Higher One Holdings, Inc.
Form 10-Q
August 03, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011.

or

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

For the transition period from to .

Commission File Number: 001-34779

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

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

25 Science Park
New Haven, CT 06511
(Address of Principal Executive Offices)(Zip Code)
(203) 776-7776
(Registrant's Telephone Number, Including Area Code)
N/A
(Former Name, Former Address and Former Fiscal Year, If Changes Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

As of July 29, 2011 there were 57,087,888 shares of common stock, par value $0.001 per share, outstanding.

HIGHER ONE HOLDINGS, INC.
INDEX TO REPORT ON FORM 10-Q
FOR QUARTER ENDED JUNE 30, 2011

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

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

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

	December 31, 2010	June 30, 2011
Assets		
Current assets:		
Cash and cash equivalents	$34,484	$50,473
Investments in marketable securities	14,697	16,884
Accounts receivable	2,622	5,330
Income receivable	3,719	3,407
Deferred tax assets	48	41
Prepaid expenses and other current assets	6,981	7,432
Restricted cash	8,250	–
Total current assets	70,801	83,567
Deferred costs	3,782	3,447
Fixed assets, net	9,919	18,890
Intangible assets, net	18,456	16,921
Goodwill	15,830	15,830
Other assets	653	542
Deferred tax assets	–	762
Restricted cash	–	1,075
Total assets	$119,441	$141,034
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$3,063	$3,473
Accrued expenses	11,786	13,948
Acquisition payable	8,250	–
Deferred revenue	7,974	10,573
Total current liabilities	31,073	27,994
Deferred revenue	2,051	2,217
Deferred tax liabilities	2,926	–
Total liabilities	36,050	30,211
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock, $.001 par value; 200,000,000 shares authorized; 56,109,234 and 56,763,635 shares issued and outstanding at December 31, 2010 and June 30, 2011, respectively;	56	57

Additional paid-in capital	136,760	148,395
Accumulated deficit, net of 2008 $93,933 of stock tender transaction	(53,425)	(37,629)
Total stockholders' equity	83,391	110,823
Total liabilities and stockholders' equity	$119,441	$141,034

See notes to these unaudited condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
Revenue:				
Account revenue	$21,732	$27,701	$53,474	$69,700
Payment transaction revenue	2,671	3,080	6,515	7,385
Higher education institution revenue	2,744	3,725	5,421	8,101
Other revenue	603	561	1,210	1,264
Total revenue	27,750	35,067	66,620	86,450
Cost of revenue	10,399	13,423	22,938	30,856
Gross margin	17,351	21,644	43,682	55,594
Operating expenses:				
General and administrative	7,784	9,015	15,583	18,787
Product development	793	895	1,762	1,680
Sales and marketing	5,516	6,701	9,420	12,165
Total operating expenses	14,093	16,611	26,765	32,632
Income from operations	3,258	5,033	16,917	22,962
Interest income	2	11	3	36
Interest expense	(247)	(56)	(476)	(130)
Other income	–	1,500	–	1,500
Net income before income taxes	3,013	6,488	16,444	24,368
Income tax expense	1,183	1,734	6,350	8,572
Net income	$1,830	$4,754	$10,094	$15,796
Net income available to common stockholders:				
Basic	$532	$4,754	$2,520	$15,796
Participating Securities	1,298	–	7,574	–
Diluted	$1,830	$4,754	$10,094	$15,796
Weighted average shares outstanding				
Basic	14,518,962	55,117,635	12,333,141	54,859,367
Diluted	55,687,536	59,718,105	55,267,583	59,645,471
Net income available to common stockholders per common share:				
Basic	$0.04	$0.09	$0.20	$0.29
Diluted	$0.03	$0.08	$0.18	$0.26

See notes to these unaudited condensed consolidated financial statements.

Table of Contents

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

	Common Stock		Additional Paid-in	Accumulated	Total Stockholders'
	Shares	Amount	Capital	Deficit	Equity
Balance at December 31, 2010	56,109,234	$56	$136,760	$(53,425)	$83,391
Stock-based compensation	–	–	2,160	–	2,160
Stock-based customer acquisition expense	–	–	6,935	–	6,935
Tax benefit related to options	–	–	1,878	–	1,878
Exercise of stock options	654,401	1	662	–	663
Net income	–	–	–	15,796	15,796
Balance at June 30, 2011	56,763,635	$57	$148,395	$(37,629)	$110,823

See notes to these unaudited condensed consolidated financial statements.

