

HEARTLAND PAYMENT SYSTEMS INC
Form 10-12G/A
August 09, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**AMENDMENT NO. 4
TO
FORM 10-12G/A**

**GENERAL FORM FOR REGISTRATION OF SECURITIES
PURSUANT TO SECTION 12(b) OR 12(g) OF
THE SECURITIES EXCHANGE ACT OF 1934**

HEARTLAND PAYMENT SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

Delaware **22-3755714**
(State or other jurisdiction of (I.R.S. Employer Identification Number)
incorporation or organization)

47 Hulfish Street, Suite 400
Princeton, New Jersey 08542
(Address, including zip code, of principal executive office)

(609) 683-3831
(Registrant's telephone number, including area code)

Securities to be registered pursuant to Section 12(b) of the Act: None

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

Common Stock, par value \$.001 per share

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We have made forward-looking statements in this registration statement that are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include the information concerning our possible or assumed future results of operations, business strategies, financing plans, competitive position, industry environment, potential growth opportunities, the effects of future regulation and the effects of competition. Forward-looking statements include all statements that are not historical facts and can be identified by the use of forward-looking terminology such as the words "believe," "expect," "anticipate," "intend," "plan," "estimate" or similar expressions.

Forward-looking statements involve risks, uncertainties and assumptions. Actual results may differ materially from those expressed in the forward-looking statements. We do not have any intention or obligation to update forward-looking statements after the date of this registration statement.

You should understand that many important factors, in addition to those discussed elsewhere in this registration statement, could cause our results to differ materially from those expressed in the forward-looking statements. These factors include, without limitation, our competitive environment, the business cycles and credit risks of our merchants, chargeback liability, merchant attrition, problems with our bank sponsor, our reliance on other bank card payment processors, our inability to pass increased interchange fees along to our merchants, the unauthorized disclosure of merchant data, economic conditions, system failures and government regulation.

**INFORMATION REQUIRED IN REGISTRATION STATEMENT
CROSS-REFERENCE SHEET BETWEEN REGISTRATION STATEMENT ON FORM S-1
AND ITEMS OF FORM 10**

This Amendment No. 4 to Form 10-12G/A has been filed due to the fact that the Company has amended its registration statement on Form S-1 (333-118073), as amended (the "Registration Statement"), which reflects a discussion on new developments in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section.

Item 1. Business

The information required by this item is contained under the sections "Summary," "Risk Factors," "Business" and "Where You Can Find More Information" of the Registration Statement, filed as an exhibit hereto. Those sections are incorporated herein by reference.

Item 2. Financial Information

The information required by this item is contained under the sections "Selected Historical Consolidated Financial Information and Other Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" of the Registration Statement. Those sections are incorporated herein by reference.

Item 3. Properties

The information required by this item is contained under the section "Business Properties" of the Registration Statement. That section is incorporated herein by reference.

Item 4. Security Ownership of Certain Beneficial Owners and Management

Set forth below is information relating to the beneficial ownership of our common stock as of July 15, 2005, by each person known by us to beneficially own more than 5% of our outstanding shares of common stock of each class, each of our directors and our named executive officers, and all of our directors and executive officers as a group.

Each stockholder's percentage ownership in the following table is based on 29,794,934 shares of common stock outstanding as of July 15, 2005, as adjusted to reflect the conversion of all outstanding shares of our Series A Senior Convertible Participating Preferred Stock and treating as outstanding all options held by that stockholder and exercisable within 60 days of July 15, 2005. As of July 15, 2005, there were 134 holders of our common stock.

Except as otherwise indicated, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all shares of common stock held by them. Unless otherwise indicated, the address of each officer, director and 5% stockholder

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listed below is c/o Heartland Payment Systems, Inc., 47 Hulfish Street, Suite 400, Princeton, New Jersey 08542.

Name of Beneficial Owner	Number of Shares Beneficially Owned Prior to this Offering	Percentage of Shares Beneficially Owned	
		Prior to this Offering	After this Offering
5% Holders:			
Greenhill Capital Partners, L.P. and affiliated investment funds(1)	8,632,084	29.0%	20.5%
LLR Equity Partners, L.P. and affiliated investment fund(2)	5,209,252	17.5%	16.1%
Directors and Executive Officers			
Robert O. Carr(3)	10,692,000	35.5%	32.3%
Robert H.B. Baldwin, Jr.(4)	939,500	3.1%	2.9%
Michael C. Hammer(5)	524,500	1.8%	1.6%
Brooks L. Terrell(6)	674,500	2.3%	2.1%
Scott L. Bok(1)	8,632,084	29.0%	20.5%
Mitchell L. Hollin(2)	5,209,252	17.5%	16.1%
Robert H. Niehaus(1)	8,632,084	29.0%	20.5%
David L. Morris(7)	76,820	*	*
Thomas Sheridan(8)	160,000	*	*
Marc J. Ostro(9)	30,000	*	*
Jonathan J. Palmer(10)	20,000	*	*
George F. Raymond(11)	20,000	*	*
All directors and executive officers as a group (12 persons)(12)	25,188,656	81.2%	68.6%

*
Less than 1% of the outstanding stock

(1) Beneficial ownership consists of 5,285,438 shares of common stock held by Greenhill Capital Partners, L.P.; 1,612,082 shares of common stock held by Greenhill Capital, L.P.; 853,228 shares of common stock held by Greenhill Capital Partners (Executives), L.P.; and 881,336 shares of common stock held by Greenhill Capital Partners (Cayman), L.P. By virtue of their ownership and positions as the Senior Members of GCP 2000, LLC and as Managing Directors of Greenhill Capital Partners, LLC, which control the general partners of Greenhill Capital Partners, L.P. and its affiliated investment funds, Scott L. Bok, Robert F. Greenhill and Robert H. Niehaus may be deemed to beneficially own these shares. In addition, GCP Managing Partner, L.P. and GCP, L.P., the general partners of Greenhill Capital Partners, L.P. and its affiliated investment funds, as well as Greenhill Capital Partners, LLC and GCP 2000, LLC, which control the general partners, and Greenhill & Co., Inc., the sole member of Greenhill Capital Partners, LLC, may be deemed to beneficially own these shares. Beneficial ownership includes 1,093,750 shares of common stock that are subject to an option granted to Robert O. Carr. Each of Scott L. Bok and Robert H. Niehaus disclaims beneficial ownership of these shares except to extent of each of their pecuniary interest therein.

(2) Beneficial ownership consists of 4,729,296 shares of common stock held by LLR Equity Partners, L.P. and 479,956 shares of common stock held by LLR Equity Partners Parallel, L.P. By virtue of his position as a Partner of LLR Capital, L.P., which is the General Partner of LLR Equity Partners and its affiliated investment funds, Mr. Hollin may be deemed to beneficially own these shares. Beneficial ownership includes 656,250 shares of common stock that are subject to an option granted to Robert O. Carr.

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- (3) Beneficial ownership consists of 8,143,488 shares of common stock held by Carr Holdings, L.L.C., a New Jersey limited liability company owned and managed by Robert O. Carr and Jill Carr, Mr. Carr's wife; 400,000 shares of common stock held by The Robert O. Carr 2001 Charitable Remainder Unitrust; 10,780 shares of common stock held by The Robert O. Carr 2000 Irrevocable Trust for Emily Carr; 10,780 shares of common stock held by The Robert O. Carr 2000 Irrevocable Trust for Ryan Carr; 10,780 shares of common stock held by The Robert O. Carr 2000 Irrevocable Trust for Kelly Carr; 8,086 shares of common stock held by The Robert O. Carr 2003 Grantor Retained Annuity Trust; 8,086 shares of common stock held by The Jill A Carr 2003 Grantor Retained Annuity Trust; options to purchase 350,000 shares of common stock under our 2000 Equity Incentive Plan; and an option from Greenhill Capital Partners, L.P. and its affiliated funds and LLR Equity Partners, L.P. and its affiliated investment fund, to purchase up to 1,750,000 shares of common stock.
- (4) Beneficial ownership consists of 333,476 shares of common stock held by Mr. Baldwin, 138,524 shares of common stock held by Margaret J. Sieck and Whitney H. Baldwin as Trustees for an Indenture created June 30, 2004 and options to purchase 467,500 shares of common stock under our 2000 Equity Incentive Plan.
- (5) Beneficial ownership consists of 400,000 shares of common stock held by the MCMJH Limited Partnership, an Arizona Limited Partnership of which Michael C. Hammer is the Managing Partner and options to purchase 124,500 shares of common stock under our 2000 Equity Incentive Plan.
- (6) Beneficial ownership consists of 550,000 shares of common stock held by the B. Terrell Limited Partnership, a Texas limited partnership of which Brooks L. Terrell is the general partner; and options to purchase 124,500 shares of common stock under our 2000 Equity Incentive Plan.
- (7) Beneficial ownership consists of 50,000 shares of common stock held by Mr. Morris and his wife, Lisa T. Morris, jointly; options to purchase 26,820 shares of common stock under our 2000 Equity Incentive Plan.
- (8) Beneficial ownership consists of 40,000 shares of common stock held by Mr. Sheridan; options to purchase 80,000 shares of common stock under our 2000 Equity Incentive Plan; and an option from Carr Holdings, L.L.C. to purchase 40,000 shares of common stock.
- (9) Beneficial ownership consists of options to purchase 30,000 shares of common stock under our 2000 Equity Incentive Plan.
- (10) Beneficial ownership consists of options to purchase 20,000 shares of common stock under our 2000 Equity Incentive Plan.
- (11) Beneficial ownership consists of options to purchase 20,000 shares of common stock under our 2000 Equity Incentive Plan.
- (12) Includes options to purchase an aggregate of 1,243,320 shares of common stock exercisable within 60 days of July 15, 2005 under our 2000 Equity Incentive Plan.

Item 5. Directors and Executive Officers

The information required by this item is contained under the section "Management" of the Registration Statement. That section is incorporated herein by reference.

Item 6. Executive Compensation

The information required by this item is contained under the section "Management Compensation of Executive Officers and Other Information" of the Registration Statement. That section is incorporated herein by reference.

Item 7. Certain Relationships and Related Transactions

The information required by this item is contained under the section "Related Party Transactions" of the Registration Statement. That section is incorporated herein by reference.

Item 8. Legal Proceedings

The information required by this item is contained under the section "Business Legal Proceedings" of the Registration Statement. That section is incorporated herein by reference.

Item 9. Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters

The information required by this item is contained under the section "Dividend Policy" of the Registration Statement and under the section "Item 11 Description of Registrant's Securities to be Registered" herein. Each section is incorporated herein by reference.

Item 10. Recent Sales of Unregistered Securities

The information required by this item is contained under the section "Item 15 Recent Sales of Unregistered Securities" of the Registration Statement. That section is incorporated herein by reference.

Item 11. Description of Registrant's Securities to be Registered

General

The following is a summary of the rights of our common stock and Series A Senior Convertible Participating Preferred Stock and related provisions of our certificate of incorporation and bylaws.

Our authorized capital stock consists of 110,000,000 shares, each with a par value of \$0.001 per share, of which:

100,000,000 shares are designated as common stock.

10,000,000 shares are designated as Series A Senior Convertible Participating Preferred Stock.

At July 15, 2005, we had outstanding 16,461,600 shares of common stock, held of record by 134 stockholders, and 7,619,048 shares of Series A Senior Convertible Participating Preferred Stock, held of record by 6 stockholders.

In addition, at March 31, 2005, 9,261,002 shares of our common stock were subject to outstanding options, and 168,904 shares of our common stock were subject to outstanding warrants.

Common Stock

The holders of our common stock are entitled to one vote per share on any matter to be voted upon by stockholders. The holders of our common stock are entitled to dividends as our board of directors may declare from time to time from legally available funds subject to the preferential rights of the holders of any shares of our Series A Senior Convertible Participating Preferred Stock.

Our amended and restated certificate of incorporation does not provide for cumulative voting in connection with the election of directors. Accordingly, directors will be elected by a plurality of the shares voting once a quorum is present. No holder of our common stock will have any preemptive right to subscribe for any shares of capital stock issued in the future.

Upon any voluntary or involuntary liquidation, dissolution or winding up of our affairs, the holders of our common stock are entitled to share, on a pro rata basis, all assets remaining after payment to creditors and subject to prior distribution rights of any shares of Series A Senior Convertible Participating Preferred Stock that we may issue in the future. All of the outstanding shares of common stock are fully paid and non-assessable.

Preferred Stock

The number of authorized shares of our preferred stock is 10,000,000 shares, \$0.001 par value, 7,619,048 of which are designated as Series A Senior Convertible Participating Preferred Stock and 7,619,048 of which were issued and outstanding at July 15, 2005. The rights, privileges, preferences and restrictions of our Series A Senior Convertible Participating Preferred Stock are as follows:

Dividend Rights

The holders of our Series A Senior Convertible Participating Preferred Stock are entitled to receive dividends prior and in preference to any dividends on our common stock, if and when declared by our board of directors.

Liquidation Rights

In the event we decide to liquidate, dissolve or wind-up, the holders of our Series A Senior Convertible Participating Preferred Stock shall be entitled to receive, prior to any distribution of any of our assets to the holders of the common stock, an amount equal to the greater of (i) \$10.50 plus any accrued but unpaid dividends and (ii) the amount that would have been payable on the number of shares of Common Stock into which such shares of Series A Senior Convertible Participating Preferred Stock were convertible immediately prior to such event for each share held by them (the "Liquidation Value"). Prior to October 2, 2006, any sale, conveyance, exchange or transfer of all or substantially all of our property or assets and any merger, reorganization, consolidation or other transaction in which the holders of our capital stock immediately prior to such transaction do not retain a majority of the voting power in the continuing entity shall be deemed, at the election of holders of at least two-thirds of the Series A Senior Convertible Participating Preferred Stock then outstanding, to be a liquidation, dissolution or winding-up of our company. If such election is made, then we may, at our option, pay the holders of our Series A Senior Convertible Participating Preferred Stock either (i) the full Liquidation Value of all shares of Series A Senior Convertible Participating Preferred Stock in cash or (ii) a new series of Series A Senior Convertible Participating Preferred Stock. In the event the assets and funds available for distribution to the holders of our Series A Senior Convertible Participating Preferred Stock shall be insufficient to permit the payment of full preferential amounts, then our entire assets shall be distributed ratably among the holders of our Series A Senior Convertible Participating Preferred Stock.

Voting Rights

The holder of each share of our Series A Senior Convertible Participating Preferred Stock is entitled to notice of any stockholder's meeting in accordance with our bylaws and any other matter submitted to the vote of stockholders and shall be entitled to vote, together with the holders of common stock, with respect to any matters upon which the holders of our common stock have the right to vote.

Election of Directors

Holders of our Series A Senior Convertible Participating Preferred Stock, voting as a single class, shall be entitled to elect three directors to our board of directors. In addition, the holders of our Series A Senior Convertible Participating Preferred Stock are entitled to vote together with the holders of our common stock (voting together as a single class and on an as-converted to common stock basis) for the election of the remaining directors.

Voluntary Conversion

At the option of the holder, each share of our Series A Senior Convertible Participating Preferred Stock is convertible into shares of our common stock at the then effective and applicable conversion rate.

Automatic Conversion

Each share of our Series A Senior Convertible Participating Preferred Stock automatically converts into shares of our common stock at the then effective and applicable conversion rate immediately prior to (i) the closing of an initial public offering where common stock is sold to the public for net proceeds of at least \$25 million and where our company has an implied valuation of at least \$250 million, (ii) the closing of (A) any merger, reorganization, consolidation or other transaction in which the holders of our capital stock immediately prior to such transaction do not retain a majority of the voting power in the continuing entity or (B) any sale, conveyance, exchange or transfer of all or substantially all of our property or assets, provided that in either case the consideration per share of common stock in such transaction exceeds \$10.50 plus any accrued but unpaid dividends thereon and (iii) the election of the holders of at least two-thirds of the shares of our outstanding Series A Senior Convertible Participating Preferred Stock.

Antidilution Protection

In the event we issue certain additional securities without consideration or for consideration per share less than the applicable conversion price of our Series A Senior Convertible Participating Preferred Stock, then the conversion rate of the Series A Senior Convertible Participating Preferred Stock shall be reduced concurrently with such issuance.

Protective Provisions

Our certificate of incorporation contains provisions that limit our ability to take certain actions without the approval of the holders of at least two-thirds of our Series A Senior Convertible Participating Preferred Stock. These actions include, among other things: (i) amending or repealing any provision of our certificate of incorporation or bylaws if such action would materially or adversely affect the preferences, rights, privileges or powers of the Series A Senior Convertible Participating Preferred Stock; (ii) authorizing or issuing shares of any class or series of stock, other than issuance of options and common stock pursuant to such options and as permitted by the Securities Purchase Agreement entered into between the holders of the Series A Senior Convertible Participating Preferred Stock and us; and (iii) effecting a sale of us, either by way of merger, sale or otherwise.

Description of Outstanding Warrants

We have outstanding five-year mandatory redeemable warrants to purchase 168,904 shares of our common stock for \$0.005 per share.

Registration Rights

We have entered into a shareholders' agreement with the holders of our Series A Senior Convertible participating Preferred Stock and some of the holders of our common stock. The holders of 28,580,398 shares of common stock and Series A Senior Convertible Participating Preferred Stock on an as-converted to common stock basis are entitled to registration rights with respect to their shares. Any group of holders of at least 10% of the securities with registration rights can require us to register all or part of their shares at any time following six months after our initial public offering, so long as the thresholds in the shareholders' agreement are met with respect to the amount of securities to be sold. After we have completed four such registrations we are no longer subject to these demand registration rights. In addition, the holders of securities with registration rights may also require us to include their shares in future registration statements that we file, subject to reduction at the option of the underwriters of such an offering. Upon any of these registrations, these shares will be freely tradable in the public market without restriction. We are obligated under the shareholders' agreement to pay the registration expenses incurred in connection with any registration, qualification or compliance relating to the exercise of a holder's registration rights. Additionally, we have agreed to indemnify and hold harmless holders (and their affiliates) of registrable securities covered by a registration statement against certain liabilities, including liabilities under the Securities Act of 1933, or to contribute to payments the holders (or their affiliates) may be required to make because of any of those liabilities.

