10-cv-114, and, on March 16, 2010, filed a Notice of Potential Tag-Along Action, requesting centralization of the action with the MDL proceedings. On April 29, 2010, the action was centralized with the MDL proceedings. On February 18, 2010, Quad City Bank and Trust filed a complaint in the District Court for Collin County, Texas, Civ. No. 380-00721-2010. The complaint identifies as a party in interest the Federal Insurance Company, which is alleged to have insured plaintiff and reimbursed it for $432,420.32, less a $100,000 deductible. On March 15, 2010, we filed an answer to the complaint and removed the action to the United States District Court for the Eastern District of Texas, case no. 4:10-cv-115 and, on March 16, 2010, filed a Notice of Potential Tag-Along Action, requesting centralization of the action with the MDL proceedings. On April 29, 2010, the action was centralized with the MDL proceedings. On May 5, 2010, Napus Federal Credit Union filed a complaint in the United States District Court for the Southern District of Texas, case no. 4:10-cv-1616, and the action was consolidated with the MDL proceedings on June 9, 2010.

On January 19, 2010, financial institution plaintiffs, including certain of the named plaintiffs in the MDL proceedings, commenced an action against our sponsor banks in the United States District Court for the Southern District of Texas, captioned Lonestar National Bank, N.A. et al. v. KeyBank NA, et al., Civ. No. 4:10-cv-00171. This action against our sponsor banks asserts common-law claims similar to those asserted against us, and likewise seeks to represent all financial institutions that issued payment cards to cardholders whose transaction information is alleged to have been placed at risk in the course of the Processing System Intrusion. On March 4, 2010, this action was transferred to the judge overseeing the MDL proceedings. On April 9, 2010, our sponsor banks moved to dismiss the complaint. Briefing on that motion to dismiss concluded on June 7, 2010 and the motion remains pending. The sponsor banks could seek indemnification from us in regard to the claims asserted in this action.

We have been advised by the SEC that it has commenced an informal inquiry and we have been advised by the United States Attorney for the District of New Jersey that it has commenced an investigation, in each case to determine whether there have been any violations of the federal securities laws in connection with our disclosure of the Processing Systems Intrusion and the alleged trading in our securities by certain of our employees, including certain executive officers. We are cooperating with these inquiries.

We were contacted by the Federal Financial Institutions Examination Council and informed that it would make inquiries into the Processing System Intrusion, and the Federal Trade Commission, by letters dated February 19, 2009, August 4, 2009, and March 10, 2010, has requested that we provide information about our payment processing services and information security practices. Additionally, we have received written or telephonic inquiries relating to the Processing System Intrusion from a number of state Attorneys General s offices, including a Civil Investigative Demand from the Louisiana Department of Justice Office of the Attorney General, the Canadian Privacy Commission, and other government officials. We are cooperating with the government officials in response to each of these inquiries. Additional lawsuits may be filed against us relating to the Processing System Intrusion and that additional inquiries from governmental agencies may be received or investigations may be commenced.

Although we intend to defend the lawsuits, investigations and inquiries described above vigorously, we cannot predict the outcome of such lawsuits, investigations and inquiries. Apart from damages claimed in such lawsuits and in other lawsuits relating to the Processing System Intrusion that may be filed, we may be subject to fines or other obligations as a result of the government inquiries and investigations described above and additional governmental inquiries or investigations relating to the Processing System Intrusion that may be commenced.

Since our announcement of the Processing System Intrusion on January 20, 2009 and through December 31, 2010, we have expensed a total of \$146.1 million, before reducing those charges by \$31.2 million of total insurance recoveries. The majority of the total charges, or approximately \$114.7 million, related to settlements of claims. Approximately \$31.4 million of the total charges were for legal fees and costs we incurred for investigations, defending various claims and actions, remedial actions and crisis management services.

During the year ended December 31, 2010, we recovered from our insurance providers approximately \$27.2 million of the costs we incurred for the Processing System Intrusion and expensed approximately \$13.1 million for accruals, legal fees and costs we incurred for defending various claims and actions, resulting in a net recovery of \$14.1 million, or \$0.22 per share.

For the year ended December 31, 2009, we expensed a total of \$132.9 million for settlement accruals, legal fees and costs we incurred for defending various claims and actions associated with the Processing System Intrusion, and recovered from our insurance providers approximately \$4.0 million of the costs we incurred resulting in net expenses of \$128.9 million, or about \$2.16 per share.

At December 31, 2010 and 2009, we carried a Reserve for Processing System Intrusion on our Consolidated Balance Sheet of \$1.6 million and \$99.9 million, respectively. During the year ended December 31, 2010, we settled the following claims and disputes related to the Processing System Intrusion: