

VERIFONE SYSTEMS, INC.

Form 10-Q

March 11, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended January 31, 2013

Or

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

For the transition period from _____ to _____

Commission file number: 001-32465

VERIFONE SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware

04-3692546

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

2099 Gateway Place, Suite 600

San Jose, CA 95110

(Address of principal executive offices with zip code)

(408) 232-7800

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

At February 28, 2013, the number of shares outstanding of the registrant's common stock, \$0.01 par value was 108,336,269.

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (Unaudited)

VERIFONE SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended January 31,	
	2013	2012
	(Unaudited, in thousands, except per share data)	
Net revenues:		
System solutions	\$281,708	\$312,641
Services	147,039	106,883
Total net revenues	428,747	419,524
Cost of net revenues:		
System solutions	174,243	198,752
Services	82,542	64,134
Total cost of net revenues	256,785	262,886
Gross margin	171,962	156,638
Operating expenses:		
Research and development	39,802	35,079
Sales and marketing	45,748	39,986
General and administrative	39,981	46,038
Amortization of purchased intangible assets	24,696	13,615
Total operating expenses	150,227	134,718
Operating income	21,735	21,920
Interest expense	(12,590	) (14,634
Interest income	1,088	1,007
Other income (expense), net	3,940	(20,849
Income (loss) before income taxes	14,173	(12,556
Provision for (benefit from) income taxes	2,463	(9,782
Consolidated net income (loss)	11,710	(2,774
Net (income) loss attributable to noncontrolling interests	128	(350
Net income (loss) attributable to VeriFone Systems, Inc. stockholders	\$11,838	\$(3,124
Net income (loss) per share attributable to VeriFone Systems, Inc. stockholders:		
Basic	\$0.11	\$(0.03
Diluted	\$0.11	\$(0.03
Weighted average number of shares used in computing net income per share:		
Basic	107,934	105,833
Diluted	110,558	105,833

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of ContentsVERIFONE SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended January 31,		
	2013	2012	
	(Unaudited, in thousands)		
Net income (loss) attributable to VeriFone Systems, Inc. stockholders	\$11,838	\$ (3,124)
Other comprehensive income (loss):			
Net change in:			
Foreign currency translation	48,275	6,958	
Unrealized gain (loss) on marketable equity investment	484	(100)
Unrealized loss on derivatives designated as cash flow hedges, net of \$253 tax	927	—	
Pension plan obligations	(174	) 142	
Comprehensive income attributable to VeriFone Systems, Inc. stockholders	\$61,350	\$3,876	

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of ContentsVERIFONE SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	January 31, 2013	October 31, 2012
	(Unaudited, in thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$476,668	\$454,072
Accounts receivable, net of allowances of \$9,424 and \$8,491	355,119	366,887
Inventories	188,783	178,274
Prepaid expenses and other current assets	138,175	136,210
Total current assets	1,158,745	1,135,443
Fixed assets, net	152,107	146,803
Purchased intangible assets, net	719,134	734,808
Goodwill	1,206,008	1,179,381
Deferred tax assets	215,963	215,139
Other long-term assets	82,109	79,033
Total assets	\$3,534,066	\$3,490,607
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$154,598	\$193,062
Accruals and other current liabilities	221,172	230,867
Deferred revenue, net	119,003	91,545
Short-term debt	52,585	54,916
Total current liabilities	547,358	570,390
Long-term deferred revenue, net	39,056	37,062
Long-term deferred tax liabilities	216,494	214,537
Long-term debt	1,238,966	1,252,701
Other long-term liabilities	71,110	70,440
Total liabilities	2,112,984	2,145,130
Commitments and contingencies	—	—
Redeemable noncontrolling interest in subsidiary	817	861
Stockholders' equity:		
Preferred stock: 10,000 shares authorized, no shares issued and outstanding as of January 31, 2013 and October 31, 2012	—	—
Common stock: \$0.01 par value, 200,000 shares authorized, 108,409 and 108,074 shares issued, and 108,265 and 107,930 shares outstanding as of January 31, 2013 and October 31, 2012	1,084	1,081
Additional paid-in capital	1,557,640	1,543,127
Accumulated deficit	(192,185)	(204,023)
Accumulated other comprehensive income (loss)	17,123	(32,390)
Total stockholders' equity	1,383,662	1,307,795
Noncontrolling interest in subsidiaries	36,603	36,821
Total liabilities and equity	\$3,534,066	\$3,490,607

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of ContentsVERIFONE SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended January 31,	
	2013	2012
	(Unaudited, in thousands)	
Cash flows from operating activities		
Consolidated net income (loss)	\$ 11,710	\$ (2,774)
Adjustments to reconcile consolidated net income (loss) to net cash provided by operating activities:		
Depreciation and amortization, net	50,932	31,859
Stock-based compensation expense	12,359	10,704
Non-cash interest expense	—	4,112
Deferred income taxes	(3,934	) (8,490)
Gain on divestiture of assets	(4,080) —
Write-off of debt issuance costs upon debt extinguishment	—	2,115
Other	(987	) (1,804)
Net cash provided by operating activities before changes in operating assets and liabilities	66,000	35,722
Changes in operating assets and liabilities, net of effects of business acquisitions:		
Accounts receivable, net	13,235	17,154
Inventories, net	(8,072	) (1,994)
Prepaid expenses and other assets	(1,832	) (10,694)
Accounts payable	(39,297	) (10,913)
Deferred revenue, net	28,175	28,589
Other current and long term liabilities	(4,778	) (25,696)
Net change in operating assets and liabilities	(12,569	) (3,554)
Net cash provided by operating activities	53,431	32,168
Cash flows from investing activities		
Capital expenditures	(20,789	) (8,010)
Acquisition of businesses, net of cash and cash equivalents acquired	(1,000	) (1,067,517)
Proceeds from divestiture of assets	6,000	—
Other investing activities, net	132	7
Net cash used in investing activities	(15,657	) (1,075,520)
Cash flows from financing activities		
Proceeds from debt, net of issuance costs	2,427	1,409,177
Repayments of debt	(18,506	) (307,760)
Repayments of senior convertible notes, including interest	—	(279,159)
Proceeds from issuance of common stock through employee equity incentive plans	2,965	8,812
Payments of acquisition-related contingent consideration	(4,993) —
Distribution to noncontrolling interest stockholders	(134	) (135)
Net cash provided by (used in) financing activities	(18,241	) 830,935
Effect of foreign currency exchange rate changes on cash and cash equivalents	3,063	(2,166)
Net increase (decrease) in cash and cash equivalents	22,596	(214,583)
Cash and cash equivalents, beginning of period	454,072	594,562
Cash and cash equivalents, end of period	\$ 476,668	\$ 379,979

The accompanying notes are an integral part of these condensed consolidated financial statements.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Unaudited

Note 1. Principles of Consolidation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of VeriFone Systems, Inc. (“we,” “us,” “our,” “VeriFone,” and “the Company” refer to VeriFone Systems, Inc. and its consolidated subsidiaries) as of January 31, 2013 and October 31, 2012, and for the three months ended January 31, 2013 and 2012, have been prepared in accordance with GAAP (U.S. generally accepted accounting principles) for interim financial information and with the instructions on Form 10-Q pursuant to the rules and regulations of the SEC (U.S. Securities and Exchange Commission). In accordance with those rules and regulations, we have omitted certain information and notes normally provided in our annual consolidated financial statements. In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments, consisting only of normal recurring items, necessary for the fair presentation of our financial position and results of operations for the interim periods. These unaudited condensed consolidated financial statements should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2012. The results of operations for the three months ended January 31, 2013 are not necessarily indicative of the results expected for the entire fiscal year.

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of VeriFone Systems, Inc. and our wholly-owned and majority-owned subsidiaries. The accompanying unaudited Condensed Consolidated Financial Statements also include the results of companies acquired by us from the date of each acquisition. All significant inter-company accounts and transactions have been eliminated. Amounts pertaining to the noncontrolling ownership interests held by third parties in the operating results and financial position of our majority-owned subsidiaries are reported as "Net income (loss) attributable to noncontrolling interests" in our unaudited Condensed Consolidated Statements of Operations and as "Redeemable noncontrolling interest in subsidiary" on our unaudited Condensed Consolidated Balance Sheets when the third party ownership interest is redeemable at the option of the stockholder, outside of our control, and as "Noncontrolling interest in subsidiaries" on our unaudited Condensed Consolidated Balance Sheets in all other cases.

The condensed consolidated balance sheet at October 31, 2012 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements.

Certain prior period amounts reported in our unaudited Condensed Consolidated Financial Statements and Notes thereto have been reclassified to conform to the current period presentation, with no impact on previously reported operating results or financial position.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions about future events that affect the amounts reported in the Condensed Consolidated Financial Statements and accompanying Notes to Condensed Consolidated Financial Statements. The estimates and judgments affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. On an ongoing basis, we evaluate our estimates including those related to revenues, product returns, warranty obligations, bad debts, inventories, goodwill and intangible assets, income taxes, contingencies, share-based compensation, and litigation, among others. We base our estimates on historical experience and information available to us at the time these estimates are made. Actual results could differ materially from these estimates.

Significant Accounting Policies

During the three months ended January 31, 2013, there have been no changes in our significant accounting policies as described in our Annual Report on Form 10-K for the fiscal year ended October 31, 2012.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Concentrations of Credit Risk

For the three months ended January 31, 2013 and 2012, no single customer accounted for more than 10% of our total net revenues. For the three months ended January 31, 2013 and 2012, no single customer accounted for more than 10% of net revenues in either of our two reportable segments. As of January 31, 2013 and October 31, 2012, no single customer accounted for more than 10% of our total net accounts receivable.

Recent Accounting Pronouncements

During the three months ended January 31, 2013, we adopted ASU (Accounting Standards Update) 2011-05, Comprehensive Income (Topic 22)-Presentation of Comprehensive Income, which changed our condensed consolidated financial statements to present components of other comprehensive income in a separate statement. This change impacted only the financial statement presentation and had no impact on our financial position or results of operations.

We also adopted ASU 2012-02, Intangibles-Goodwill and Other (Topic 350)-Testing Indefinite-Lived Intangible Assets for Impairment, which provides us with the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that an indefinite-lived intangible asset other than goodwill is impaired. Adoption of this guidance had no impact on our financial position or results of operations.

In February 2013, the FASB (Financial Accounting Standards Board) issued ASU (Accounting Standards Update) 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU 2013-02 requires presentation of the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source, and the income statement line items affected by the reclassification. The information may be presented either in a single note or parenthetically on the face of the financial statements, provided that all of the required information is presented in a single location. If a component is not required to be reclassified to net income in its entirety, we may instead provide a reference to the related footnote. ASU 2013-02 is effective for us in our second quarter of fiscal year 2013, and will only change our financial statement presentation.

Note 2. Business Combinations

Pending Fiscal Year 2013 Acquisitions

EFTPOS New Zealand Limited and Sektor Payment Limited

On December 17, 2012, we signed a sale and purchase agreement with ANZ Bank New Zealand Limited to acquire all the outstanding shares of EFTPOS (EFTPOS New Zealand Limited) for approximately 70.0 million New Zealand dollars (approximately \$58.6 million at foreign exchange rates as of January 31, 2013). Upon completion of the acquisition, EFTPOS will be our wholly-owned subsidiary and will hold the switching and terminal business of ANZ Bank New Zealand Limited.

Also, on December 17, 2012, we signed an asset sale and purchase agreement to acquire the business of Sektor Payments Limited for approximately \$8.0 million. Sektor Payments Limited is our main distributor in New Zealand.