Voting Agreement

On March 21, 2003, we entered into a letter agreement with Carr Holdings, LLC, LLR Equity Partners, L.P., LLR Equity Partners Parallel, L.P., Greenhill Capital Partners, L.P., Greenhill Capital Partners (Cayman), L.P., Greenhill Capital Partners, (Executives), L.P. and Greenhill Capital, L.P. Pursuant to such agreement, Carr Holdings, LLC agreed to sell an aggregate of 370,000 common shares to LLR Equity Partners, L.P., LLR Equity Partners Parallel, L.P., Greenhill Capital Partners, L.P., Greenhill Capital Partners (Cayman), L.P., Greenhill Capital Partners, (Executives), L.P. and Greenhill Capital, L.P. In connection with such sale, each buyer agreed either (i) not to vote any of the shares purchased by it in connection with any designation of directors under the Amended and Restated Shareholders' Agreement dated October 11, 2001, or (ii) to vote the shares purchased by it in favor of the directors designated by holders of a majority of our issued and outstanding shares of common stock, in each case for so long as Carr Holdings, LLC, The Robert O. Carr 2001 Charitable Remainder Unitrust and each of their respective permitted transferees own, in the aggregate, more than 50% of our issued and outstanding common stock.

Anti-Takeover Effects of Delaware Law

We are subject to Section 203 of the Delaware General Corporation Law, an anti-takeover law. In general, Section 203 prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that the stockholder became an interested stockholder, unless:

prior to that date, the board of directors of the corporation approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder;

upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding those shares owned by persons who are directors and also officers and by excluding employee stock plans in which employee participants do not

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have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or

on or subsequent to that date, the business combination is approved by the board of directors of the corporation and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least 66²/₃% of the outstanding voting stock that is not owned by the interested stockholder.

Section 203 defines "business combination" to include the following:

any merger or consolidation involving the corporation and the interested stockholder;

any sale, transfer, pledge or other disposition of 10% or more of the assets of the corporation involving the interested stockholder;

subject to certain exceptions, any transaction that results in the issuance or transfer by the corporation of any stock of the corporation to the interested stockholder;

any transaction involving the corporation that has the effect of increasing the proportionate share of the stock of any class or series of the corporation beneficially owned by the interested stockholder; or

the receipt by the interested stockholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation.

In general, Section 203 defines an interested stockholder as an entity or person beneficially owning 15% or more of the outstanding voting stock of the corporation and any entity or person affiliated with or controlling or controlled by any of these entities or persons.

Anti-Takeover Effects of Our Amended and Restated Certificate of Incorporation and Bylaws

Amended and Restated Certificate of Incorporation and Bylaw Provisions

Our amended and restated certificate of incorporation and bylaws include provisions that may have the effect of discouraging, delaying or preventing a change in control or an unsolicited acquisition proposal that a stockholder might consider favorable, including a proposal that might result in the payment of a premium over the market price for the shares held by stockholders.

Listing

We are not listed on any stock market or exchange.

Item 12. Indemnification of Directors and Officers

The information required by this item is contained under the section "Item 14 Indemnification of Officers and Directors" of the Registration Statement. That section is incorporated herein by reference.

Item 13. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Heartland Payment Systems, Inc.

We have audited the accompanying consolidated balance sheets of Heartland Payment Systems, Inc. and subsidiary (the "Company") as of December 31, 2003 and 2004, and the related consolidated statements of operations, changes in stockholders' (deficit) equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2003 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 21, the accompanying consolidated financial statements have been restated.

/s/ Deloitte & Touche LLP

Princeton, New Jersey
March 28, 2005
(July 26, 2005
as to the effects of the matters
described in Note 20; July 18, 2005 as to
the restatement described in Note 21.)

HEARTLAND PAYMENT SYSTEMS, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	December 31,		March 31,
	2003	2004	2005
	(As Restated See Note 21)	(As Restated See Note 21)	(As Restated See Note 21) (unaudited)
Assets			
Current assets			
Cash and cash equivalents	\$ 13,004	\$ 13,237	\$ 12,706
Receivables	44,934	64,325	64,664
Investments	1,354	1,100	1,340
Inventory	966	818	362
Prepaid expenses	611	2,151	2,989
Current deferred tax assets, net	3,684	2,129	2,179
Total current assets	64,553	83,760	84,240
Capitalized customer acquisition costs, net	22,321	34,247	35,586
Deferred tax assets, net	7,783	4,651	4,488
Property and equipment, net	5,499	10,944	11,827
Deposits and other assets	586	324	251
Total assets	\$ 100,742	\$ 133,926	\$ 136,392
Liabilities and stockholders' (deficit) equity			
Current liabilities			
Due to sponsor bank	\$ 34,225	\$ 45,153	\$ 45,465
Accounts payable	17,923	27,103	26,891
Current portion of accrued buyout liability	17,985	9,327	10,258
Merchant deposits and loss reserves	4,761	7,175	8,145
Accrued expenses and other	5,685	6,701	5,932
Current portion of borrowings and financing arrangement	3,654	5,286	5,227
Total current liabilities	84,233	100,745	101,918
Long-term portion of borrowings and financing arrangements	12,312	7,808	7,324
Warrants with mandatory redemption provisions	2,111	1,566	1,655
Long-term portion of accrued buyout liability		17,708	16,665
Total liabilities	98,656	127,827	127,562
Commitments and contingencies (Note 15)			
Series A Senior Convertible Participating Preferred Stock, \$80 million liquidation preference, \$.001 par value, 10,000,000 shares authorized, 7,619,048 issued and outstanding	43,401		
Stockholders' (deficit) equity:			
Series A Senior Convertible Participating Preferred Stock, \$80 million liquidation preference, \$.001 par value, 10,000,000 shares authorized, 7,619,048 issued and outstanding			
		8	8

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	<u>December 31,</u>	<u>March 31,</u>	
Common Stock, \$.001 par value, 100,000,000 shares authorized, 16,019,196, 16,437,760 and 16,451,080 issued and outstanding in 2003, 2004 and at the period ending March 31, 2005, respectively	8	8	8
Warrants outstanding	1,500		
Additional paid-in capital	1,001	41,065	41,110
Accumulated other comprehensive income (loss)	3	(10)	(18)
Accumulated deficit	(43,827)	(34,972)	(32,278)
	<u>(41,315)</u>	<u>6,099</u>	<u>8,830</u>
Total liabilities and stockholders' (deficit) equity	<u>\$ 100,742</u>	<u>\$ 133,926</u>	<u>\$ 136,392</u>

See notes to consolidated financial statements.

HEARTLAND PAYMENT SYSTEMS, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31,			Three Months Ended March 31,	
	2002	2003	2004	2004	2005
	(unaudited)				
	(As Restated See Note 21)	(As Restated See Note 21)	(As Restated See Note 21)	(As Restated See Note 21)	
Revenue:					
Gross processing revenue	\$ 330,975	\$ 414,715	\$ 595,524	\$ 119,202	\$ 166,172
Other revenue, net	9,607	7,522	7,225	2,002	3,693
Total net revenue	340,582	422,237	602,749	121,204	169,865
Costs of services:					
Interchange	242,407	302,057	438,738	86,372	122,416
Dues and assessments	12,616	15,945	23,348	4,785	6,415
Processing and servicing	44,224	50,805	70,232	14,748	19,820
Customer acquisition costs	12,422	13,380	18,908	4,135	5,841
Depreciation and amortization	1,587	2,571	3,912	876	1,283
Total costs of services	313,256	384,758	555,138	110,916	155,775
Selling and administrative	20,786	25,751	31,501	7,233	8,989
Total expenses	334,042	410,509	586,639	118,149	164,764
Income from operations	6,540	11,728	16,110	3,055	5,101
Other income (expense):					
Interest income	171	124	182	38	110
Interest expense	(1,182)	(1,188)	(1,385)	(298)	(435)
Fair value adjustment for warrants with mandatory redemption provisions	(509)	(893)	(509)		(90)
Other, net	(62)	(740)	833	833	(3)
Total other income (expense)	(1,582)	(2,697)	(879)	573	(418)
Income before income taxes	4,958	9,031	15,231	3,628	4,683
Provision for (benefit from) income taxes	51	(11,102)	6,376	1,482	1,989
Net income	\$ 4,907	\$ 20,133	\$ 8,855	\$ 2,146	\$ 2,694
Accretion of Series A Senior Convertible Participating Preferred Stock	(6,509)				

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	Year Ended December 31,		Three Months Ended March 31,	
Income allocated to Series A Senior Convertible Participating Preferred Stock	(9,843)	(4,263)	(1,037)	(1,295)
Net (loss) income attributable to Common Stock	\$ (1,602)	\$ 10,290	\$ 4,592	\$ 1,109
Net income	\$ 4,907	\$ 20,133	\$ 8,855	\$ 2,146
Other comprehensive income, net of tax:				
Unrealized gains (losses) on investments	17	(14)	(13)	7
Comprehensive income	\$ 4,924	\$ 20,119	\$ 8,842	\$ 2,153
Earnings (loss) per share:				
Basic	\$ (0.10)	\$ 0.65	\$ 0.28	\$ 0.07
Diluted	\$ (0.10)	\$ 0.62	\$ 0.26	\$ 0.07
Weighted average number of shares outstanding:				
Basic	15,642	15,932	16,408	16,296
Diluted	15,642	32,231	33,786	32,871

See notes to consolidated financial statements.

HEARTLAND PAYMENT SYSTEMS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' (DEFICIT) EQUITY
(In thousands)

	Preferred Stock		Common Stock			Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount	Warrants				
Balance, January 1, 2002 as previously reported		\$	15,440	\$ 8	\$ 1,500	\$	\$	(47,916)	\$ (46,408)
Adjustments to as previously reported								(15,193)	(15,193)
Balance, January 1, 2002 (as restated see note 21)		\$	15,440	\$ 8	\$ 1,500	\$	\$	(63,109)	\$ (61,601)
Issuance of Common Stock for commission buyout			124			282			282
Issuance of Common Stock in connection with Welsch Financial Merchant Services, Inc. purchase			284			670			670
Repurchase of Common Stock			(96)			(201)			(201)
Accretion of Series A Senior Convertible Participating Preferred Stock						(751)		(5,758)	(6,509)
Accumulated other comprehensive income							17		17
Net income for the period (as restated see note 21)								4,907	4,907
Balance, December 31, 2002 (as restated see note 21)		\$	15,752	\$ 8	\$ 1,500	\$	\$ 17	\$ (63,960)	\$ (62,435)
Issuance of Common Stock for earnout provisions		\$	267	\$	\$	998	\$	\$	\$ 998
Issuance of Common Stock options exercised			2			11			11
Repurchase of Common Stock			(2)			(8)			(8)
Accumulated other comprehensive loss							(14)		(14)
Net income for the period (as restated see note 21)								20,133	20,133
Balance, December 31, 2003 (as restated see note 21)		\$	16,019	\$ 8	\$ 1,500	\$ 1,001	\$ 3	\$ (43,827)	\$ (41,315)
Reclassification of Series A Senior Convertible Participating Preferred Stock to stockholders' (deficit) equity	7,619	\$ 8	\$	\$	\$	43,393	\$	\$	\$ 43,401
Issuance of Common Stock options exercised			554			1,584			1,584
Redemption of warrants issued in connection with Series A Senior Convertible Participating Preferred					(1,500)	(3,750)			(5,250)

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	Preferred Stock		Common Stock		Accumulated Other Comprehensive Income	
Stock						
Repurchase of Common Stock					(1,231)	(1,231)
Deferred compensation on accelerated vesting of options		(135)			68	68
Accumulated other comprehensive income					(13)	(13)
Net income for the period (as restated see note 21)						8,855
Balance, December 31, 2004 (as restated see note 21)	7,619 \$	8	16,438 \$	8 \$	\$ 41,065	(10) \$ (34,972) \$ 6,099
Issuance of Common Stock options exercised (unaudited)			13		45	45
Accumulated other comprehensive income (unaudited)					(8)	(8)
Net income for the period (unaudited)						2,694
Balance, March 31, 2005 (unaudited)	7,619 \$	8	16,451 \$	8 \$	\$ 41,110	(18) \$ (32,278) \$ 8,830

See notes to consolidated financial statements.

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	Year Ended December 31,			Three Months Ended March 31,	
Net cash used in financing activities	(2,889)	(3,599)	(8,821)	(2,026)	(499)
Net increase (decrease) in cash	(4,974)	4,931	233	2,073	(531)
Cash and cash equivalents, beginning of period	13,047	8,073	13,004	13,004	13,237
Cash and cash equivalents, end of period	\$ 8,073	\$ 13,004	\$ 13,237	\$ 15,077	\$ 12,706
Supplemental cash flow information:					
Cash paid for interest	\$ 1,178	\$ 1,164	\$ 1,387	\$ 225	\$ 409
Cash paid for income taxes	43	116	851	273	801
Supplemental schedule of non cash activities:					
Accretion of Series A Senior Convertible Participating Preferred Stock	6,509				
Value of merchant contract conversions assigned to satisfy financing arrangement	2,196				
Stock issued to satisfy buyout and earnout liabilities	952	999			
Amortization of other assets	216	255	255	64	64

See notes to consolidated financial statements.

HEARTLAND PAYMENT SYSTEMS, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND OPERATIONS

The accompanying consolidated financial statements include those of Heartland Payment Systems, Inc. (the "Company") and its wholly-owned subsidiary, Heartland Payroll Company ("HPC"). All intercompany balances and transactions with the Company's wholly-owned subsidiary have been eliminated upon consolidation. The Company provides payment-processing services related to bank card transactions for merchants throughout the United States. In addition, the Company provides certain other merchant services, including the sale and rental of terminal equipment and supplies. HPC provides payroll and related tax filing services throughout the United States.

The officers and directors of the Company represent a majority of the outstanding shares, and so control the Company.

As discussed in Note 20, all outstanding common shares, average common shares, earnings per common share and conversion amounts related to stock options, warrants and Series A Senior Convertible Participating Preferred Stock have been retroactively adjusted to reflect a two-for-one stock split on July 26, 2005.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, 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 period. Estimates include the accrued buyout liability, capitalized customer acquisition costs, loss reserves, certain accounts payable and accrued expenses and certain tax assets and liabilities as well as the related valuation allowances. Actual results could differ from those estimates.

Concentrations The majority of the Company's merchant processing activity is processed by a single vendor. The Company believes that the vendor maintains appropriate backup systems and alternative arrangements to avoid a significant disruption of processing in the event of an unforeseen event.

Substantially all of the Company's revenue is derived from processing Visa and MasterCard bank card transactions. Because the Company is not a "member bank" as defined by Visa and MasterCard, in order to process these bank card transactions the Company has entered into a sponsorship agreement with a bank. The agreement with the bank sponsor requires, among other things, that the Company abide by the by-laws and regulations of the Visa and MasterCard associations and maintain a certificate of deposit with the bank sponsor. If the Company breaches the sponsorship agreement, the bank sponsor may terminate the agreement and, under the terms of the agreement, the Company would have 180 days to identify an alternative bank sponsor. The Company is dependent on its bank sponsor, Visa and MasterCard for notification of any compliance breaches. As of December 31, 2004, the Company has not been notified of any such issues by its bank sponsor, Visa or MasterCard.

The Company processes for merchants throughout the United States. California represented 15.3% of the Company's total processing volume in December 2004.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents The Company considers all highly liquid investments with original maturities of three months or less when purchased to be cash equivalents.

Receivables The Company carries receivables from its merchants resulting from the practice of advancing interchange fees to most of its merchants during the month and collecting those fees from merchants at the beginning of the following month. During each month, the Company's sponsor bank advances interchange fees to most of the Company's merchants so that during the month a payable to the sponsor bank is incurred. The payable to the sponsor bank is repaid at the beginning of the following month out of the fees the Company collects from its merchants.

Investments Investments consist of corporate and U.S. Government debt securities and certificates of deposit. The Company classifies its investments as available-for-sale and records them at the fair value of the investments based on quoted market prices. Cost is determined on a specific identification basis.

Inventories Inventories consist of point-of-sale terminal equipment held for sale to merchants, and are valued at the lower of cost or market price. Cost is arrived at using the first-in, first-out method. Market price is estimated based on current sales of equipment.

Capitalized Customer Acquisition Costs, net Capitalized customer acquisition costs consist of (1) up-front signing bonus payments made to Relationship Managers and sales managers for the establishment of new merchant relationships, and (2) a deferred acquisition cost representing the cost of buying out the commissions of vested sales employees. Pursuant to Staff Accounting Bulletin Topic 13, *Revenue Recognition*, and FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*, capitalized customer acquisition costs represent incremental, direct customer acquisition costs that are recoverable through gross margins associated with merchant contracts. The capitalized customer acquisition costs are amortized using a method which approximates a proportional revenue approach over the initial three-year term of the merchant contract.

The up-front signing bonus is based on the estimated gross margin for the first year of the merchant contract. The signing bonus, amount capitalized, and related amortization are adjusted after one year to reflect the actual gross margin generated by the merchant contract during that year. The deferred customer acquisition cost asset is accrued over the first year of merchant processing, consistent with the build-up in the accrued buyout liability, as described below.

Management evaluates the capitalized customer acquisition costs for impairment at each balance sheet date by comparing, on a pooled basis by vintage month of origination, the expected future net cash flows from underlying merchant relationships to the carrying amount of the capitalized customer acquisition costs. If the estimated future net cash flows are lower than the recorded carrying amount, indicating an impairment of the value of the capitalized customer acquisition costs, the impairment loss will be charged to operations.

