

ALLIANCE DATA SYSTEMS CORP

Form 10-K

February 28, 2008

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2007

or

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

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

Commission file number 001-15749

**ALLIANCE DATA SYSTEMS CORPORATION**

(Exact name of registrant as specified in its charter)

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<b>Delaware</b> (State or Other Jurisdiction of Incorporation or Organization)	<b>31-1429215</b> (I.R.S. Employer Identification No.)
<b>17655 Waterview Parkway,</b>  <b>Dallas, Texas</b> (Address of Principal Executive Offices)	<b>75252</b> (Zip Code)
<b>(972) 348-5100</b>  (Registrant's telephone number, including area code)	

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

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

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

**None**

(Title of Class)

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

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

Indicate by check mark if disclosure of delinquent filers 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 amendments 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 definition 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  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  No

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As of June 30, 2007, the last business day of the registrant's most recently completed second fiscal quarter, 77,456,956 shares of common stock were outstanding and the aggregate market value of the common stock held by non-affiliates of the registrant on that date was approximately \$6.0 billion (based upon the closing price on the New York Stock Exchange on June 30, 2007 of \$77.40 per share). Aggregate market value is estimated solely for the purposes of this report. This shall not be construed as an admission for the purposes of determining affiliate status.

As of February 22, 2008, 79,134,089 shares of common stock were outstanding.

### **Documents Incorporated By Reference**

Certain information called for by Part III is incorporated by reference to certain sections of the Proxy Statement for the 2008 Annual Meeting of our stockholders which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2007.

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**Caution Regarding Forward-Looking Statements**

This Form 10-K and the documents incorporated by reference herein contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may use words such as anticipate, believe, estimate, expect, intend, predict, project, and similar expressions as they relate to us or our management. When we make forward-looking statements, we are basing them on our management's beliefs and assumptions, using information currently available to us. Although we believe that the expectations reflected in the forward-looking statements are reasonable, these forward-looking statements are subject to risks, uncertainties and assumptions, including those discussed in the Risk Factors section in Item 1A of this Form 10-K and elsewhere in this Form 10-K and the documents incorporated by reference in this Form 10-K.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary materially from what we projected. Any forward-looking statements contained in this Form 10-K reflect our current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. These risks, uncertainties and assumptions include those made with respect to and any developments related to the proposed merger of the Company with an affiliate of The Blackstone Group, including the risk that conditions to closing, including the condition relating to regulatory approvals, may not be satisfied and that the proposed merger may not be consummated, as well as risks and uncertainties arising from actions that the parties to the related merger agreement or others may take in response to the filing or outcome of any litigation with respect to the proposed merger. The Company cannot provide any assurance that the conditions to closing the proposed merger will be satisfied or that the transactions will be completed. We have no intention, and disclaim any obligation, to update or revise any forward-looking statements, whether as a result of new information, future results or otherwise, except as required by law.

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**PART I**

**Item 1. Business  
Agreement and Plan of Merger**

On May 17, 2007, we entered into an Agreement and Plan of Merger by and among Aladdin Solutions, Inc. (f/k/a Aladdin Holdco, Inc., Parent ), Aladdin Merger Sub, Inc. ( Merger Sub ) and the Company (the Merger Agreement ). Under the terms of the Merger Agreement, Merger Sub will be merged with and into the Company, and as a result the Company will continue as the surviving corporation and a wholly-owned subsidiary of Parent (the Merger ). Parent and Merger Sub were formed and are controlled by affiliates of The Blackstone Group. Under the terms of the Merger Agreement, at the effective time of the Merger, each outstanding share of common stock of the Company, other than shares owned by the Company, Parent, any subsidiary of the Company or Parent, or by any stockholders who are entitled to and who properly exercise appraisal rights under Delaware law, will be cancelled and converted into the right to receive \$81.75 in cash, without interest. In addition, the Merger Agreement provides that the vesting and/or lapse of restrictions on substantially all stock options, restricted stock awards and restricted stock units will be accelerated at the effective time of the Merger and holders of such securities will receive consideration in accordance with the terms of the Merger Agreement. The Company will also accelerate the recognition of stock compensation expense resulting from the vesting of substantially all outstanding unvested stock options, restricted stock and restricted stock units in connection with the Merger. Consummation of the Merger is subject to closing conditions, including conditions relating to regulatory approvals. No assurances can be given that the conditions precedent to consummating the Merger will be satisfied or that the Merger will be consummated.

We filed our definitive proxy statement and proxy supplement with the SEC on July 5, 2007 and July 30, 2007, respectively, soliciting stockholder approval of the Merger Agreement, which was approved at a special meeting of our stockholders on August 8, 2007. We filed our Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, notification and report forms with the Federal Trade Commission and the Antitrust Division of the Department of Justice on June 1, 2007 and early termination of the applicable waiting period was granted on June 11, 2007. We filed a request for an advance ruling certificate ( ARC ) regarding the Merger under the Competition Act (Canada) with the Canadian Commissioner of Competition on June 1, 2007 and received an ARC on June 7, 2007. We filed a notification under the German Act against Restraints of Competition, as amended with the German Federal Cartel Office on June 14, 2007. The waiting period under the German Competition Act expired on July 14, 2007. Parent filed the required notices with the Office of the Comptroller of the Currency ( OCC ) on June 28, 2007. Parent also filed the required notices with the Federal Deposit Insurance Corporation ( FDIC ) and the Utah Department of Financial Institutions, in each case on July 2, 2007.

On January 25, 2008, Parent informed us in a written notice that it does not anticipate the condition to closing the Merger relating to obtaining approvals from the Office of the Comptroller of the Currency will be satisfied.

On January 30, 2008, we filed a lawsuit against Parent and Merger Sub (together, the Merger Entities ). The lawsuit, filed in the Delaware Court of Chancery, sought specific performance to compel the Merger Entities to comply with their obligations under the Merger Agreement, including their covenants to use reasonable best efforts to obtain required regulatory approvals and to consummate the Merger.