We expect to close these acquisitions during our second or third quarter of fiscal year 2013.

Fiscal Year 2013 Divestiture

On January 25, 2013, we signed an agreement to sell to a third party for \$6.0 million certain assets and business operations related to our SAIL mobile payment product. The transaction closed on January 31, 2013. The results of operations of the SAIL product from its launch in May 2012 until its divestiture in January 2013, as well as the gain on the sale, are immaterial in relation to our overall financial position and results of operations.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Fiscal Year 2012 Acquisitions

Point Acquisition

On December 30, 2011, we completed our acquisition of Point (Electronic Transaction Group Nordic Holding AB), a Swedish company operating the Point International business, Northern Europe's largest provider of payment and gateway services and solutions for retailers. The purchase price was approximately €600.0 million (approximately USD \$774.3 million at foreign exchange rates on the acquisition date), plus repayment of Point's outstanding multi-currency debt of €193.3 million (approximately \$250.2 million at exchange rates on the acquisition date), for a total cash purchase price of \$1,024.5 million, based on exchange rates at the acquisition date. The source of funds for the cash consideration was the 2011 Credit Agreement that is described further in Note 10, Financings. We acquired Point to, among other things, provide a broader set of product and service offerings to customers globally, including expansion in the Northern European markets.

As a result of the acquisition, Point became our wholly-owned subsidiary. One subsidiary of Point, Babs Paylink AB, is owned 51% by Point and 49% by a third party that has a noncontrolling interest. The acquisition of Point was accounted for using the acquisition method of accounting. The results of operations for the acquired businesses have been included in our financial results since the acquisition date.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed (in thousands) as part of our acquisition of Point.

Liabilities assumed, net of assets acquired	\$(81,415)
Intangible assets	567,007	
Goodwill	575,704	
Noncontrolling interest in Babs Paylink AB	(36,764)
Total purchase price	\$1,024,532	

The estimated fair value of acquired contingent consideration owed by Point related to its prior acquisitions was \$20.4 million as of the acquisition date. This contingent consideration is payable in cash if certain operating and financial targets are achieved in the two years following the dates of those acquisitions. The payout criteria for the contingent consideration contain provisions for prorated payouts if the target criteria are not met, provided that certain minimum thresholds are achieved. Subsequent to the acquisition of Point, through January 31, 2013, we have paid \$19.5 million of the contingent consideration. The \$1.0 million remaining balance accrued at January 31, 2013 is expected to be paid during the quarter ending October 31, 2013 and is presented as acquisition earn-out payables in Accruals and Other Current Liabilities on our Condensed Consolidated Balance Sheets. As of January 31, 2013, the maximum contingent consideration payable, if all the financial performance targets were met totals \$4.7 million.

Other Fiscal Year 2012 Acquisitions

During fiscal year 2012, in addition to Point, we completed acquisitions of other businesses and net assets described in the table below for an aggregate purchase price of \$81.5 million. The \$81.5 million aggregate purchase price includes \$6.4 million of holdback payments that will be paid between 12 to 15 months after the date the respective acquisitions closed, and contingent consideration having a fair value as of the respective acquisition dates totaling \$3.8 million.

The holdback amounts will be paid out to selling stockholders unless the general representations and warranties made by the sellers as of the acquisition date were untrue and are presented as deferred acquisition consideration payable in Accruals and Other Current Liabilities on our Condensed Consolidated Balance Sheets. The contingent consideration

will be payable in cash for the ChargeSmart and LIFT Retail acquisitions, if certain operating and financial targets are achieved in the first three years of operations after the acquisition. The payout criteria for the contingent consideration contain provisions for prorated payouts if the target criteria are not met, provided that certain minimum thresholds are achieved. The contingent consideration was valued at \$0.4 million and \$3.4 million for the ChargeSmart and LIFT Retail acquisitions as of the respective acquisition dates, and the maximum contingent consideration payable under the purchase agreements, if all the financial performance targets were met, totaled \$11.0 million and \$8.0 million for the ChargeSmart and LIFT Retail acquisitions. To date, we have not paid any amounts under these arrangements although certain measurement dates have passed. Including imputed interest, the amount accrued for this contingent consideration at January 31, 2013 totals \$2.7 million and is presented as acquisition-related earn-out payables in Other long-term liabilities on our Condensed Consolidated Balance Sheets. The remaining maximum payouts for this contingent

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

consideration, if all remaining financial performance targets are met, total \$5.0 million and \$8.0 million for the ChargeSmart and LIFT Retail acquisitions.

The acquisition of each company was accounted for using the acquisition method of accounting. No VeriFone equity interests were issued, and in each transaction 100% of the voting equity interests of the applicable business was acquired, except for Show Media, which was an acquisition of assets and assumption of certain liabilities. The results of operations for the acquired businesses have been included in our financial results since their respective acquisition dates.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed (in thousands) at the acquisition date of each transaction.

	LIFT Retail	ChargeSmart	Show Media	Global Bay	Total
Acquisition date	March 1, 2012	January 3, 2012	November 1, 2011	November 1, 2011	
Assets acquired (liabilities assumed), net	\$477	\$(4,225)	) \$1,593	\$(4,608)	) \$(6,763)
Intangible assets	1,600	9,770	6,660	14,490	32,520
Goodwill	4,417	13,829	19,871	17,630	55,747
Total purchase price	\$6,494	\$19,374	\$28,124	\$27,512	\$81,504

Acquisition-Related Costs

Certain costs directly related to our acquisitions are recorded as expenses in our Condensed Consolidated Statements of Operations. These acquisition-related costs consist of external expenses directly related to our acquisitions and include expenditures for professional fees such as banking, legal, accounting and other directly related incremental costs incurred to close the acquisition.

