Higher One Holdings, Inc.
Form 10-Q
August 09, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 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: 001-34779

HIGHER ONE HOLDINGS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	26-3025501 (I.R.S. Employer Identification No.)

115 Munson Street
New Haven, CT 06511
(Address of Principal Executive Offices)(Zip Code)
(203) 776-7776
(Registrant's Telephone Number, Including Area Code)
N/A
(Former Name, Former Address and Former Fiscal Year, If Changes 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 x 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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" or "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one).

Large accelerated filer	¨	Accelerated filer	x
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 x

As of August 3, 2012 there were 54,625,045 shares of common stock, par value $0.001 per share, outstanding.

HIGHER ONE HOLDINGS, INC.
INDEX TO REPORT ON FORM 10-Q
FOR QUARTER ENDED JUNE 30, 2012

As used herein, the terms "we," "us," "our," "the Company" or "Higher One," unless the context otherwise requires, mean Higher One Holdings, Inc. and its subsidiaries.

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PART I – FINANCIAL INFORMATION

Item 1.Financial Statements (unaudited)

Higher One Holdings, Inc.
Condensed Consolidated Balance Sheets
(In thousands of dollars, except share and per share amounts)
(unaudited)

	December 31, 2011	June 30, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 39,085	$ 25,449
Investments in marketable securities and certificates of deposit	15,743	11,146
Accounts receivable	3,672	6,900
Income receivable	5,961	8,085
Deferred tax assets	33	28
Income tax receivable	12,671	4,294
Prepaid expenses and other current assets	6,774	7,134
Restricted cash	–	2,635
Total current assets	83,939	65,671
Deferred costs	3,776	3,475
Fixed assets, net	46,088	53,714
Intangible assets, net	16,787	16,704
Goodwill	15,830	15,830
Loan receivable related to New Markets Tax Credit financing	7,633	7,633
Other assets	712	619
Restricted cash	1,250	1,500
Total assets	$ 176,015	$ 165,146
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 3,118	$ 3,369
Accrued expenses	26,414	13,285
Deferred revenue	9,690	12,741
Total current liabilities	39,222	29,395
Deferred revenue	2,173	2,156
Loan payable and deferred contribution related to New Markets Tax Credit financing	9,801	9,646
Deferred tax liabilities	1,233	649
Total liabilities	52,429	41,846
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock, $.001 par value; 200,000,000 shares authorized; 57,675,806 shares issued and 56,615,683 shares outstanding at December 31, 2011; 57,140,831 shares issued and 54,569,580 shares outstanding at June 30, 2012	58	58
Additional paid-in capital	161,268	166,347
	(16,208)	(39,013)

Treasury stock, 1,060,123 and 2,571,251 shares at December 31, 2011 and June 30, 2012, respectively				
Accumulated deficit, net of 2008 stock tender transaction of $93,933		(21,532)		(4,092)
Total stockholders' equity		123,586		123,300
Total liabilities and stockholders' equity	$	176,015	$	165,146

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

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Higher One Holdings, Inc.
Condensed Consolidated Statements of Operations
(In thousands of dollars, except share and per share amounts)
(unaudited)

