VERIFONE SYSTEMS, INC.
Form 10-Q
March 12, 2012
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended January 31, 2012

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 þ 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 þ 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 þ	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 þ

At February 29, 2012, the number of shares outstanding of the registrant's common stock, $0.01 par value was 106,700,887.

Table of Contents

VERIFONE SYSTEMS, INC.
TABLE OF CONTENTS
INDEX

Table of Contents

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (Unaudited)

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

	Three Months Ended January 31,	
	2012	2011
	(Unaudited) (In thousands, except per share data)	
Net revenues:		
System Solutions	$312,641	$225,707
Services	106,883	58,058
Total net revenues	419,524	283,765
Cost of net revenues:		
System Solutions	198,752	140,140
Services	64,134	32,134
Total cost of net revenues	262,886	172,274
Gross profit	156,638	111,491
Operating expenses:		
Research and development	35,079	21,642
Sales and marketing	39,986	28,306
General and administrative	46,038	24,016
Amortization of purchased intangible assets	13,615	2,316
Total operating expenses	134,718	76,280
Operating income	21,920	35,211
Interest expense	(14,634)	(7,570)
Interest income	1,007	283
Other income (expense), net	(21,198)	1,651
Income (loss) before income taxes	(12,905)	29,575
Benefit from income taxes	(9,782)	(2,456)
Net income (loss)	(3,123)	32,031
(Income) loss attributable to noncontrolling interest in subsidiaries	350	(76)
Net income (loss) attributable to VeriFone Systems, Inc. stockholders	$(2,773)	$31,955
Net income (loss) per share attributable to VeriFone Systems, Inc. stockholders:		
Basic	$(0.03)	$0.37
Diluted	$(0.03)	$0.35
Weighted average shares used in computing net income (loss) per share attributable to VeriFone Systems, Inc. stockholders:		
Basic	105,833	87,090
Diluted	105,833	91,321

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

Table of Contents

VERIFONE SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	January 31, 2012 (Unaudited)	October 31, 2011*
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$379,979	$594,562
Accounts receivable, net of reserves of $5,613 and $5,658	302,559	294,440
Inventories	171,414	144,316
Restricted cash and cash equivalents	279,965	4
Deferred income tax assets	40,607	39,040
Prepaid expenses and other current assets	106,510	88,086
Total current assets	1,281,034	1,160,448
Property, plant and equipment, net	77,884	65,504
Purchased intangible assets, net	828,952	263,767
Goodwill	1,203,287	561,414
Deferred tax assets	221,404	205,496
Debt issuance costs, net	40,998	2,749
Other assets	94,639	54,183
Total assets	$3,748,198	$2,313,561
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$152,279	$144,278
Income taxes payable	9,066	9,116
Accrued compensation	49,697	51,515
Accrued warranty	17,055	20,358
Deferred revenue, net	97,715	68,824
Deferred tax liabilities	9,297	4,960
Accrued expenses	80,690	74,775
Other current liabilities	88,188	57,399
Senior convertible notes	271,080	266,981
Short-term debt	53,191	5,074
Total current liabilities	828,258	703,280
Deferred revenue, net	33,178	31,467
Long-term debt	1,313,175	211,756
Deferred tax liabilities	243,801	92,594
Other long-term liabilities	75,435	78,971
Total liabilities	2,493,847	1,118,068
Commitments and contingencies (Note 13)		
Redeemable noncontrolling interest	900	855
Stockholders' equity:		
VeriFone Systems, Inc. stockholders' equity:		
Preferred Stock: 10,000 shares authorized as of January 31, 2012 and October 31, 2011; no shares issued and outstanding as of January 31, 2012 and October 31, 2011	—	—
Common stock: $0.01 par value, 200,000 shares authorized as of January 31, 2012 and October 31, 2011; 106,488 and 105,826 shares issued and 106,359 and 105,697	1,065	1,058

outstanding as of January 31, 2012 and October 31, 2011		
Additional paid-in capital	1,486,477	1,468,862
Accumulated deficit	(272,179)	(269,056)
Accumulated other comprehensive loss	329	(6,671)
Total VeriFone Systems, Inc. stockholders’ equity	1,215,692	1,194,193
Noncontrolling interests in subsidiaries	37,759	445
Total stockholders' equity	1,253,451	1,194,638
Total liabilities and equity	$3,748,198	$2,313,561

* Derived from audited consolidated financial statements.

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

Table of Contents

VERIFONE SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended January 31,	
	2012	2011
	(Unaudited) (In thousands)	
OPERATING ACTIVITIES:		
Net income (loss)	$(3,123)	$32,031
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization, net	31,859	9,485
Stock-based compensation expense	10,704	7,439
Non-cash interest expense	6,227	3,818
Gain on bargain purchase of a business	—	(1,476)
Deferred income taxes	(8,490)	(319)
Other non-cash items	(1,455)	(178)
Net cash provided by operating activities before changes in working capital	35,722	50,800
Changes in operating assets and liabilities, excluding effects of acquisitions:		
Accounts receivable, net	17,154	(13,299)
Inventories	(1,994)	5,474
Prepaid expenses and other current assets	(10,694)	(15,323)
Accounts payable	(10,913)	5,263
Income taxes payable	(2,418)	2,744
Accrued compensation	(15,258)	(4,469)
Accrued warranty	(3,996)	1,999
Deferred revenue, net	28,589	(664)
Accrued expenses and other current liabilities	(4,024)	(2,116)
Net cash provided by operating activities	32,168	30,409
INVESTING ACTIVTIES:		
Purchases of property, plant and equipment	(7,289)	(2,315)
Cash payments for acquisitions, net of cash acquired	(1,067,517)	(9,730)
Other	(714)	(261)
Net cash used in investing activities	(1,075,520)	(12,306)
FINANCING ACTIVITES:		
Proceeds from debt, net of issuance costs	1,409,177	—
Repayments of debt	(307,760)	(1,358)
Proceeds from issuance of common stock through equity incentive plans	8,812	16,678
Restricted cash and cash equivalents held in escrow for debt repayment	(279,159)	—
Other	(135)	—
Net cash provided by financing activities	830,935	15,320
Effect of exchange rate fluctuations on cash and cash equivalents	(2,166)	607
Change in cash and cash equivalents	(214,583)	34,030
Beginning cash and cash equivalents	594,562	445,137
Ending cash and cash equivalents	$379,979	$479,167

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

5

Table of Contents

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 all of its subsidiaries) as of January 31, 2012 and October 31, 2011, and for the three months ended January 31, 2012 and 2011, have been prepared in accordance with generally accepted accounting principles ("GAAP") in the United States of America for interim financial information and with the instructions on Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). 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, except as otherwise noted, 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, 2011. The results of operations for the three months ended January 31, 2012 are not necessarily indicative of the results expected for the entire fiscal year. All significant intercompany 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 noncontrolling interests. The condensed consolidated balance sheet at October 31, 2011 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