On February 8, 2008, we filed a motion to dismiss our lawsuit without prejudice in response to the Merger Entities' confirmation of their commitment to work to consummate the Merger. We are working with the Merger Entities to effect an acceptable solution to the unresolved regulatory issues. There can be no assurance, however, that an acceptable solution will be obtained or that the Merger will be completed.

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**Our Company**

We are a leading provider of data-driven and transaction-based marketing and customer loyalty solutions. We offer a comprehensive portfolio of integrated outsourced marketing solutions, including customer loyalty programs, database marketing services, marketing strategy consulting, analytics and creative services, permission-based email marketing and private label retail credit card programs. We focus on facilitating and managing interactions between our clients and their customers through a variety of consumer marketing channels, including in-store, catalog, mail, telephone and on-line. We capture data created during each customer interaction, analyze the data and leverage the insight derived from that data to enable clients to identify and acquire new customers, as well as to enhance customer loyalty. We believe that our services are becoming increasingly valuable as companies continue to shift their marketing resources away from traditional mass marketing campaigns toward more targeted marketing programs that provide measurable returns on marketing investments.

Our clients are primarily large consumer-based businesses and include such well-known brands in North America as BMO Bank of Montreal, Citibank, Hilton, Bank of America, Victoria's Secret, Canada Safeway, Shell Canada, Amex Bank of Canada, J. Crew and Expedia. Our client base of more than 800 companies is diversified across a broad range of end-markets, including, among others, financial services, specialty retail, grocery and drugstore chains, petroleum retail, technology, hospitality and travel, media and pharmaceuticals. We believe our comprehensive suite of marketing solutions offers us a significant competitive advantage, as many of our competitors offer a more limited range of services. We believe the breadth and quality of our service offerings have led to long-standing client relationships.

We are the result of the 1996 merger of two entities acquired by Welsh, Carson, Anderson & Stowe: J.C. Penney's transaction services business, BSI Business Services, Inc., and Limited Brands, Inc.'s credit card bank operation, World Financial Network National Bank. In June 2001, we concluded the initial public offering of our common stock, which is listed on the New York Stock Exchange. During 2003, we completed two secondary public offerings whereby Limited Commerce Corp., which is a wholly owned subsidiary of Limited Brands and was our second largest stockholder, sold all of our shares of common stock it beneficially owned. During 2006, Welsh, Carson, Anderson & Stowe completed the distribution of its shares to its limited partners.

We continue to execute on our growth strategy through internal growth and acquisitions. In 2007, we entered into new arrangements for private label retail card services with Orchard Supply Hardware and Gardner-White. We also signed Labrador Liquor Corporation, Roins Financial Services Limited, Réno-Dépot and Vision Electronics as new sponsors in the AIR MILES® Reward Program. We signed new contracts with Tesco, EachNet, Charter Communications, and Helzberg Diamond to provide integrated email and marketing solutions. We also signed a multi-year agreement with 7-Eleven, Inc. to provide payment processing services, including authorization and settlement for debit and credit transactions, and prepaid card services.

We further expanded our relationships with several key clients, including the signing of a multi-year agreement with Redcats USA to provide integrated credit and marketing services, including co-branded credit card services to supplement Redcats USA's existing private label card program and co-branded credit card services to The Sportsman's Guide, a new client of Redcats USA. We also entered into an agreement with Williams-Sonoma, Inc. (to launch a private label retail card program for the West Elm brand) and continue providing private label retail card services for the Pottery Barn brands. We also expanded our co-branded credit card services with Fortunoff.

We also completed significant AIR MILES Reward Program sponsor renewals in 2007 with A&P Canada, Goodyear Canada, Forzani Group, Ltd. and Katz Group Canada's Rexall and Pharma Plus pharmacies. We also renewed contracts with Alon USA for integrated private label card services and Truckee Meadows Water Authority to provide customer care solutions as well as to provide bill print and payment solutions.

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In February 2007, we continued to expand our marketing services offering with the acquisition of Abacus, formerly a division of DoubleClick Inc., and a leading provider of data and multi-channel direct marketing services. In November 2007, we sold our Mail Services business. The sale allows us to increase our focus on the capabilities, technologies and businesses that more closely align with our strategy.

Our corporate headquarters is located at 17655 Waterview Parkway, Dallas, Texas 75252, and our telephone number is 972-348-5100.

### **Our Market Opportunity and Growth Strategy**

We intend to enhance our position as a leading provider of targeted, data-driven and transaction-based marketing and loyalty solutions and to continue our growth in revenue and earnings by pursuing the following strategies:

*Capitalize on our Leadership in Targeted and Data-Driven Consumer Marketing.* We intend to continue to capitalize on the ongoing shift away from traditional mass marketing campaigns to targeted and data-driven marketing programs with measurable return on investment. As consumer companies initiate or expand their targeted and transaction-based marketing strategies, we believe we are well-positioned to acquire new clients and sell additional services to existing clients based on our extensive experience in capturing and analyzing our clients' customer transaction data to develop targeted marketing programs. We believe our comprehensive portfolio of high-quality targeted marketing and loyalty solutions provides a competitive advantage over peers with more limited service offerings. We seek to extend our leadership position in the transaction-based and targeted marketing services sector by continuing to improve the breadth and quality of our products and services. We also intend to enhance our leadership position in loyalty programs by expanding the scope of the AIR MILES Reward Program and by continuing to develop stand-alone loyalty programs such as the *Hilton HHonors Program* and the *Citi Thank You Network*. We believe that building on our market leadership will enable us to benefit from the anticipated growth in demand for targeted marketing strategies.

*Sell More Fully Integrated End-to-End Marketing Solutions.* In our U.S. marketing business (Epsilon), we have assembled what we believe is the industry's most comprehensive suite of targeted and data-driven marketing services, including marketing strategy consulting, data services, database development and management, marketing analytics, creative design and delivery services such as email communications. As a result of our acquisition of Abacus in February 2007, we are able to offer an end-to-end solution to clients, providing a significant opportunity to expand our relationships with existing clients, the majority of which do not currently purchase the full suite of services we offer. In addition, we further intend to integrate our product and service offerings across our business units so that we can provide clients in a broad range of industries with a comprehensive portfolio of targeted marketing solutions, including both coalition and individual loyalty programs, private label retail card programs and other transaction-based marketing solutions. By selling integrated solutions within and across our business units and our entire client base, we have a significant opportunity to maximize the value of our long-standing client relationships.