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2012	Six Months Ended June 30, 2011	Six Months Ended June 30, 2012
Revenue:				
Account revenue	$ 27,701	$ 30,033	$ 69,700	$ 77,143
Payment transaction revenue	3,080	4,172	7,385	9,501
Higher education institution revenue	3,725	4,027	8,101	8,651
Other revenue	561	681	1,264	1,399
Total revenue	35,067	38,913	86,450	96,694
Cost of revenue	13,423	17,141	30,856	38,465
Gross margin	21,644	21,772	55,594	58,229
Operating expenses:				
General and administrative	9,015	11,077	18,787	22,303
Product development	895	1,085	1,680	1,991
Sales and marketing	6,701	2,946	12,165	5,813
Total operating expenses	16,611	15,108	32,632	30,107
Income from operations	5,033	6,664	22,962	28,122
Interest income	11	32	36	64
Interest expense	(56)	(108)	(130)	(217)
Other income	1,500	78	1,500	155
Net income before income taxes	6,488	6,666	24,368	28,124
Income tax expense	1,734	2,614	8,572	10,684
Net income	$ 4,754	$ 4,052	$ 15,796	$ 17,440
Net income available to common stockholders:				
Basic	$ 4,754	$ 4,052	$ 15,796	$ 17,440
Diluted	$ 4,754	$ 4,052	$ 15,796	$ 17,440
Weighted average shares outstanding:				
Basic	55,117,635	54,653,888	54,859,367	55,350,851
Diluted	59,718,105	57,717,127	59,645,471	58,588,952
Net income available to common stockholders per common share:				
Basic	$ 0.09	$ 0.07	$ 0.29	$ 0.32
Diluted	$ 0.08	$ 0.07	$ 0.26	$ 0.30

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

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Higher One Holdings, Inc.
Condensed Consolidated Statement of Changes in Stockholders' Equity
(In thousands of dollars, except shares)
(unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Treasury Stock	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2011	56,615,683	$ 58	$ 161,268	$ (16,208)	$ (21,532)	$ 123,586
Stock-based compensation	–	–	2,434	–	–	2,434
Cancellation of shares (Note 2)	(1,051,878)	(1)	–	–	–	(1)
Tax benefit related to options	–	–	1,744	–	–	1,744
Repurchase of common stock	(1,511,128)	–	–	(22,805)		(22,805)
Exercise of stock options	516,903	1	901	–	–	902
Net income	–	–	–	–	17,440	17,440
Balance at June 30, 2012	54,569,580	$ 58	$ 166,347	$ (39,013)	$ (4,092)	$ 123,300

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

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Higher One Holdings, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands of dollars)
(unaudited)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2012
Cash flows from operating activities		
Net income	$ 15,796	$ 17,440
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,434	4,531
Amortization of deferred finance costs	36	68
Stock-based customer acquisition expense	6,935	–
Stock-based compensation	2,160	2,325
Deferred income taxes	(3,681)	(579)
Other income	–	(155)
Gain on litigation settlement agreement	(1,500)	–
Loss on disposal of fixed assets	107	26
Changes in operating assets and liabilities:		
Accounts receivable	(2,708)	(3,228)
Income receivable	312	(2,124)
Deferred costs	(367)	(506)
Prepaid expenses and other current assets	(451)	8,017
Other assets	75	(114)
Accounts payable	410	381
Accrued expenses	(1,417)	(2,742)
Deferred revenue	2,765	3,034
Net cash provided by operating activities	21,906	26,374
Cash flows from investing activities		
Purchases of available for sale investment securities	(7,787)	(11,230)
Proceeds from sales of available for sale investment securities	–	8,732
Proceeds from maturities of available for sale investment securities	5,600	7,095
Purchases of fixed assets, net of changes in construction payables of $3,494 and ($10,169), respectively	(6,696)	(20,524)
Proceeds from development related subsidies	–	330
Additions to internal use software	–	(1,369)
Deposits to restricted cash	–	(2,885)
Payment to escrow agent	(1,075)	–
Proceeds from escrow agent	1,500	–
Net cash used in investing activities	(8,458)	(19,851)
Cash flows from financing activities		
Tax benefit related to stock options	1,878	1,744
Proceeds from exercise of stock options	663	902
Repurchase of common stock	–	(22,805)
Net cash provided by (used in) financing activities	2,541	(20,159)
Net change in cash and cash equivalents	15,989	(13,636)
Cash and cash equivalents at beginning of period	34,484	39,085
Cash and cash equivalents at end of period	$ 50,473	$ 25,449

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

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Higher One Holdings, Inc.

Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Nature of Business and Organization

Higher One Holdings, Inc. is a leading provider of technology and payment services to the higher education industry. The Company is incorporated in Delaware, maintains its headquarters in New Haven, Connecticut and provides a comprehensive suite of disbursement and payment solutions specifically designed for higher education institutions and their students. The Company has developed proprietary software-based solutions to provide these services. The Company has a wholly-owned subsidiary, Higher One, Inc., or HOI, which has two wholly-owned subsidiaries, Higher One Machines, Inc., or HOMI, and Higher One Real Estate, Inc., or Real Estate Inc. HOI and HOMI together own 100% of Higher One Financial Technology Private Limited, or HOFTPL, an Indian entity formed during the quarter ending June 30, 2012 to perform certain operational support functions. Higher One Payments, Inc., the acquired entity formerly known as Informed Decisions Corporation, or IDC, was previously a subsidiary and was merged into HOI in December 2011. As of June 30, 2012, Real Estate Inc. has a 98% ownership interest in Higher One Real Estate SP, LLC, or Real Estate LLC. HOMI and HOFTPL perform certain operational support functions. Real Estate Inc. and Real Estate LLC were each formed to hold and operate certain of our real estate.

2. Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements and the related interim information contained within the notes to such condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, and the applicable rules of the Securities and Exchange Commission, or SEC, for interim information and quarterly reports on Form 10-Q.

The unaudited condensed consolidated financial statements have been prepared on a consistent basis with the audited consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2011, and in the opinion of management, include all normal recurring adjustments that are necessary for the fair statement of our interim period results reported herein. The December 31, 2011 condensed consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP. Due to seasonal fluctuations and other factors, the results of operations for the three months and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year.

The unaudited condensed consolidated financial statements reflect our financial position and results of operations, including our majority and wholly-owned subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could materially differ from management’s estimates.

Basic and Diluted Net Income Available to Common Stockholders per Common Share

Basic net income per common share excludes dilution for potential common stock issuances and is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted net income per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the calculation of diluted net income per common share, the basic weighted-average number of shares is increased by the dilutive effect of restricted stock and stock options using the treasury-stock method. The treasury-stock method assumes that the options or warrants are exercised at the beginning of the year (or date of issue if later), and that we use those proceeds to purchase common stock for treasury at the average price for the reporting period.

The dilutive effect of stock options totaling 1,040,302 and 1,480,533 were not included in the computation of diluted net income per common share for the three months ended June 30, 2011 and 2012, respectively, as their effect would be anti-dilutive. The dilutive effect of stock options totaling 1,031,352 and 1,348,909 were not included in the computation of diluted net income per common share for the six months ended June 30, 2011 and 2012, respectively, as their effect would be anti-dilutive. Anti-dilutive securities are securities that upon conversion or exercise increase earnings per share (or reduce the loss per share). Restricted stock shares totaling 1,276,800 and 21,672 were not included in the computation of either basic or diluted earnings per share as all necessary conditions for vesting have not been satisfied by the end of the three and six months ended June 30, 2011 and 2012, respectively. In March 2012, 1,051,878 shares reverted back to us and were cancelled as a result of our exercise of certain repurchase rights pursuant to the purchase agreement with one of the officers of Educard, LLC.

Comprehensive Income

There are no comprehensive income items other than net income. There are no recorded unrealized gains or losses on the investments in marketable securities as of the balance sheet dates. Comprehensive income equals net income for all periods presented.

Restricted Cash

During the three months ended June 30, 2012, we deposited various amounts of cash with our bank partners in connection with the deposit processing services that they provide to us. The amounts are reflected in both current and non-current portions of restricted cash as of June 30, 2012.

Recent Accounting Pronouncements

There was no accounting standards adopted during 2011 or during the six months ended June 30, 2012 which had a material impact on our consolidated financial position, results of operations or liquidity. There are no new accounting standards issued which we expect to have a material impact on our consolidated financial position, results of operations, liquidity or disclosure.