Certain footnote amounts reported in previous periods have been reclassified to conform to the current period presentation.
Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. 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 product returns, bad debts, inventories, goodwill and intangible assets, income taxes, warranty obligations, contingencies, share-based compensation and litigation, among others. We base our estimates on historical experience and information available to us at the time that these estimates are made. Actual results could differ materially from these estimates.
Summary of Significant Accounting Policies

There have been no changes to our significant accounting policies during the three months ended January 31, 2012 as compared to the significant accounting policies described in our audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2011 except that debt issuance costs are now material.
Debt Issuance Costs

Debt issuance costs are stated at cost, net of accumulated amortization in Other assets on the Condensed Consolidated Balance Sheets. Amortization expense is calculated using the effective interest method over the period of the loans and is recorded in Interest expense in the accompanying Condensed Consolidated Statements of Operations. At

January 31, 2012, interest amortization periods range from 5 to 7 years based upon the duration of outstanding debt.
Concentrations of Credit Risk

No customer accounted for more than 10% of net revenues in any of our reportable segments during the three months

6

Table of Contents

ended January 31, 2012. For the three months ended January 31, 2011, First Data and its affiliates accounted for 15.7% of North America segment revenues. As of January 31, 2012, no customer accounted for more than 10% of accounts receivable. At October 31, 2011, one customer, Cielo S.A. and its affiliates, accounted for 10% of our total accounts receivable in the International segment.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standard Board (“FASB”) issued Accounting Standards Update No. (“ASU”) 2011-05, Comprehensive Income (Topic 220)—Presentation of Comprehensive Income, which requires an entity to present the total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. This new guidance is effective for us in our first quarter of fiscal year 2013 and will have financial statement presentation impact only.

There have been no other significant changes in accounting pronouncements from the list of recent accounting pronouncements described in our audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2011.

Note 2. Business Combinations

Point Acquisition

On December 30, 2011, we completed our acquisition of Electronic Transaction Group Nordic Holding AB, a Swedish company operating the Point International business (collectively, "Point"), Northern Europe's largest provider of payment and gateway services and solutions for retailers for a purchase price of approximately €600.0 million plus payoff of Point outstanding debt ($1,024.5 million at the close date). The source of funds for the cash consideration was a new credit agreement provided by a syndicate of banks ("the 2011 Credit Agreement"). See Note 5. Financings in the Notes to Condensed Consolidated Financial Statements for information on the 2011 Credit Agreement.

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

We acquired Point to, among other things, provide a broader set of product and service offerings to customers globally, especially in the Northern European markets. For the three months ended January 31, 2012, we estimate that our total net revenues increased approximately $14.5 million due to the sale of Point products and services. For the three months ended January 31, 2012, the acquisition of Point negatively impacted our operating income by approximately $6.1 million which included management's allocations and estimates of expenses that were not separately identifiable due to our integration activities, non-recurring charges associated with the step-down in deferred revenue, amortization, and acquisition and integration expenses.

The fair value of consideration transferred for Point was comprised of (in thousands):

Cash paid to Point stockholders	$774,268
Cash for repayment of long-term debt	250,264
Total	$1,024,532

Recording of Assets Acquired and Liabilities Assumed

The acquisition method of accounting requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. Because of the short time frame since the acquisition closed, at January 31, 2012 we recorded the net tangible and intangible assets acquired and liabilities assumed based upon their preliminary fair values as of December 30, 2011. The fair values were based upon a preliminary valuation, and our estimates and assumptions are subject to change within the measurement period (up to one year from the acquisition date). The primary areas of the preliminary purchase price allocation that are not yet finalized relate to the fair values of acquired assets and liabilities, certain legal matters, certain pre-acquisition contingencies including acquisition and divestiture related claims, income and non-income based taxes and residual goodwill. We expect to continue to obtain information to assist us in determining the fair values of the net assets acquired at the acquisition date during the measurement period.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition

7

Table of Contents

date. As described above, fair values assigned to certain assets acquired and liabilities assumed are preliminary and thus subject to change (in thousands):

Cash and cash equivalents	$25,314
Accounts receivable (gross contractual value of $25.1 million, of which $0.6 million not expected to be collected)	24,505
Inventories	25,104
Deferred tax assets	13,235
Prepaid expense and other assets	44,288
Property, plant and equipment	11,152
Intangible assets	550,512
Accounts payable and other liabilities	(72,464)
Deferred revenues	(1,387)
Deferred tax liabilities	(153,222)
Noncontrolling interests	(37,132)
Total identifiable net assets	429,905
Goodwill	594,627
Total consideration transferred	$1,024,532

Goodwill is calculated as the excess of the consideration transferred over the identifiable net assets and represents future benefits arising from other assets acquired that could not be individually identified and separately recognized. Specifically, the goodwill recorded as part of the acquisition of Point includes the expected synergies and other benefits that we believe will result from combining the operations of Point with the operations of VeriFone and the value of the going-concern element of Point's business (which represents the higher rate of return on the assembled collection of net assets versus if VeriFone acquired all of the net assets separately). We generally do not expect the goodwill recognized to be deductible for income tax purposes. The assignment of goodwill to reporting units has not been completed as of this filing date.

The fair value of the noncontrolling interest in a Point subsidiary of $37.1 million was estimated by employing an income approach. The fair value estimate was based on (i) an assumed discount rate of 16% and (ii) an assumed terminal value based on a range of terminal stabilized cash flow multiples between 8 to 9 times.

Valuations of Intangible Assets Acquired

The following table sets forth the components of intangible assets acquired in connection with the Point acquisition (in thousands, except for estimated useful life):

	Fair Value	Estimated Useful Life (Years)
Customer relationships	$484,399	9.5
Developed software technology	52,528	4.4
Trade names	13,585	4.0
Total	$550,512	

Customer relationships represent the fair value of the underlying relationship and agreement with Point customers. Developed software technology represents the fair values of Point's proprietary technologies, processes, patents and trade secrets related to the design of Point's products that have reached technological feasibility and are a part of Point's product lines.

Some of the more significant estimates and assumptions inherent in the estimates of the fair values of identifiable intangible assets include all assumptions associated with forecasting product profitability from the perspective of a market participant. Specifically:

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Revenue - we use historical, forecast and industry or other sources of market data, including the number of units to be sold, selling prices, market penetration, market share and year-over-year growth rates over the product life cycles.

Table of Contents

- Cost of sales, research and development expenses, sales and marketing expenses and general administrative expenses - we use historical, forecast, industry and other sources of market data, including any expected synergies that can be realized by a likely buyer.
- Estimated life of the asset - we assess the asset's life cycle by considering the impact of technology changes and applicable payment security compliance/regulatory requirements.
- Discount rates - we use a discount rate that is based on the weighted average cost of capital with adjustments to reflect the risks associated with the specific intangible assets, such as country risks and commercial risks.
- Customer attrition rates - we use historical and forecast data to determine the customer attrition rates and the expected customer life.