The following table presents a summary of acquisition-related costs included in our Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended January 31,	
	2013	2012
Sales and marketing	\$—	\$118
General and administrative	463	6,934
Total acquisition-related costs	\$463	\$7,052

Note 3. Net Income (Loss) per Share of Common Stock

Basic net income (loss) per share of common stock is computed by dividing net income or loss by the weighted average number of shares of common stock outstanding for the period. Diluted net income (loss) per share of common stock is computed using the weighted average number of shares of common stock outstanding plus the effect of common stock equivalents, unless the common stock equivalents are anti-dilutive. The potential dilutive shares of our common stock resulting from assumed exercises of equity related instruments are determined using the treasury stock method. Under the treasury stock method, an increase in the fair market value of our common stock will result in a greater number of dilutive securities.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

The following table presents the computation of net income (loss) per share of common stock (in thousands, except per share data):

	Three Months Ended January 31,	
	2013	2012
Basic and diluted net income (loss) per share attributable to VeriFone Systems, Inc. stockholders:		
Numerator:		
Net income (loss) attributable to VeriFone Systems, Inc. stockholders	\$11,838	\$(3,124)
Denominator:		
Weighted average shares attributable to VeriFone Systems, Inc. stockholders - basic	107,934	105,833
Weighted average effect of dilutive securities:		
Employee equity incentive plans	2,624	—
Weighted average shares attributable to VeriFone Systems, Inc. stockholders - diluted	110,558	105,833
Net income (loss) per share attributable to VeriFone Systems, Inc. stockholders:		
Basic	\$0.11	\$(0.03)
Diluted	\$0.11	\$(0.03)

For the three months ended January 31, 2013 and 2012, equity incentive awards to purchase 4.3 million and 10.0 million shares of common stock were excluded from the calculation of weighted average shares for diluted net income (loss) per share as they were anti-dilutive. These awards could impact future calculations of diluted net income (loss) per share if the fair market value of our common stock increases.

The diluted weighted average shares attributable to VeriFone Systems, Inc. stockholders for the three months ended January 31, 2012 does not include the anti-dilutive effects of the senior convertible notes or the note hedge transactions on those notes, both of which were outstanding as of January 31, 2012. The senior convertible notes were considered to be Instrument C securities, and therefore, only the conversion spread relating to the notes would be included in our diluted earnings per share calculation, if dilutive. The conversion spread of the notes had a dilutive effect when the average share price of our common stock during any quarter exceeded \$44.02. The average share price of our common stock for the three months ended January 31, 2012 did not exceed \$44.02, and therefore the effect of the senior convertible notes was anti-dilutive for that period. The senior convertible notes were repaid in full in June 2012 without any conversion rights having been exercised. In connection with the offering of the senior convertible notes, we entered into note hedge transactions. The note hedge transactions would have reduced the dilution attributable to the senior convertible notes by 50% if and when the notes had been converted and the note hedge transactions exercised. The note hedge transactions outstanding at January 31, 2012 expired unused in June 2012.

Warrants to purchase 7.2 million shares of our common stock were outstanding at January 31, 2013 and 2012. The warrants were not included in the computation of diluted earnings per share because the warrants' \$62.356 exercise price was greater than the average share price of our common stock during the three months ended January 31, 2013 and 2012. Therefore, the effect of the warrants was anti-dilutive for those periods.

Additionally, all shares attributable to the equity incentive awards, senior convertible notes and warrants at January 31, 2012 were anti-dilutive because we incurred a net loss for the three months ended January 31, 2012.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Note 4. Employee Benefit Plans

Equity Incentive Plans

We grant stock awards, including stock options, RSUs (restricted stock units) and RSAs (restricted stock awards) pursuant to stockholder-approved equity incentive plans. Our stock awards include vesting provisions that are based on either time, performance, or market conditions. These equity incentive plans are described in further detail in Note 4, Employee Benefits Plan, of Notes to Consolidated Financial Statements in our 2012 Annual Report on Form 10-K. All stock awards granted during the three months ended January 31, 2013 were granted under the 2006 Equity Incentive Plan, as amended. The number of shares available for future grants under the 2006 Equity Incentive Plan was 0.7 million as of January 31, 2013. Shares issued to employees on the exercise or vesting of equity incentive awards are issued from authorized unissued common stock.

Equity Incentive Plan Activity

The following table provides a summary of stock option activity for the three months ended January 31, 2013:

	Shares Under Option (Thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (Thousands)
Outstanding at October 31, 2012	8,000	\$23.93		
Granted	302	\$29.75		
Exercised	(249)	) \$11.90		
Canceled	(216)	) \$34.94		
Expired	(54)	) \$36.12		
Outstanding at January 31, 2013	7,783	\$24.15	4.6	\$95,073
Vested or expected to vest at January 31, 2013	7,460	\$23.71	4.5	\$94,210
Exercisable at January 31, 2013	4,441	\$19.51	3.7	\$72,433

The weighted-average grant-date fair value per share for stock options granted during the three months ended January 31, 2013 and 2012 was \$11.29 and \$17.65.

The total proceeds received from employees as a result of employee stock option exercises for the three months ended January 31, 2013 and 2012 were \$3.0 million and \$8.8 million. We recognized no tax benefit in the three months ended January 31, 2013 related to employee stock option exercises, and \$0.1 million of tax benefits in the three months ended January 31, 2012. The total intrinsic value of options exercised during the three months ended January 31, 2013 and 2012 was \$5.0 million and \$13.0 million.

The following table summarizes RSU and RSA balances as of January 31, 2013 and October 31, 2012, as well as activity for the three months ended January 31, 2013:

	Shares (Thousands)	Aggregate Intrinsic Value (Thousands)
Outstanding at October 31, 2012	1,913	

Granted	703	
Released	(132)
Canceled	(37)
Outstanding at January 31, 2013	2,447	\$84,948
Expected to vest at January 31, 2013	2,148	\$74,582
Ending vested and deferred at January 31, 2013	623	\$21,636

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

There were no RSAs granted during the three months ended January 31, 2013. RSUs granted during the three months ended January 31, 2013 included grants with time and performance based vesting conditions. The vesting conditions of the performance-based RSUs are contingent upon meeting certain financial and operational targets. One of these performance-based RSUs is a long-term incentive grant to our Chief Executive Officer that vests based on our achievement of total shareholder return relative to peers on a stacked-ranking basis over a three year performance period ("LTIG"). All other performance grants vest upon meeting internal financial and operational targets. The vesting conditions of all of these grants were set by the compensation committee of the board of directors at the time of the grant.