*Continue to Expand our Global Footprint.* We plan to grow our business by leveraging our core competencies in the North American marketplace to further penetrate international markets. Global reach is increasingly important as our clients grow into new markets, and we are well positioned to cost-effectively increase our global presence. We believe international expansion will provide us with strong revenue growth opportunities.

*Optimize our Business Portfolio.* We will continue to evaluate our products and services given our strategic direction and demand trends. While we are focused on realizing organic revenue growth and margin expansion, we will consider select acquisitions of complementary businesses that would enhance our product portfolio, market positioning or geographic presence. We have a strong track record of identifying and integrating such targeted acquisitions.



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Our products and services are reported under three segments Marketing Services, Credit Services, and Transaction Services. We have traditionally marketed and sold our products and services on a stand-alone basis but increasingly market and sell them on an integrated basis. Our products and services are listed below. Financial information about our segments and geographic areas appears in Note 21 of our consolidated financial statements.

<b>Segment</b>	<b>Products and Services</b>
Marketing Services	Loyalty Programs Coalition loyalty Stand alone loyalty  Marketing Services Analytical services Strategic consulting and creative services Proprietary data services Database marketing services Interactive communications
Credit Services	Private Label Receivables Financing Underwriting and risk management Receivables funding
Transaction Services	Processing Services New account processing Billing and payment processing Remittance processing Customer care  Utility Services Customer information system hosting Billing and payment processing Customer care  Merchant Services Point-of-Sale Services Merchant bankcard services
	<b>Marketing Services</b>

Our clients are focused on targeting, acquiring and retaining loyal and profitable customers. We create and manage targeted marketing programs that result in securing more frequent and sustained customer behavior. We utilize the information gathered through our loyalty and targeted marketing programs to help our clients design and implement effective marketing programs. Our clients within this segment include financial services providers, supermarkets, petroleum retailers, specialty retailers and pharmaceutical companies. BMO Bank of Montreal, the largest Marketing Services client in 2007, represented approximately 21.5% of this segment's 2007 revenue.

**Coalition Loyalty.** Our AIR MILES Reward Program is the largest coalition loyalty program in Canada with over 120 participating sponsors participating in the program. The AIR MILES Reward Program enables consumers to earn AIR MILES reward miles, which operate as points, as they shop within a range of retailers and other sponsors participating in the AIR MILES Reward Program. We believe that one of the reasons our AIR MILES Reward Program is so popular with consumers, as evidenced by the approximately 70% participation rate

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for Canadian households, is that consumers are able to rapidly accumulate AIR MILES reward miles across a significant portion of their everyday spending.

We deal with three primary parties in connection with our AIR MILES Reward Program: sponsors, collectors and suppliers.

*Sponsors.* Our AIR MILES Reward Program has more than 120 brand name sponsors participating in the program such as Canada Safeway, Shell Canada, Jean Coutu, Amex Bank of Canada and BMO Bank of Montreal. The AIR MILES Reward Program is a full service outsourced loyalty program for our sponsors, who pay us a fee per AIR MILES reward mile issued, for which we provide all marketing, customer service and rewards and redemption management. We typically grant participating sponsors exclusivity in their category, which allows them to realize incremental sales and increase their market share as a result of their participation in the AIR MILES Reward Program coalition.

*Collectors.* Consumers participating in the AIR MILES Reward Program, who we refer to as collectors, earn AIR MILES reward miles at over 10,000 retail and service locations, in addition to the many locations where collectors can use certain cards issued by BMO Bank of Montreal and Amex Bank of Canada. The AIR MILES Reward Program offers a reward structure that provides a quick, easy and free way for collectors to earn a broad selection of travel, entertainment and other lifestyle rewards by shopping at participating sponsors.

*Suppliers.* We enter into supply agreements with suppliers of rewards to the program such as airlines, movie theaters and manufacturers of consumer electronics. We obtain rewards from over 300 suppliers who utilize the AIR MILES Reward Program as an additional distribution channel for their products. Suppliers include such well-recognized companies as Apple, Starbucks, Sony and Air Canada.

*U.S Marketing Services.* Our Epsilon business is a leader in providing integrated direct marketing solutions that combine database marketing technology and analytics with a broad range of direct marketing services. We offer customer management and loyalty solutions by utilizing data, database technologies, analytics and delivery platforms to maximize the value and loyalty of our clients' customers and assist our clients in acquiring new customers. Our marketing programs target and reach individual consumers and provide a measurable return on our clients' marketing investments. As a result of our acquisition of Abacus, in February 2007, we have become the industry leader in providing customer acquisition and retention solutions through cooperative databases that contain consumer transactional data from more than 1,500 multi-channel catalogers, retailers, on-line merchants and business-to-business marketers. We also operate what we believe is the world's largest permission-based email marketing platform. We offer our clients a full end-to-end solution, including marketing strategy consulting, data services, database development and management, marketing analytics, creative design and delivery services such as email communications, which we believe provides us with a competitive advantage over other marketing services providers with more limited service offerings. Epsilon has over 500 clients, primarily in the financial services, specialty retail, hospitality and pharmaceutical end-markets.

*Analytical Services.* We provide behavior-based, demographic and attitudinal segmentation; acquisition, attrition, cross-sell and up-sell, retention, loyalty and value predictive modeling; and program evaluation, testing and measurement across our integrated marketing services.

*Strategic Consulting and Creative.* We provide consulting services that analyze our clients' business, brand and/or product strategy to create customer campaigns and sales channel strategies and tactics designed to further optimize our clients' customer relationships and marketing return on investment. We also provide direct marketing program design, development and management; campaign design and execution; value proposition and business case development; concept development and creative media consulting; print, imaging and personalization services; data processing services; fulfillment services; and mailing services.