Table of Contents

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

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2011
Cash flows from operating activities		
Net income	$10,094	$15,796
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,373	3,434
Amortization of deferred finance costs	102	36
Non-cash interest expense	240	–
Stock-based customer acquisition expense	4,866	6,935
Stock-based compensation	1,541	2,160
Deferred income taxes	(2,354)	(3,681)
Gain on litigation settlement agreement	–	(1,500)
Loss on disposal of fixed assets	–	107
Changes in operating assets and liabilities:		
Accounts receivable	(1,851)	(2,708)
Income receivable	(132)	312
Deferred costs	(1,321)	(367)
Prepaid expenses and other current assets	(3,524)	(451)
Other assets	(532)	75
Accounts payable	2,642	410
Accrued expenses	555	(1,417)
Deferred revenue	3,495	2,765
Net cash provided by operating activities	17,194	21,906
Cash flows from investing activities		
Purchases of available for sale investment securities	–	(7,787)
Proceeds from sales and maturities of available for sale investment securities	–	5,600
Purchases of fixed assets, net of changes in construction payables of $0 and $3,494, respectively	(2,415)	(6,696)
Payment to escrow agent	(8,250)	(1,075)
Proceeds from escrow agent	–	1,500
Payment of acquisition payable	(1,750)	–
Acquisition of Informed Decisions Corporation, net of cash acquired	9	–
Net cash used in investing activities	(12,406)	(8,458)
Cash flows from financing activities		
Repayment of capital lease obligations	(6)	–
Proceeds from line of credit	4,000	–
Repayments of line of credit	(22,000)	–
Proceeds from issuance of common stock, net of issuance costs	37,756	–
Tax benefit related to stock options	1,598	1,878
Proceeds from exercise of stock options	393	663
Net cash provided by financing activities	21,741	2,541
Net change in cash and cash equivalents	26,529	15,989

Cash and cash equivalents at beginning of period	3,339	34,484
Cash and cash equivalents at end of period	$29,868	$50,473

See notes to these unaudited condensed consolidated financial statements.

Table of Contents

Higher One Holdings, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Nature of Business and Organization

Higher One Holdings, Inc. is incorporated in Delaware and provides a comprehensive suite of disbursement and payment solutions specifically designed for higher education institutions and their students. We have developed proprietary software-based solutions to provide these services. We have one wholly-owned subsidiary, Higher One, Inc., or HOI, which has three wholly-owned subsidiaries: Higher One Machines, Inc., or HOMI; Higher One Payments, Inc., or HOPI; and Higher One Real Estate, Inc., or Real Estate Inc. Real Estate Inc has one wholly-owned subsidiary, Higher One Real Estate SP, LLC, or Real Estate LLC. HOMI owns and manages our cash disbursement machines and home-based customer service agent services. HOPI is the acquired entity formerly known as Informed Decisions Corporation that provides payment solutions and services. Real Estate Inc and Real Estate LLC were formed for purposes related to our real estate development project discussed in Note 4.

2. Significant Accounting Policies

Basis of Presentation and Consolidation

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

The unaudited condensed consolidated financial statements have been prepared on a consistent basis with the audited consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2010 and in the opinion of management include all normal recurring adjustments that are necessary for the fair statement of our interim period results reported herein. The December 31, 2010 condensed consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP. Due to seasonal fluctuations and other factors, the results of operations for the three months and six months ended June 30, 2011 are not necessarily indicative of the results to be expected for the full year.

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

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

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

As discussed in Note 6 below, on June 22, 2010, we consummated an initial public offering of common stock. Had we made a distribution to stockholders prior to the initial public offering, all classes of preferred stock would have participated pro rata in dividends if and when we declared a dividend. Therefore, the two class method of calculating basic net income per common share was applied for the three months and six months ended June 30, 2010. Upon completion of the initial public offering, all classes of preferred stock converted to common shares. As a result, the two class method does not apply to the three months and six months ended June 30, 2011.

Higher One Holdings, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

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

The dilutive effect of stock options totaling 933,750 and 1,040,302 were not included in the computation of diluted net income per common share for the three months ended June 30, 2010 and 2011, respectively, as their effect would be anti-dilutive. The dilutive effect of stock options totaling 933,750 and 1,031,352 were not included in the computation of diluted net income per common share for the six months ended June 30, 2010 and 2011, respectively, as their effect would be anti-dilutive. Anti-dilutive securities are securities that upon conversion or exercise increase earnings per share (or reduce the loss per share). Restricted stock shares totaling 1,885,626 and 1,276,800 were not included in the computation of either basic or diluted earnings per share as all necessary conditions for vesting have not been satisfied by the end of the three and six months ended June 30, 2010 and 2011, respectively.