The discount rates used in the intangible asset valuations ranged from 14% to 20%. The customer attrition rates used in our valuation of customer relationship intangible assets ranged from 0% to 7% depending on the geographic region. The estimated life of developed software technology intangible assets ranged from 2 years to 10 years. All of these judgments and estimates can materially impact the fair values of intangible assets.

Preliminary Pre-Acquisition Contingencies Assumed

We have evaluated and will continue to evaluate pre-acquisition contingencies relating to Point that existed as of the acquisition date. We have preliminarily determined that certain of these pre-acquisition contingencies are probable in nature and estimable as of the acquisition date and, accordingly, have preliminarily recorded our best estimates for these contingencies. If we make changes to the amounts recorded or identify additional pre-acquisition contingencies during the remainder of the measurement period, such amounts recorded will be included in the purchase price allocation during the measurement period and, subsequently, in our results of operations.

Other Fiscal Year 2012 Acquisitions

During the three months ended January 31, 2012, in addition to Point, we completed the acquisitions of other businesses for an aggregate purchase price of $75.0 million. 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 structured as 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 at the acquisition date. As discussed above, fair values assigned to certain assets acquired and liabilities assumed are preliminary and thus subject to change (in thousands):

	ChargeSmart	Show Media	Global Bay	Total
Acquisition date	January 3, 2012	November 1, 2011	November 1, 2011	
Assets acquired (liabilities assumed), net	$ (4,225)	$ 1,593	$ (5,028)	$ (7,660)
Intangible assets (1)	9,770	6,660	14,490	30,920
Goodwill (2)	13,829	19,871	18,050	51,750
Total purchase price	$ 19,374	$ 28,124	$ 27,512	$ 75,010

Explanatory notes:

(1) Intangible assets included developed technology, customer relationships, non-compete agreement, trademarks and in process research and development of $19.7 million, $6.6 million, $3.0 million, $0.9 million and $0.8 million,

respectively, which are amortized over their estimated useful lives of 1 to 10 years.
(2) Goodwill is generally not expected to be tax deductible for ChargeSmart and Global Bay, but is expected to be deductible for tax purposes for Show Media. The amount of Goodwill resulted primarily from our expectation of increased value resulting from the integration of the acquired companies' product offerings with our product offerings.

Table of Contents

Fiscal Year 2011 Acquisitions

Hypercom Corporation

On August 4, 2011, we completed our acquisition of Hypercom, a provider of electronic payment solutions and value-added services at the point of transaction, by means of a merger of one of our wholly-owned subsidiaries with and into Hypercom such that Hypercom became a wholly-owned subsidiary of VeriFone following the merger. We acquired Hypercom to, among other things, provide a broader set of product and service offerings to customers globally. We have included the financial results of Hypercom in our Consolidated Financial Statements from the date of acquisition. For the three months ended January 31, 2012, we estimate that our total net revenues increased approximately $73.5 million due to the sale of Hypercom products and services. Other revenue and earnings contributions from Hypercom were not separately identifiable due to our integration activities. The total fair value of consideration transferred was $644.6 million which consisted of $557.1 million VeriFone stock issues, $16.2 million for the fair value of stock options assumed and $71.2 million for the cash used to repay Hypercom's long term debt. We recorded the preliminary fair value of assets acquired and liabilities assumed of approximately $363.5 million of goodwill, $210.7 million of intangible assets and $70.3 million net tangible assets. There were no material changes to the fair values assigned for the three months ended January 31, 2012.
The primary areas of the preliminary fair values that are not yet finalized related to the fair values of certain tangible assets and liabilities assumed, certain legal matters, income and non-income taxes and residual goodwill. We expect to continue to obtain information to assist us in finalizing these preliminary valuations during the measurement period.
Pro Forma Financial Information

The supplemental pro forma financial information below was prepared using the acquisition method of accounting and is based on the historical financial information of VeriFone, Point, Hypercom and other acquired companies, reflecting results of operations for the three month period ended January 31, 2012 and 2011 on a comparative basis as though the aforementioned companies were combined as of the beginning of fiscal year 2011. The historical financial information has been adjusted to give effect to the pro forma events that are: (i) directly attributable to the acquisition, (ii) factually supportable and (iii) expected to have a continuing impact on the combined results. These adjustments for the three months ended January 31, 2012 and 2011, include:.

- Net additional amortization expense related to the fair value of acquired identifiable intangible assets totaling $7.2 million and $26.9 million, respectively.

- Additional interest expense of $4.1 million and $1.9 million, respectively, that would be incurred on additional borrowings made to fund the acquisitions, offset by elimination of acquired business interest expense on borrowings that were settled as part of the acquisitions,

- Elimination of other charges that would not have a continuing impact on combined results, such as deal costs, one time professional fees, foreign currency losses related to deal consideration and amortization of FMV adjustments, totaling $40.6 million and $2.3 million, respectively.

The supplemental pro forma financial information for the three months ended January 31, 2012 combined the historical results of VeriFone for the three months ended January 31, 2012, the historical results of Point and ChargeSmart for the two months ended December 31, 2011, and the effects of the pro forma adjustments listed above.

The supplemental pro forma financial information for the three months ended January 31, 2011 combined the historical results of VeriFone for three months ended January 31, 2011, the historical results of all fiscal year 2011 and fiscal year 2012 acquired businesses for the three months ended January 31, 2011 based upon their respective previous reporting periods, the dates that these companies were acquired by us, and the effects of the pro forma adjustments listed above.

The following table presents supplemental pro forma financial information as if all fiscal 2012 and 2011 acquisitions occurred on November 1, 2010 (in thousands except per share data):

10

Table of Contents

(Unaudited)	For the Three Months Ended January 31, 2012	2011
Total revenues	$463,215	$461,061
Net income	$17,123	$6,590
Net income per share attributable to VeriFone Systems, Inc. stockholders - diluted	$0.16	$0.06

Acquisition-related Costs

Acquisition related and other expenses consist of i) transaction costs, which represent external costs directly related to our acquisitions and primarily include expenditures for professional fees such as banking, legal, accounting and other directly related incremental costs incurred to close the acquisition and ii) integration costs, which represent personnel related costs for transitional and certain other employees, integration related professional services, additional asset write offs and other integration activity related expenses.