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*Proprietary Data Services.* We provide various data services that are essential to making informed marketing decisions. Together with our clients, we utilize this data to develop highly targeted, individualized marketing programs that build stronger customer relationships and increase response rates in marketing programs.

*Marketing Database Services.* We provide design and management of outsourced loyalty programs, integrated marketing databases; customer and prospect data integration and data hygiene; campaign management and marketing application integration; and web design and development.

*Interactive Communications.* We provide strategic, permission-based email communication solutions and marketing technologies. Our end-to-end suite of industry specific products and services includes scalable email campaign technology, delivery optimization, marketing automation tools, turnkey integration solutions, strategic consulting and creative expertise to produce email programs that generate measurable results throughout the customer lifecycle.

### **Credit Services**

Our Credit Services segment provides risk management solutions, account origination and funding services for our more than 85 private label retail card programs. Through these programs, we managed approximately \$3.9 billion in average receivables from approximately 23 million active accounts for the year ended December 31, 2007, with an average balance during that period of approximately \$360 for accounts with outstanding balances. We process millions of credit applications each year using automated proprietary scoring technology and verification procedures to make risk-based origination decisions when approving new cardholders and establishing their credit limits. These procedures help us segment prospects into narrower ranges within each risk score provided by credit bureaus, allowing us to better evaluate individual credit risk and tailor our risk-based pricing accordingly. Our cardholders tend to be middle- to upper-income individuals, in particular 35 to 49 year-old married females who use our cards primarily as brand affinity tools rather than pure financing instruments, which has resulted in lower average balances than on general purpose credit cards. We focus our sales efforts on prime borrowers and do not target sub-prime borrowers.

We utilize a securitization program as our primary funding vehicle for private label retail card receivables. Securitizations involve the packaging and selling of both current and future receivable balances of credit card accounts to a special purpose entity that then sells them to a master trust. Our securitizations are treated as sales for accounting purposes and, accordingly, the receivables are removed from our balance sheet. We retain an ownership interest in the receivables, which is commonly referred to as a seller's interest, and a residual interest in the trust, which is commonly referred to as an interest-only strip. As of December 31 2007, Intimate Brands and Redcats accounted for approximately 18.9% and 14.0%, respectively, of the receivables in the trust portfolio.

### **Transaction Services**

We facilitate and manage transactions between our clients and their customers through our scalable processing systems.

*Processing Services.* We assist clients in extending their brand with a private label or co-branded credit card that can be used by customers at the clients' store locations, catalogs or on-line. We provide service and maintenance to our clients' private label credit and co-branded card programs and assist our clients in acquiring, retaining and managing valuable repeat customers. Our Transaction Services segment performs processing services for our Credit Services segment in connection with that segment's private label credit card and co-branded programs. These inter-segment services accounted for 47.4% of Transaction Services revenue in 2007. We have developed a proprietary private label credit card system designed specifically for retailers that has

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the flexibility to be customized to accommodate our clients' specific needs. We have also built into the system marketing tools to assist our clients in increasing sales. We utilize our Quick Credit and On-Line Prescreen products to originate new private label credit card accounts. We believe that these products provide an effective marketing advantage over competing services.

We use automated technology for bill preparation, printing and mailing, as well as offer consumers the ability to view, print and pay their bills on-line. By doing so, we improve the funds availability for both our clients and for those private label credit card receivables that we own or securitize. Our customer care operations are influenced by our retail heritage. We focus our training programs in all areas to achieve the highest possible standards. We monitor our performance by conducting surveys with our clients and their customers. Our call centers are equipped to handle phone, mail, fax and on-line inquiries. We also provide collection activities on delinquent accounts to support our retail private label credit card programs.

*Utility Services.* We believe that we are one of the largest independent service providers of customer information systems for utilities in North America. We provide a comprehensive single source business solution for customer care and billing solutions. We have solutions for the regulated, de-regulated and municipal marketplace. These solutions provide not only hosting of the customer information system, but also customer care, statement generation and payment processing. We focus on the successful acquisition, value enhancement and retention of our clients' customers.

In both a regulated and de-regulated environment, providers will need more sophisticated and complex billing and customer information systems to effectively compete in the marketplace. We believe that our ability to integrate transaction and marketing services effectively provides a competitive advantage for us.

*Merchant Services.* We are a provider of transaction processing services with an emphasis on the U.S. petroleum retail industry. We have built a network that enables us to process virtually all electronic payment types including credit card, debit card, prepaid card, gift card, electronic benefits and check transactions.

### **Safeguards to Our Business; Disaster and Contingency Planning**

We operate multiple data processing centers to process and store our customer transaction data. Given the significant amount of data that we manage, much of which is real-time data to support our clients' commerce initiatives, we have established redundant capabilities for our data centers. We have a number of safeguards in place that are designed to protect our company from data related risks and in the event of a disaster, to restore our data centers' systems.

### **Protection of Intellectual Property and Other Proprietary Rights**

We rely on a combination of copyright, trade secret and trademark laws, confidentiality procedures, contractual provisions and other similar measures to protect our proprietary information and technology used in each business unit of our business. We currently have seven patent applications pending with the U.S. Patent and Trademark Office and two international applications. We generally enter into confidentiality or license agreements with our employees, consultants and corporate partners, and generally control access to and distribution of our technology, documentation and other proprietary information. Despite the efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain the use of our products or technology that we consider proprietary and third parties may attempt to develop similar technology independently. We pursue registration and protection of our trademarks primarily in the United States and Canada, although we also have either registered trademarks or applications pending in Argentina, New Zealand, the European Union, Peru, Venezuela, Brazil, Great Britain, Australia, China, Hong Kong, Japan and Singapore.

Effective protection of intellectual property rights may be unavailable or limited in some countries. The laws of some countries do not protect our proprietary rights to the same extent as in the United States and Canada. We are the exclusive Canadian licensee of the AIR MILES family of trademarks pursuant to a perpetual

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license agreement with Air Miles International Trading B.V., for which we pay a royalty fee. We believe that the AIR MILES family of trademarks and our other trademarks are important for our branding, corporate identification and marketing of our services in each business unit.