Property and Equipment Property and equipment are carried at cost, net of accumulated depreciation. Depreciation is computed straight-line over periods ranging from three to ten years for furniture and equipment. Leasehold improvements are amortized over the lesser of the economic useful life of the improvement or the term of the lease. The Company capitalizes the cost of computer software developed for internal use and amortizes such costs over an estimated useful life of three years.

Long-Lived Assets The Company evaluates the potential for impairment when changes in circumstances indicate that undiscounted cash flows estimated to be generated by the related assets are less than the carrying amount. Management believes that no such changes in circumstances or impairment have occurred as of December 31, 2004.

Merchant Deposits and Loss Reserves Disputes between a cardholder and a merchant periodically arise due to the cardholder's dissatisfaction with merchandise quality or the merchant's service, and the disputes may not always be resolved in the merchant's favor. In some of these cases, the transaction is "charged back" to the merchant and the purchase price is refunded to the cardholder by the credit card-issuing institution. If the merchant is unable to fund the refund, the Company is liable for the full amount of the transaction. The Company may have partial recourse to the Relationship Manager originally soliciting the merchant contract, if the Relationship Manager is still receiving income from the merchant's processing activities. During 2003, the Company adopted FIN 45. Under FIN 45 the Company's obligation to stand ready to perform is minimal. The Company maintains deposits or the pledge of a letter of credit from certain merchants as an offset to potential contingent liabilities that are the responsibility of such merchants. The Company evaluates its ultimate risk and records an estimate of potential loss for chargebacks related to merchant fraud based upon an assessment of actual historical fraud loss rates compared to expected processing volume levels.

Accrued Buyout Liability Relationship Managers and sales managers are paid residual commissions based on the gross margin generated by monthly merchant processing activity. Until May 2004, Relationship Managers and sales managers had the contractual right to sell their portfolio equity at a fixed multiple. The Company has the right to buy out some or all of these commissions, and intends to do so periodically. Because of the Company's intent and ability to execute purchases of the residual commissions, and the mutual understanding between the Company and the Relationship Managers and sales managers, the Company has accounted for this deferred compensation arrangement pursuant to the substantive nature of the plan. The Company therefore records the amount currently payable (the "settlement cost") to buy out non-servicing related commissions ("owned commissions") from vested Relationship Managers and sales managers, and an accrual, based on their progress towards vesting, for those unvested Relationship Managers and sales managers who are expected to vest in the future. As noted above, as the liability increases over the first year of a merchant contract, the Company also records for vested Relationship Managers and sales managers a related deferred acquisition cost asset. The accrued buyout liability associated with unvested Relationship Managers and sales managers is not included in the deferred acquisition cost asset since future services are required in order to vest. Subsequent changes in the settlement cost, due to account attrition, same-store sales growth and changes in gross margin, are included in the same income statement caption as customer acquisition cost amortization expense.

The accrued buyout liability is based on the merchants under contract at the balance sheet date, the gross margin generated over the prior 12 months, and the contractual buyout multiple. The liability related to a new merchant is therefore zero when the merchant is installed, and increases over the twelve months following the installation date. The same procedure is applied to unvested commissions over the expected vesting period, but is further adjusted to reflect the Company's experience that 31% of unvested Relationship Managers and sales managers become vested.

For December 31, 2004 and March 31, 2005, the classification of the accrued buyout liability between current and non-current liabilities on the consolidated balance sheet is based upon the

Company's estimate of the amount of the accrued buyout liability that it reasonably expects to pay over the next twelve months. This estimate is developed by calculating the cumulative annual average percentage that total historical buyout payments represent of the accrued buyout liability. That percentage is applied to the period-end accrued buyout liability to determine the current portion. At December 31, 2003, the total accrued buyout liability is classified as current in accordance with ARB No. 43, which requires a liability to be classified as current if by its terms it is due on demand. At December 31, 2003, the Company's vested Relationship Managers and sales managers had the contractual right to sell their residual equity to the Company. This right was eliminated in May 2004.

Warrants Warrants with mandatory redemption provisions are classified as debt and are recorded at estimated fair value.

Financing Arrangements Pursuant to EITF 88-18, the Company recognizes the transfer of merchant contracts as financing arrangements included under Borrowings and Financing Arrangements, until such time as the conditions for recognizing the transfer as a sale are met.

The interest rates on these financing arrangements are computed based on the expected cash flows resulting from these contracts, reduced by an expected annual volume attrition rate of 15%. Any significant differences between actual future payments and expected payments will result in a change to that interest rate, which will be applied prospectively.

Revenue Revenue is mainly comprised of transaction and discount fees from the processing of merchant transactions. Revenue is recorded as bank card transactions are processed or payroll services are performed. The Company passes through to its customers any changes in interchange or association fees. Payroll revenue represents periodic and annual processing fees, which are recorded as services are performed.

Other revenue includes fees earned from customer service, termination fees on terminated contracts, fees for the sale, rental, leasing and deployment of credit card terminals and other miscellaneous revenue. These amounts are shown net of their associated direct costs, if any, and are recorded at the time the service is performed.

Income Taxes The Company accounts for income taxes by recognizing deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statements and the tax basis of assets and liabilities using enacted tax rates.

Stock Options The Company accounts for its stock options using the intrinsic value method in which no compensation expense has been recognized for its stock-based compensation plan because the options are granted at an exercise price greater than or equal to the estimated fair value at the grant date. The estimated fair value of options granted during 2002 and 2003 was \$0 and \$0, respectively, due to the Company's use of a 0% volatility factor as a private company. The fair value of options for the periods ended December 31, 2002, 2003 and 2004, and the three months ended March 31, 2004 and 2005 was estimated at the date of grant using a Black-Scholes option-pricing model with the following assumptions: weighted-average risk-free interest rate of 2.93%, 1.82%, 2.31%, 2.20% and 3.43% respectively; no dividends; a volatility factor of 0%, 0%, 50%, 0% and 50%, respectively and an expected life of one to three years.

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For those periods prior to the filing of the Company's initial August 2004 registration statement on Form S-1, the Company assumed a volatility factor of 0%, which was consistent with existing accounting literature pertaining to non-public companies. For those periods after filing the Company's initial August 2004 registration statement on Form S-1, the Company assumed a volatility factor of 50%. The 50% volatility assumption was determined by referencing the average volatility assumed by six of the Company's public company peers.

Basic earnings per share is computed based on the weighted average number of common shares outstanding. Diluted earnings per share is computed based on the weighted average outstanding common shares plus equivalent shares assuming exercise of stock options, warrants and conversion of Series A Senior Convertible Participating Preferred Stock, where dilutive. As discussed in Note 20, weighted average shares outstanding and dilutive securities have been adjusted to reflect a two-for-one stock split of the Company's common stock on July 26, 2005. The following table presents the effect on net (loss) income and basic and diluted net (loss) income per common share had the Company adopted the fair value method of accounting for stock-based compensation under SFAS No. 123 (in thousands, except per share data):

	Years Ended December 31			Three Months Ended March 31,	
	2002	2003	2004	2004	2005
	(unaudited)				
	(In thousands)				
Net income	\$ 4,907	\$ 20,133	\$ 8,855	\$ 2,146	\$ 2,694
Deduct: Total stock-based employee compensation expense determined under fair-value-based method, net of related tax expense			5,493		1,444
Pro forma net (loss) income	4,907	20,133	3,362	2,146	1,250
Less: Accretion of Series A Senior Convertible Participating Preferred Stock	(6,509)				
Less: Income allocated to Series A Senior Convertible Participating Preferred Stock		(9,843)	(1,618)	(1,037)	(635)
Pro forma net (loss) income attributable to common stock	\$ (1,602)	\$ 10,290	\$ 1,744	\$ 1,109	\$ 615
Earnings per share:					
As reported:					
Basic	\$ (0.10)	\$ 0.65	\$ 0.28	\$ 0.07	\$ 0.09
Diluted	\$ (0.10)	\$ 0.62	\$ 0.26	\$ 0.07	\$ 0.08
Pro forma:					
Basic	\$ (0.10)	\$ 0.65	\$ 0.11	\$ 0.07	\$ 0.04
Diluted	\$ (0.10)	\$ 0.62	\$ 0.10	\$ 0.07	\$ 0.04

New Accounting Pronouncements On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 153, "Exchanges of Nonmonetary Assets, an Amendment of APB Opinion No. 29." SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods

beginning after June 15, 2005. The Company does not believe adoption of Statement 153 will have a material effect on its consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS No. 123 revised"). This statement revises SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. The most significant change resulting from this statement is the requirement for public companies to expense employee share-based payments under fair value as originally introduced in SFAS No. 123. SFAS No. 123 revised is effective, as amended on April 21, 2005 by the Securities and Exchange Commission, beginning with the first interim or annual reporting period of the registrant's first fiscal year beginning on or after June 15, 2005. The Company will adopt this statement when effective, and continues to assess its impact.

3. RECEIVABLES

A summary of receivables by major class are as follows at December 31, 2003 and 2004 and March 31, 2005:

	December 31,		March 31,
	2003	2004	2005
	(In thousands)		(unaudited) (In thousands)
Accounts receivable from merchants	\$ 43,468	\$ 60,739	\$ 62,432
Accounts receivable from others	1,466	3,753	2,399
	44,934	64,492	64,831
Less allowance for doubtful accounts		(167)	(167)
	\$ 44,934	\$ 64,325	\$ 64,664

Receipts from settlement of the accounts receivable from merchants are primarily used to satisfy accounts payable to bank card processing banks.

4. INVESTMENTS

The cost, gross unrealized gains (losses) and estimated fair value for available-for-sale investments by major security type and class of security are as follows at December 31, 2003 and 2004 and March 31, 2005:

	<u>Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
(In thousands)				
December 31, 2003				
Debt securities of the U.S. Government	\$ 440	\$ 6	\$	\$ 446
Corporate debt securities	360	5	(1)	364
Certificates of deposit	544			544
	<u>\$ 1,344</u>	<u>\$ 11</u>	<u>\$ (1)</u>	<u>\$ 1,354</u>
December 31, 2004				
Debt securities of the U.S. Government	\$ 195	\$	(1)	\$ 194
Corporate debt securities	360	1	(4)	357
Certificates of deposit	549			549
	<u>\$ 1,104</u>	<u>\$ 1</u>	<u>\$ (5)</u>	<u>\$ 1,100</u>
March 31, 2005 (unaudited)				
Debt securities of the U.S. Government	\$ 443	\$	(3)	\$ 440
Corporate debt securities	360		(11)	349
Certificates of deposit	551			551
	<u>\$ 1,354</u>	<u>\$</u>	<u>\$ (14)</u>	<u>\$ 1,340</u>

As of December 31, 2004, all unrealized losses in investments were the result of increases in interest rates. The unrealized losses in any individual security did not exceed 1.5% of the Company's cost basis. These investments are not considered other-than-temporarily impaired because the Company has the ability and intent to hold these investments for a period of time sufficient for a forecasted recovery in value, which may be upon maturity.

The maturity schedule of all investments owned along with amortized cost and estimated fair value as of March 31, 2005 (unaudited) is as follows:

	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
(In thousands)		
Due in one year or less	\$ 802	\$ 801
Due after one year through five years	552	539
	<u>\$ 1,354</u>	<u>\$ 1,340</u>

5. CAPITALIZED CUSTOMER ACQUISITION COSTS, NET

A summary of the capitalized customer acquisition costs, net is as follows as of December 31, 2003 and 2004 and March 31, 2005:

	December 31,		March 31,
	2003	2004	2005
	(In thousands)		(unaudited) (In thousands)
Capitalized signing bonuses	\$ 27,428	\$ 40,407	\$ 42,754
Less accumulated amortization	(11,926)	(15,862)	(17,454)
	\$ 15,502	\$ 24,545	\$ 25,300
Capitalized customer deferred acquisition costs	13,055	21,349	26,576
Less accumulated amortization	(6,236)	(11,647)	(16,290)
	6,819	9,702	10,286
	\$ 22,321	\$ 34,247	\$ 35,586

Amortization expense was \$8.8 million, \$13.1 million and \$18.3 million for the years ended December 31, 2002, 2003 and 2004, respectively, and \$4.0 million (unaudited) and \$5.6 million (unaudited) for the three months ended March 31, 2004 and 2005, respectively.

The Company believes that no impairment has occurred as of December 31, 2003 and 2004. Net signing bonus adjustments from estimated amounts to actual were \$0.8 million and \$1.4 million for the years ended December 31, 2003, and 2004, respectively, and \$0.5 million (unaudited) for the three months ended March 31, 2005. Fully amortized signing bonuses of \$5.7 million and \$7.2 million were written off during the years ended December 31, 2003 and 2004 respectively and \$1.9 million (unaudited) for the three months ended March 31, 2005.

6. PROPERTY AND EQUIPMENT, NET

A summary of property and equipment, net is as follows as of December 31, 2003 and 2004 and March 31, 2005:

	December 31,		March 31,
	2003	2004	2005
	(In thousands)		(unaudited) (In thousands)
Computer hardware and software	\$ 7,252	\$ 13,611	\$ 15,173
Furniture, fixtures and equipment	1,401	1,709	1,713
Leasehold improvements	877	1,601	2,138
	9,530	16,921	19,024
Less accumulated depreciation	(4,031)	(5,977)	(7,197)
	\$ 5,499	\$ 10,944	\$ 11,827

Depreciation expense of property and equipment was \$1.4 million, \$2.3 million and \$3.7 million for the years ended December 31, 2002, 2003 and 2004, respectively, and \$0.7 million (unaudited) and \$1.2 million (unaudited) for the three months ended March 31, 2004 and 2005, respectively. Fully depreciated assets of \$1.2 million, \$1.1 million and \$1.7 million were written off during 2002, 2003, and 2004, respectively.

7. BORROWINGS AND FINANCING ARRANGEMENTS

A summary of borrowings are as follows as of December 31, 2003 and 2004 and March 31, 2005:

	December 31,		March 31,
	2003	2004	2005
	(In thousands)		(unaudited) (In thousands)
Financing Arrangements	\$ 12,863	\$ 10,241	\$ 9,698
Revolver Advance Facility	2,069	2,069	2,069
Purpose and Ability Line of Credit	784	784	784
Welsch Asset Purchase Agreement Note	250		
	15,966	13,094	12,551
Less Current Portion	3,654	5,286	5,227
	\$ 12,312	\$ 7,808	\$ 7,324

Principal payments due on borrowings and financing arrangements for the next five years are as follows:

Year Ended December 31,	(in thousands)
2005	\$ 5,286
2006	2,160
2007	1,851
2008	1,503
2009	1,315
Thereafter	979
	\$ 13,094

Financing Arrangements

On December 31, 1999 the Company signed a Merchant Services Purchase and Sale Agreement with National Processing Company, which was amended by a First Modification Agreement in December, 2000, and Amendment No. 1 to the First Modification Agreement in December, 2001. Under these agreements, the Company agreed to the transfer of merchant contracts generating a specified amount of net revenue to the transferee, and to pay all cash flows, net of servicing fees and chargeback losses, associated with specific lists of merchant contracts that were committed to the arrangement. This transaction has been treated as a financing arrangement, as discussed in Note 2. As a result, the Company had recorded a liability of \$23.0 million on December 31, 1999, which was reduced by servicing payments and the value of converted contracts. The respective amendments of the agreements had the effect of triggering sale treatment for those contracts that were converted to the transferee's systems in 2000, 2001 and 2002. Effective August 1, 2002, the Company signed a five-year servicing agreement with the transferee, in which the Company agreed to provide servicing to those merchants in a defined final pool that had not been converted to the transferee's processing systems, and that no further conversions would be made. The servicing agreement is terminable by the transferee upon the occurrence of certain change in control events, upon material breach by the Company, if merchant losses exceed a specified threshold, or if the Company enters into bankruptcy, receivership or other like status, in which event the transferee will be responsible for the conversion of

the remaining serviced merchants to their processing systems. The interest rate at December 31, 2004 was 4.26%

On November 1, 2000, the Company signed a Merchant Portfolio Purchase Agreement and an associated Servicing Agreement with Certegy Inc., each of which was amended on January 16, 2002. Under these agreements, the Company pays all cash flows, net of servicing fees and chargeback losses, related to the transferred merchant contracts to the transferee. This transaction has been treated as a financing arrangement, as discussed in Note 2. As a result, the Company recorded a liability of \$22.0 million on November 1, 2000, and the payments made represent interest plus principal repayments. The interest rate at December 31, 2004 is 2.53%. The servicing agreement is terminable only upon material breach by either party, or if the Company enters into bankruptcy, receivership or other like status.

Loan and Security Agreement

On August 28, 2002, the Company signed a Loan and Security Agreement for two loan instruments; this Agreement was amended on November 6, 2003 and June 23, 2004. The first instrument is a Revolver Advance Facility ("Revolver"), which is to be used solely to fund the buyout of future commissions from current or former Relationship Managers or from Independent Sales Organizations ("ISOs"). The Company may draw down on the Revolver up to but not exceeding an aggregate unpaid principal amount outstanding of \$3,500,000. The entire principal balance plus all accrued interest and fees is due on May 31, 2005 (subsequently extended to August 31, 2005), or on demand if there were to be a default. The Revolver accrues interest at a rate equal to the prime rate, which was 5.25% at December 31, 2004. The Company's assets, including accounts receivable, inventory, furniture and equipment and general intangibles, serve as collateral to secure the Revolver.

On May 26, 2005, the Company entered into an amendment to its Loan and Security Agreement, which extended the scheduled maturity date from May 31, 2005 to August 31, 2005.

The second instrument is a \$3,000,000 Purpose and Ability Line of Credit Facility ("Line of Credit"). The Line of Credit accrues interest at the prime rate, which was 5.25% at December 31, 2004, and is secured by the assets of the Company, including accounts receivable, inventory, furniture and equipment and general intangibles. The entire principal balance plus all accrued interest and fees is due upon demand.

The Company is subject to standard loan covenants and financial statement reporting requirements on both of the debt instruments and was in compliance at December 31, 2003 and 2004.