The following table presents a summary of acquisition related and other expenses for the three months ended January 31, 2012 as follows (in thousands):

	Transaction Costs		Integration Costs	Total
Cost of net revenues	$—	34	$2,368	$2,368
Research and development	—	17	1,859	1,859
Sales and marketing	118		777	895
General and administrative	6,934	17,711	5,568	12,502
	$7,052		$10,572	$17,624

The following table presents a summary of acquisition related and other expenses for the three months ended January 31, 2011 as follows (in thousands):

	Transaction Costs		Integration Costs	Total
Cost of net revenues	$—	34	$21	$21
Research and development	1	17	3	4
Sales and marketing	82		15	97
General and administrative	2,661	17,711	98	2,759
	$2,744		$137	$2,881

Note 3. Goodwill and Purchased Intangible Assets

Goodwill

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

	Three Months Ended January 31, 2012	Year Ended October 31, 2011
Balance at October 31, 2011	$561,414	$169,322
Additions related to acquisitions	646,377	392,723
Adjustments related to prior acquisitions	(3,129)	622
Currency translation adjustments	(1,375)	(1,253)
Balance at January 31, 2012	$1,203,287	$561,414

Based on our review for potential indicators of impairment performed during the three months ended January 31, 2012 and the fiscal year ended October 31, 2011, there were no indicators of impairment.

11

Table of Contents

As of both January 31, 2012 and October 31, 2011, we had accumulated goodwill impairment losses of $372.4 million and $65.5 million in our International and North America segments, respectively.

Purchased Intangible Assets

Purchased intangible assets consisted of the following (in thousands, except weighted-average useful life):

	January 31, 2012			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted-Average Useful Life
Customer relationships	$687,578	$(32,666)	$654,912	8.4
Developed and core technology	$254,321	$(119,127)	$135,194	4.2
In-process research and development	19,304	—	19,304	Indefinite
Trade name	17,489	(1,288)	16,201	4.0
Internal use software	3,031	(2,615)	416	3.6
Non-Compete	3,000	(75)	2,925	10.0
	$984,723	$(155,771)	$828,952	

	October 31, 2011			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted-Average Useful Life
Developed and core technology	$187,193	$(114,112)	$73,081	4.0
In-process research and development	19,021	—	19,021	Indefinite
Trade name	2,692	(897)	1,795	3.3
Internal use software	3,031	(2,418)	613	3.6
Customer relationships	185,872	(16,615)	169,257	5.5
	$397,809	$(134,042)	$263,767	

Amortization of purchased intangible assets for the three months ended January 31, 2012 and 2011 was allocated as follows (in thousands):

	Three Months Ended January 31,	
	2012	2011
Included in cost of net revenues	$8,489	$4,859
Included in general and administrative expenses	13,615	2,316
	$22,104	$7,175

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, 2012, is estimated as follows (in thousands):

Table of Contents

Fiscal Years Ending October 31:	Cost of Net Revenues	Operating Expenses	Total
Remainder of fiscal 2012	$31,082	$70,356	$101,438
2013	38,869	91,240	130,109
2014	38,013	90,652	128,665
2015	17,409	89,395	106,804
2016	10,031	84,515	94,546
Thereafter	1,632	246,468	248,100
	$137,036	$672,626	$809,662

Note 4. Balance Sheet and Statement of Income Details

Restricted Cash

The 2011 Credit Agreement required that we fund an escrow account to repay, at maturity, the principal and interest of our 1.375% Senior Convertible Notes due June 2012. As a result, $279.2 million was deposited in the escrow account and reported as short-term Restricted cash and cash equivalents in our Condensed Consolidated Balance Sheets.

We had $7.6 million and $4.8 million of long-term restricted cash as of January 31, 2012 and October 31, 2011, respectively, consisting mainly of pledged deposits for bank guarantees to customers and borrowings, which was included in Other assets in the Condensed Consolidated Balance Sheets.

Inventories

Inventories consisted of the following (in thousands):

	January 31, 2012	October 31, 2011
Raw materials	$43,244	$37,216
Work-in-process	456	859
Finished goods	127,714	106,241
Total inventories	$171,414	$144,316

Prepaid Expenses and Other Current Assets

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

	January 31, 2012	October 31, 2011
Prepaid taxes	$37,608	$18,490
Other prepaid expenses	37,958	34,111
Assets held for sale	4,148	—
Investments in equity securities and warrants	5,988	6,132
Receivables from sales of Hypercom divested businesses	7,082	13,984
Sales-type lease receivables	4,547	3,340
Other receivables	6,707	9,696
Other current assets	2,472	2,333
Total prepaid expenses and other current assets	$106,510	$88,086

Accrued Warranty

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

Table of Contents

	Three Months Ended January 31, 2012	Year Ended October 31, 2011
Balance at beginning of period	$22,032	$12,747
Warranty charged to cost of net revenues	3,083	17,888
Utilization of warranty accrual	(5,889)	(16,573)
Acquired warranty obligations	348	7,139
Change in estimates	(1,142)	831
Balance at end of period	18,432	22,032
Less current portion	(17,055)	(20,358)
Long-term portion	$1,377	$1,674

Deferred Revenue, net

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

	January 31, 2012	October 31, 2011
Deferred revenue	$145,949	$113,154
Deferred cost of revenue	(15,056)	(12,863)
	130,893	100,291
Less current portion	(97,715)	(68,824)
Long-term portion	$33,178	$31,467

Other Current Liabilities

Other current liabilities consisted of the following (in thousands):

	January 31, 2012	October 31, 2011
Accrued liabilities for contingencies	$44,429	$30,561
Deferred acquisition consideration payable - current portion	27,974	5,681
Restructuring liabilities - current portion	2,192	5,137
Unfavorable lease contracts accrual	3,028	3,793
Customer deposits	4,468	4,501
Other current liabilities	$6,097	$7,726
Total other current liabilities	$88,188	$57,399

Other Long-Term Liabilities

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

	January 31, 2012	October 31, 2011
Other tax liabilities	$44,165	$51,918
Retirement and pension obligations	9,927	10,292
Deferred acquisition consideration payable - non-current portion	7,976	5,125
Accrued warranties	1,377	1,674
Other liabilities	11,990	9,962
Total other long-term liabilities	$75,435	$78,971

Table of Contents

Noncontrolling Interests in Subsidiaries

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

	January 31, 2012	October 31, 2011
Noncontrolling interests in subsidiaries at beginning of period	$445	$572
Additions due to acquisitions	37,132	—
Distributions to owners	(135)	(418)
Net income attributable to noncontrolling interests in subsidiaries, net	317	291
Noncontrolling interests in subsidiaries at end of period	$37,759	$445

Other Income (Expense), net

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

	Three Months Ended January 31,	
	2012	2011
Foreign currency exchange (losses), net	$(21,005)	$(259)
Gain on bargain purchase of a business, net	—	1,476
Other income (expense), net	(193)	434
Total other income (expense), net	$(21,198)	$1,651

We recorded a $22.5 million foreign currency loss in the three months ended January 31, 2012 related to the difference between the forward rate on contracts purchased to lock in the U.S. dollar equivalent purchase price for our Point acquisition, and the actual rate on the date of derivative settlement. This loss was offset by a $1.5 million gain on the currency we held from the date of the derivative settlement until the funds were transfered to purchase Point.