Comprehensive Income

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

Recent Accounting Pronouncements – Standards Implemented

We adopted each of the following standards on January 1, 2011. The adoption of these standards did not have a material impact on our results of operations, cash flows or financial position. There was no material impact to our units of accounting, the way in which we allocate consideration to various units of accounting or changes in the pattern or timing of revenue recognition.

In October 2009, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update , or ASU, No. 2009-13 "Multiple-Deliverable Revenue Arrangements." This ASU establishes the accounting and reporting guidance for arrangements including multiple revenue-generating activities. This ASU provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. The amendments in this ASU also establish a selling price hierarchy for determining the selling price of a deliverable. Significantly enhanced disclosures are also required to provide information about a vendor's multiple-deliverable revenue arrangements, including information about the nature and terms, significant deliverables, and its performance within arrangements. The amendments also require providing information about the significant judgments made and changes to those judgments and about how the application of the relative selling-price method affects the timing or amount of revenue recognition. The amendments in this ASU are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010.

-7-

Table of Contents

Higher One Holdings, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

In October 2009, the FASB issued ASU No. 2009-14, “Certain Revenue Arrangements That Include Software Elements.” This ASU changes the accounting model for revenue arrangements that include both tangible products and software elements that are essential to the functionality of the product, and scopes these products out of current software revenue guidance. The new guidance includes factors to help companies determine what software elements are considered essential to the functionality of the product. The amendments subject software-enabled products to other revenue guidance and disclosure requirements, such as guidance surrounding revenue arrangements with multiple-deliverables. The amendments in this ASU are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010.

In April 2010, the FASB issued ASU No. 2010-17, “Milestone Method of Revenue Recognition,” which indicates the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. Companies can recognize consideration that is contingent upon achievement of a milestone in its entirety as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive. This ASU is effective for fiscal years beginning on or after June 15, 2010.

Recent Accounting Pronouncements – New Standards to be Implemented

In June 2011, the FASB issued ASU No. 2011-05, “Comprehensive Income (Topic 220)—Presentation of Comprehensive Income,” which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This accounting standard update eliminates the option to present the components of other comprehensive income as part of the statement of equity and is effective for fiscal years beginning after December 15, 2011. This accounting standard update is not expected to have a significant impact on our consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards,” which provides a consistent definition of fair value and ensures that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. We are currently evaluating the impact of adopting ASU 2011-04, but believe there will be no significant impact on our consolidated financial statements.

In December 2010, the FASB issued amended guidance to clarify the acquisition date that should be used for reporting pro-forma financial information for business combinations. If comparative financial statements are presented, the pro-forma revenue and earnings of the combined entity for the comparable prior reporting period should be reported as though the acquisition date for all business combinations that occurred during the current year had been completed as of the beginning of the comparable prior annual reporting period. The amendments in this guidance are effective prospectively for business combinations for which the acquisition date is on or after January 1, 2011. There will be no impact on our consolidated financial results as the amendments relate only to additional disclosures.

In December 2010, the FASB issued amendments to the guidance on goodwill impairment testing. The amendments modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In making such a determination, the guidance states that an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The amendments are effective for fiscal years and interim periods beginning January 1, 2011 and are not expected to have a material impact on our consolidated financial statements.

Table of Contents

Higher One Holdings, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

3. Investments in Marketable Securities and Fair Value Measurements

As of June 30, 2011 and December 31, 2010, all of our investments in marketable securities were classified as available for sale. Amortized cost basis was equal to aggregate fair value for each of the major security types as reflected in the table below. We had no recorded unrealized gains or losses from investments as of December 31, 2010 and June 30, 2011. The contractual maturities of our available for sale securities ranged from one to fifteen months as of June 30, 2011.