3. Investments in Marketable Securities and Fair Value Measurements

The following table reflects the assets carried at fair value measured on a recurring basis (in thousands):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Fair values at June 30, 2012			
Assets:			
U.S. government debt securities	$ 4,999	$ 4,999	$ —
Certificates of deposit	6,147	—	6,147
Total assets	$ 11,146	$ 4,999	$ 6,147
Fair values at December 31, 2011			
Assets:			
U.S. government debt securities	$ 15,498	$ 15,498	$ —
Certificate of deposit	245	—	245
Total assets	$ 15,743	$ 15,498	$ 245

We had no unrealized gains or losses from investments as of December 31, 2011 and June 30, 2012 and there is no difference between the amortized cost and fair value of the securities we held. The contractual maturities of our available for sale securities ranged from approximately one to ten months as of June 30, 2012. We do not have any liabilities carried at fair value as of either December 31, 2011 or June 30, 2012.

The carrying amounts of our cash equivalents, accounts receivable, accounts payable and accrued expenses, approximate fair value because of the short-term nature of these instruments. Our loan receivable related to New Markets Tax Credit financing is a debt instrument that we classify as held to maturity. The loan receivable is recorded at amortized cost and the value as of June 30, 2012 approximates fair value. The carrying value of our loan payable related to New Markets Tax Credit financing approximates fair value as of June 30, 2012. Our loan receivable and loan payable related to New Markets Tax Credit financing were each estimated using discounted cash flow analysis based on borrowing rates for similar types of arrangements.

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Higher One Holdings, Inc.

Notes to Condensed Consolidated Financial Statements
(unaudited)

4. Real Estate Development Project

As of June 30, 2012, we have incurred approximately $33.4 million on a project to develop two existing commercial buildings located in New Haven, Connecticut. We moved our headquarters into these buildings at the end of 2011. We have provided two guarantees related to the real estate development project. We provided a guaranty to the State of Connecticut Department of Economic and Community Development related to our obligation to repay the amounts which were granted to us if we fail to meet certain criteria. The maximum potential amount of future payments of this guaranty is approximately $5.9 million.

We have also provided a guaranty related to tax credits that are expected to be generated by an investment made by an unrelated entity into the real estate development project. In the event that we cause either a recapture or disallowance of the tax credits expected to be generated under this program, then we will be required to repay the disallowed or recaptured tax credits plus an amount sufficient to pay the taxes on such repayment, to the counterparty of the guaranty agreement. This guaranty will remain in place through 2018. The maximum potential amount of future payments of this guaranty is approximately $6.0 million.

We currently believe that the likelihood of us being required to make a payment under either of the guaranties described above is remote and we have thus not recorded any liability on our balance sheet in connection with these guaranties.

5. Credit Facility

On December 31, 2010, HOI entered into a senior secured revolving credit facility, or the Credit Facility. As of June 30, 2012, $50.0 million in borrowings were available to us under the Credit Facility and we were in compliance with all of the applicable affirmative, negative and financial covenants in the Credit Facility. The amount available to be drawn under the Credit Facility may be increased by an additional $50.0 million upon our request and the agreement of the lenders party to the Credit Facility. The Credit Facility provides for the issuance of letters of credit of up to $3 million in the aggregate and includes certain restrictions on the amount of acquisitions we may complete. Any amounts drawn under the Credit Facility are payable in a single maturity on December 31, 2013.

6. Capital Stock

Treasury Stock

In August 2011, our board of directors authorized a share repurchase program pursuant to which we may repurchase up to $40 million of our issued and outstanding shares of common stock through September 7, 2012. During the six months ended June 30, 2012, we repurchased 1,511,128 shares of our common stock at a cost of $22.8 million. All shares repurchased were held in treasury as of June 30, 2012.

7. Commitments and Contingencies

From time to time we are subject to litigation relating to matters in the ordinary course of business, as well as regulatory examinations, information gathering requests, inquiries and investigations.