Note 5. Financings

Our financings as of January 31, 2012 and October 31, 2011 consisted of the following (in thousands):

	January 31, 2012	October 31, 2011
2011 Credit Agreement		
Term A loan	$918,500	$—
Term B loan	231,500	—
Revolving loan	210,000	—
2006 Credit Agreement - Term B loan	—	216,250
Senior convertible notes	271,080	266,981
Point overdraft facility	4,620	—
Other	1,746	580
Total borrowings	1,637,446	483,811
Short-term debt	(324,271)	(272,055)
Long-term debt	$1,313,175	$211,756

2011 Credit Agreement

A syndicate of banks has committed to provide VeriFone, Inc., our main operating subsidiary, up to 1.5 billion, of which $1.45 billion was funded at December 28, 2011 (the "Effective Date"), under the 2011 Credit Agreement. The loans,

15

Table of Contents

supplemented by our cash on hand, funded the acquisition of Point, repaid our existing Term B Loan and funded an escrow account to pay the interest and principal of the 1.375% Senior Convertible Notes due June 2012.

The key terms of the 2011 Credit Agreement are as follows:

- The 2011 Credit Agreement is made up of a Term A loan, a Term B loan and a Revolving loan. The Term A loan is in the amount of $918.5 million, the Term B loan is in the amount of $231.5 million, and the Revolving loan is in the amount of $350.0 million.

- At VeriFone, Inc.'s option, the Term A loan, Term B loan and the Revolving loan bear interest at a "Base Rate" or "Eurodollar Rate" plus an applicable margin. Base Rate loans bear interest at a per annum rate equal to a margin over the greater of the Federal Funds rate plus 0.50% or the JP Morgan prime rate or the one-, two-, three- or six-month (or, in certain circumstances, nine-, twelve- or less than one month) LIBOR rate plus 1.00%. For the Base Rate Term A loan and Revolving loan, the margin varies between 1.00% to 2.00% depending upon our consolidated leverage ratio and is initially 1.75%. For the Base Rate Term B loan, the margin varies between 2.00% to 2.25% depending upon our consolidated leverage ratio and is initially 2.25% with a minimum LIBOR floor rate of 1.00%. Eurodollar Rate loans bear interest at a margin over the one-, two-, three- or six-month LIBOR rate. For the Eurodollar Term A Loan and Revolving loan, the margin varies between 2.00% to 3.00% depending upon our consolidated leverage ratio and is initially 2.75%. The margin for the Eurodollar Rate Term B loan varies between 3.00% to 3.25% depending upon our consolidated leverage ratio and is initially 3.25% with a minimum LIBOR floor rate of 1.00%.

- The terms of the 2011 Credit Agreement require VeriFone, Inc. to comply with financial covenants from January 31, 2012. VeriFone, Inc. may not permit its total Leverage Ratio to exceed (i) 4.25 to 1.00, in the case of any fiscal quarter ending prior to November 1, 2012, (ii) 3.75 to 1.00 in the case of any fiscal quarter ending prior to November 1, 2013 and (iii) 3.50 to 1.00, in the case of any fiscal quarter ending thereafter. In addition, VeriFone, Inc. must maintain an interest coverage ratio of at least (i) 3.50 to 1.00, in the case of any fiscal quarter ending prior to November 1, 2012 and (ii) 4.00 to 1.00, in the case of any fiscal quarter ending thereafter. Noncompliance with any of the financial covenants without cure or waiver would constitute an event of default under the 2011 Credit Agreement. The 2011 Credit Agreement also contains customary events of default that include, among others, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, bankruptcy and insolvency events, material judgments, cross defaults to material indebtedness and events constituting a change of control. The occurrence of an event of default could result in the termination of commitments under the 2011 Credit Agreement, the declaration that all outstanding loans are immediately due and payable in whole or in part and the requirement of cash collateral deposits in respect of outstanding letters of credit.

- The 2011 Credit Agreement contains certain representations and warranties, certain affirmative covenants, certain negative covenants, certain financial covenants and certain conditions that are customarily required for similar financings. These covenants include, among others:
A restriction on incurring additional indebtedness, subject to specified permitted debt;
A restriction on creating certain liens;
A restriction on mergers and consolidations, subject to specified exceptions;
A restriction on certain investments, subject to certain exceptions and a suspension if VeriFone, Inc. achieves certain credit ratings; and
A restriction on entering into certain transactions with affiliates.

- Pursuant to a Guaranty, dated as of December 28, 2011 (the "Guaranty"), among certain wholly-owned domestic subsidiaries of VeriFone, Inc. identified therein (the "Guarantors"), obligations under the 2011 Credit Agreement are guaranteed by the Guarantors. Pursuant to a Security Agreement and a Pledge Agreement, each dated as of December 28, 2011 (the "Collateral Agreements") among VeriFone, Inc. and the Guarantors on the one hand and JPMorgan, as collateral agent, on the other hand, obligations under the 2011 Credit Agreement, and the guarantees of such obligations are also secured by a first priority lien and security interest, subject to customary exceptions, in certain assets of VeriFone, Inc. and the Guarantors and equity interests owned by VeriFone, Inc. and the Guarantors in certain of their respective domestic and foreign subsidiaries (limited, in the case of foreign subsidiaries, to 65% of the voting stock of such subsidiaries). Certain equity interests owned by existing and subsequently acquired subsidiaries may also be pledged in the future. Other existing and subsequently acquired or newly-formed domestic subsidiaries of VeriFone, Inc. and the Guarantors, may become Guarantors in the future.

Table of Contents

- VeriFone, Inc. will pay an undrawn commitment fee ranging from 0.25% to 0.50% (depending on VeriFone, Inc.'s leverage ratio) on the unused portion of the Revolving loan. For letters of credit issued under the Revolving loan, VeriFone, Inc. will pay upon the aggregate face amount of each letter of credit a fronting fee to be agreed to the issuer of the letter of credit together with a fee on all outstanding letters of credit at a per annum rate equal to the margin then in effect with respect to LIBOR-based loans under the Revolving loan.

- The outstanding principal balance of the Term A loan is required to be repaid in quarterly installments of the following percentages of the original balance outstanding under the Term A loan: 1.25% for each of the first eight calendar quarters after the Effective Date through the quarter ending December 31, 2013; 2.50% for each of the next eight calendar quarters through the quarter ending December 31, 2015 and 5.00% for each of the calendar quarters ending March 31, 2016, June 30, 2016 and September 30, 2016 with the balance being due at maturity on December 28, 2016. The outstanding principal balance of the Term B loan is required to be repaid in equal quarterly installments of 0.25% with the balance being due at maturity on December 28, 2018. The Revolving loan will terminate on December 28, 2016. Outstanding amounts may also be subject to mandatory prepayment with the proceeds of certain asset sales and debt issuances and, in the case of the Term B loan only, from a portion of annual excess cash flows (as determined under the 2011 Credit Agreement) depending on VeriFone Inc.'s leverage ratio.