Welsch Asset Purchase Agreement

Effective March 31, 2002, the Company entered into an Asset Purchase Agreement with Welsch Financial Merchant Services, Inc. The purchase price included a note for \$2,000,000. The outstanding amount of this note was \$250,000 and \$0 at December 31, 2003 and 2004, respectively.

8. MERCHANT DEPOSITS AND LOSS RESERVES

The Company's merchants have the liability for any charges properly reversed by the cardholder through a mechanism known as a chargeback. If the merchant is unable to pay this amount, the Company will be liable to the Visa and MasterCard associations for the reversed charges.

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During 2003, the Company adopted FIN 45. Under FIN 45, the Company's obligation to stand ready to perform is minimal. The Company requires personal guarantees, merchant deposits and letters of credit from certain merchants to minimize its obligation. As of December 31, 2003, December 31, 2004 and March 31, 2005, the Company held merchant deposits totaling \$4.2 million, \$6.7 million and \$7.7 million (unaudited), and letters of credit totalling \$80,000, \$30,000 and \$480,000 (unaudited), respectively.

The Visa and MasterCard associations generally allow chargebacks up to four months after the later of the date the transaction is processed or the delivery of the product or service to the cardholder. As the majority of the Company's transactions involve the delivery of the product or service at the time of the transaction, a reasonable basis for determining an estimate of the Company's exposure to chargebacks is the last four months' processing volume on its portfolio, which was \$5.0 billion, \$6.6 billion, \$9.0 billion and \$9.4 billion (unaudited) for the four months ended December 31, 2002, 2003 and 2004, and March 31, 2005, respectively. However, for the four months ended December 31, 2002, 2003, 2004 and March 31, 2005, the Company was presented with \$4.5 million, \$5.4 million, \$5.6 million and \$5.5 million (unaudited), respectively, in chargebacks by issuing banks. In the years ended December 31, 2002, 2003, and 2004 and the three months ended March 31, 2005, the Company incurred merchant credit losses of \$561,928, \$605,256, \$939,500 and \$299,714 (unaudited), respectively, on total dollar volume processed of \$14.4 billion, \$17.9 billion, \$25.0 billion and \$6.9 billion (unaudited), respectively. These credit losses are included in "cost of services" in the Company's consolidated statements of operations.

The loss recorded by the Company for chargebacks associated with any individual merchant is typically small, due both to the relatively small size and the processing profile of the Company's clients. However, from time to time the Company will encounter instances of merchant fraud, and the resulting chargeback losses may be considerably more significant to the Company. The Company has established a reserve for estimated credit and fraud losses on its consolidated balance sheets, amounting to \$773,000, \$558,225, \$468,000 and \$471,000 (unaudited) on December 31, 2002, 2003 and 2004 and March 31, 2005, respectively. This reserve is determined by performing an analysis of the Company's historical loss experience applied to current processing volume and exposures.

A summary of the loss reserve for the years ended December 31, 2002, 2003 and 2004 and March 31, 2005 is as follows:

	December 31			March 31,
	2002	2003	2004	2005
	(In thousands)			(unaudited) (In thousands)
Beginning balance	\$ 736	\$ 773	\$ 558	\$ 468
Additions to reserve	598	390	849	303
Charges against reserve	(561)	(605)	(939)	(300)
Ending Balance	\$ 773	\$ 558	\$ 468	\$ 471

9. ACCRUED BUYOUT LIABILITY

A summary of the accrued buyout liability is as follows as of December 31, 2003 and 2004 and March 31, 2005:

	December 31,		March 31,
	2003	2004	2005
	(In thousands)		(unaudited) (In thousands)
Vested Relationship Managers and sales managers	\$ 17,632	\$ 25,788	\$ 25,709
Unvested Relationship Managers and sales managers	353	1,247	1,214
	17,985	27,035	26,923
Less current portion	17,985	9,327	10,258
Long-term portion of accrued buyout liability	\$	\$ 17,708	\$ 16,665

	December 31,			March 31,
	2002	2003	2004	2005
	(In thousands)			(unaudited) (In thousands)
Beginning balance	\$ 13,321	\$ 13,551	\$ 17,985	\$ 27,035
Increase in settlement obligation, net	8,774	9,174	11,263	3,175
Buyouts	(8,544)	(4,740)	(2,213)	(3,287)
Ending balance	\$ 13,551	\$ 17,985	\$ 27,035	\$ 26,923

The increase in settlement obligation is due to new merchant account signings, as well as same store sales growth and changes in gross margin, primarily attributable to account attrition.

In calculating the accrued buyout liability for unvested Relationship Managers and sales managers, the Company has assumed that 31% of the unvested Relationship Managers and sales managers will vest in the future, which represents the Company's historical vesting rate. A 5% increase to 36% in the expected vesting rate would have increased the accrued buyout liability for unvested Relationship Managers and sales managers by \$56,974 at December 31, 2003, \$201,139 at December 31, 2004 and \$195,713 (unaudited) at March 31, 2005.

10. CONVERTIBLE PREFERRED STOCK AND WARRANTS

The Series A Senior Convertible Participating Preferred Stock (the "Convertible Preferred") is convertible by the holders at any time and automatically converts upon the closing of a qualified public offering up to 15,238,096 shares of the Company's Common Stock, participates equally in dividends and distributions with the Common Stock, pays no other dividends and has a liquidation preference of \$80 million. The Convertible Preferred was redeemable at the option of two-thirds of the holders after October 1, 2006 at the higher of the liquidation preference or value per common share. The carrying value of the Convertible Preferred was accreted to its mandatory redeemable value by \$6,509,019 in the year ended December 31, 2002, using the effective interest rate method. During 2002, the Company stopped accreting the Convertible Preferred because the terms of the Certificate of Designations for the Convertible Preferred and the Shareholders' Agreement by and among the holders of the Company's Common Stock and the Convertible Preferred were amended to eliminate certain rights of the holders of the Convertible Preferred that might, in certain circumstances, have allowed those holders to cause redemption of the Convertible Preferred. The holders of the Convertible Preferred have the right to elect three directors to the Company's Board and have certain other rights with respect to the governance of the Company.

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In addition, the holders of the Convertible Preferred received five-year warrants to purchase an additional 2,000,000 shares of the Company's Common Stock at a price of \$2.63 per share, which were valued at \$1.5 million. The Company redeemed these warrants on September 28, 2004 by paying the holders the net consideration of \$5.25 million.

In August 2004, the Certificate of Designations of the Convertible Preferred was amended to eliminate after October 1, 2006 certain rights of the holders to treat a merger of the Company as a liquidation event. This amendment was in addition to amendments made in 2002 to the terms of the Certificate of Designations for the Convertible Preferred and the Shareholders' Agreement by and among the holders of the Company's Common Stock. As a result of the amendment, the Company has classified the Convertible Preferred as a part of stockholders' (deficit) equity in its December 31, 2004 and March 31, 2005 financial statements.

The Board of Directors is authorized to issue shares of preferred stock in one or more classes or series without any further action by the Company's stockholders.

On July 26, 2001, the Company signed a Loan and Security Agreement with BHC Interim Funding, L.P., and received a Term Loan (the "BHC Bridge Loan") in the amount of \$4.76 million, which accrued interest at a rate of 13.75%, and was secured by a first priority lien on the Company's merchant contracts and certain other assets. The BHC Bridge Loan was repaid on October 11, 2001. In connection with this agreement, the Company issued 337,810 five-year mandatory redeemable warrants to purchase its Common Stock for \$0.005, which were valued at \$605,049. Commencing July 26, 2003, the holder can require the Company to redeem these warrants at their per share fair value. The Company records these warrants at their estimated fair value and adjusted these warrants by \$0.5 million and \$0.9 million in December 2002 and 2003 because transactions indicated that \$3.61 and \$6.25 per share, respectively, was an appropriate fair value. On January 8, 2004, the warrant holder elected to cause the Company to redeem 168,906 shares at the fair value of \$6.25 per share. The Company has adjusted the warrants by an additional \$0.5 million in the period ending December 31, 2004 and by \$0.1 million (unaudited) on March 31, 2005 to reflect the estimated fair value of \$9.28 and \$9.80 per share, respectively.

11. INCOME TAXES

Income tax provision (benefit) for the years ended December 31, 2002, 2003 and 2004 and the three months ended March 31, 2005 and 2004 is as follows:

	December 31,			March 31,	
	2002	2003	2004	2004	2005
				(unaudited)	
				(In thousands)	
Current tax:					
Federal	\$	\$ 130	\$ 1,318	\$ 356	\$ 1,531
State	51	235	371	122	345
Deferred taxes:					
Federal		(9,364)	3,859	847	92
State		(2,103)	828	157	21
Provision for (benefit from) income taxes	\$ 51	\$ (11,102)	\$ 6,376	\$ 1,482	\$ 1,989

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The net deferred tax asset was comprised of the following:

	December 31,		March 31,	
	2003	2004	2005	
	(In thousands)		(unaudited) (In thousands)	
Merchant contract costs	\$ 12,348	\$ 15,317	\$ 15,671	
Borrowings and financing arrangement	5,466	4,353	4,123	
Federal net operating loss carryforwards	1,188			
State net operating loss carryforwards	221			
Loss reserve and accounts receivable allowance	251	270	271	
Other	138	1	2	
Deferred tax asset	19,612	19,941	20,067	
Capitalized signing bonus	6,588	10,432	10,753	
Deferred state tax liability	736	447	439	
Software development	645	1,065	1,193	
Property and equipment	176	1,217	1,015	
Deferred tax liability	8,145	13,161	13,400	
Net deferred tax asset	11,467	6,780	6,667	
Less current portion	3,684	2,129	2,179	
	\$ 7,783	\$ 4,651	\$ 4,488	

Based on the Company's performance in 2003 and the Company's forecast of future taxable income, management determined that the deferred tax assets that were previously provided were more likely than not to be realized, and the valuation allowance was released as of December 31, 2003. As a result, the Company realized a tax benefit within the consolidated statement of operations for the year ended December 31, 2003.

At December 31, 2004 the Company has fully utilized all federal and state net operating loss carryforwards.

The differences in federal income taxes provided and the amounts determined by applying the federal statutory tax rate (34% and 35%, respectively) to income before income taxes for the years ended December 31, 2002, 2003 and 2004 and for the three months ended March 31, 2005 and 2004 are:

	December 31,			March 31,						
	2002	2003	2004	2004	2005					
	(In thousands)			(unaudited) (In thousands)						
U.S. federal income tax at statutory rate	34.00%	\$ 1,686	35.00%	\$ 3,161	35.00%	\$ 5,331	35.00%	\$ 1,237	35.00%	\$ 1,639
U.S. state and local income taxes, net	0.68%	34	(13.44)%	(1,214)	5.12%	779	5.12%	181	5.08%	238
Warrants	3.49%	173	3.46%	313	1.17%	178	1.17%	42	1.24%	58
Change in valuation allowance	(37.75)%	(1,872)	(143.98)%	(13,004)						

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	December 31,				March 31,					
Change in tax rate	0.00%		(4.23)%	(383)						
Nondeductible expenses	0.35%	17	0.28%	26	0.58%	88	0.59%	23	0.25%	12
Other, net	0.26%	13	(0.01)%	(1)			(0.01)%	(1)	0.91%	42
Provision for (benefit from) income taxes	1.03%	\$ 51	(122.92)%	\$ (11,102)	41.87%	\$ 6,376	41.87%	\$ 1,482	42.48%	\$ 1,989

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Tax contingencies are recorded for probable exposures involving tax positions taken that could be challenged by taxing authorities. These probable exposures result from the varying application of statutes, rules, regulations and interpretations. The Company does not have income tax contingencies.

12. STOCK INCENTIVE PLAN

On July 29, 2003, the Company amended its employee and director stock option plan, the Heartland Payment Systems, Inc. Amended and Restated 2000 Equity Incentive Plan (the "Plan"). The maximum number of shares with respect to which Plan awards may be granted during the term of the Plan is 11,000,000 (as adjusted for a two-for-one stock split of the Company's common stock on July 26, 2005), of which 843,406, 2,583,458, 3,167,594 and 682,782 (unaudited) options were granted during 2002, 2003, 2004 and the three months ended March 31, 2005, respectively. The options were granted with a term of 10 years, or in certain cases five years, and an exercise price equal to or in excess of the estimated fair value at the date of the grant. Lacking any transactions in our common stock, the fair value was determined using a "sum of the parts" of the value of the Company's merchant portfolio, payroll business line and financial condition. This model used the portfolio valuation multiple achieved in the Company's transfer of merchant portfolios to National Processing Company, "market" multiples of revenue for the payroll business, and added the Company's net cash, receivables and payables. This approach resulted in values that were higher than a third-party evaluation of the fair value of the Company's common stock that was performed as of March 2003. This approach was employed for all option grants through December 2003 and resulted in option issuances at prices (\$5 through July 2003 and \$6.25 through year-end 2003) that were above the third-party and internally determined fair value. At year-end 2003, two transactions, a sale of common stock by certain executives, senior managers, and former consultants to an institutional investor, and a redemption at their fair value of warrants held by BHC Interim Fund, L.P., occurred, each at a price of \$6.25 per share. This value was used as the fair value for issuances in the first quarter of 2004. For the second quarter of 2004, given the Company's decision to file a registration statement, newly issued options' exercise prices were raised to \$7.50 per share. On the date of the initial filing of a registration statement for the public offering of the Company's stock, this was raised to \$9.28 per share, reflecting a private company discount to the price that the underwriters estimated that the initial public offering could have been priced at, if the offering had occurred on that date. The majority of the options granted vested immediately; however, 22,500, 375,000, 755,474 and 884,350 (unaudited) options as of December 31, 2002, 2003, 2004 and March 31, 2005, respectively, vest over a period of one to five years. During 2004, the Company accelerated the vesting of 22,500 options as a part of a separation agreement.

In April 2002, the Company approved its 2002 PEPSHares Plan, as amended (the "PEPSHares Plan"). The maximum number of shares with respect to which the PEPSHares Plan option awards may be granted during the term of the PEPSHares Plan is 2,400,000 (as adjusted for a two-for-one stock split of the Company's common stock on July 26, 2005), of which 742,772, 618,968 and 282,152 options were granted in 2002, 2003 and 2004, respectively. The options will be exercisable at a price per share equal to the estimated fair value at the date of the grant. The options will become exercisable in a series of five equal annual installments of 20%, contingent on continued service with the Company, provided that all unvested options will vest as of their final vesting date. The vesting of options may be accelerated upon the completion of an initial public offering. The Administrator of the PEPSHares Plan determined that no elections to defer compensation earned after December 31, 2004 will be permitted.

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and no amounts will be deferred and contributed to the PEPShares Plan from compensation earned after December 31, 2004.

Equity Incentive and PEPShares plan activity in 2002, 2003, 2004 and the three months ended March 31, 2005 was as follows:

	2000 Equity Incentive Plan		2002 PEPShares Plan	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Options outstanding at January 1, 2002	1,362,344	\$ 2.91		\$
Issued	843,406	\$ 5.00	742,772	\$ 5.00
Forfeited/cancelled	(122,398)	\$ 3.47	(91,728)	\$ 5.00
Outstanding at December 31, 2002	2,083,352	\$ 3.72	651,044	\$ 5.00
Options exercisable at December 31, 2002	2,060,852	\$ 3.71	130,208	\$ 5.00
Issued	2,583,458	\$ 5.50	618,968	\$ 5.97
Exercised	(2,156)	\$ 5.00		\$
Forfeited/cancelled	(14,556)	\$ 5.14	(7,030)	\$ 5.00
Outstanding at December 31, 2003	4,650,098	\$ 4.70	1,262,982	\$ 5.48
Options exercisable at December 31, 2003	4,275,098	\$ 4.57	384,212	\$ 5.31
Issued	3,167,594	\$ 7.87	282,152	\$ 7.72
Exercised	(552,520)	\$ 2.85	(2,044)	\$ 5.14
Forfeited/cancelled	(133,078)	\$ 5.83	(4,960)	\$ 5.14
Outstanding at December 31, 2004	7,132,094	\$ 6.23	1,538,130	\$ 5.89
Options exercisable at December 31, 2004	6,376,620	\$ 6.11	686,380	\$ 5.57
Issued (unaudited)	682,782	\$ 9.76		\$
Exercised (unaudited)	(13,320)	\$ 3.42		\$
Forfeited/cancelled (unaudited)	(70,532)	\$ 6.89	(8,152)	\$ 6.11
Outstanding at March 31, 2005 (unaudited)	7,731,024	\$ 6.54	1,529,978	\$ 5.89
Options exercisable at March 31, 2005 (unaudited)	6,846,674	\$ 6.35	678,228	\$ 5.64

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Options outstanding and exercisable at December 31, 2004 summarized by exercise are:

Exercise price per share	Outstanding		
	2000 Equity Incentive Plan	2002 PEPShares Plan	Total
\$3.00	700,944		700,944
\$5.00	2,376,610	777,598	3,154,208
\$6.25	2,189,854	593,294	2,783,148
\$7.50	311,232	51,186	362,418
\$9.28	1,553,454	116,052	1,669,506
	7,132,094	1,538,130	8,670,224
Exercise price per share	Exercisable		
	2000 Equity Incentive Plan	2002 PEPShares Plan	Total
\$3.00	700,944		700,944
\$5.00	2,376,610	438,598	2,815,208
\$6.25	1,676,480	214,334	1,890,814
\$7.50	311,232	10,238	321,470
\$9.28	1,311,354	23,210	1,334,564
	6,376,620	686,380	7,063,000

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Options outstanding and exercisable at March 31, 2005 (unaudited) summarized by exercise price are:

Outstanding			
Exercise price per share	2000 Equity Incentive Plan	2002 PEPShares Plan	Total
\$3.00	681,540		681,540
\$5.00	2,361,340	773,398	3,134,738
\$6.25	2,176,848	590,974	2,767,822
\$7.50	299,656	50,686	350,342
\$9.28	1,588,308	114,920	1,703,228
\$9.80	623,332		623,332
	7,731,024	1,529,978	9,261,002
Exercisable			
Exercise price per share	2000 Equity Incentive Plan	2002 PEPShares Plan	Total
\$3.00	681,540		681,540
\$5.00	2,361,340	434,398	2,795,738
\$6.25	1,764,598	212,014	1,976,612
\$7.50	299,656	9,738	309,394
\$9.28	1,311,208	22,078	1,333,286
\$9.80	428,332		428,332
	6,846,674	678,228	7,524,902

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

Management uses methods and assumptions to estimate the fair value of each class of financial instruments for which it is practicable to estimate fair value. Fair value equals quoted market price for securities held as available-for-sale investments. Other financial instruments include cash and cash equivalents, certificates of deposit, receivables, various accounts payable and accrued expenses. The fair value of such financial instruments approximates their carrying value due to their short maturity and pricing terms.