**Competition**

The markets for our products and services are highly competitive. We compete with marketing services companies, credit card issuers, and data processing companies, as well as with the in-house staffs of our current and potential clients.

**Marketing Services.** As a provider of marketing services, we generally compete with advertising and other promotional and loyalty programs, both traditional and on-line, for a portion of a client's total marketing budget. In addition, we compete against internally developed products and services created by our existing and potential clients. For each of our marketing services, we expect competition to intensify as more competitors enter our market. Competitors with our AIR MILES Reward Program may target our sponsors and collectors as well as draw rewards from our rewards suppliers. Our ability to generate significant revenue from clients and loyalty partners will depend on our ability to differentiate ourselves through the products and services we provide and the attractiveness of our loyalty and rewards programs to consumers. The continued attractiveness of our loyalty and rewards programs will also depend on our ability to remain affiliated with sponsors that are desirable to consumers and to offer rewards that are both attainable and attractive to consumers. Intensifying competition may make it more difficult for us to do this.

Our Epsilon business generally competes with advertising and other promotional programs, both traditional and on-line. In addition, Epsilon competes against internally developed products and services created by our existing clients and others. For each of our marketing services, we expect competition to intensify as more competitors enter our market. For our targeted direct marketing services offerings, our ability to continue to capture detailed customer transaction data is critical in providing effective customer relationship management strategies for our clients. Our ability to differentiate the mix of products and services that we offer, together with the effective delivery of those products and services, are also important factors in meeting our clients' objective to continually improve their return on marketing investment.

**Credit Services.** Our credit services business competes primarily with financial institutions whose marketing focus has been on developing credit card programs with large revolving balances. These competitors further drive their businesses by cross selling their other financial products to their cardholders. Our focus has primarily been on targeting specialty retailers that understand the competitive advantage of developing loyal customers. Typically these retailers have customers that make more frequent and smaller transactions. As a result, we are able to analyze card-based transaction data we obtain through managing our card programs, including customer specific transaction data and overall consumer spending patterns, to develop and implement targeted marketing strategies and to develop successful customer relationship management strategies for our clients. As an issuer of private label retail cards, we compete with other payment methods, primarily general purpose credit cards like Visa and MasterCard, which we also issue primarily as co-branded private label retail cards, American Express and Discover Card, as well as cash, checks and debit cards.

**Transaction Services.** Our focus has been on industry segments characterized by companies with large customer bases, detail-rich data and high transaction volumes. Targeting these specific market sectors allows us to develop and deliver solutions that meet the needs of these sectors. This focus is consistent with our marketing strategy for all products and services. Additionally, we believe we effectively distinguish ourselves from other transaction processors by providing solutions that help our clients leverage investments they have made in payment systems by using these systems for electronic marketing programs. Competition in the area of utility services comes primarily from larger, more well-funded and well-established competitors and from companies developing in-house solutions and capabilities.

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**Regulation**

Federal and state laws and regulations extensively regulate the operations of our credit card services bank subsidiary, World Financial Network National Bank, as well as our industrial bank, World Financial Capital Bank. Many of these laws and regulations are intended to maintain the safety and soundness of World Financial Network National Bank and World Financial Capital Bank, and they impose significant restraints on those companies to which other non-regulated companies are not subject. Because World Financial Network National Bank is deemed a credit card bank and World Financial Capital Bank is an industrial bank within the meaning of the Bank Holding Company Act, we are not subject to regulation as a bank holding company. If we were subject to regulation as a bank holding company, we would be constrained in our operations to a limited number of activities that are closely related to banking or financial services in nature. Nevertheless, as a national bank, World Financial Network National Bank is still subject to overlapping supervision by the OCC and the FDIC; and, as an industrial bank, World Financial Capital Bank is still subject to overlapping supervision by the FDIC and the State of Utah.

World Financial Network National Bank and World Financial Capital Bank must maintain minimum amounts of regulatory capital. If World Financial Network National Bank or World Financial Capital Bank do not meet these capital requirements, their respective regulators have broad discretion to institute a number of corrective actions that could have a direct material effect on our financial statements. World Financial Capital Bank, as an institution insured by the FDIC, must maintain certain capital ratios, paid-in capital minimums and adequate allowances for loan losses. World Financial Network National Bank must meet specific guidelines that involve measures and ratios of its assets, liabilities, regulatory capital, interest rate exposure and certain off-balance sheet items under regulatory accounting standards, among other factors. Under the National Bank Act, if the capital stock of World Financial Network National Bank is impaired by losses or otherwise, we, as the sole shareholder, may be assessed the deficiency. To the extent necessary, if a deficiency in capital still exists, the FDIC may be appointed as a receiver to wind up World Financial Network National Bank's affairs.

Before World Financial Network National Bank can pay dividends to us, it must obtain prior regulatory approval if all dividends declared in any calendar year would exceed its net profits for that year plus its retained net profits for the preceding two calendar years, less any transfers to surplus. In addition, World Financial Network National Bank may only pay dividends to the extent that retained net profits, including the portion transferred to surplus, exceed bad debts. Moreover, to pay any dividend, World Financial Network National Bank must maintain adequate capital above regulatory guidelines. Further, if a regulatory authority believes that World Financial Network National Bank is engaged in or is about to engage in an unsafe or unsound banking practice, which, depending on its financial condition, could include the payment of dividends, that regulatory authority may require, after notice and hearing, that World Financial Network National Bank cease and desist from the unsafe practice. Before World Financial Capital Bank can pay dividends to us, it must obtain prior written regulatory approval.

As part of an acquisition in 2003 by World Financial Network National Bank, which required approval by the OCC, the OCC required World Financial Network National Bank to enter into an operating agreement with it and a capital adequacy and liquidity maintenance agreement with us. The operating agreement requires World Financial Network National Bank to continue to operate in a manner consistent with its current practices, regulatory guidelines and applicable law, including those related to affiliate transactions, maintenance of capital and corporate governance. This operating agreement has not required any changes in World Financial Network National Bank's operations. The capital adequacy and liquidity maintenance agreement memorializes our current obligations to World Financial Network National Bank.