On December 28, 2011, in connection with entering into the 2011 Credit Agreement, VeriFone, Inc. repaid in full all outstanding loans, together with interest and all other amounts due in connection with such repayment under the credit agreement entered into on October 31, 2006 totaling an aggregate of $216.8 million, and terminated that agreement. No penalties were due in connection with such repayments.

In addition, the 2011 Credit Agreement required that we fund an escrow account to repay at maturity, or upon earlier conversion at the option of the holders thereof, our 1.375% Senior Convertible Notes. As a result, $279.2 million, which includes interest payable at maturity, was deposited in the escrow account, which was reported as short-term Restricted Cash in our Condensed Consolidated Balance Sheets related to this escrow.

We incurred $41.6 million of issuance costs in connection with the 2011 Credit Agreement. These costs were capitalized in Other assets on the Condensed Consolidated Balance Sheets, and the costs are being amortized to interest expense using the effective interest method over the term of the credit facilities, which is 5 or 7 years.

As of January 31, 2012:

- The Term A and Revolving loan bore interest at 3.05% which was one month LIBOR plus 2.75% margin;
- The Term B loan bore interest at 4.25%which was the higher of LIBOR or 1.00% plus 3.25% margin.

As of January 31, 2012 interest margins are 2.75% for the Term A loan and the Revolving loan, and 3.25% for the Term B loan.

We were in compliance with all financial covenants as of January 31, 2012.

1.375% Senior Convertible Notes

On June 22, 2007, we issued and sold $316.2 million aggregate principal amount of 1.375% Senior Convertible Notes due in June 2012 (the "Notes".) The net proceeds from the offering, after deducting transaction costs, were approximately $307.9 million. We incurred approximately $8.3 million of debt issuance costs. The transaction costs, consisting of the initial purchasers' discounts and offering expenses, were primarily recorded in debt issuance costs, net and are being amortized to interest expense using the effective interest method over five years. The Notes are effectively subordinated to any secured indebtedness to the extent of the value of the related collateral and structurally subordinated to indebtedness and other liabilities of our subsidiaries including any secured indebtedness of such subsidiaries.

Each $1,000 of principal of the Notes is initially convertible into 22.719 shares of our common stock, which is equivalent to a conversion price of approximately $44.02 per share, subject to adjustment upon the occurrence of specified events. Upon conversion, we would pay the holder an amount in cash to the principal amount of the Notes. The value of the applicable number of shares of our common stock that are issuable on conversion of the Notes, if any, that exceeds the principal amount will be paid in shares of stock.

Holders of the Notes may convert their Notes prior to maturity during specific periods upon certain events described in Note 5. Financings of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended October 31, 2011. As of January 31, 2012, none of these conditions had been met. If a fundamental change, as defined in the

Table of Contents

indenture, occurs prior to the maturity date, holders of the Notes may require us to repurchase all or a portion of their Notes for cash at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest (including additional interest, if any) up to, but excluding, the repurchase date.

As of January 31, 2012, our stock price was less than the conversion price of $44.02, hence the if-converted value of the Notes did not exceed the principal amount.

We pay 1.375% interest per annum on the principal amount of the Notes, semi-annually in arrears on June 15 and December 15 of each year, subject to increase in certain circumstances.

We separately account for the liability and equity components of the Notes. The principal amount of the liability components of the Notes was $236.0 million as of date of issuance, which was recognized at the present value of its cash flows using a discount rate of 7.6%, our approximate borrowing rate at the date of the issuance for a similar debt instrument without the conversion feature. The carrying value of the equity component was $80.2 million.

Through January 31, 2012, we had repurchased and extinguished $38.9 million in aggregate principal amount of our outstanding Notes. As of January 31, 2012, the remaining principal amount of the outstanding Notes was $277.3 million.

The following table presents the carrying value of the Notes (in thousands):

	January 31, 2012	October 31, 2011
Accounting amount of the equity component	$77,903	$77,903
Principal amount of the Notes	$277,250	$277,250
Unamortized debt discount (1)	(6,170)	(10,269)
Net carrying amount	$271,080	$266,981

(1) As of January 31, 2012, the remaining period over which the unamortized debt discount will be amortized is 5 months.

A summary of interest expense and interest rate on the liability component related to the Notes for the three months ended January 31, 2012 and 2011 is as follows (in thousands, except percentages):

	Three Months Ended January 31,	
	2012	2011
Interest rate on the liability component	7.6 %	7.6 %
Interest expense related to contractual interest coupon	$961	$953
Interest expense related to amortization of debt discount	4,099	3,805
Total interest expense recognized	$5,060	$4,758

In connection with the offering of the Notes, we entered into note hedge transactions with affiliates of the initial purchasers (the "counterparties"), consisting of Lehman Brothers OTC Derivatives ("Lehman Derivatives") and JPMorgan Chase Bank, National Association, London Branch. These note hedge transactions serve to reduce the potential dilution upon conversion of the outstanding Notes in the event that the volume weighted average price of our common stock on each trading day of the relevant conversion period or other relevant valuation period for the Notes is greater than $44.02 per share. We terminated the note hedge transaction with Lehman Derivatives during June 2011. The remaining note hedge transactions, which reduce the potential dilution by one half upon conversion of the outstanding Notes in the event certain conditions are met, are set to expire on the earlier of the last day on which any Notes remain outstanding and June 14, 2012.

In addition, we sold warrants to the counterparties whereby they have the option to purchase up to approximately 7.2 million shares of our common stock at a price of $62.356 per share. The warrants expire in equal amounts on each trading day from December 19, 2013 to February 3, 2014.

The cost incurred in connection with the note hedge transactions and the proceeds from the sale of the warrants are included as a net reduction in Additional paid-in capital in the accompanying Condensed Consolidated Balance Sheets as of January 31, 2012 and October 31, 2011.

Table of Contents

Point Overdraft Facility

The 51% majority owned subsidiary of Point, Babs Paylink AB, has an unsecured overdraft facility with Swedbank, the 49% shareholder of Babs Paylink AB that terminates in December 2012. The overdraft facility limit is Swedish Kroner ("SEK") 60.0 million (approximately $8.9 million). The interest rate is the bank's published rate plus a margin of 2.55%. At January 31, 2012, the interest rate was 4.67% . There is a 0.25% commitment fee payable annually in advance, and the overdraft facility is renewable annually on December 31. As of January 31, 2012, SEK 31.1 million (approximately $4.6 million) was outstanding and SEK 28.9 million (approximately $4.3 million) was available.