14. EMPLOYEE BENEFIT PLAN

The Company offers a defined contribution plan to all employees. Company contributions are generally based upon fixed amounts of eligible compensation and the Company contributed approximately \$142,586, \$189,188 and \$256,539 to the Plan for the years ended December 31, 2002, 2003 and 2004, respectively.

15. COMMITMENTS AND CONTINGENCIES

Litigation The Company is involved in certain legal proceedings and claims, which arise in the ordinary course of business. In the opinion of the Company, the results of any of these matters, individually and in the aggregate, are not expected to have a material effect on its results of operations, financial condition or cash flows.

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Leases The Company leases various office spaces and certain equipment under operating leases with remaining terms ranging up to eight years. The majority of the office space lease agreements contain renewal options and generally require the Company to pay certain operating expenses. Rental expenses for the years ended December 31, 2002, 2003 and 2004 were \$0.8 million, \$1.0 million and \$1.1 million, respectively.

Future minimum lease commitments under noncancelable leases as of December 31, 2004 are as follows:

	Leases
	(In thousands)
2005	\$ 1,250
2006	1,478
2007	1,316
2008	1,118
2009	541
Thereafter	923
	\$ 6,626

Commitments

Certain officers of the Company have entered into an employee confidential information and non-competition agreement under which they are entitled to severance pay equal to their base salary and medical benefits for 12 months and a pro-rated bonus in the event they are terminated by the Company other than for cause.

The following table reflects the Company's other significant contractual obligations as of December 31, 2004:

	Cash Payments Due By Period as of December 31, 2004				
	Total	Less Than One Year	1-3 Years	4-5 Years	After 5 Years
	(In thousands)				
Processing providers (minimum processing fees payable)	\$ 12,630	\$ 7,017	\$ 4,110	\$ 1,503	\$
Financing arrangement (expected payments, including interest)	10,913	2,673	4,309	2,939	992
Telecommunications providers (committed usage fees payable)	4,763	1,950	2,813		
Revolver advance	2,069	2,069			
Line of credit	784	784			
	\$ 31,159	\$ 14,493	\$ 11,232	\$ 4,442	\$ 992

Contingencies

The Company collects and stores sensitive data about its merchant customers and bank cardholders. If the Company's network security is breached or sensitive merchant or cardholder data is misappropriated, the Company could be exposed to assessments, fines or litigation costs.

16. RELATED PARTY TRANSACTIONS

In March 2003, Carr Holdings, L.L.C., a New Jersey limited liability company, which is owned and managed by the Company's Chief Executive Officer and his wife sold an aggregate of 370,000 shares of the Company's Common Stock to Greenhill Capital Partners, L.P. and its affiliated investment funds and LLR Equity Partners, L.P. and its affiliated investment fund at a price of \$5.00 per share. The Company was responsible for paying all reasonable out-of-pocket expenses incurred by the purchasers in connection with the sale, which expenses totaled approximately \$7,500. Various officers, directors, partners and members of Greenhill Capital Partners, L.P. and its affiliated investment funds and LLR Equity Partners, L.P. and its affiliated investment fund are members of the Company's board of directors.

In July 2003, Greenhill Capital Partners, L.P. and its affiliated investment funds and LLR Equity Partners, L.P. and its affiliated investment fund granted the Company's Chief Executive Officer an irrevocable option to purchase up to an aggregate of 1,000,000 shares of the Company's Series A Senior Convertible Participating Preferred Stock at any time on or before July 31, 2006 at a purchase price of \$12.50 per share.

In November 2004, Carr Holdings, L.L.C., a New Jersey limited liability company, which is owned and managed by the Company's Chief Executive Officer and his wife sold an aggregate of 108,000 shares of the Company's Common Stock to Greenhill Capital Partners, L.P. and its affiliated investment funds and LLR Equity Partners, L.P. and its affiliated investment fund at a price of \$9.28 per share. Various officers, directors, partners and members of Greenhill Capital Partners, L.P. and its affiliated investment funds and LLR Equity Partners, L.P. and its affiliated investment fund are members of the Company's board of directors.

17. WELSCH ASSET PURCHASE

Effective March 31, 2002, the Company entered into an Asset Purchase Agreement with Welsch Financial Merchant Services, Inc. ("Welsch") whereby the Company extinguished its contractual obligations for an expense of \$2,994,487 under the portfolio of merchant contracts established by Welsch, and acquired certain fixed assets and records for \$668,229. The consideration paid included \$678,415 in cash, a note for \$2,000,000, and 283,744 shares of the Company's stock. The fair value of shares issued was estimated by the Company's board of directors at \$2.36 per share as of the effective date of the transaction. An additional 266,666 shares of the Company's Common Stock valued at \$3.75 per share was issued in April 2003, reflecting an earnout provision related to the performance of the portfolio and the Relationship Managers who joined the Company as a result of the transaction.

The following table summarizes the estimated fair values of the assets acquired at the date of acquisition. The purchase price allocations were determined by the Company's management.

	At March 31, 2002	
Current assets	\$	7,967
Inventory		60,153
Property, plant and equipment		124,379
Intangible assets		475,730
Total asset acquired	\$	668,229

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The intangible asset of \$475,730 was assigned to work force and has a useful life of three years. An additional amount of \$2,994,487 was expensed to accrued buyout liability expense. A summary of the intangible asset is as follows as of December 31, 2003 and 2004 and March 31, 2005:

	December 31,		March 31,
	2003	2004	2005
	(In thousands)		(unaudited) (In thousands)
Intangible asset	\$ 476	\$ 476	\$ 476
Less accumulated amortization	(278)	(436)	(476)
	\$ 198	\$ 40	\$ 0

Amortization expense for the years ended December 31, 2002, 2003 and 2004 and March 31, 2004 and 2005 was \$118,932, \$158,577, \$158,577, \$39,622 (unaudited) and \$39,642 (unaudited), respectively. The asset was fully amortized at March 31, 2005.

18. SEGMENTS

The determination of the Company's business segments is based on how the Company monitors and manages the performance of its operations. The Company has two operating segments, as follows: (1) Card, which provides payment processing and related services related to bank card transactions; and (2) Payroll, which provides payroll and related tax filing services.

The Company's operating segments are strategic business units that offer different products and services. They are managed separately because each business requires different marketing strategies, personnel skill sets and technology.

The Company allocates revenues, expenses, assets and liability to segments only where directly attributable. The unallocated corporate administration amounts are costs attributed to finance, corporate administration, human resources and corporate services. For the reported periods, between 70% and 90% of the payroll segment total assets are funds that the Company holds as a fiduciary for payment to taxing authorities. The Company only operates in the United States and does not have any major individual customers.

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A summary of the segments are as follows as of December 31, 2002, 2003 and 2004 and March 31, 2004 and 2005.

	Card	Payroll	Unallocated Corporate Administration Amounts	Total
(In thousands)				
December 31, 2002				
Total net revenue	\$ 338,703	\$ 1,879	\$	\$ 340,582
Depreciation and amortization	1,224	279	84	1,587
Interest income	113	58		171
Interest expense	1,182			1,182
Net income (loss)	11,306	(278)	(6,121)	4,907
Total assets	59,452	6,144		65,596
December 31, 2003				
Total net revenue	419,528	2,709		422,237
Depreciation and amortization	2,134	379	58	2,571
Interest income	47	77		124
Interest expense	1,188			1,188
Net income (loss)	27,249	(635)	(6,481)	20,133
Total assets	94,201	6,541		100,742
December 31, 2004				
Total net revenue	599,131	3,618		602,749
Depreciation and amortization	3,739	115	58	3,912
Interest income	80	102		182
Interest expense	1,385			1,385
Net income (loss)	15,697	381	(7,223)	8,855
Total assets	123,869	10,057		133,926
March 31, 2004 (unaudited)				
Total net revenue	120,157	1,047		121,204
Depreciation and amortization	836	29	11	876
Interest income	16	22		38
Interest expense	298			298
Net income (loss)	3,288	233	(1,375)	2,146
Total assets	102,437	5,212		107,649
March 31, 2005 (unaudited)				
Total net revenue	168,623	1,242		169,865
Depreciation and amortization	1,198	28	57	1,283
Interest income	20	90		110
Interest expense	435			435
Net income (loss)	3,821	423	(1,550)	2,694
Total assets	128,059	8,333		136,392

19. EARNINGS PER SHARE

The Company presents earnings per share data in accordance with SFAS No. 128, "Earnings Per Share" ("SFAS 128"), which establishes the standards for the computation and presentation of basic and diluted earnings per share data. Under SFAS 128, the dilutive effect of stock options is excluded from the calculation of basic earnings per share but included in diluted earnings per share except in periods of net loss where

inclusion would be anti-dilutive. As the Convertible Preferred does not participate in the Company's losses, in 2002 the basic and diluted share count excludes those shares.

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Weighted average shares outstanding and dilutive securities have been adjusted to reflect a two-for-one stock split on July 26, 2005. The following is a reconciliation of the amounts used to calculate basic and diluted earnings per share using the two-class method:

	December 31,			March 31,	March 31,
	2002	2003	2004	2004	2005
	(unaudited)				
Basic:					
Weighted average common stock outstanding	15,642,356	15,931,626	16,407,554	16,295,846	16,449,452
(Loss) earnings per share:	\$ (0.10)	\$ 0.65	\$ 0.28	\$ 0.07	\$ 0.09
Diluted:					
Net (loss) income attributable to common stock	\$ (1,602)	\$ 10,290	\$ 4,592	\$ 1,109	\$ 1,399
Plus: income allocated to Series A Senior Convertible Participating Preferred Stock		9,843	4,263	1,037	1,295
Net (loss) income	\$ (1,602)	\$ 20,133	\$ 8,855	\$ 2,146	\$ 2,694

Section 18. Concerning the Rights Agent. The Company agrees to pay to the Rights Agent reasonable compensation for all services rendered by it hereunder, and, from time to time, on demand of the Rights Agent, its reasonable expenses and counsel fees and other disbursements incurred in the preparation, negotiation, delivery, amendment, administration and execution of this Agreement and the exercise and performance of its duties hereunder. The Company also agrees to indemnify the Rights Agent for, and to hold it harmless against, any loss, liability, damage, judgment, fine, penalty, claim, demand, settlement or expense (including without limitation, the reasonable fees and expenses of legal counsel) incurred without gross negligence, bad faith or willful misconduct on the part of the Rights Agent (each as determined by a final, nonappealable judgment of a court of competent jurisdiction), for anything done or omitted by the Rights Agent in connection with the acceptance, administration, exercise and performance of its duties under this Agreement, including the costs and expenses of defending against any claim of liability in connection herewith. The reasonable costs and expenses incurred in enforcing this right of indemnification shall be paid by the Company to the extent that the Rights Agent is successful in so enforcing its right of indemnification.

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The Rights Agent shall be protected and shall incur no liability for, or in respect of any action taken, suffered or omitted by it in connection with, its administration of this Agreement in reliance upon any Right Certificate or certificate for the Preferred Shares or Common Shares or for other securities of the Company, instrument of assignment or transfer, power of attorney, endorsement, affidavit, letter, notice, direction, consent, certificate, statement, or other paper or document believed by it to be genuine and to be signed, executed and, where necessary, verified or acknowledged, by the proper person or persons, or otherwise upon the advice of counsel as set forth in Section 20 hereof. Notwithstanding anything in this Agreement to the contrary, in no event will the Rights Agent be liable for special, punitive, indirect, incidental or consequential loss or damage of any kind whatsoever (including but not limited to lost profits), even if the Rights Agent has been advised of the likelihood of such loss or damage and regardless of the form of action. The Rights Agent shall not be deemed to have knowledge of any event of which it was supposed to receive notice thereof hereunder, and the Rights Agent shall be fully protected and shall incur no liability for failing to take any action in connection therewith unless and until it has received such notice.

The provisions of this Section 18 and Section 20 hereof shall survive the termination of this Agreement, the exercise or expiration of the Rights and the resignation, replacement or removal of the Rights Agent.

Section 19. Merger or Consolidation or Change of Name of Rights Agent. Any Person into which the Rights Agent or any successor Rights Agent may be merged or with which it may effect a share exchange, be consolidated, or any Person resulting from any merger, share exchange, or consolidation to which the Rights Agent or any successor Rights Agent shall be a party, or any Person succeeding to the stock transfer or corporate trust powers of the Rights Agent or any successor Rights Agent, shall be the successor to the Rights Agent under this Agreement without the execution or filing of any paper or document or any further act on the part of any of the parties hereto; provided that such Person would be eligible for appointment as a successor Rights Agent under the provisions of Section 21 hereof. In case at the time such successor Rights Agent shall succeed to the agency created by this Agreement, any of the Right Certificates shall have been countersigned but not delivered, any such successor Rights Agent may adopt the countersignature of the predecessor Rights Agent and deliver such Right Certificates so countersigned; and, in case at that time any of the Right Certificates shall not have been countersigned, any successor Rights Agent may countersign such Right Certificates either in the name of the predecessor Rights Agent or in the name of the successor Rights Agent; and, in all such cases, such Right Certificates shall have the full force provided in the Right Certificates and in this Agreement.

In case at any time the name of the Rights Agent shall be changed and at such time any of the Right Certificates shall have been countersigned but not delivered, the Rights Agent may adopt the countersignature under its prior name and deliver Right Certificates so countersigned; and, in case at that time any of the Right Certificates shall not have been countersigned, the Rights Agent may countersign such Right Certificates either in its prior name or in its changed name; and, in all such cases, such Right Certificates shall have the full force provided in the Right Certificates and in this Agreement.

Section 20. Duties of Rights Agent. The Rights Agent undertakes to perform only the duties and obligations imposed by this Agreement and no implied duties or obligations shall be read into this Agreement against the Rights Agent. The Rights Agent shall perform those duties and obligations upon the following terms and conditions, by all of which the Company and the holders of Right Certificates, by their acceptance thereof, shall be bound:

(a) The Rights Agent may consult with legal counsel (who may be legal counsel for the Company), and the advice or opinion of such counsel shall be full and complete authorization and protection to the Rights Agent and the Rights Agent shall incur no liability for or in respect of any action taken or omitted by it in good faith and in accordance with such advice or opinion.

(b) Whenever in the performance of its duties under this Agreement the Rights Agent shall deem it necessary or desirable that any fact or matter (including, without limitation, the identity of an Acquiring Person

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and the determination of the current per share market price of any security) be proved or established by the Company prior to taking or suffering any action hereunder, such fact or matter (unless other evidence in respect thereof be herein specifically prescribed) may be deemed to be conclusively proved and established by a certificate signed by any one of the Chairman of the Board, the Chief Executive Officer, the President, any Vice President, the Treasurer, the Secretary or any Assistant Secretary of the Company and delivered to the Rights Agent; and such certificate shall be full and complete authorization and protection to the Rights Agent and the Rights Agent shall incur no liability for any action taken or suffered in good faith by it under the provisions of this Agreement in reliance upon such a certificate.

(c) The Rights Agent shall be liable hereunder to the Company and any other Person only for its own gross negligence, bad faith or willful misconduct (each as determined by a final, nonappealable judgment of a court of competent jurisdiction). Any liability of the Rights Agent shall be limited to three times the amount of aggregate annual fees paid by the Company to the Rights Agent.

(d) The Rights Agent shall not be liable for or by reason of any of the statements of fact or recitals contained in this Agreement or in the Right Certificates (except its countersignature thereof) or be required to verify the same, but all such statements and recitals are and shall be deemed to have been made by the Company only.

(e) The Rights Agent shall not be under any responsibility in respect of the validity of this Agreement or the execution and delivery hereof (except the due execution hereof by the Rights Agent) or in respect of the validity or execution of any Right Certificate (except its countersignature thereof); nor shall it be responsible for any breach by the Company of any covenant or condition contained in this Agreement or in any Right Certificate; nor shall it be responsible for any change in the exercisability of the Rights (including but not limited to the Rights becoming null and void pursuant to Section 11(a)(ii) hereof) or any adjustment in the terms of the Rights (including but not limited to the manner, method or amount thereof) provided for in Section 3, 11, 13, 23 or 24 hereof, or the ascertaining of the existence of facts that would require any such change or adjustment (except with respect to the exercise of Rights evidenced by Right Certificates after receipt of a certificate furnished pursuant to Section 12 describing such change or adjustment upon which the Rights Agent may rely); nor shall it by any act hereunder be deemed to make any representation or warranty as to the authorization or reservation of any Preferred Shares or other securities to be issued pursuant to this Agreement or any Right Certificate or as to whether any Preferred Shares or other securities will, when so issued, be validly authorized and issued, fully paid and nonassessable.

(f) The Company agrees that it will perform, execute, acknowledge and deliver or cause to be performed, executed, acknowledged and delivered all such further and other acts, instruments and assurances as may reasonably be required by the Rights Agent for the carrying out or performing by the Rights Agent of the provisions of this Agreement.