In February 2011, the New York Regional Office of the Federal Deposit Insurance Corporation, or FDIC, notified us that it was prepared to recommend to the Director of FDIC Supervision that an enforcement action be taken against us for alleged violations of certain applicable laws and regulations principally relating to our compliance management system and policies and practices for past overdraft charging on persistently delinquent accounts, collections and transaction error resolution. We responded to the FDIC's notification and have been in regular dialogue with the FDIC since 2010. We voluntarily initiated a plan in December 2011 that provided credits to certain current and former customers that were previously assessed certain insufficient fund fees. As a result of this plan, we recorded a reduction in our revenue of approximately $4.7 million in 2011, which excludes the restitution of unpaid fees. The insufficient funds fees that were credited to customers under this plan were originally assessed beginning in 2008. Of the total charge of $4.7 million, an accrual of approximately $2.6 million was established for amounts which were not paid as of December 31, 2011. All amounts were paid to our customers as of March 31, 2012. On August 8, 2012, we received a Consent Order, Order for Restitution, and Order to Pay Civil Money Penalty, or the Consent Order, dated August 7, 2012, issued by the FDIC to settle such alleged violations. Pursuant to the terms of the Consent Order, we neither admitted nor denied any charges when agreeing to the terms of the Consent Order. Under the terms of the Consent Order, we are required to, among other things, review and revise our compliance management system and, to date, we have already substantially revised our compliance management system. Additionally, the Consent Order provides for restrictions on the charging of certain fees. The Consent Order further provides that we shall make restitution to less than 2% of our customers since 2008 for fees previously assessed, which restitution has been substantially completed through the voluntary customer credit plan described above, and pay a civil money penalty of $110,000. As a result of the Consent Order and completion of the related examination, we believe that all material exposure related to this matter has been recorded and we do not expect any further losses as a result of this matter.

On April 18, 2012, Sherry McFall, a Higher One customer, filed a putative class action in the United States District Court for the Central District of California, Western Division, against Higher One Holdings, Inc. alleging, among other things, violations of California's Unfair Competition Law, the Consumer Legal Remedies Act and the Electronic Funds Transfer Act in connection with alleged improper disclosures of fees and costs associated with opening and maintaining an account, as well as various common law claims. The complaint was subsequently voluntarily withdrawn by the plaintiff. On April 24, 2012, Sherry McFall filed a new complaint in the Superior Court of California for the County of Ventura, the claims of which are substantially the same as the first complaint. The case was transferred to the United States District Court for the Central District of California, Western Division on July 11, 2012. On July 27, 2012, the plaintiff voluntary dismissed all claims in the complaint.

On July 3, 2012, Higher One customer Ashley Parker and three other customers filed a putative class action in the United States District Court for the Northern District of Mississippi, Eastern Division, against Higher One Holdings, Inc. alleging, among other things, violations of the Electronic Funds Transfer Act and the Connecticut Unfair Trade Practices Act, as well as various common law claims. We believe the claims to be without merit. Although we plan to defend the matter vigorously, there can be no assurances of our success in this matter.

On July 27, 2012, Higher One customer Jeanette Price and six other customers filed a putative class action in the United States District Court for the District of Connecticut against Higher One Holdings, Inc. alleging, among other things, violations of the Connecticut Unfair Trade Practices Act, statutory theft and various common law claims. We believe the claims to be without merit. Although we plan to defend the matter vigorously, there can be no assurances of our success in this matter.

In February 2009 and September 2010, Higher One, Inc. filed two separate complaints against TouchNet Information Systems, Inc., or TouchNet, in the United States District Court for the District of Connecticut alleging patent infringement related to TouchNet's offering for sale and sales of its "eRefund" product in violation of two of our patents. In the complaints, we sought judgments that TouchNet has infringed two of our patents, a judgment that TouchNet pay damages and interest on damages to compensate us for infringement, an award of our costs in connection with these actions and an injunction barring TouchNet from further infringing our patents. TouchNet answered the complaint and asserted a number of defenses and counterclaims, including that it does not infringe our patent, that our patent is invalid or unenforceable and certain allegations of unfair competition and state and federal antitrust violations. In addition, TouchNet's counterclaims sought dismissal of our claims with prejudice, declaratory judgment that TouchNet does not infringe our patent and that our patent is invalid or unenforceable, as well as an award of fees and costs related to the action, and an injunction permanently enjoining us from suing TouchNet regarding infringement of our patent. The parties are currently in the discovery stage of the proceeding. We intend to pursue the matter vigorously. There can be no assurances of our success in these proceedings.