All of our assets carried at fair value measured on a recurring basis are valued based on quoted prices in active markets for identical assets (Level 1). We do not have any liabilities carried at fair value as of either June 30, 2011 or December 31, 2010. The following table provides the assets carried at fair value measured on a recurring basis as of June 30, 2011 and December 31, 2010 (in thousands of dollars):

Fair values at June 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)
Assets:	
U.S. government debt securities	$15,883
Corporate debt securities	1,001
Total assets	$16,884
Fair values at December 31, 2010	Level 1
Assets:	
U.S. government debt securities	$13,695
Corporate debt securities	1,002
Total assets	$14,697

4. Real Estate Development Project

As of June 30, 2011, we have incurred approximately $10.9 million on a project to develop two existing commercial buildings located in New Haven, Connecticut. We will move into these buildings at the completion of the project in 2012. In connection with the real estate development project, HOI and Real Estate LLC entered into an agreement with the Connecticut Development Authority which provides for sales and use tax relief for property purchases made for the project. The total amount of potential sales and use tax relief is $1 million. The conditions of the sales and use tax agreement require repayment to the Connecticut Development Authority of the actual amount of sales and use tax savings plus an additional 7.5% if HOI fails to meet certain criteria. In accordance with this obligation, we deposited $1.1 million into an escrow account in February 2011, which is reflected on the condensed consolidated balance sheet as noncurrent restricted cash.

5. Credit Facility

On December 31, 2010, HOI entered into a senior secured revolving credit facility, or the Credit Facility. The amount available to be drawn under the Credit Facility may be increased by an additional $50.0 million upon our request and the agreement of the lenders party to the Credit Facility. In addition, the Credit Facility provides for letters of credit of up to $3 million and includes certain restrictions on the amount of acquisitions we may complete. As of June 30, 2011, $50.0 million in borrowings were available to us under the Credit Facility and we were in compliance with all of the applicable affirmative, negative and financial covenants in the Credit Facility.

Higher One Holdings, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

6. Capital Stock

Initial Public Offering

On June 22, 2010, we consummated an initial public offering of 3,569,395 shares of newly issued common stock and 6,780,605 shares offered by selling stockholders. The aggregate public offering price of the offering amount registered was $124.2 million and the offering did not terminate before all of the shares registered in the registration statement were sold. Our proceeds of $37.2 million, net of issuance costs, were used to pay outstanding amounts on our credit facility in effect at that time, make an escrow payment of $8.25 million related to the acquisition payable described in Note 7 below and fund working capital. We did not receive any of the proceeds from the sale of shares by the selling stockholders.

Upon consummation of our initial public offering, 417,049 shares of Series A convertible preferred stock outstanding, 1,086,784 shares of Series B convertible preferred stock outstanding, 2,522,554 shares of Series C convertible preferred stock outstanding, 2,180,633 shares of Series C-1 convertible preferred stock outstanding, 1,313,604 shares of Series D convertible preferred stock outstanding and 5,454,545 shares of Series E convertible preferred stock outstanding were converted into 38,925,507 shares of common stock after giving effect to the 3-for-1 stock split discussed below. Following the consummation of the offering, there were no shares of preferred stock outstanding.

Common Stock

In connection with the initial public offering, we effected a 3-for-1 stock split of the outstanding shares of our Common Stock that was previously approved by stockholders. All common share amounts and per common share amounts have been adjusted in the financial statements for all periods presented. We are authorized to issue up to 200,000,000 shares of Common Stock with a par value of $.001 per share. Each share of Common Stock entitles the holder to one vote on all matters submitted to a vote of our stockholders. Common stockholders are not entitled to receive dividends unless declared by the Board of Directors.

Preferred Stock

We are authorized to issue 20,000,000 shares of Preferred Stock with a par value of $.001 per share. As of December 31, 2010 and June 30, 2011, no shares of preferred stock were outstanding.

7. Commitments and Contingencies

From time to time we are subject to litigation relating to matters in the ordinary course of business, as well as regulatory examinations, information gathering requests, inquiries and investigations. In February 2011, the New York Regional Office of the Federal Deposit Insurance Corporation, or FDIC, notified us that it was prepared to recommend to the Director of FDIC Supervision that an enforcement action be taken against us for alleged violations of certain applicable laws and regulations principally relating to our compliance management system and policies and practices for past overdraft charging on persistently delinquent accounts, collections and transaction error resolution.

Any such enforcement action could result in an order to pay restitution and civil money penalties. We have responded to the FDIC's notification and have amended certain practices. In view of the inherent difficulty of predicting the outcome of regulatory matters, including the FDIC notification, we generally cannot predict what the eventual outcome of pending matters will be or what the timing of the ultimate resolution of these matters will be. However, we currently estimate the potential range of loss associated with these matters to be between $0 and $10 million. In accordance with applicable accounting guidance, we would establish a liability for litigation and regulatory matters if and when those matters were to present loss contingencies that were both probable and reasonably estimable.