Principal Payments

Principal payments due for financings over the next five years are as follows (in thousands):

Fiscal Years Ending October 31:	
2012 (Remainder of the fiscal year)	$313,485
2013	53,333
2014	82,710
2015	94,182
2016	163,071
Thereafter	936,835
	$1,643,616

Note 6. Fair Value Measurements

For assets and liabilities measured at fair value such amounts are based on an expected exit price, representing the amount that would be received on the sale of an asset or paid to transfer a liability, as the case may be, in an orderly transaction between market participants. As such, fair value may be based on assumptions that market participants would use in pricing an asset or liability. The authoritative guidance on fair value measurements establishes a consistent framework for measuring fair value on either a recurring or nonrecurring basis whereby inputs, used in valuation techniques, are assigned a hierarchical level. The following are the hierarchical levels of inputs to measure fair value:

Level 1 -	Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2 -	Observable inputs that reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
Level 3 -	Unobservable inputs reflecting our own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

Assets Measured and Recorded at Fair Value on a Recurring Basis

There have been no transfers between fair value measurement levels during the three months ended January 31, 2012. The following table presents our assets and liabilities that were measured at fair value on a recurring basis as of January 31, 2012 and October 31, 2011, classified by the level within the fair value hierarchy (in thousands):

Table of Contents

	January 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				
Money market funds (1)	$58,571	$ 58,571	$ —	$—
Marketable equity investment (2)	5,350	5,350	—	—
Israeli severance funds (3)	2,004	—	2,004	—
Equity warrants (4)	633	—	633	—
Foreign exchange forward contracts (5)	1	—	1	—
Assets held for sale (6)	4,148	—	4,148	—
Total assets measured and recorded at fair value	$70,707	$ 63,921	$ 6,786	$—
Liabilities				
Acquisition related earn-out payables (7)	$25,826	$ —	$ —	$25,826
Foreign exchange forward contracts (5)	415	—	415	—
Total liabilities measured and recorded at fair value	$26,241	$ —	$ 415	$25,826

	October 31, 2011			
	Carrying Value	Quoted Price in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Money market funds (1)	$186,530	$ 186,530	$ —	$—
Marketable equity investment (2)	5,450	5,450	—	—
Israeli severance funds (3)	2,097	—	2,097	—
Equity warrants (4)	682	—	682	—
Foreign exchange forward contracts (5)	58	—	58	—
Total assets measured and recorded at fair value	$194,817	$ 191,980	$ 2,837	$—
Liabilities				
Acquisition related earn-out payables (7)	$6,728	$ —	$ —	$6,728
Foreign exchange forward contracts (5)	314	—	314	—
Total liabilities measured and recorded at fair value	$7,042	$ —	$ 314	$6,728

Explanatory footnotes:

1.Money market funds are classified as Level 1 because the funds are valued using quoted market prices.

2.The marketable equity investment is classified as Level 1 because it is valued using quoted market prices.

3.The Israeli severance funds are classified as Level 2 because there are no quoted market prices, but the fund managers provide a daily redemption value for each of the investments that make up the funds.

4.The equity warrants are classified as Level 2 because they are valued using the Black-Scholes 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.

5.The foreign exchange forward contracts are classified as Level 2 because they are valued using quoted market prices and other observable data for similar instruments in an active market.

6.Assets held for sale are classified as Level 2 because they are measured at fair value, using inputs consisting of recent offers made by third parties to purchase the properties. Assets held for sale were included in Prepaid expenses

and other current assets.
7.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 sales and contributions for the acquired businesses, the probability of achieving the sales and contribution targets and an appropriate discount rate.
Fair Value of Acquisition-Related Earn-out Payables

20

Table of Contents

The following table presents a reconciliation for our earn-out payables measured and recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3) for the three months ended January 31, 2012 (in thousands):

	Three Months Ended January 31, 2012
Balance at October 31, 2011	$6,728
Increase due to business acquisitions	21,657
Other, including the impact of fluctuations in foreign currency exchange rates	370
Earn-out paid	(2,929)
Balance at January 31, 2012	$25,826

Fair Value of Other Financial Instruments

Other financial instruments consist 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 long-term debt related to the Term A, Term B and revolving loan approximates the carrying value since the rate of interest on the long-term debt adjusts to market rates on a periodic basis. The fair value of the Notes, using level one inputs of the closing trading price as of January 31, 2012 and October 31, 2011 was $295.6 million and $304.6 million, respectively.

Note 7. Investment in Equity Securities

On February 9, 2010, we invested in Trunkbow International Holdings Ltd. ("Trunkbow"), a Jinan, People's Republic of China-based mobile payments and value-added service applications company. We paid $5.0 million for 2.5 million shares of common stock and warrants to purchase 500,000 shares of common stock. The warrants have a strike price of $2.00 per share and are exercisable anytime up to 5 years from the closing date. The investment was originally accounted for using the cost-method and reflected in Other assets in our Condensed Consolidated Balance Sheets. The allocated costs of the shares and warrants were approximately $4.7 million and $0.3 million, respectively.

On February 3, 2011, Trunkbow's shares began trading on the NASDAQ Global Market. As a result, our investment in Trunkbow shares became marketable, and we reclassified this investment as available-for-sale. Accordingly, our investment in the Trunkbow shares is recorded at fair value which is the quoted market price of the shares. Any unrealized gains on the shares are included in Accumulated other comprehensive income, a component of Stockholders' equity. Realized gains (losses) on the sale of available-for-sale securities, which will be calculated based on the specific identification method, and declines in value below cost judged to be other-than-temporary, if any, will be recorded in Other income (expense), net as incurred.

Trunkbow Shares: The fair value of our Trunkbow shares as of January 31, 2012 and October 31, 2011 was estimated at $5.4 million and $5.5 million, respectively. The net unrealized gain as of January 31, 2012 was $0.6 million. We recorded an unrealized loss in Accumulated other comprehensive income of $0.1 million during the three months ended January 31, 2012.

Trunkbow Warrants: The Trunkbow warrants are derivatives. Accordingly, the warrants are recorded at fair value. We estimated the fair value of the warrants using the Black-Scholes valuation model. The changes in fair value are recorded as Other income (expense), net, in our Condensed Consolidated Statements of Operations. The fair value of our Trunkbow warrants as of January 31, 2012 and October 31, 2011 was estimated at $0.6 million and $0.7 million, respectively. We reflected a 0.1 million mark-to-market loss in Other income (expense), net in our Condensed Consolidated Statements of Operations for the three months ended January 31, 2012.

Note 8. Derivative Financial Instruments

We use derivative financial instruments primarily to manage exposures to foreign currency exchange 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. 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 do not use derivative financial instruments for speculative or trading purposes, nor do we hold or issue leveraged derivative financial instruments.