8. Subsequent Events

On August 7, 2012, we entered into an Asset Purchase Agreement with Campus Labs, LLC, or Campus Labs, and Eric Reich and Michael Weisman, as the members of Campus Labs, to purchase substantially all of the assets of Campus Labs for consideration consisting of (i) $38.4 million in cash; (ii) warrants to purchase 150,000 shares our common stock; and (iii) a potential earn out payment calculated by multiplying the amount of 2013 revenues for the acquired business in excess of $12.5 million, if any, by 3.5. We completed the acquisition on August 7, 2012, and used cash on hand and borrowing available under our Credit Facility to pay the cash portion of the purchase price and related transaction costs. Campus Labs offers specialized, comprehensive assessment programs that combine data collection, reporting, organization, and campus-wide integration for higher education institutions, which we believe will help us deepen our relationships with higher education institutions by providing additional value-added services. The net assets and results of operations of the acquired assets of Campus Labs, LLC will be included in our consolidated financial statements from August 8, 2012. The relevant business combination disclosures will be included in our financial statements once the preliminary accounting has been finalized.

On August 1, 2012, our board of directors authorized a share repurchase program pursuant to which we may repurchase up to $100 million of our issued and outstanding shares of common stock through August 15, 2013. Repurchases under the program may be effected through open market purchases, trading plans established in accordance with Securities and Exchange Commission rules, derivative transactions or other means. The timing and amount of repurchases under the authorization will depend on market conditions and our other funding requirements.

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Item 2.Management's Discussion and Analysis of Financial Condition and Results of Operations

The information contained in this section should be read in conjunction with our audited consolidated financial statements and related notes as included in our annual report on Form 10-K for the year ended December 31, 2011 and information contained elsewhere in such annual report on Form 10-K and in this quarterly report on Form 10-Q. The discussion contains forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995) involving risks, uncertainties and assumptions that could cause our results to differ materially from expectations. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," "should" a similar expressions are intended to identify forward-looking statements. Factors that might cause these differences include those described under "Risk Factors" and elsewhere in the annual report on Form 10-K and in this quarterly report on Form 10-Q. The forward-looking statements included in this quarterly report on Form 10-Q are made only as of the date of this report. We do not undertake any obligation to update or supplement any forward-looking statements to reflect subsequent events or circumstances, except as required by law. We cannot assure you that projected results or events will be achieved or will occur.

Overview

We believe that based on market share and the number of campuses employing our products, we are a leading provider of technology and payment services to the higher education industry. We believe that none of our competitors can match our ability to provide solutions for higher education institutions' financial services needs, including compliance monitoring, and, consequently, that we provide the most comprehensive suite of disbursement and payment solutions specifically designed for higher education institutions and their students. We also provide campus communities with convenient, cost-competitive and student-oriented banking services, which include extensive user-friendly features.

Our products and services for our higher education institution clients include our OneDisburse® Refund Management® funds disbursement service and our CASHNet® suite of payment transaction products and services. Through our bank partners, we offer our OneAccount service to the students of our higher education institution clients, which includes an FDIC-insured checking account, a OneCard, which is a debit MasterCard® ATM card, and other retail banking services.

As of June 30, 2012, more than 550 campuses serving more than 4.4 million students had purchased the OneDisburse service and more than 400 campuses serving more than 2.8 million students had contracted to use one or more of our payment products and services. We also service approximately 1.9 million OneAccounts as of June 30, 2012.