(g) The Rights Agent is hereby authorized and directed to accept instructions with respect to the performance of its duties hereunder from any one of the Chairman of the Board, the Chief Executive Officer, the President, any Vice President, the Secretary, any Assistant Secretary, the Treasurer or any Assistant or the Treasurer of the Company, and to apply to such officers for advice or instructions in connection with its duties, and it shall not be liable for any action taken or suffered by it in good faith in accordance with instructions of any such officer or for any delay in acting while waiting for those instructions. The Rights Agent shall be fully authorized and protected in relying upon the most recent instructions received by any such officer. Any application by the Rights Agent for written instructions from the Company may, at the option of the Rights Agent, set forth in writing any action proposed to be taken, suffered or omitted to be taken by the Rights Agent with respect to its duties and obligations under this Agreement and the date on and/or after which such action shall be taken, suffered or such omission shall be effective. The Rights Agent shall not be liable for any action taken, suffered or omitted to be taken by it in accordance with a proposal included in any such application on or after the date specified therein (which date shall not be less than three (3) Business Days after the date indicated in such application unless any such officer shall have consented in writing to an earlier date) unless, prior to taking, suffering or omitting to take any such action, the Rights Agent has received written instructions in response to such application specifying the action to be taken, suffered or omitted to be taken.

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(h) The Rights Agent and any stockholder, director, officer or employee of the Rights Agent may buy, sell or deal in any of the Rights or other securities of the Company or become pecuniarily interested in any transaction in which the Company may be interested, or contract with or lend money to the Company or otherwise act as fully and freely as though it were not the Rights Agent under this Agreement. Nothing herein shall preclude the Rights Agent from acting in any other capacity for the Company or for any other Person.

(i) The Rights Agent may execute and exercise any of the rights or powers hereby vested in it or perform any duty hereunder either itself (through its directors, officers and employees) or by or through its attorneys or agents, and the Rights Agent shall not be answerable or accountable for any act, default, neglect or misconduct of any such attorneys or agents or for any loss to the Company resulting from any such act, default, neglect or misconduct, provided that reasonable care was exercised in the selection and continued employment thereof.

Section 21. Change of Rights Agent. The Rights Agent or any successor Rights Agent may resign and be discharged from its duties under this Agreement upon 30 days' notice in writing mailed to the Company and, in the event that the Rights Agent or one of its Affiliates is not also the transfer agent for the Company, to each transfer agent of the Common Shares or Preferred Shares by registered or certified mail. In the event the transfer agency relationship in effect between the Company and the Rights Agent terminates, the Rights Agent will be deemed to have resigned automatically and be discharged from its duties as Rights Agent under this Agreement as of the effective date of such termination, and the Company shall be responsible for sending any required notice. The Company may remove the Rights Agent or any successor Rights Agent (with or without cause) upon 30 days' notice in writing, mailed to the Rights Agent or successor Rights Agent, as the case may be, and to each transfer agent of the Common Shares or Preferred Shares by registered or certified mail, and to the holders of the Right Certificates by first-class mail. If the Rights Agent shall resign or be removed or shall otherwise become incapable of acting, the Company shall appoint a successor to the Rights Agent. If the Company shall fail to make such appointment within a period of 30 days after giving notice of such removal or after it has been notified in writing of such resignation or incapacity by the resigning or incapacitated Rights Agent or by the holder of a Right Certificate (which holder shall, with such notice, submit such holder's Right Certificate for inspection by the Company), then the registered holder of any Right Certificate may apply to any court of competent jurisdiction for the appointment of a new Rights Agent. Any successor Rights Agent, whether appointed by the Company or by such a court, shall be either (a) a Person organized and doing business under the laws of the United States or of the State of New York (or of any other state of the United States so long as such corporation is authorized to do business as a banking institution in such state), in good standing which is authorized under such laws to exercise corporate trust or stock transfer powers and is subject to supervision or examination by federal or state authority and which has at the time of its appointment as Rights Agent a combined capital and surplus of at least \$50 million or (b) an Affiliate or direct or indirect wholly-owned Subsidiary of such Person or its wholly-owning parent. After appointment, the successor Rights Agent shall be vested with the same powers, rights, duties and responsibilities as if it had been originally named as Rights Agent without further act or deed; but the predecessor Rights Agent shall deliver and transfer to the successor Rights Agent any property at the time held by it hereunder, and execute and deliver any further assurance, conveyance, act or deed necessary for the purpose. Not later than the effective date of any such appointment, the Company shall file notice thereof in writing with the predecessor Rights Agent and each transfer agent of the Common Shares or Preferred Shares, and mail a notice thereof in writing to the registered holders of the Right Certificates. Failure to give any notice provided for in this Section 21, however, or any defect therein, shall not affect the legality or validity of the resignation or removal of the Rights Agent or the appointment of the successor Rights Agent, as the case may be.

Section 22. Issuance of New Right Certificates. Notwithstanding any of the provisions of this Agreement or of the Rights to the contrary, the Company may, at its option, issue new Right Certificates evidencing Rights in such form as may be approved by the Board of Directors of the Company to reflect any adjustment or change in the Purchase Price and the number or kind or class of shares or other securities or property purchasable under the Right Certificates made in accordance with the provisions of this Agreement.

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Section 23. Redemption. (a) The Board of Directors of the Company may, at its option, at any time prior to such time as any Person becomes an Acquiring Person, redeem all but not less than all the then outstanding Rights at a redemption price of per Right equal to the quotient of \$1.00 divided by the Formula Number then in effect (such redemption price being hereinafter referred to as the Redemption Price). The redemption of the Rights by the Board of Directors of the Company may be made effective at such time, on such basis and with such conditions as the Board of Directors of the Company, in its sole discretion, may establish.

(b) Immediately upon the action of the Board of Directors of the Company ordering the redemption of the Rights pursuant to paragraph (a) of this Section 23, and without any further action and without any notice, the right to exercise the Rights will terminate and the only right thereafter of the holders of Rights shall be to receive the Redemption Price. The Company shall promptly give public notice of any such redemption (with prompt written notice thereof to the Rights Agent); provided, however, that the failure to give, or any defect in, any such notice shall not affect the validity of such redemption. Within ten (10) days after such action of the Board of Directors of the Company ordering the redemption of the Rights, the Company shall mail a notice of redemption to all the holders of the then outstanding Rights at their last addresses as they appear upon the registry books of the Rights Agent or, prior to the Distribution Date, on the registry books of the transfer agent for the Common Shares. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of redemption will state the method by which the payment of the Redemption Price will be made. Neither the Company nor any of its Affiliates or Associates may redeem, acquire or purchase for value any Rights at any time in any manner other than that specifically set forth in this Section 23 or in Section 24 hereof, and other than in connection with the purchase of Common Shares prior to the Distribution Date.

Section 24. Exchange. (a) The Board of Directors of the Company may, at its option, at any time after any Person becomes an Acquiring Person, exchange all or part of the then outstanding and exercisable Rights (which shall not include Rights that have become null and void pursuant to the provisions of Section 11(a)(ii) hereof) for Common Shares at an exchange ratio of one Common Share per Right, appropriately adjusted to reflect any adjustment in the number of Rights pursuant to Section 11(i) (such exchange ratio being hereinafter referred to as the Exchange Ratio). Notwithstanding the foregoing, the Board of Directors of the Company shall not be empowered to effect such exchange at any time after any Person (other than the Company, any Subsidiary of the Company, any employee benefit plan of the Company or any such Subsidiary, or any entity holding Common Shares for or pursuant to the terms of any such plan), together with all Affiliates and Associates of such Person, becomes the Beneficial Owner of 50% or more of the Common Shares then outstanding.

(b) Immediately upon the action of the Board of Directors of the Company ordering the exchange of any Rights pursuant to paragraph (a) of this Section 24 and without any further action and without any notice, the right to exercise such Rights shall terminate and the only right thereafter of a holder of such Rights shall be to receive that number of Common Shares equal to the number of such Rights held by such holder multiplied by the Exchange Ratio. The Company shall promptly give public notice of any such exchange (with prompt written notice thereof to the Rights Agent); provided, however, that the failure to give, or any defect in, such notice shall not affect the validity of such exchange. The Company promptly shall mail a notice of any such exchange to all of the holders of such Rights at their last addresses as they appear upon the registry books of the Rights Agent. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of exchange will state the method by which the exchange of the Common Shares for Rights will be effected, and, in the event of any partial exchange, the number of Rights which will be exchanged. Any partial exchange shall be effected pro rata based on the number of Rights (other than Rights which have become null and void pursuant to the provisions of Section 11(a)(ii) hereof) held by each holder of Rights.

(c) In the event that there shall not be sufficient Common Shares issued but not outstanding or authorized but unissued to permit any exchange of Rights as contemplated in accordance with this Section 24, the Company shall take all such action as may be necessary to authorize additional Common Shares for issuance upon exchange of the Rights. In the event the Company shall, after good faith effort, be unable to take all such action as may be necessary to authorize such additional Common Shares, the Company shall substitute, for each Common Share that would otherwise be issuable upon exchange of a Right, a number of Preferred Shares or

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fraction thereof such that the current per share market price of one Preferred Share multiplied by such number or fraction is equal to the current per share market price of one Common Share as of the date of issuance of such Preferred Shares or fraction thereof.

(d) The Company shall not be required to issue fractions of Common Shares or to distribute certificates which evidence fractional Common Shares. In lieu of such fractional Common Shares, the Company shall pay to the registered holders of the Right Certificates with regard to which such fractional Common Shares would otherwise be issuable an amount in cash equal to the same fraction of the current market value of a whole Common Share. For the purposes of this paragraph (d), the current market value of a whole Common Share shall be the closing price of a Common Share (as determined pursuant to the second sentence of Section 11(d)(i) hereof) for the Trading Day immediately prior to the date of exchange pursuant to this Section 24.

Section 25. Notice of Certain Events. (a) In case the Company shall, at any time after the Distribution Date, propose (i) to pay any dividend payable in stock of any class to the holders of the Preferred Shares or to make any other distribution to the holders of the Preferred Shares (other than a regular quarterly cash dividend), (ii) to offer to the holders of the Preferred Shares rights or warrants to subscribe for or to purchase any additional Preferred Shares or shares of stock of any class or any other securities, rights or options, (iii) to effect any reclassification of the Preferred Shares (other than a reclassification involving only the subdivision of outstanding Preferred Shares), (iv) to effect any share exchange, consolidation or merger into or with, or to effect any sale or other transfer (or to permit one or more of its Subsidiaries to effect any sale or other transfer), in one or more transactions, of 50% or more of the assets or earning power of the Company and its Subsidiaries (taken as a whole) to, any other Person, (v) to effect the liquidation, dissolution or winding up of the Company, or (vi) to declare or pay any dividend on the Common Shares payable in Common Shares or to effect a subdivision, combination or consolidation of the Common Shares (by reclassification or otherwise than by payment of dividends in Common Shares), then, in each such case, the Company shall give to each holder of a Right Certificate, in accordance with Section 26 hereof, a notice of such proposed action, which shall specify the record date for the purposes of such stock dividend, or distribution of rights or warrants, or the date on which such share exchange, reclassification, consolidation, merger, sale, transfer, liquidation, dissolution, or winding up is to take place and the date of participation therein by the holders of the Common Shares and/or Preferred Shares, if any such date is to be fixed, and such notice shall be so given in the case of any action covered by clause (i) or (ii) above at least 10 days prior to the record date for determining holders of the Preferred Shares for purposes of such action, and, in the case of any such other action, at least 10 days prior to the date of the taking of such proposed action or the date of participation therein by the holders of the Common Shares and/or Preferred Shares, whichever shall be the earlier.

(b) In case the event set forth in Section 11(a)(ii) hereof shall occur, then the Company shall, as soon as practicable thereafter, give to the Rights Agent and each holder of a Right Certificate, in accordance with Section 26 hereof, a notice of the occurrence of such event, which notice shall describe such event and the consequences of such event to holders of Rights under Section 11(a)(ii) hereof.

Section 26. Notices. Notices or demands authorized by this Agreement to be given or made by the Rights Agent or by the holder of any Right Certificate to or on the Company shall be sufficiently given or made if sent by overnight delivery service or first-class mail, postage prepaid, addressed (until another address is filed in writing with the Rights Agent) as follows:

Synacor, Inc.

40 La Riviere Drive, Suite 300

Buffalo, New York 14202

Attention: Corporate Secretary

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Subject to the provisions of Section 21 hereof, any notice or demand authorized by this Agreement to be given or made by the Company or by the holder of any Right Certificate to or on the Rights Agent shall be sufficiently given or made if sent by overnight delivery service or first-class mail, postage prepaid, addressed (until another address is filed in writing with the Company) as follows:

American Stock Transfer & Trust Company, LLC

6201 15th Avenue

Brooklyn, New York 11219

Attention: Corporate Trust Department

Notices or demands authorized by this Agreement to be given or made by the Company or the Rights Agent to the holder of any Right Certificate shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed to such holder at the address of such holder as shown on the registry books of the Company.

Section 27. Supplements and Amendments. Subject to this Section, the Company may, and the Rights Agent shall, if directed by the Company, from time to time supplement or amend this Agreement without the approval of any holders of Right Certificates in order to cure any ambiguity, to correct or supplement any provision contained herein which may be defective or inconsistent with any other provisions herein, or to make any other provisions with respect to the Rights which the Company may deem necessary or desirable, any such supplement or amendment to be evidenced by a writing signed by the Company and the Rights Agent; provided, however, that, from and after such time as any Person becomes an Acquiring Person, this Agreement shall not be amended in any manner which would adversely affect the interests of the holders of Rights. For the avoidance of doubt, the Company shall be entitled to adopt and implement such procedures and arrangements (including with third parties) as it may deem necessary or desirable to facilitate the exercise, exchange, trading, issuance or distribution of the Rights (and Preferred Shares) as contemplated hereby and to ensure that an Acquiring Person does not obtain the benefits thereof, and amendments in respect of the foregoing shall not be deemed to adversely affect the interests of the holders of Rights. Upon the delivery of a certificate from an appropriate officer of the Company that states that the proposed supplement or amendment is in compliance with the terms of this Section 27, the Rights Agent shall execute such supplement or amendment; provided, that notwithstanding anything in this Agreement to the contrary, the Rights Agent may, but shall not be obligated to, enter into any supplement or amendment that materially and adversely affects the Rights Agent's own rights, duties, obligations or immunities under this Agreement.

Section 28. Successors. All the covenants and provisions of this Agreement by or for the benefit of the Company or the Rights Agent shall bind and inure to the benefit of their respective successors and assigns hereunder.

Section 29. Benefits of this Agreement. Nothing in this Agreement shall be construed to give to any Person other than the Company, the Rights Agent and the registered holders of the Right Certificates (and, prior to the Distribution Date, the Common Shares) any legal or equitable right, remedy or claim under this Agreement; but this Agreement shall be for the sole and exclusive benefit of the Company, the Rights Agent and the registered holders of the Right Certificates (and, prior to the Distribution Date, the Common Shares).

Section 30. Severability. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated; provided, however, that if any such excluded term, provision, covenant or restriction shall materially and adversely affect the rights, immunities, duties or obligations of the Rights Agent, the Rights Agent shall be entitled to resign upon 10 Business Days' written notice to the Company pursuant to the requirements of Section 26 of this Agreement.

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Section 31. Governing Law. This Agreement and each Right Certificate issued hereunder shall be deemed to be a contract made under the laws of the State of Delaware and for all purposes shall be governed by and construed in accordance with the laws of such state applicable to contracts to be made and performed entirely within such state.

Section 32. Counterparts. This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and all such counterparts shall together constitute but one and the same instrument. A signature to this Agreement transmitted electronically shall have the same authority, effect, and enforceability as an original signature.

Section 33. Descriptive Headings. Descriptive headings of the several Sections of this Agreement are inserted for convenience only and shall not control or affect the meaning or construction of any of the provisions hereof.

Section 34. Customer Identification Program. The Company acknowledges that the Rights Agent is subject to the customer identification program (Customer Identification Program) requirements under the USA PATRIOT Act and its implementing regulations, and that the Rights Agent must obtain, verify and record information that allows the Rights Agent to identify the Company. Accordingly, prior to accepting an appointment hereunder, the Rights Agent may request information from the Company that will help the Rights Agent to identify the Company, including without limitation the Company's physical address, tax identification number, organizational documents, certificate of good standing, license to do business, or any other information that the Rights Agent deems necessary. The Company agrees that the Rights Agent cannot accept an appointment hereunder unless and until the Rights Agent verifies the Company's identity in accordance with the Customer Identification Program requirements.

Section 35. Force Majeure. Notwithstanding anything to the contrary contained herein, the Rights Agent shall not be liable for any delays or failures in performance resulting from acts beyond its reasonable control including, without limitation, acts of God, terrorist acts, shortage of supply, breakdowns or malfunctions, interruptions or malfunctions of computer facilities, or loss of data due to power failures or mechanical difficulties with information storage or retrieval systems, labor difficulties, war, or civil unrest. The Rights Agent shall provide the Company prompt notice as soon as practicable in the event that any such delay or failure in performance occurs and keep the Company apprised of developments and mitigation effort with respect thereto.

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IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and attested, all as of the day and year first above written.

Attest:

SYNACOR, INC.

By /s/ Ronald Frankel
Name: Ronald Frankel
Title: President and Chief Executive Officer

By /s/ William Stuart
Name: William Stuart
Title: Chief Financial Officer and Secretary

Attest:

AMERICAN STOCK TRANSFER & TRUST COMPANY, LLC,
as Rights Agent

By /s/ Alexandra Albrecht
Name: Alexandra Albrecht
Title: Vice President

By /s/ Michael A. Nespoli
Name: Michael A. Nespoli
Title: Executive Director

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Exhibit A

FORM
of
CERTIFICATE OF DESIGNATION
OF
SERIES A JUNIOR PARTICIPATING PREFERRED STOCK
OF
SYNACOR, INC.