We are limited under Sections 23A and 23B of the Federal Reserve Act in the extent to which we can borrow or otherwise obtain credit from or engage in other covered transactions with World Financial Network National Bank or World Financial Capital Bank, which may have the effect of limiting the extent to which World Financial Network National Bank or World Financial Capital Bank can finance or otherwise supply funds to us.

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Covered transactions include loans or extensions of credit, purchases of or investments in securities, purchases of assets, including assets subject to an agreement to repurchase, acceptance of securities as collateral for a loan or extension of credit, or the issuance of a guarantee, acceptance, or letter of credit. Although the applicable rules do not serve as an outright bar on engaging in covered transactions, they do require that we engage in covered transactions with World Financial Network National Bank or World Financial Capital Bank only on terms and under circumstances that are substantially the same, or at least as favorable to World Financial Network National Bank or World Financial Capital Bank, as those prevailing at the time for comparable transactions with nonaffiliated companies. Furthermore, with certain exceptions, each loan or extension of credit by World Financial Network National Bank or World Financial Capital Bank to us or our other affiliates must be secured by collateral with a market value ranging from 100% to 130% of the amount of the loan or extension of credit, depending on the type of collateral.

We are required to monitor and report unusual or suspicious account activity as well as transactions involving amounts in excess of prescribed limits under the Bank Secrecy Act, Internal Revenue Service ( IRS ) rules, and other regulations. Congress, the IRS and the bank regulators have focused their attention on banks monitoring and reporting of suspicious activities. Additionally, Congress and the bank regulators have proposed, adopted or passed a number of new laws and regulations that may increase reporting obligations of banks. We are also subject to numerous laws and regulations that are intended to protect consumers, including state laws, the Truth in Lending Act, Equal Credit Opportunity Act and Fair Credit Reporting Act. These laws and regulations mandate various disclosure requirements and regulate the manner in which we may interact with consumers. These and other laws also limit finance charges or other fees or charges earned in our activities. We conduct our operations in a manner that we believe excludes us from regulation as a consumer reporting agency under the Fair Credit Reporting Act. If we were deemed a consumer reporting agency, however, we would be subject to a number of additional complex regulatory requirements and restrictions.

A number of privacy regulations have been implemented in the United States, Canada, the European Union and China in recent years. These regulations place many new restrictions on our ability to collect and disseminate customer information. In addition, the enactment of new or amended legislation around the world could place additional restrictions on our ability to utilize customer information.

Under the Gramm-Leach-Bliley Act, we are required to maintain a comprehensive written information security program that includes administrative, technical and physical safeguards relating to customer information. We also were required to develop an initial privacy notice and we are required to provide annual privacy notices to customers that describe in general terms our information sharing practices. If we intend to share nonpublic personal information about customers with nonaffiliated third parties, we must provide our customers with a notice and a reasonable period of time for each customer to opt out of any such disclosure.

In addition to the federal privacy laws with which we must comply, states also have adopted statutes, regulations or other measures governing the collection and distribution of nonpublic personal information about customers. In some cases these state measures are preempted by federal law, but if not, we monitor and seek to comply with individual state privacy laws in the conduct of our business.

We also have systems and processes to comply with the USA PATRIOT ACT of 2001, which is designed to deter and punish terrorist acts in the United States and around the world, to enhance law enforcement investigatory tools, and for other purposes.

Canada has likewise enacted privacy legislation known as the Personal Information Protection and Electronic Documents Act. This act requires organizations to obtain a consumer's consent to collect, use or disclose personal information. Under this act, which took effect on January 1, 2001, the nature of the required consent depends on the sensitivity of the personal information, and the act permits personal information to be used only for the purposes for which it was collected. Some provinces have enacted substantially similar privacy legislation. We believe we have taken appropriate steps with our AIR MILES Reward Program to comply with these laws.

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**Employees**

As of December 31, 2007, we had approximately 9,800 employees. We believe our relations with our employees are good. We have no collective bargaining agreements with our employees.

**Available Information**

We file or furnish annual, quarterly, current and special reports, proxy statements and other information with the SEC. You may read and copy, for a fee, any document we file or furnish at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. Our SEC filings are also available to the public at the SEC's web site at [www.sec.gov](http://www.sec.gov). You may also obtain copies of our annual, quarterly and current reports, proxy statements and certain other information filed or furnished with the SEC, as well as amendments thereto, free of charge from our web site. Our web site is [www.AllianceData.com](http://www.AllianceData.com). No information from this web site is incorporated by reference herein. These documents are posted to our web site as soon as reasonably practicable after we have filed or furnished these documents with the SEC. We post our audit committee, compensation committee, nominating and corporate governance committee, and executive committee charters, our corporate governance guidelines, and our code of ethics, code of ethics for Senior Financial Executives and Chief Executive Officer, and code of ethics for Board Members on our web site. These documents are available free of charge to any stockholder upon request.

We submitted the certification of the Chief Executive Officer required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual, relating to our compliance with the NYSE's corporate governance listing standards, to the NYSE on June 26, 2007 with no qualification. In addition, we included the certifications of our Chief Executive Officer and Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act of 2002 and related rules, relating to the quality of our public disclosure, in this Annual Report on Form 10-K as Exhibits 31.1 and 31.2.