We had a total of 2.4 million RSUs and 0.1 million RSAs outstanding as of January 31, 2013.

The weighted-average grant-date fair value per share for RSUs granted during the three months ended January 31, 2013 and 2012, was \$31.00 and \$38.54.

The total fair value of RSUs and RSAs that vested in the three months ended January 31, 2013 and 2012 was \$4.0 million and \$7.4 million.

Equity Incentive Award Valuations

We estimate the grant-date fair value of stock options using the Black-Scholes-Merton valuation model, using the following weighted-average assumptions:

	Three Months Ended January 31,			
	2013	2012		
Expected term (in years)	3.5	3.6		
Risk-free interest rate	0.6	% 0.7		%
Expected dividend rate	0.0	% 0.0		%
Expected stock price volatility over option expected term	51.0	% 67.4		%

The grant-date fair value of the LTIG granted in January 2013 is determined using the Monte Carlo simulation method assuming the following (i) expected term of 3.0 years, (ii) risk free interest rate of 0.37%, (iii) expected dividend rate of zero and (iv) expected stock price volatility over the expected term of the LTIG of 47.24%. The grant-date fair value of all other RSUs is equal to the closing market price of our common stock on the date of grant. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive equity awards.

These assumptions used to value our awards are determined as follows:

The expected term of the options granted is derived from the historical actual term of previous grants and an estimate of future exercises during the remaining contractual period of the award, and represents the period of time that awards granted are expected to be outstanding.

The expected term of the LTIG is the contractual term of the award.

The average risk-free interest rate is based on the U.S. Treasury zero-coupon issues with a remaining term equal to the expected term of the awards.

The dividend yield assumption is based on our dividend history and future expectations of dividend payouts.

The expected stock price volatility considers the historical volatility of common stock for the expected term of the awards, and includes the elements listed below at the weighted percentages presented:

Three Months Ended January 31,

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	2013	2012	
Historical volatility of our common stock	95.0	% 75.0	%
Historical volatility of comparable companies' common stock	0.0	% 20.0	%
Implied volatility of our traded common stock options	5.0	% 5.0	%

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

We placed the greatest weighting on the historic volatility of our common stock because we believe that, in general, it is representative of our expected volatility. However, our stock price during the second half of calendar year 2007 and most of calendar year 2008 was significantly impacted by our announcement on December 3, 2007 of a restatement of certain of our financial statements. Our restated financial statements were filed on August 19, 2008. Given that the historic volatility of our common stock over the then-expected term of the awards included the volatility during this restatement period, which we do not believe is representative of our expected volatility, we also used peer group data and implied volatility in our stock price volatility calculation during fiscal quarters ended prior to July 31, 2012. We included peer group data in an effort to capture a broader view of the marketplace over the expected term of the awards. We included the implied volatility of our traded options to capture market expectations regarding our stock price. In determining the weighting between our peer group data and implied volatility, we accorded less weighting to our implied volatility because there is a relatively low volume of trades and the terms of the traded options are shorter than the expected term of our share awards. Beginning with our fiscal quarter ended July 31, 2012, we have historical volatility data for our common stock for a period of time that covers the expected term of the awards, and that we believe provides a reasonable basis for an estimation of our expected volatility. Accordingly, as of the fiscal quarter ended July 31, 2012 we no longer use historic volatility of comparable companies' common stock in our weighting percentages.

Our computation of stock-based compensation expense also includes an estimate of award forfeitures based on historical experience. We record compensation expense only for those awards that are expected to vest.

Stock-Based Compensation Expense

The following table presents the stock-based compensation expense recognized in our Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended January 31,	
	2013	2012
Cost of net revenues	\$547	\$479
Research and development	1,617	1,253
Sales and marketing	4,093	4,262
General and administrative	6,102	4,710
Total stock-based compensation	\$12,359	\$10,704

As of January 31, 2013, total unrecognized compensation expense adjusted for estimated forfeitures related to unvested stock options was \$38.4 million and related to unvested RSUs and RSAs was \$42.5 million, which is expected to be recognized over the remaining weighted-average vesting periods of 2.4 years for stock options and 2.3 years for RSUs and RSAs.

Note 5. Income Taxes

We recorded income tax expense of \$2.5 million for the three months ended January 31, 2013 and an income tax benefit of \$9.8 million for the three months ended January 31, 2012. The effective tax rates for the three months ended January 31, 2013 and 2012 are lower than the U.S. statutory tax rate primarily due to earnings in countries where we are taxed at lower rates compared to the U.S. federal and state statutory rates, reversal of uncertain tax position liabilities as statutes of limitations expired and reinstatement of a prior year research credit as a result of the American Taxpayer Relief Act of 2012. The income tax expense for the three months ended January 31, 2013 includes a discrete tax benefit of \$1.3 million related to the reinstatement of such prior year research credit. The income tax benefit for the three months ended January 31, 2012 includes a discrete tax benefit of \$8.5 million related to the foreign exchange

loss on future contracts that was incurred during December 2011.