(Pursuant to Section 151 of the Delaware General Corporation Law)

Synacor, Inc., a corporation organized and existing under the General Corporation Law of the State of Delaware (hereinafter called the Corporation), hereby certifies that the following resolution was adopted by the Board of Directors of the Corporation as required by Section 151 of the General Corporation Law at a meeting duly called and held on July 14, 2014:

RESOLVED, that pursuant to the authority granted to and vested in the Board of Directors of this Corporation (hereinafter called the Board of Directors or the Board) in accordance with the provisions of the Fifth Amended and Restated Certificate of Incorporation of the Corporation (the Certificate of Incorporation), the Board of Directors hereby creates a series of Preferred Stock, par value \$0.01 per share, of the Corporation (the Preferred Stock), and hereby states the designation and number of shares, and fixes the relative rights, preferences, and limitations thereof as follows:

Section 1. Designation and Amount. The shares of such series shall be designated as Series A Junior Participating Preferred Stock (the Series A Preferred Stock) and the number of shares initially constituting the Series A Preferred Stock shall be 2,000,000; provided, however, that, if more than a total of 2,000,000 shares of Series A Preferred Stock shall be issuable upon the exercise of Rights (the Rights) issued pursuant to the Rights Agreement dated as of July 14, 2014, between the Corporation and American Stock Transfer & Trust Company, LLC, as Rights Agent (the Rights Agreement), the Board, pursuant to Section 151(g) of the General Corporation Law of the State of Delaware, shall direct by resolution or resolutions that a certificate be properly executed, acknowledged, filed and recorded, in accordance with the provisions of Section 103 thereof, providing for the total number of shares of Series A Preferred Stock authorized to be issued to be increased (to the extent that the Certificate of Incorporation then permits) up to the largest number of whole shares (rounded up to the nearest whole number) issuable upon exercise of such Rights; provided, further, that such number of shares may be decreased by resolution of the Board of Directors, but not to a number less than the number of shares then outstanding plus the number of shares reserved for issuance upon the exercise of the Rights or any other outstanding options, rights or warrants or upon the conversion of any outstanding securities issued by the Corporation convertible into Series A Preferred Stock.

Section 2. Dividends and Distributions.

(A) Subject to the rights of the holders of shares of any other series of Preferred Stock or other class of capital stock of the Corporation ranking superior to the shares of Series A Preferred Stock with respect to dividends, the holders of shares of Series A Preferred Stock shall be entitled to receive, when, as and if declared by the Board, out of funds of the Corporation legally available therefor, (1) quarterly dividends payable in cash on the last day of each fiscal quarter in each year, or such other dates as the Board shall approve (each such date

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being referred to herein as a Quarterly Dividend Payment Date), commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or a fraction of a share of Series A Preferred Stock, in the amount of \$1.00 per whole share (rounded to the nearest cent) less the amount of all cash dividends declared on the Series A Preferred Stock pursuant to the following clause (2) since the immediately preceding Quarterly Dividend Payment Date or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series A Preferred Stock (the total of which shall not, in any event, be less than zero) and (2) dividends payable in cash on the payment date for each cash dividend declared on the shares of Common Stock, par value \$0.01 per share, of the Corporation (the Common Stock) in an amount per whole share (rounded to the nearest cent) equal to the Formula Number (as hereinafter defined) then in effect times the cash dividends then to be paid on each share of Common Stock. In addition, if the Corporation shall pay any dividend or make any distribution on the Common Stock payable in assets, securities or other forms of noncash consideration (other than dividends or distributions solely in shares of Common Stock), then, in each such case, the Corporation shall simultaneously pay or make on each outstanding whole share of Series A Preferred Stock a dividend or distribution in like kind equal to the Formula Number then in effect times such dividend or distribution on each share of Common Stock. As used herein, the Formula Number shall be 100; provided, however, that, if at any time after July 14, 2014, the Corporation shall (i) declare or pay any dividend on the Common Stock payable in shares of Common Stock or make any distribution on the Common Stock in shares of Common Stock, (ii) subdivide (by a stock split or otherwise) the outstanding shares of Common Stock into a larger number of shares of Common Stock or (iii) combine (by a reverse stock split or otherwise) the outstanding shares of Common Stock into a smaller number of shares of Common Stock, then in each such event the Formula Number shall be adjusted to a number determined by multiplying the Formula Number in effect immediately prior to such event by a fraction, the numerator of which is the number of shares of Common Stock that are outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that are outstanding immediately prior to such event (and rounding the result to the nearest whole number); and provided further that, if at any time after July 14, 2014, the Corporation shall issue any shares of its capital stock in a merger, reclassification, or change of the outstanding shares of Common Stock, then in each such event the Formula Number shall be appropriately adjusted to reflect such merger, reclassification or change so that each share of Preferred Stock continues to be the economic equivalent of a Formula Number of shares of Common Stock prior to such merger, reclassification or change.

(B) The Corporation shall declare a cash dividend on the Series A Preferred Stock as provided in Section 2(A)(2) immediately prior to or at the same time it declares a cash dividend on the Common Stock; provided, however, that, in the event no cash dividend shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date or, with respect to the first Quarterly Dividend Payment Date, during the period between the first issuance of any share or fraction of a share of Series A Preferred Stock and the next subsequent Quarterly Dividend Payment Date, a dividend of \$1.00 per whole share on the Series A Preferred Stock shall nevertheless accrue on such subsequent Quarterly Dividend Payment Date or the first Quarterly Dividend Payment Date, as the case may be. The Board may fix a record date for the determination of holders of shares of Series A Preferred Stock entitled to receive a dividend or distribution declared thereon, which record date shall be the same as the record date for any corresponding dividend or distribution on the Common Stock.

(C) Dividends shall begin to accrue and be cumulative on outstanding shares of Series A Preferred Stock from and after the Quarterly Dividend Payment Date next preceding the date of issue of such shares, unless the date of issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case dividends on such shares shall begin to accrue and be cumulative from and after the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series A Preferred Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from and after such Quarterly Dividend Payment Date. Accrued but unpaid dividends shall not bear interest. Dividends paid on the shares of Series A Preferred Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding.

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Section 3. Voting Rights. The holders of shares of Series A Preferred Stock shall have the following voting rights:

(A) Subject to the provision for adjustment set forth herein, each share of Series A Preferred Stock shall entitle the holder thereof to a number of votes on all matters submitted to a vote of the stockholders of the Corporation equal to the Formula Number then in effect.

(B) Except as otherwise provided herein, in the Certificate of Incorporation, in any other Certificates of Designation creating a series of Preferred Stock or any similar stock, or by law, the holders of shares of Series A Preferred Stock and the holders of shares of Common Stock and any other capital stock of the Corporation having general voting rights shall vote together as one class on all matters submitted to a vote of stockholders of the Corporation.

(C) Except as set forth herein, or as otherwise provided by law, holders of Series A Preferred Stock shall have no special voting rights and their consent shall not be required (except to the extent they are entitled to vote with holders of Common Stock and any other capital stock of the Corporation having general voting rights as set forth herein) for taking any corporate action.

Section 4. Certain Restrictions.

(A) Whenever quarterly dividends or other dividends or distributions payable on the Series A Preferred Stock as provided in Section 2 are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series A Preferred Stock outstanding shall have been paid in full, the Corporation shall not:

(i) declare or pay dividends, or make any other distributions, on any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock;

(ii) declare or pay dividends, or make any other distributions, on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Preferred Stock, except dividends paid ratably on the Series A Preferred Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled;

(iii) redeem or purchase or otherwise acquire for consideration shares of any stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock, provided that the Corporation may at any time redeem, purchase or otherwise acquire shares of any such junior stock in exchange for shares of any stock of the Corporation ranking junior (either as to dividends or upon dissolution, liquidation or winding up) to the Series A Preferred Stock; or

(iv) redeem or purchase or otherwise acquire for consideration any shares of Series A Preferred Stock, or any shares of stock ranking on a parity with the Series A Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of such shares upon such terms as the Board of Directors, after consideration of the respective annual dividend rates and other relative rights and preferences of the respective series and classes, shall determine in good faith will result in fair and equitable treatment among the respective series or classes.

(B) The Corporation shall not permit any subsidiary of the Corporation to purchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under paragraph (A) of this Section 4, purchase or otherwise acquire such shares at such time and in such manner.

Section 5. Reacquired Shares. Any shares of Series A Preferred Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall not be reissued as shares of Series A Preferred Stock, and the Board shall take all action necessary to retire and cancel such shares promptly after the acquisition thereof. The Corporation shall take all such actions as shall be necessary to cause all such shares upon their cancellation to become authorized but unissued shares of Preferred Stock that may be reissued as part of a new series of Preferred Stock subject to the conditions and restrictions on issuance set forth herein, in the Certificate of Incorporation, or in any other Certificates of Designation creating a series of Preferred Stock or any similar stock or as otherwise required by law.

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Section 6. Liquidation, Dissolution or Winding Up. Upon any liquidation, dissolution or winding up of the Corporation, no distribution shall be made (1) to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock unless, prior thereto, the holders of shares of Series A Preferred Stock shall have received \$100 per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment, plus an aggregate amount per whole share equal to the Formula Number then in effect times the aggregate amount to be distributed per whole share to holders of shares of Common Stock, or (2) to the holders of shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Preferred Stock, except distributions made ratably on the Series A Preferred Stock and all such parity stock in proportion to the total amounts to which the holders of all such shares are entitled upon such liquidation, dissolution or winding up.

Section 7. Consolidation, Merger, etc. In case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case each share of Series A Preferred Stock shall at the same time be similarly exchanged or changed into an amount per share, subject to the provision for adjustment hereinafter set forth, equal to the Formula Number then in effect times the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged.

Section 8. No Redemption. The shares of Series A Preferred Stock shall not be redeemable and shall not be subject to or entitled to the operation of a retirement or sinking fund.

Section 9. Rank. The Series A Preferred Stock shall rank, with respect to the payment of dividends and the distribution of assets, junior to all series of any other class of the Corporation's Preferred Stock unless the Board shall specifically determine otherwise in fixing the powers, preferences and relative, participating, optional and other special rights of the shares of such series and the qualifications, limitations and restrictions thereof.

Section 10. Fractional Shares. The Series A Preferred Stock shall be issuable upon exercise of the Rights issued pursuant to the Rights Agreement in whole shares or in any fraction of a share that is one one-hundredth of a share (as such fraction may be adjusted as provided in the Rights Agreement) or any integral multiple of such fraction which shall entitle the holder, in proportion to such holder's fractional shares, to receive dividends, participate in distributions, vote and to have the benefit of all other rights of holders of Series A Preferred Stock. In lieu of fractional shares, the Corporation, prior to the first issuance of a share or a fraction of a share of Series A Preferred Stock, may elect (a) to make a cash payment as provided in the Rights Agreement for fractions of a share other than one one-hundredth of a share (as such fraction may be adjusted as provided in the Rights Agreement) or any integral multiple thereof or (b) to issue depository receipts evidencing such authorized fraction of a share of Series A Preferred Stock pursuant to an appropriate agreement between the Corporation and a depository selected by the Corporation; provided, however, that such agreement shall provide that the holders of such depository receipts shall have all the rights, privileges and preferences to which they are entitled as holders of the Series A Preferred Stock.

Section 11. Amendment. So long as any shares of Series A Preferred Stock shall be outstanding, without the affirmative vote of the holders of at least two-thirds of the outstanding shares of Series A Preferred Stock, voting together as a single class, (i) none of the powers, preferences and relative, participating, optional and other special rights of the Series A Preferred Stock as herein provided shall be amended in any manner which would alter or change the powers, preferences, rights or privileges of the holders of Series A Preferred Stock so as to affect them adversely and (ii) no amendment, alteration or repeal of the Certificate of Incorporation or of the By-laws of the Corporation shall be effected so as to affect adversely any of such powers, preferences, rights or privileges.

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IN WITNESS WHEREOF, this Certificate of Designation is executed on behalf of the Corporation by its Chairman of the Board and attested by its Secretary this 14th day of July, 2014.

Name: Jordan Levy
Title: Chairman of the Board

Attest:

Name: William J. Stuart
Title: Secretary

Signature page for Synacor, Inc. certificate of designation

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Exhibit B

Form of Right Certificate

Certificate No. R- Rights

NOT EXERCISABLE AFTER THE FINAL EXPIRATION DATE (AS DEFINED IN THE AGREEMENT) OR EARLIER IF REDEMPTION OR EXCHANGE OCCURS. THE RIGHTS ARE SUBJECT TO REDEMPTION AT \$0.01 PER RIGHT AND TO EXCHANGE ON THE TERMS SET FORTH IN THE AGREEMENT.

Right Certificate

SYNACOR, INC.

This certifies that _____, or registered assigns, is the registered owner of the number of Rights set forth above, each of which entitles the owner thereof, subject to the terms, provisions and conditions of the Agreement, dated as of July 14, 2014 (the Agreement), between Synacor, Inc., a Delaware corporation (the Company), and American Stock Transfer & Trust Company, LLC (the Rights Agent), to purchase from the Company at any time after the Distribution Date (as such term is defined in the Agreement) and prior to 5:00 P.M., New York City time, on July 14, 2017, at the principal office of the Rights Agent, or at the office of its successor as Rights Agent, one one-hundredth of a fully paid non-assessable share of Series A Junior Participating Preferred Stock, par value \$0.01 per share, of the Company (the Preferred Shares), at a purchase price of \$10 per one one-hundredth of a Preferred Share (the Purchase Price), upon presentation and surrender of this Right Certificate with the Form of Election to Purchase duly executed. The number of Rights evidenced by this Right Certificate (and the number of one one-hundredths of a Preferred Share which may be purchased upon exercise hereof) set forth above, and the Purchase Price set forth above, are the number and Purchase Price as of July 14, 2014, based on the Preferred Shares as constituted at such date. As provided in the Agreement, the Purchase Price and the number of one one-hundredths of a Preferred Share which may be purchased upon the exercise of the Rights evidenced by this Right Certificate are subject to modification and adjustment upon the happening of certain events.

This Right Certificate is subject to all of the terms, provisions and conditions of the Agreement, which terms, provisions and conditions are hereby incorporated herein by reference and made a part hereof and to which Agreement reference is hereby made for a full description of the rights, limitations of rights, obligations, duties and immunities hereunder of the Rights Agent, the Company and the holders of the Right Certificates. Copies of the Agreement are on file at the principal executive offices of the Company and the offices of the Rights Agent.

This Right Certificate, with or without other Right Certificates, upon surrender at the principal office of the Rights Agent, may be exchanged for another Right Certificate or Right Certificates of like tenor and date evidencing Rights entitling the holder to purchase a like aggregate number of Preferred Shares as the Rights evidenced by the Right Certificate or Right Certificates surrendered shall have entitled such holder to purchase. If this Right Certificate shall be exercised in part, the holder shall be entitled to receive upon surrender hereof another Right Certificate or Right Certificates for the number of whole Rights not exercised.

Subject to the provisions of the Agreement, the Rights evidenced by this Right Certificate (i) may be redeemed by the Company at a redemption price of \$0.01 per Right or (ii) may be exchanged in whole or in part for Preferred Shares or shares of the Company's Common Stock, par value \$0.01 per share.

No fractional Preferred Shares will be issued upon the exercise of any Right or Rights evidenced hereby (other than fractions which are integral multiples of one one-hundredth of a Preferred Share, which may, at the election of the Company, be evidenced by depositary receipts), but, in lieu thereof, a cash payment will be made, as provided in the Agreement.

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No holder of this Right Certificate shall be entitled to vote or receive dividends or be deemed for any purpose the holder of the Preferred Shares or of any other securities of the Company which may at any time be issuable on the exercise hereof, nor shall anything contained in the Agreement or herein be construed to confer upon the holder hereof, as such, any of the rights of a stockholder of the Company or any right to vote for the election of directors or upon any matter submitted to stockholders at any meeting thereof, or to give or withhold consent to any corporate action, or to receive notice of meetings or other actions affecting stockholders (except as provided in the Agreement), or to receive dividends or subscription rights, or otherwise, until the Right or Rights evidenced by this Right Certificate shall have been exercised as provided in the Agreement.

This Right Certificate shall not be valid or obligatory for any purpose until it shall have been countersigned by the Rights Agent.

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WITNESS the facsimile signature of the proper officers of the Company and its corporate seal. Dated as of _____, _____.

Attest: SYNACOR, INC.

By
Name: By
Title: Name:
Title:

Countersigned:

AMERICAN STOCK TRANSFER & TRUST COMPANY, LLC,
as Rights Agent

By
Name:
Title:

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Form of Reverse Side of Right Certificate

FORM OF ASSIGNMENT

(To be executed by the registered holder if such holder desires to transfer the Right Certificate.)

FOR VALUE RECEIVED hereby sells, assigns and transfers unto

(Please print name and address of transferee)

this Right Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint Attorney, to transfer the within Right Certificate on the books of the within-named Company, with full power of substitution.

Dated: _____

Signature

Signature Guaranteed:

Signatures must be guaranteed by a member or participant in the Medallion Signature Guarantee Program at a guarantee level acceptable to the Company's Transfer Agent.

The undersigned hereby certifies that the Rights evidenced by this Right Certificate are not Beneficially Owned by an Acquiring Person or an Affiliate or Associate thereof (as defined in the Agreement) and are not issued with respect to notional or other Common Shares related to a Derivatives Interest described in clause (iv) of the definition of Beneficial Owner (as such terms are defined in the Agreement).

Signature

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Form of Reverse Side of Right Certificate continued

FORM OF ELECTION TO PURCHASE

(To be executed if holder desires to exercise

Rights represented by the Right Certificate.)

To: SYNACOR, INC.