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**Item 1A. Risk Factors**

**Risk Factors**

**Risks Related to Our Company**

*We cannot give any assurance that the Merger will be consummated.*

Consummation of the Merger is subject to the satisfaction of various closing conditions. While certain of these conditions have been satisfied, including, among others, adoption of the Merger Agreement by a vote of two-thirds of the outstanding shares of our common stock, the expiration or termination of applicable waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, and issuance of a ruling under the Competition Act (Canada) or expiration, termination or waiver under that Act, there are still several conditions to closing that have not been satisfied, including obtaining required approvals from the FDIC, the OCC and the Utah Commissioner of Financial Institutions with respect to our banking operations and certain other customary closing conditions described in the Merger Agreement. We cannot guarantee that all of the conditions precedent to consummating the Merger will be satisfied or that the Merger will be successfully completed. On January 25, 2008, Aladdin Solutions, Inc. (f/k/a Aladdin Holdco, Inc.) informed us in a written notice that it did not anticipate the condition to closing the Merger relating to obtaining approvals from the OCC would be satisfied. In response to the notice and subsequent conversations with Aladdin Solutions, Inc.'s representatives, on January 30, 2008, we filed a lawsuit against Aladdin Solutions, Inc. and Aladdin Merger Sub, Inc., the acquisition entities formed by affiliates of The Blackstone Group to acquire us pursuant to the terms of the Merger Agreement, seeking specific performance to compel these entities to comply with their obligations under the Merger Agreement, including their covenants to use reasonable best efforts to obtain required regulatory approvals and to consummate the Merger. On February 8, 2008, we filed a motion to dismiss our lawsuit without prejudice in response to confirmation of these entities' commitment to work to consummate the Merger. Although we are working with these entities to effect an acceptable solution to the unresolved regulatory issues, there can be no assurance that an acceptable solution will be obtained or that the Merger will be completed.

In the event that the Merger is not completed:

management's attention from our day-to-day business may be diverted;

we may lose key employees;

our relationships with customers and vendors may be disrupted as a result of uncertainties with regard to our business and prospects;

we may be required to pursue legal action to enforce our rights under the Merger Agreement;

we may be exposed to litigation claims from third parties relating to the failure to complete the Merger;

we may be required to pay significant transaction costs related to the Merger; and

the market price of shares of our common stock may decline to the extent that the current market price of those shares reflects a market assumption that the Merger will be completed.

Any such events could have a material negative impact on our results of operations and financial condition and could adversely affect our stock price.

*Delaware law and our charter documents could prevent a change of control that might be beneficial to you.*

## Edgar Filing: ALLIANCE DATA SYSTEMS CORP - Form 10-K

Delaware law, as well as provisions of our certificate of incorporation and bylaws, could discourage unsolicited proposals to acquire us, even though such proposals may be beneficial to you. These include:

a board of directors classified into three classes of directors with the directors of each class having staggered, three-year terms;

our board's authority to issue shares of preferred stock without further stockholder approval; and

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provisions of Delaware law that restrict many business combinations and provide that directors serving on staggered boards of directors, such as ours, may be removed only for cause.

These provisions of our certificate of incorporation, bylaws and Delaware law could discourage tender offers or other transactions that might otherwise result in our stockholders receiving a premium over the market price for our common stock.

*Future sales of our common stock, or the perception that future sales could occur, may adversely affect our common stock price.*

As of February 22, 2008, we had an aggregate of 100,909,467 shares of our common stock authorized but unissued and not reserved for specific purposes. While we are currently restricted by the terms of the Merger Agreement, in general, we may issue all of these shares without any action or approval by our stockholders. We have reserved 21,003,000 shares of our common stock for issuance under our employee stock purchase plan and our long-term incentive plans, of which 5,212,133 shares are issuable upon vesting of restricted stock awards, restricted stock units, and upon exercise of options granted as of February 22, 2008, including options to purchase approximately 4,030,114 shares exercisable as of February 22, 2008 or that will become exercisable within 60 days after February 22, 2008. We have reserved for issuance 1,500,000 shares of our common stock, all of which remain issuable, under our 401(k) and Retirement Savings Plan. In addition, we may pursue acquisitions of competitors and related businesses and may issue shares of our common stock in connection with these acquisitions. Sales or issuances of a substantial number of shares of common stock, or the perception that such sales could occur, could adversely affect prevailing market prices of our common stock, and any sale or issuance of our common stock will dilute the percentage ownership held by our stockholders.

*A limited number of stockholders report ownership of a significant amount of our common stock. These stockholders may have interests that conflict with yours and, if they were to act together, may be able to control the election of directors and the approval of significant corporate transactions, including a change in control.*

Pursuant to the information provided in various filings with the SEC on Schedules 13D or 13G and amendments thereto, there are five separate groups of affiliated entities that beneficially own, in the aggregate, approximately 35% of our outstanding common stock. These stockholders, if acting together, may be able to exercise significant influence over matters requiring stockholder approval, including the election of directors, changes to our charter documents and significant corporate actions, including a change in control. These stockholders may have interests that conflict with our interests or those of other stockholders. This concentration of ownership may prevent any other holder or group of holders of our common stock from being able to affect the way we are managed or the direction of our business. Accordingly, this concentration of ownership could adversely affect the prevailing market price of our common stock.

**Risks Related to General Business Operations**

*Our 10 largest clients represented 40.7% of our consolidated revenue in 2007, and the loss of any of these clients could cause a significant drop in our revenue.*

We depend on a limited number of large clients for a significant portion of our consolidated revenue. Our 10 largest clients represented approximately 40.7% of our consolidated revenue during the year ended December 31, 2007, with BMO Bank of Montreal representing approximately 10.2% of our 2007 consolidated revenue. A decrease in revenue from any of our significant clients for any reason, including a decrease in pricing or activity, or a decision to either utilize another service provider or to no longer outsource some or all of the services we provide, could have a material adverse effect on our consolidated revenue.

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*Marketing Services.* Our 10 largest clients in this segment represented approximately 48.9% of our Marketing Services revenue in 2007. BMO Bank of Montreal represented approximately 21.5% of this segment's 2007 revenue. Our contract with BMO Bank of Montreal expires in 2009.

*Credit Services.* Our 10 largest clients and their customers in this segment represented approximately 84.5% of our Credit Services revenue in 2007. Intimate Brands and its retail affiliates represented approximately 20.9%, and Redcats represented approximately 12.4% of our Credit Services revenue in 2007. Our contracts with Intimate Brands and its retail affiliates expire in 2012, and our contract with Redcats expires in 2016.

*Transaction Services.* Our 10 largest clients in this segment represented approximately 45.8% of our Transaction Services revenue in 2007.