Our historical experience has been that account revenue generated per OneAccount has been generally stable year over year, with total account revenue generally increasing proportionally with increases in the number of OneAccounts. During the three months and six months ended June 30, 2012, our account revenue grew at a slower pace than the growth in our number of OneAccounts. We believe that this is due to a lower proportion of our OneAccounts receiving a financial aid refund compared to prior year periods, a trend we believe is indicative of slower enrollment growth. We believe that there is the potential for additional volatility in the relationship between the number of OneAccounts and account revenue in the future as a result of variability in student enrollment growth at higher education institutions and changes in financial aid refund timing at higher education institutions. As a result of federal legislation which was signed into law in 2011, students are only allowed to receive one federal Pell grant under the federal Pell grant program in 2012, compared to two federal Pell grants in prior years. We believe this change contributed to a decrease in financial aid disbursed to students during the three months ended June 30, 2012 through a reduction in federal Pell grants awarded for summer school programs.

Our revenue fluctuates as a result of seasonal factors related to the academic year. A large proportion of our revenue is either directly or indirectly dependent on academic financial aid received by students and in turn the number of students enrolled at our higher education institution clients. Higher education institution clients typically disburse financial aid refunds to students at the start of each academic term. Distribution of financial aid disbursements through our OneDisburse service (1) indirectly generates revenue through deposits of financial aid into OneAccounts, which generates account revenue, and (2) directly generates revenue through our higher education institution clients' use of the OneDisburse service, which generates higher education institution revenue.

While revenue fluctuates over the course of the year, our fixed expenses remain relatively constant, resulting in wide disparities in our net income and adjusted net income from quarter to quarter. Typically, the second quarter accounts for the smallest proportion of our revenues but an equal proportion of certain of our expenses. This is primarily because the majority of financial aid is disbursed during other times of the year and higher education institutions tend to enroll more new students in the third fiscal quarter. We expect that this trend will continue.

As we previously reported, we entered into agreements for FDIC-insured depository service with Urban Trust Bank, a federal savings bank, or UTB, Wright Express Financial Services Corporation, a Utah industrial bank, or Wright Express FSC, and Cole Taylor Bank, an Illinois chartered bank and Federal Reserve Member, or Cole Taylor. We refer to UTB, Wright Express FSC and Cole Taylor, sometimes together with the Bancorp Bank, as our Bank Partners. These three banks collectively perform the services that were previously performed for us by the Bancorp Bank. In May 2012, we completed the process of implementing our relationships with these new Bank Partners and terminating the services previously provided by the Bancorp Bank.

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Results of Operations for the Three Months Ended June 30, 2011 and 2012

The following tables summarize key components of our results of operations for the periods indicated, both in dollars and as a percentage of total revenue:

	Three Months Ended June 30, (Unaudited)			
	2011	2012	$ Change	% Change
		(in thousands)		
Account revenue	$ 27,701	$ 30,033	$ 2,332	8.4%
Payment transaction revenue	3,080	4,172	1,092	35.5%
Higher education institution revenue	3,725	4,027	302	8.1%
Other revenue	561	681	120	21.4%
Total revenue	35,067	38,913	3,846	11.0%
Cost of revenue	13,423	17,141	3,718	27.7%
Gross margin	21,644	21,772	128	0.6%
General and administrative	9,015	11,077	2,062	22.9%
Product development	895	1,085	190	21.2%
Sales and marketing	6,701	2,946	(3,755)	(56.0)%
Income from operations	5,033	6,664	1,631	32.4%
Interest income	11	32	21	190.9%
Interest expense	(56)	(108)	(52)	92.9%
Other income	1,500	78	(1,422)	(94.8)%
Net income before income taxes	6,488	6,666	178	2.7%
Income tax expense	1,734	2,614	880	50.7%
Net income	$ 4,754	$ 4,052	$ (702)	(14.8)%

Three Months Ended June 30,	
2011	2012