The undersigned hereby irrevocably elects to exercise _____ Rights represented by this Right Certificate to purchase the Preferred Shares issuable upon the exercise of such Rights and requests that certificates for such Preferred Shares be issued in the name of:

Please insert social security

or other identifying number

(Please print name and address)

(Please print name and address)

If such number of Rights shall not be all the Rights evidenced by this Right Certificate, a new Right Certificate for the balance remaining of such Rights shall be registered in the name of and delivered to:

Please insert social security

or other identifying number

(Please print name and address)

(Please print name and address)

Dated: _____

Signature

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Signature Guaranteed:

Signatures must be guaranteed by a member or participant in the Medallion Signature Guarantee Program at a guarantee level acceptable to the Company's Transfer Agent.

The undersigned hereby certifies that the Rights evidenced by this Right Certificate are not Beneficially Owned by an Acquiring Person or an Affiliate or Associate thereof (as defined in the Agreement) and are not issued with respect to notional or other Common Shares related to a Derivatives Interest described in clause (iv) of the definition of Beneficial Owner (as such terms are defined in the Agreement).

Signature

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NOTICE

The signature in the Form of Assignment or Form of Election to Purchase, as the case may be, must conform to the name as written upon the face of this Right Certificate in every particular, without alteration or enlargement or any change whatsoever.

In the event the certification set forth above in the Form of Assignment or the Form of Election to Purchase, as the case may be, is not completed, the Company and the Rights Agent will deem the Beneficial Owner of the Rights evidenced by this Right Certificate to be an Acquiring Person or an Affiliate or Associate thereof (as defined in the Agreement) and such Assignment or Election to Purchase will not be honored.

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Exhibit C

SUMMARY OF RIGHTS TO PURCHASE

PREFERRED SHARES

Introduction

On July 14, 2014, the Board of Directors of our Company (the Board), Synacor, Inc., a Delaware corporation (the Company), declared a dividend of one preferred share purchase right (a Right) for each outstanding share of common stock, par value \$0.01 per share. The dividend is payable on July 14, 2014, to the stockholders of record on that date.

Our Board has adopted this Rights Agreement to prevent the accumulation of shares of Synacor and the acquisition of actual or practical control of the company by any party or group in a manner that undermines stockholder value and corporate policy and effectiveness by, among other things, bypassing negotiation with the Board, disregarding the Synacor business plan and long-term corporate goals and otherwise coercively or unfairly promoting an inadequately priced takeover of the company. In general terms, it works by imposing a significant penalty upon any person or group which acquires 10% or more of our outstanding common stock without the approval of our Board. If a stockholder's beneficial ownership of our common stock as of the time of the public announcement of the rights plan and associated dividend declaration is at or above the applicable threshold (including through entry into certain derivative positions), that stockholder's then-existing ownership percentage would be grandfathered, but the rights would become exercisable if at any time after such announcement, the stockholder increases its ownership percentage by 0.001% or more. The Rights Agreement should not interfere with any merger or other business combination approved by our Board.

For those interested in the specific terms of the Rights Agreement as made between our Company and American Stock Transfer & Trust Company, LLC, as the Rights Agent, on July 14, 2014, we provide the following summary description. Please note, however, that this description is only a summary, and is not complete, and should be read together with the entire Rights Agreement, which has been filed with the Securities and Exchange Commission as an exhibit to a Current Report on Form 8-K filed July 14, 2014, and a Registration Statement on Form 8-A filed July 14, 2014. A copy of the agreement is available free of charge from our Company.

The Rights. Our Board authorized the issuance of a Right with respect to each outstanding share of common stock as of July 14, 2014. The Rights will initially trade with, and will be inseparable from, the common stock. The Rights are evidenced only by certificates that represent shares of common stock. New Rights will accompany any new shares of common stock we issue after July 14, 2014, until the Distribution Date described below or the earlier expiration of the Rights Agreement in accordance with its terms.

Exercise Price. Each Right will allow its holder to purchase from our Company one one-hundredth of a share of Series A Junior Participating Preferred Stock (Preferred Share) for \$10, once the Rights become exercisable. This portion of a Preferred Share will give the stockholder approximately the same dividend, voting, and liquidation rights as would one share of common stock. Prior to exercise, the Right does not give its holder any dividend, voting, or liquidation rights.

Exercisability. The Rights will not be exercisable until 10 days after the public announcement that a person or group has become an Acquiring Person by obtaining beneficial ownership of 10% or more of our outstanding common stock.

Certain synthetic interests in securities created by derivative positions whether or not such interests are considered to be ownership of the underlying common stock or are reportable for purposes of Regulation 13D

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of the Securities Exchange Act are treated as beneficial ownership of (i) the notional or other number of shares of the company's common stock to be acquired upon exercise or settlement of such instrument or as the basis upon which the value or settlement amount of such instrument is to be calculated, or (ii) if no such number of shares is specified in the relevant documentation of such instrument, that number of shares of the company's common stock determined by the Board in its sole discretion to be the number of such shares to which such instrument relates.

We refer to the date when the Rights become exercisable as the Distribution Date. Until that date, the common stock certificates (or, in the case of uncertificated shares, by notations in the book-entry account system) will also evidence the Rights, and any transfer of shares of common stock will constitute a transfer of Rights. After that date, the Rights will separate from the common stock and be evidenced by book-entry credits or by Rights certificates that we will mail to all eligible holders of common stock. Any Rights held by an Acquiring Person are null and void and may not be exercised.

Consequences of a Person or Group Becoming an Acquiring Person.

Flip In. If a person or group becomes an Acquiring Person, all holders of Rights except the Acquiring Person may, for \$10, purchase shares of our common stock with a market value of \$20, based on the market price of the common stock prior to such acquisition.

Flip Over. If our Company is later acquired in a merger or similar transaction after the Rights Distribution Date, all holders of Rights except the Acquiring Person may, for \$10, purchase shares of the acquiring corporation with a market value of \$20 based on the market price of the acquiring corporation's stock, prior to such merger.

Notional Shares. Shares held by Affiliates and Associates of an Acquiring Person, and notional or other Shares related to Derivatives Interests of an Acquiring Person, will be deemed to be beneficially owned by the Acquiring Person.

Preferred Share Provisions.

Each one one-hundredth of a Preferred Share, if issued:

will not be redeemable.

will entitle holders to quarterly dividend payments of \$0.01 per share, or an amount equal to the dividend paid on one share of common stock, whichever is greater.

will entitle holders upon liquidation either to receive \$1.00 per share, or an amount equal to the payment made on one share of common stock, whichever is greater.

will have the same voting power as one share of common stock.

if shares of our common stock are exchanged via merger, consolidation, or a similar transaction, will entitle holders to a per share payment equal to the payment made on one share of common stock.

The value of one one-hundredth interest in a Preferred Share should approximate the value of one share of common stock.

Expiration. The Rights will expire on July 14, 2017; provided that if our stockholders have not ratified the Rights Agreement by July 14, 2015, the Rights will expire on such date.

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Redemption. Our Board may redeem the Rights for \$0.01 per Right at any time before any person or group becomes an Acquiring Person. If our Board redeems any Rights, it must redeem all of the Rights. Once the Rights are redeemed, the only right of the holders of Rights will be to receive the redemption price of \$0.01 per Right. The redemption price will be adjusted if we have a stock split or stock dividends of our common stock.

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Exchange. After a person or group becomes an Acquiring Person, but before an Acquiring Person owns 50% or more of our outstanding common stock, our Board may extinguish the Rights by exchanging one share of common stock or an equivalent security for each Right, other than Rights held by the Acquiring Person.

Anti-Dilution Provisions. Our Board may adjust the purchase price of the Preferred Shares, the number of Preferred Shares issuable and the number of outstanding Rights to prevent dilution that may occur from a stock dividend, a stock split, a reclassification of the Preferred Shares or common stock. No adjustments to the Exercise Price of less than 1% will be made.

Amendments. The terms of the Rights Agreement may be amended by our Board without the consent of the holders of the Rights. After a person or group becomes an Acquiring Person, our Board may not amend the agreement in a way that adversely affects holders of the Rights.

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Table of Contents**APPENDIX B****ADDITIONAL INFORMATION REGARDING PARTICIPANTS****IN THE SOLICITATION**

Under applicable SEC rules and regulations, the members of the Board of Directors, the Nominees, and certain of our executive officers are participants with respect to the solicitation of proxies in connection with the Annual Meeting. The following sets forth certain information about the persons who are participants.

Directors and Nominees

The following table sets forth the names and business addresses of our directors (three of whom are also Nominees), and the names and principal business addresses of the corporation or other organization in which the principal occupations or employment of the directors is carried on. The principal occupations or employment of our directors are set forth under the heading *Proposal 1: Election of Directors* in this Proxy Statement.

Name	Business Name and Address
Himesh Bhise	Synacor, Inc. 40 La Riviere Drive, Suite 300, New York, NY 14202
Marwan Fawaz	Synacor, Inc. 40 La Riviere Drive, Suite 300, New York, NY 14202
Gary Ginsberg	Time Warner Inc. One Time Warner Center, New York, NY 10019
Andrew Kau	Walden International One California Street, Suite 2800, San Francisco, CA 94111
Jordan Levy	Softbank Capital 640 Ellicott Street, 1st Floor, Buffalo, NY 14203
Michael Montgomery	Synacor, Inc. 40 La Riviere Drive, Suite 300, New York, NY 14202
Scott Murphy	Advantage Capital 909 Poydras Street, Suite 2230, New Orleans, LA 70112

Executive Officers

The following table sets forth the name and principal occupation of our executive officers and employees who are participants. The principal occupation refers to such person's position with Synacor, and the principal business address of each such person is 40 La Riviere Drive, Suite 300, Buffalo, NY 14202.

Name	Business Name and Address
Himesh Bhise	President and Chief Executive Officer
George Chamoun	President of Sales and Marketing
William J. Stuart	Chief Financial Officer

Information Regarding Ownership of the Company's Securities by Participants and Participant Associates

Except as described in this Appendix B or in this Proxy Statement, none of the persons listed above under Directors and Nominees or Executive Officers owns any of our securities of record that they do not own beneficially. The number of our securities beneficially owned by directors and executive officers as of March 1, 2015 is set forth under the heading Security Ownership of Certain Beneficial Owners and Management in this Proxy Statement. No associate or affiliate of any participant owns beneficially, directly or indirectly, any of our securities.

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Table of Contents**Information Regarding Transactions in the Company's Securities by Participants**

The following table sets forth purchases and sales of our securities during the past two years by the persons listed above under "Directors and Nominees" and "Executive Officers." None of the purchase price or market value of the securities listed below is represented by funds borrowed or otherwise obtained for the purposes of acquiring or holding such securities.

Name	Transaction Date	# of Shares	Transaction Description
Himesh Bhise	August 4, 2014	2,001,338	Grant of option to acquire common stock
	February 12, 2015	10,100	Grant of option to acquire common stock
	March 3, 2015	16,000	Open market purchase of common stock (direct)
George Chamoun	March 11, 2013	50,000	Exercise of stock option and acquisition of common stock
	May 16, 2013	45,000	Grant of option to acquire common stock
	January 15, 2014	10,000	Exercise of stock option and acquisition of common stock
	January 15, 2014	(5,000)	Sale of common stock pursuant to Rule 10b5-1 trading plan
	March 10, 2014	(5,000)	Sale of common stock pursuant to Rule 10b5-1 trading plan
	March 11, 2014	20,000	Exercise of stock option and acquisition of common stock
	March 17, 2014	(5,000)	Sale of common stock pursuant to Rule 10b5-1 trading plan
	March 18, 2014	10,000	Exercise of stock option and acquisition of common stock
	April 15, 2014	(5,000)	Sale of common stock pursuant to Rule 10b5-1 trading plan
	April 17, 2014	10,000	Exercise of stock option and acquisition of common stock
	April 17, 2014	8,004	Exercise of stock option and acquisition of common stock
May 22, 2014	200,000	Grant of option to acquire common stock	
February 12, 2015	7,900	Grant of option to acquire common stock	
Marwan Fawaz	May 16, 2013	30,000	Grant of option to acquire common stock
	May 22, 2014	15,000	Grant of option to acquire common stock
	March 3, 2015	25,000	Open market purchase of common stock
Gary Ginsberg	May 16, 2013	15,000	Grant of option to acquire common stock
	May 22, 2014	30,000	Grant of option to acquire common stock
	March 9, 2015	5,000	Open market purchase of common stock (direct)
	March 11, 2015	15,000	Open market purchase of common stock (direct)
Andrew Kau	May 16, 2013	15,000	Grant of option to acquire common stock
	May 22, 2014	15,000	Grant of option to acquire common stock
Jordan Levy	March 14, 2013	33,000	Open market purchase of common stock (direct)
	May 16, 2013	15,000	Grant of option to acquire common stock
	May 22, 2014	15,000	Grant of option to acquire common stock
	March 16, 2015	7,500	Open market purchase of common stock (indirect)

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Name	Transaction Date	# of Shares	Transaction Description
Michael Montgomery	March 15, 2013	40,000	Open market purchase of common stock (indirect)
	May 16, 2013	30,000	Grant of option to acquire common stock
	May 22, 2014	15,000	Grant of option to acquire common stock
	March 3, 2015	25,000	Open market purchase of common stock (indirect)
Scott Murphy	March 11, 2013	25,700	Open market purchase of common stock (direct)
	March 13, 2013	24,300	Open market purchase of common stock (direct)
	June 24, 2014	2,700	Open market purchase of common stock (direct)
	June 27, 2014	10,000	Open market purchase of common stock (direct)
	July 1, 2014	6,000	Open market purchase of common stock (indirect)
	October 29, 2014	50,000	Grant of option to acquire common stock
William J. Stuart	May 16, 2013	45,000	Grant of option to acquire common stock
	February 12, 2015	125,000	Grant of option to acquire common stock
	February 12, 2015	7,800	Grant of option to acquire common stock
	March 5, 2015	10,000	Open market purchase of common stock (direct)
	March 5, 2015	5,000	Open market purchase of common stock (indirect)

Miscellaneous Information Concerning Participants

Except as described in this Appendix B or in this Proxy Statement, neither any participant nor any of their respective associates or affiliates (together, the Participant Affiliates) is either a party to any transaction or series of transactions since January 1, 2014 or has knowledge of any current proposed transaction or series of proposed transaction (i) to which Synacor or any of its subsidiaries was or is to be a participant, (ii) in which the amount involved exceeds \$120,000 and (iii) in which any participant or Participant Affiliate had, or will have, a director or indirect material interest. Furthermore, except as described in this Appendix B or this Proxy Statement, (a) no participant or Participant Affiliate, directly or indirectly, beneficially owns any securities of Synacor or any securities of any subsidiary of Synacor, and (b) no participant owns any of our securities of record but not beneficially.

Except as described in this Appendix B or in this Proxy Statement, no participant or Participant Affiliates has entered into any agreement or understanding with any person with respect to any future employment by Synacor or any of its affiliates or any future transactions to which Synacor or any of its affiliates will or may be a party.

Except as described in this Appendix B or in this Proxy Statement, there are no contracts, arrangements or understandings by any participant or Participant Affiliate since January 1, 2014 with any person with respect to any of our securities, including, but not limited to, joint ventures, loan or option arrangements, puts or calls, guarantees against loss or guarantees of profit, division of losses or profits, or the giving or withholding of proxies.

Except as described in this Appendix B or in this Proxy Statement, and excluding any director or executive officer of Synacor acting solely in that capacity, no person who is a party to an arrangement or understanding pursuant to which a nominee for election as director is proposed to be elected has any substantial interest, director or indirect, by security holdings or otherwise, in any matter to be acted upon at the Annual Meeting.

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PRELIMINARY COPIES SUBJECT TO COMPLETION

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SYNACOR, INC.

40 LA RIVIERE DRIVE, SUITE 300

BUFFALO, NY 14202

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS

If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

THIS PORTION FOR YOUR RECORDS

M86682-P63644

KEEP

DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

SYNACOR, INC.

For All **Withhold All** **For All Except**

To withhold authority to vote for any individual nominee, mark **For All Except** and write the number of the nominee on the line below.

The Board of Directors recommends you vote FOR the following:

..

Proposal No. 1: Election of the three (3) members of the Board of Directors identified in Proposal No. 1 and listed below, to serve as Class I directors until the Company's 2018 Annual Meeting of Stockholders or until their successors are duly elected and qualified.

Nominees:

- 01) Himesh Bhise
- 02) Andrew Kau
- 03) Jordan Levy

The Board of Directors recommends you vote FOR the following proposals:

For **Against** **Abstain**

Proposal No. 2: Ratification of the appointment of Deloitte & Touche LLP as the independent registered public accounting firm for the Company for the fiscal year ending December 31, 2015.

..

Proposal No. 3: Ratification of the Rights Agreement, dated as of July 14, 2014, between the Company and American Stock Transfer & Trust Company, LLC as rights agent.

..

NOTE: Such other business as may properly come before the meeting or any adjournment thereof.

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor,

administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name by authorized officer.

Signature [PLEASE SIGN
WITHIN BOX]

Date

Signature (Joint
Owners)

Date

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Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting:

The Notice and Proxy Statement and Annual Report are available at www.proxyvote.com.

M86683-P63644

SYNACOR, INC.

Annual Meeting of Stockholders

April 20, 2015 9:00 AM

This proxy is solicited by the Board of Directors

The stockholder(s) hereby appoint(s) Himesh Bhise and William J. Stuart, or either of them, as proxies, each with the power to appoint his substitute, and hereby authorize(s) them to represent and to vote, as designated on the reverse side of this ballot, all of the shares of common stock of SYNACOR, INC. that the stockholder(s) is/are entitled to vote at the Annual Meeting of Stockholders to be held at 9:00 AM, EDT on April 20, 2015, at the Embassy Suites Hotel, 200 Delaware Ave., Buffalo, New York 14202, and any adjournment or postponement thereof.

This proxy, when properly executed, will be voted in the manner directed herein. If no such direction is made, this proxy will be voted in accordance with the Board of Directors' recommendations.

In their discretion, the proxies are authorized to vote upon such other business as may properly come before the meeting.

Continued and to be signed on reverse side