Table of Contents

Higher One Holdings, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

On June 22, 2010, HOI provided notice and a certificate of claim for indemnity under the Stock Purchase Agreement by and among us and the former stockholders of Informed Decisions Corporation, or IDC, dated November 19, 2009, arising from certain misrepresentations and breaches of warranty. At the same time, we deposited $8.25 million, equal to the remaining balance of the post-closing payments, with an escrow agent. Separately, the former stockholders of IDC filed a complaint against HOI in the United States District Court for the Northern District of California, or the Complaint, on July 20, 2010, disputing that misrepresentations were made and that warranties were breached; alleging breach of contract and anticipatory breach; and seeking a declaratory judgment ordering that the post-closing payments be made in accordance with the schedule set forth in the stock purchase agreement.

On April 25, 2011, HOI and the former stockholders of IDC agreed to a settlement, the material terms of which are as follows: (a) $2 million of the amount held in escrow, plus pro-rated interest, was to be paid to HOI; (b) $6.25 million of the amount held in escrow, plus pro-rated interest, was to be paid to the former stockholders; and (c) HOI and the former stockholders generally and mutually released each other from all past and future claims, known and unknown, arising out of the stock purchase agreement and related transition services agreements between HOI and each of the former stockholders, relating to the operation or sale of IDC, including all indemnification and payment obligations, with the exception of certain rights, obligations and claims. The amount held in escrow was distributed to HOI and the former stockholders of IDC in accordance with the terms of the settlement agreement in May 2011.

We recorded the impact of the settlement agreement in the quarter ending June 30, 2011. The $2 million returned from escrow to us was recorded as other income of $1.5 million, reflecting a payment made under the indemnification provisions of the stock purchase agreement and a reduction of general and administrative expenses of $0.5 million, reflecting the recovery of certain legal costs incurred for the litigation.

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

Table of Contents

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

The information contained in this section should be read in conjunction with our audited consolidated financial statements and related notes as included in our annual report on Form 10-K for the year ended December 31, 2010 and information contained elsewhere in such annual report on Form 10-K and in this quarterly report on Form 10-Q. The discussion contains forward-looking statements involving risks, uncertainties and assumptions that could cause our results to differ materially from expectations. Factors that might cause these differences include those described under "Risk Factors" and elsewhere in the annual report on Form 10-K and in this quarterly report on Form 10-Q. The forward-looking statements included in this quarterly report on Form 10-Q are made only as of the date of this report. We do not undertake any obligation to update or supplement any forward-looking statements to reflect subsequent events or circumstances, except as required by law. We cannot assure you that projected results or events will be achieved or will occur.

Overview

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

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

As of June 30, 2011, more than 490 campuses serving approximately 3.7 million students had purchased the OneDisburse® funds disbursement service. This represents an increase of 246 thousand students, or 7.2%, from the level as of March 31, 2011 and 378 thousand students, or 11.5%, from December 31, 2010. As of June 30, 2011, more than 350 campuses serving approximately 2.6 million students had contracted to use one or more of our CASHNet® payment products and services. As of June 30, 2011, there were approximately 1.7 million OneAccounts. Since the initial launch of our OneDisburse® funds disbursement service in 2002 and as of June 30, 2011, we have completed disbursement transactions with a total cash value of over $23 billion.

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

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

Table of Contents

We continue to assess the impact of certain legislative and regulatory changes that have been enacted or made effective that may impact our operations and revenue. Effective July 1, 2010, the Federal Reserve Board amended its regulations implementing the Electronic Funds Transfer Act, or Regulation E, to limit the ability of financial institutions to assess overdraft fees for paying ATM and one-time debit card transactions that overdraw a consumer's account, unless the consumer affirmatively consents, or opts in, to the institution's payments of overdrafts for these services. On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Act, was signed into law. The Act will change many banking practices over time, however, the scope and impact of many of the Act's provisions are still being defined through the rule making process. On June 29, 2011, the Federal Reserve issued its final rule implementing the limits on debit card interchange fees and requirements for future routing of transactions required by the Act. In accordance with the Act, issuers that, together with their affiliates, have less than $10 billion in assets are exempt from these debit card interchange fee limits, although they are subject to the prohibitions on network exclusivity and routing restrictions. Our banking partner, The Bancorp Bank, has assets of less than $10 billion and therefore should be exempt from the debit card interchange fee cap. While we currently do not expect the limitation on debit card interchange fees or the provisions relating to network exclusivity and routing restrictions to have a material result on our results of operations, we will continue to evaluate the Act, the ongoing rule making process and their effect on our business and results of operations. See "Risk Factors."

Results of Operations for the Three Months Ended June 30, 2010 and 2011

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

	Three Months Ended June 30, (Unaudited)			
	2010	2011	$ Change	% Change