We hold warrants to purchase equity securities of a publicly-traded company. These warrants are derivative financial instruments, and are included in Prepaid expenses and other current assets in our Condensed Consolidated Balance Sheets. Accordingly, gains or losses resulting from changes in the fair value are recorded as Other income (expense), net, in the

Table of Contents

Condensed Consolidated Statements of Income.

The fair value of the outstanding derivative instruments as of January 31, 2012 and October 31, 2011 is as follows (in thousands):

	Balance Sheet Location	As of January 31, 2012	As of October 31, 2011
Derivative Assets			
Derivatives not designated as hedging instruments:			
Foreign exchange forward contracts	Prepaid expenses and other current assets	$1	$58
Equity warrants	Prepaid expenses and other current assets	633	682
Total		$634	$740
Derivative Liabilities			
Derivatives not designated as hedging instruments:			
Foreign exchange forward contracts	Other current liabilities	$415	$314
Total		$415	$314

Foreign Currency Exchange Risk

Foreign exchange forward contracts, both designated and not designated as hedging instruments pursuant to ASC 815 Derivatives and Hedging, are recognized either as assets or liabilities on the Condensed Consolidated Balance Sheets at fair value at the end of each reporting period. We have not entered into any derivative financial instruments which qualify as hedging instruments since November 1, 2009.

Derivatives Not Designated as Hedging Instruments

We primarily utilize foreign exchange forward contracts to offset the risks associated with certain foreign currency balance sheet exposures. Under this program, foreign exchange forward contracts are arranged and maintained so as to yield gains or losses to offset changes in foreign currency denominated assets or liabilities due to movements in foreign exchange rates, thus mitigating the volatility associated with foreign currency transaction gains or losses. Our foreign currency exposures are predominantly intercompany receivables and payables arising from product sales from one of our entities to another. Foreign exchange forward contracts generally settle within 90 days. We do not use these foreign exchange forward contracts for trading purposes.

Gains or losses resulting from changes in the fair value of these foreign exchange forward contracts are recorded as Other income (expense), net, in the Condensed Consolidated Statements of Operations.

As of January 31, 2012, the notional amounts of the forward contracts we held to purchase U.S. dollars in exchange for other major international currencies were $166.6 million. As of October 31, 2011, the notional amount of the forward contracts we held to purchase U.S. dollars in exchange for other major international currencies was $87.3 million.

We recorded a $21.0 million million net loss and a $0.5 million net gain on foreign exchange contracts in the three months ended January 31, 2012 and 2011, respectively, for derivative instruments not designated as hedging instruments. Of the $21.0 million, $22.5 million represents the difference between the forward rate and the actual rate on the date of settlement of foreign exchange forward contracts entered into during the quarter ended January 31, 2012 to lock in the U.S. dollar equivalent purchase price for our Point acquisition. These gains (losses) are included in Other income (expense), net in our Condensed Consolidated Statements of Income.

Note 9. Other Comprehensive Income

The components of Accumulated other comprehensive gain or loss, net of tax were as follows (in thousands):

22

Table of Contents

	Three Months Ended January 31,	
	2012	2011
Net income (loss) attributable to VeriFone Systems, Inc. stockholders	$(2,773)	$31,955
Other comprehensive income (loss):		
Foreign currency translation adjustments, net of tax	7,100	2,038
Unrealized gain (loss) on marketable equity investment, net of tax	(100)	—
Other comprehensive income (loss) attributable to VeriFone Systems, Inc. stockholders	$4,227	$33,993

Note 10. Income Taxes

We recorded income tax benefits of $9.8 million and $2.5 million for the three months ended January 31, 2012 and 2011, respectively. The effective tax rates for the three months ended January 31, 2012 and 2011 are lower than the U.S. statutory tax rate due to earnings in countries where we are taxed at lower rates compared to the U.S. federal and state statutory rates and reversal of uncertain tax position liabilities as statutes of limitations expired. The income tax benefit for the three months ended January 31, 2012 includes the discrete tax benefit of $8.5 million related to the foreign exchange loss on futures contracts which was incurred during the quarter.

During the three months ended January 31, 2012, the Company entered into a formal settlement with the Israeli tax authorities for the calendar year 2006 audit and, accordingly, has released $2.6 million of excess accrued tax liabilities associated with this audit.

As of January 31, 2012, we remain in a net deferred tax asset position. 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 subsequent quarters as we reevaluate the underlying basis for our estimates of future domestic and certain foreign taxable income.

We have recorded our uncertain tax position liability as a long-term liability as we do not expect significant payments to occur over the next twelve months. The amount of unrecognized tax positions could be reduced upon closure of tax examinations or if the statute of limitations on certain tax filings expire without assessment from the 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 $1.7 million. Interest and penalties accrued on these uncertain tax positions will also be released upon the expiration of statutes of limitations.

Note 11. Stock-based Compensation

We grant stock awards, including stock options, restricted stock units (“RSUs”) and restricted stock awards (“RSAs”) pursuant to stockholder approved equity incentive plans. These equity incentive plans are described in further detail in Note 12. Stockholders’ Equity of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended October 31, 2011. All stock awards granted during the three months ended January 31, 2012 were granted under the 2006 Equity Incentive Plan, as amended.

Valuation Assumptions

The grant-date fair value of RSUs is equal to the market value of our common stock on the date of grant. The grant-date fair value of stock options is estimated using the Black-Scholes valuation model. We used the following weighted-average assumptions for the three months ended January 31, 2012 and 2011:

	Three Months Ended January 31,	
	2012	2011
Expected term of the options (in years)	3.6	4.0
Risk-free interest rate	0.7%	1.5%
Expected stock price volatility	67.4%	73.3%
Expected dividend rate	0.0%	0.0%

Stock-based Compensation Expense

23

Table of Contents

The following table presents the stock-based compensation expense recognized during the three months ended January 31, 2012 and 2011 (in thousands):

	Three Months Ended January 31,	
	2012	2011
Cost of net revenues	$479	$397
Research and development	1,253	875
Sales and marketing	4,262	3,030
General and administrative	4,710	3,137
Total stock-based compensation	$10,704	$7,439

As of January 31, 2012, total unrecognized compensation expense adjusted for estimated forfeitures related to unvested stock options, and RSUs and RSAs was $49.2 million and $20.5 million, respectively, which is expected to be recognized over the remaining weighted-average vesting periods of 2.1 years for stock options and 2.3 years for RSUs and RSAs.

Stock Option Activity

The following table provides a summary of stock option activity under our equity incentive plans for the three months ended January 31, 2012:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Balance at October 31, 2011	8,201	$18.38		
Granted	1,126	$36.49		
Exercised	(533)	$16.53		