As of January 31, 2013, on a worldwide basis we remain in a net deferred tax asset position of \$30.0 million. The realization of our deferred tax assets depends primarily on our ability to generate sufficient U.S. and foreign taxable income in future periods. The amount of deferred tax assets considered realizable may increase or decrease in future periods as we continue to evaluate the underlying basis for our estimates of future U.S. and foreign taxable income in subsequent matters.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Our unrecognized tax benefits increased by approximately \$0.1 million during the three months ended January 31, 2013 as a result of tax positions taken in prior periods. The amount of unrecognized tax benefits could be reduced upon closure of tax examinations or if the statute of limitations on certain tax filings expires without assessment from the relevant tax authorities. We believe that it is reasonably possible that there could be a reduction in unrecognized tax benefits due to statute of limitation expirations in multiple tax jurisdictions during the next twelve months of approximately \$1.5 million. Interest and penalties accrued on these uncertain tax positions will also be released upon the expiration of statutes of limitations.

Note 6. Balance Sheet and Statement of Operations Details

Cash

Cash and cash equivalents as of January 31, 2013 and October 31, 2012 included \$392.1 million and \$410.3 million held by our foreign subsidiaries. If we decide to distribute or use such cash and cash equivalents outside those foreign jurisdictions, including a distribution to the U.S., we may be subject to additional taxes or costs.

We had \$5.2 million and \$4.1 million of restricted cash included in Prepaid expenses and other current assets in our Condensed Consolidated Balance Sheets as of January 31, 2013 and October 31, 2012. We had \$13.5 million and \$12.8 million of restricted cash included in Other long-term assets in our Condensed Consolidated Balance Sheets as of January 31, 2013 and October 31, 2012. These restricted cash balances were mainly comprised of pledged deposits, deposits for irrevocable standby letters of credit, and deposits to secure bank guarantees to customers, other counterparties to contractual relationships, and government agencies.

Inventories

Inventories consisted of the following (in thousands):

	January 31, 2013	October 31, 2012
Raw materials	\$53,430	\$50,952
Work-in-process	1,820	552
Finished goods	133,533	126,770
Total inventory	\$188,783	\$178,274

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following (in thousands):

	January 31, 2013	October 31, 2012
Prepaid expenses	\$43,818	\$37,261
Deferred income taxes	40,193	39,072
Prepaid taxes	29,483	36,678
Other receivables	7,483	12,715
Restricted cash	5,181	4,149
Bankers acceptances receivable	5,079	2,151
Investment in equity security and warrants	3,073	2,667
Other current assets	3,865	1,517
Total prepaid expenses and other current assets	\$138,175	\$136,210

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Fixed Assets, Net

Fixed assets, net consisted of the following (in thousands):

	Estimated Useful Life (Years)	January 31, 2013	October 31, 2012
Revenue generating assets	5	\$113,725	\$101,589
Computer hardware and software	3-5	72,700	70,064
Machinery and equipment	3-10	39,174	35,865
Leasehold improvements	Lesser of the term of the lease or the estimated useful life	22,471	20,773
Office equipment, furniture, and fixtures	3-5	9,993	9,423
Buildings	40-50	6,801	6,788
Depreciable fixed assets, at cost		264,864	244,502
Accumulated depreciation		(122,152)	(106,688)
Depreciable fixed assets, net		142,712	137,814
Construction in progress	—	8,247	7,838
Land	—	1,148	1,151
Fixed assets, net		\$152,107	\$146,803

Total depreciation expense for depreciable fixed assets for the three months ended January 31, 2013 and 2012 was \$12.3 million and \$9.0 million.

Other Long-Term Assets

Other long-term assets consisted of the following (in thousands):

	January 31, 2013	October 31, 2012
Debt issuance costs, net	\$29,786	\$31,897
Capitalized software development costs, net	14,329	12,238
Long-term restricted cash	13,541	12,754
Deposits	7,479	9,068
Long-term receivables	6,990	7,531
Other long-term assets	9,984	5,545
Total other long-term assets	\$82,109	\$79,033

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Accruals and Other Current Liabilities

Accruals and other current liabilities consisted of the following (in thousands):

	January 31, 2013	October 31, 2012
Accrued expenses	\$68,200	\$68,431
Accrued compensation	44,410	47,019
Accrued patent litigation loss contingency, including interest (Note 11)	19,323	18,981
Sales and value-added taxes payable	17,733	12,461
Accrued liabilities for contingencies	17,183	20,863
Accrued warranty	12,791	11,931
Deferred tax liabilities - current portion	9,684	9,594
Income taxes payable	8,776	13,577
Deferred acquisition consideration payable - current portion	5,739	7,980
Acquisition-related earn-out payables - current portion	1,249	6,131
Other current liabilities	16,084	13,899
Total accruals and other current liabilities	\$221,172	\$230,867

Accrued Warranty

Activity related to Accrued warranty consisted of the following (in thousands):

	Three months ended January 31, 2013	Year Ended October 31, 2012
Balance at beginning of period	\$12,775	\$22,032
Warranty charged to cost of net revenues	3,282	12,340
Utilization of warranty accrual	(2,992)	(20,494)
Acquired warranty obligations	—	348
Changes in estimates	441	(1,451)
Balance at end of period	13,506	12,775
Less: current portion	(12,791)	(11,931)
Long-term portion	\$715	\$844

Deferred Revenue, Net

Deferred revenue, net of related costs consisted of the following (in thousands):

	January 31, 2013	October 31, 2012
Deferred revenue	\$185,647	\$144,492
Deferred cost of revenue	(27,588)	(15,885)
Deferred revenue, net	158,059	128,607
Less current portion	(119,003)	(91,545)
Long-term portion	\$39,056	\$37,062

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Other Long-Term Liabilities

Other long-term liabilities consisted of the following (in thousands):

	January 31, 2013	October 31, 2012
Long-term income tax liabilities	\$44,275	\$44,144
Statutory retirement and pension obligations - non-current portion	12,017	10,983
Acquisition-related earn-out payables - non-current portion	2,739	2,832
Other long-term liabilities	12,079	12,481
Total other long-term liabilities	\$71,110	\$70,440

Redeemable Noncontrolling Interest in Subsidiary

The redeemable noncontrolling interest related to ABS (All Business Solutions S.R.L.) is recognized at the greater of the initial carrying amount increased or decreased for the noncontrolling interest's share of net income or loss or its redemption value. As of January 31, 2013 and October 31, 2012, the carrying amount of the redeemable noncontrolling interests was \$0.8 million and \$0.9 million.