***Competition in our industries is intense and we expect it to intensify.***

The markets for our products and services are highly competitive and we expect competition to intensify in each of those markets. Many of our current competitors have longer operating histories, stronger brand names and greater financial, technical, marketing and other resources than we do. Certain of our business units also compete against in-house staffs of our current clients and others or internally developed products and services by our current clients and others. For example, as a result of increasing competitors in the loyalty market, including from the Aeroplan Program, one of Canada's largest loyalty marketing programs, we may experience greater competition in attracting and retaining sponsors in our AIR MILES Reward Program. Our ability to generate significant revenue from clients and partners will depend on our ability to differentiate ourselves through the products and services we provide and the attractiveness of our programs to consumers. We may not be able to compete successfully against our current and potential competitors.

***The markets for the services that we offer may fail to expand or may contract and this could negatively impact our growth and profitability.***

Our growth and continued profitability depend on acceptance of the services that we offer. Our clients may not continue to use loyalty and targeted marketing strategies. Changes in technology may enable merchants and retail companies to directly process transactions in a cost-efficient manner without the use of our services. Additionally, downturns in the economy or the performance of retailers may result in a decrease in the demand for our marketing strategies. Further, if customers make fewer purchases of our customers' products and services, we will have fewer transactions to process, resulting in lower revenue. Any decrease in the demand for our services for the reasons discussed above or any other reasons could have a materially adverse effect on our growth, revenue and operating results.

***If we fail to identify suitable acquisition candidates, or to integrate the businesses we acquire, it could negatively affect our business.***

Historically, we have engaged in a significant number of acquisitions, and those acquisitions have contributed to our growth in revenue and profitability. While we believe that acquisitions will continue to be a key component of our growth strategy, our focus for 2008 is expected to be on organic growth. However, we may not be able to continue to locate and secure acquisition candidates on terms and conditions that are acceptable to us. If we are unable to identify attractive acquisition candidates, our growth could be impaired. There are several risks to acquisitions, including:

the difficulty and expense that we incur in connection with the acquisition;

adverse accounting consequences of conforming the acquired company's accounting policies to ours;

the diversion of management's attention from other business concerns;

the potential loss of customers or key employees of the acquired company;



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the impact on our financial condition due to the timing of the acquisition or the failure to meet operating expectations of the acquired business; and

the assumption of unknown liabilities of the acquired company.

Acquisitions that we make may not be successfully integrated into our ongoing operations and we may not achieve any expected cost savings or other synergies from any acquisition. If the operations of an acquired business do not meet expectations, our profitability and cash flows may be impaired and we may be required to restructure the acquired business or write-off the value of some or all of the assets of the acquired business.

***Failure to safeguard our databases and consumer privacy could affect our reputation among our clients and their customers, and may expose us to legal claims.***

As part of our AIR MILES Reward Program, targeted marketing services programs and credit card programs, we maintain databases containing information on consumers' account transactions. Our databases may be subject to unauthorized access. If we experience a security breach, the integrity of our databases could be affected. Security and privacy concerns may cause consumers to resist providing the personal data necessary to support our profiling capability. The use of our loyalty, marketing services or credit card programs could decline if any compromise of security occurred. In addition, any unauthorized release of consumer information, or any public perception that we released consumer information without authorization, could subject us to legal claims from consumers or regulatory enforcement actions and adversely affect our client relationships.

***As a result of our significant Canadian operations, our reported financial information will be affected by fluctuations in the exchange rate between the U.S. and Canadian dollars.***

A significant portion of our revenue is derived from our operations in Canada, which transact business in Canadian dollars. Therefore, our reported financial information from quarter-to-quarter will be affected by changes in the exchange rate between the U.S. and Canadian dollars over the relevant periods. We do not hedge any of our exchange rate exposure in our Canadian operations.

The Canadian dollar has been trading at historically high rates against the U.S. dollar in recent periods. If the Canadian dollar were to decline in value in subsequent periods, our operating results would be negatively impacted and we would not have the benefit of the favorable revenue impact we have experienced in recent periods as a result of the strength of the Canadian dollar.

***The hedging activity related to our securitization trusts and our floating rate indebtedness subjects us to off-balance sheet counterparty risks relating to the creditworthiness of the commercial banks with whom we enter into hedging transactions.***

In order to execute hedging strategies related to the securitization trusts and our floating rate indebtedness, we have entered into interest rate derivative contracts with commercial banks. These banks are considered counterparties. It is our policy to enter into such contracts with counterparties that are deemed to be creditworthy. However, if macro- or micro-economic events were to negatively impact these banks, the banks might not be able to honor their obligations either to us or to the securitization trusts and we might suffer a direct loss or a loss related to our residual interest in the securitization trusts.

***Our failure to protect our intellectual property rights may harm our competitive position, and litigation to protect our intellectual property rights or defend against third party allegations of infringement may be costly.***

Third parties may infringe or misappropriate our trademarks or other intellectual property rights, which could have a material adverse effect on our business, financial condition or operating results. The actions we take to protect our trademarks and other proprietary rights may not be adequate. Litigation may be necessary to enforce our intellectual property rights, protect our trade secrets or determine the validity and scope of the

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proprietary rights of others. We may not be able to prevent infringement of our intellectual property rights or misappropriation of our proprietary information. Any infringement or misappropriation could harm any competitive advantage we currently derive or may derive from our proprietary rights. Third parties may also assert infringement claims against us. Any claims and any resulting litigation could subject us to significant liability for damages may also result in limitations on our ability to use the intellectual property subject to these claims. An adverse determination in any litigation of this type could require us to design around a third party's patent or to license alternative technology from another party. In addition, litigation is time consuming and expensive to defend and could result in the diversion of our time and resources.

***Loss of data center capacity, interruption of telecommunication links, computer viruses or inability to utilize proprietary software of third party vendors could affect our ability to timely meet the needs of our clients and their customers.***

Our ability to protect our data centers against damage or inoperability from fire, power loss, telecommunications failure, computer viruses and other disasters is critical. In order to provide many of our services, we must be able to store, retrieve, process and manage large amounts of data and periodically expand and upgrade our database capabilities. Any damage to our data centers, any failure of our telecommunication links that interrupts our operations or any impairment of our ability to use our software or the proprietary software of third party vendors, including impairments due to virus attacks, could adversely affect our ability to meet our clients' needs and their confidence in utilizing us for future services.