Noncontrolling Interest in Subsidiaries

Changes in Noncontrolling interest in subsidiaries are set forth below (in thousands):

	Three months ended January 31, 2013	Year Ended October 31, 2012
Balance at beginning of period	\$36,821	\$445
Additions due to acquisitions	—	36,781
Distributions to noncontrolling interest stockholders	(134	) (1,673
Net income attributable to noncontrolling interest in subsidiaries, net	(84	) 1,268
Balance at end of period	\$36,603	\$36,821

Other Income (Expense), net

Other income (expense), net consisted of the following (in thousands):

	Three Months Ended January 31, 2013	2012
Foreign currency exchange losses, net	\$(3,519	) \$(21,005
Gain on divestiture	4,080	—
Gain on reversal of pre-acquisition contingency	1,858	—
Other income (expense), net	1,521	156
Total other income (expense), net	\$3,940	\$(20,849

We recorded a \$22.5 million foreign currency loss in December 2011 related to the difference between the forward rate on contracts purchased to fix the U.S. dollar equivalent of the purchase price for our Point acquisition, and the actual rate on the date of derivative settlement. This loss was partially offset by a \$1.5 million gain on the currency we held from the date of the derivative settlement until the funds were transferred to purchase Point.

On January 25, 2013, VeriFone signed an agreement to sell to a third party for \$6.0 million certain assets and business operations related to our SAIL mobile payment product. The transaction closed on January 31, 2013 and resulted in a

\$4.1 million gain, which is recorded within Other Income (Expense), net.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Note 7. Fair Value Measurements

Our financial assets and liabilities are measured and recorded at fair value on a recurring basis, except for our debt. Our non-financial assets, such as goodwill, purchased intangible assets, and property, plant and equipment are measured at fair value when there is an indicator of impairment and recorded at fair value only when an impairment charge is recognized.

We define fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining fair value, we consider the principal or most advantageous market in which we would transact, and we consider assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of non-performance.

We follow a three-level fair value hierarchy based on the inputs used in measuring fair value:

Level 1 — Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 — Other inputs that are directly or indirectly observable in the marketplace.

Level 3 — Unobservable inputs which are supported by little or no market activity.

Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis

There were no transfers between fair value measurement levels during the three months ended January 31, 2013. The following table presents our assets and liabilities that were measured at fair value on a recurring basis as of January 31, 2013 and October 31, 2012, and their classification within the fair value hierarchy (in thousands):

	January 31, 2013			
	Carrying Value	Quoted Price in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Current assets:				
Cash and cash equivalents				
Money market funds (1)	\$49,766	\$49,766	\$—	\$—
Prepaid expenses and other current assets				
Marketable equity investment (2)	2,840	2,840	—	—
Equity warrants (3)	232	—	232	—
Foreign exchange forward contracts not designated as cash flow hedges (4)	59	—	59	—
Total assets measured and recorded at fair value	\$52,897	\$52,606	\$291	\$—
Liabilities				
Current liabilities:				
Accruals and other current liabilities				
Acquisition related earn-out payables (5)	\$1,249	\$—	\$—	\$1,249
Interest rate swaps designated as cash flow hedges (6)	2,404	—	2,404	—
	364	—	364	—

Foreign exchange forward contracts not designated as cash flow hedges (4)				
Other long-term liabilities				
Acquisition related earn-out payables (5)	2,739	—	—	2,739
Interest rate swaps designated as cash flow hedges (6)	1,541	—	1,541	—
Total liabilities measured and recorded at fair value	\$8,297	\$—	\$4,309	\$3,988

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

	October 31, 2012			
	Carrying Value	Quoted Price in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Current assets:				
Cash and cash equivalents				
Money market funds (1)	\$69,743	\$69,743	\$—	\$—
Prepaid expenses and other current assets				
Marketable equity investment (2)	2,471	2,471	—	—
Equity warrants (3)	196	—	196	—
Foreign exchange forward contracts not designated as cash flow hedges (4)	161	—	161	—
Total assets measured and recorded at fair value	\$72,571	\$72,214	\$357	\$—
Liabilities				
Current liabilities:				
Accruals and other current liabilities				
Acquisition related earn-out payables (5)	\$6,131	\$—	\$—	\$6,131
Interest rate swaps designated as cash flow hedges (6)	2,451	—	2,451	—
Foreign exchange forward contracts not designated as cash flow hedges (4)	291	—	291	—
Other long-term liabilities				
Acquisition related earn-out payables (5)	2,832	—	—	2,832
Interest rate swaps designated as cash flow hedges (6)	2,168	—	2,168	—
Total liabilities measured and recorded at fair value	\$13,873	\$—	\$4,910	\$8,963

1. Money market funds are classified as Level 1 because we determine the fair value of the funds using quoted market prices in markets that are active.

2. The marketable equity investment is classified as Level 1 because we determine the fair value using quoted market prices in markets that are active.

3. The equity warrants are classified as Level 2 because we determine the fair value using the Black-Scholes-Merton valuation model considering quoted market prices for the underlying shares, the treasury risk free interest rate, historic volatility and the remaining contractual term of the warrant.

4. The foreign exchange forward contracts are classified as Level 2 because we determine the fair value using quoted market prices and other observable data for similar instruments in an active market.

5. The acquisition related earn-out payables are classified as Level 3 because we use a probability-weighted expected payout model to determine the expected payout and an appropriate discount rate to calculate the fair value. The key assumptions in applying the approach are the internally forecasted net revenues, contributions, and other performance measures for the acquired businesses, the probability of achieving the net revenues, contribution, and other performance targets and an appropriate discount rate. Significant increases in the probability of achieving net revenues, contribution, and other performance targets in isolation would result in a significantly higher fair value

measurement while significant decreases in the probability of success in isolation would result in a significantly lower fair value measurement. Similarly, significant increases in the discount rate in isolation would result in a significantly lower fair value measurement while significant decreases in the discount rate in isolation would result in a significantly higher fair value measurement. We evaluate changes in each of the assumptions used to calculate fair values of our earn-out payable at the end of each period.

Interest rate swaps are classified as Level 2 because we determine the fair value using observable market inputs, such as the one month LIBOR forward pricing curve, as well as credit default spreads reflecting nonperformance risks of counterparties.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Fair Value of Acquisition-Related Earn-out Payables

The following table presents a reconciliation for our earn-out payables measured and recorded at fair value on a recurring basis, using Level 3 significant unobservable inputs (in thousands):

	Three months ended January 31, 2013	Year Ended October 31, 2012
Balance at beginning of period	\$8,963	\$6,728
Additions related to current period business acquisitions	—	24,149
Payments	(3,287	) (23,541
Changes in estimates, included in Other income (expense), net	(1,858	) 407
Interest expense	307	1,079
Foreign currency adjustments	(137	) 141
Balance at end of period	\$3,988	\$8,963
Less: current portion	1,249	6,131
Non-current portion	\$2,739	\$2,832

As of January 31, 2013, the total gross earn-out payable, if all the financial performance targets were met would have been \$18.0 million.

Fair Value of Other Financial Instruments

Other financial instruments consisted principally of cash, accounts receivable, accounts payable and long-term debt. The estimated fair value of cash, accounts receivable, and accounts payable approximates their carrying value. The estimated fair value of our Term A loan, Term B loan, and Revolving loan approximates the carrying value because the interest rate on such debt adjusts to market rates on a periodic basis.

Note 8. Goodwill and Purchased Intangible Assets

Goodwill

Activity related to goodwill consisted of the following (in thousands):

	Three months ended January 31, 2013	Year Ended October 31, 2012
Balance at beginning of period	\$1,179,381	\$561,414
Additions related to business combinations	538	631,470
Divestiture of certain assets related to SAIL mobile payment product	(507) —
Adjustment related to prior fiscal year acquisitions	—	1,632
Currency translation adjustments	26,596	(15,135
Balance at end of period	\$1,206,008	\$1,179,381

Goodwill is not amortized. We review goodwill for impairment annually, and whenever events or changes in circumstances indicate its carrying amount may not be recoverable. Based on our review for potential indicators of impairment performed during the three months ended January 31, 2013 and the fiscal year ended October 31, 2012, there were no indicators of impairment.

As of both January 31, 2013 and October 31, 2012, the accumulated impairment losses included in total goodwill were \$372.4 million for our International segment and \$65.5 million for our North America segment, excluding impacts of foreign currency fluctuations.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

Purchased Intangible Assets

Purchased intangible assets consisted of the following (in thousands):

	January 31, 2013			October 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	\$704,302	\$(118,125)	\$586,177	\$686,773	\$(95,284)	\$591,489
Developed and core technology	175,392	(58,235)	117,157	173,545	(46,618)	126,927
Trade name	18,397	(5,434)	12,963	17,707	(4,259)	13,448
Other	3,987	(1,150)	2,837	4,214	(1,270)	2,944
Total	\$902,078	\$(182,944)	\$719,134	\$882,239	\$(147,431)	\$734,808

Amortization of purchased intangible assets was allocated as follows (in thousands):

	Three Months Ended January 31,	
	2013	2012
Included in cost of net revenues	\$11,061	\$8,489
Included in operating expenses	24,696	13,615
Total amortization of purchased intangible assets	\$35,757	\$22,104

Total future amortization expense for purchased intangible assets that have finite lives, based on our existing intangible assets and their current estimated useful lives as of January 31, 2013, is estimated as follows (in thousands):

Fiscal Years Ending October 31:	Cost of Net Revenues	Operating Expenses	Total
Remainder of fiscal year 2013	\$33,337	\$70,033	\$103,370
2014	43,601	92,773	136,374
2015	22,851	91,517	114,368
2016	14,993	86,948	101,941
2017	2,281	61,111	63,392
Thereafter	94	199,595	199,689
Total future amortization expense	\$117,157	\$601,977	\$719,134

Note 9. Derivative Financial Instruments

We use derivative financial instruments, primarily forward contracts and swaps, to manage certain of our exposures to foreign currency exchange rate and interest rate risks. Our primary objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in foreign currency exchange rates and interest rates.

Our derivatives expose us to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. However, we do seek to mitigate such risks by limiting our counterparties to major financial institutions. We do not expect losses as a result of defaults by counterparties. We use derivative financial instruments to hedge or mitigate commercial risk, and our board of directors has approved the Company's qualification for and election of the Commodity Futures Trading Commission's End User Exception to the mandatory requirement under the Dodd-Frank Wall Street Reform and Consumer Protection Act to clear derivative transactions through a registered derivatives

clearing organization. We do not use derivative financial instruments for speculative or trading purposes, nor do we hold or issue leveraged derivative financial instruments.

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VERIFONE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS— Unaudited (Continued)

We recognize the fair value of our outstanding derivative financial instruments at the end of each reporting period as either assets or liabilities on our Condensed Consolidated Balance Sheets. See Note 7, Fair Value Measurements, for a presentation of the fair value of our outstanding derivative instruments as of January 31, 2013 and October 31, 2012.

The following tables present the amounts of gains and losses on our derivative instruments for the three months ended January 31, 2013 and 2012 (in thousands):

	Three Months Ended January 31, 2013		
	Net amount of gain (loss) deferred as a component of accumulated other comprehensive income (loss)	Amount of gain (loss) reclassified from accumulated other comprehensive income (loss) into net income	Amount of gain (loss) recognized in net income immediately
Derivatives designated as hedging instruments:			
Interest rate swap agreements (1)	\$(3,945)	) \$(674) \$—
	(3,945	) (674) —