

VeriFone Holdings, Inc.  
Form 10-Q  
March 06, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

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

For the quarterly period ended January 31, 2009

Or

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

For the transition period from to

Commission file number: 001-32465

**VERIFONE HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**04-3692546**  
(I.R.S. Employer  
Identification No.)

**2099 Gateway Place, Suite 600**

**San Jose, CA 95110**

(Address of principal executive offices with zip code)

**(408) 232-7800**

(Registrant's telephone number, including area code)

**N/A**

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Accelerated filer

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

At February 28, 2009 the number of shares outstanding of the registrant's common stock, \$0.01 par value was 84,455,505.

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**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

|   | <b>Three Months Ended January 31,</b>        |             |
|---|--|-------------|
|   | <b>2009</b>                                  | <b>2008</b> |
|   | <b>(Unaudited)</b>                           |             |
|   | <b>(In thousands, except per share data)</b> |             |
| Net revenues:   |  |             |
| System Solutions  | \$ 185,841                                   | \$ 155,601  |
| Services  | 28,182                                       | 29,920      |
| Total net revenues  | 214,023                                      | 185,521     |
| Cost of net revenues:   |  |             |
| System Solutions  | 128,111                                      | 109,604     |
| Services  | 16,610                                       | 18,553      |
| Total cost of net revenues                                    | 144,721                                      | 128,157     |
| Gross profit  | 69,302                                       | 57,364      |
| Operating expenses:   |  |             |
| Research and development                                      | 17,872                                       | 22,462      |
| Sales and marketing   | 19,407                                       | 24,643      |
| General and administrative                                    | 30,728                                       | 26,066      |
| Amortization of purchased intangible assets                   | 5,871  | 5,890       |
| Impairment of goodwill  | 178,257                                      |             |
| Total operating expenses                                      | 252,135                                      | 79,061      |
| Operating loss  | (182,833)                                    | (21,697)    |
| Interest expense  | (5,361)                                      | (6,440)     |
| Interest income   | 647  | 2,088       |
| Other income (expense), net                                   | 4,214  | (4,520)     |
| Loss before income taxes                                      | (183,333)                                    | (30,569)    |
| Provision for (benefit of) income taxes                       | (1,344)                                      | 2,929       |
| Net loss  | \$ (181,989)                                 | \$ (33,498) |
| Net loss per share:   |  |             |
| Basic   | \$ (2.15)                                    | \$ (0.40)   |
| Diluted   | \$ (2.15)                                    | \$ (0.40)   |
| Weighted average shares used in computing net loss per share: |  |             |
| Basic   | 84,487                                       | 84,153      |
| Diluted   | 84,487                                       | 84,153      |

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

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**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

|   | January 31,<br>2009                 | October 31,<br>2008 (1) |
|---|-------------------------------------|-------------------------|
|   | (Unaudited)                         |                         |
|   | (In thousands, except<br>par value) |                         |
| <b>ASSETS</b>   |                                     |                         |
| Current assets:   |                                     |                         |
| Cash and cash equivalents   | \$ 155,075                          | \$ 157,160              |
| Accounts receivable, net of allowance of \$4,949 and \$5,033  | 158,479                             | 170,234                 |
| Inventories   | 139,770                             | 168,360                 |
| Deferred tax assets   | 10,676                              | 9,465                   |
| Prepaid expenses and other current assets   | 60,392                              | 57,631                  |
| <b>Total current assets</b>   | <b>524,392</b>                      | <b>562,850</b>          |
| Property, plant and equipment, net  | 53,316                              | 52,309                  |
| Purchased intangible assets, net  | 81,120                              | 92,637                  |
| Goodwill  | 135,480                             | 321,903                 |
| Deferred tax assets   | 218                                 | 1,276                   |
| Debt issuance costs, net  | 11,006                              | 11,704                  |
| Other assets  | 34,800                              | 37,073                  |
| <b>Total assets</b>   | <b>\$ 840,332</b>                   | <b>\$ 1,079,752</b>     |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                                     |                         |
| Current liabilities:  |                                     |                         |
| Accounts payable  | \$ 49,533                           | \$ 81,188               |
| Income taxes payable  | 4,658                               | 2,185                   |
| Accrued compensation  | 19,274                              | 19,477                  |
| Accrued warranty  | 8,221                               | 8,527                   |
| Deferred revenue, net   | 47,049                              | 47,687                  |
| Deferred tax liabilities  | 1,305                               | 1,805                   |
| Accrued expenses  | 9,040                               | 9,475                   |
| Other current liabilities   | 72,098                              | 91,168                  |
| Current portion of long-term debt   | 5,013                               | 5,022                   |
| <b>Total current liabilities</b>  | <b>216,191</b>                      | <b>266,534</b>          |
| Accrued warranty  | 1,690                               | 1,490                   |
| Deferred revenue, net   | 12,032                              | 13,292                  |
| Long-term debt  | 541,926                             | 543,357                 |
| Deferred tax liabilities  | 63,814                              | 68,928                  |
| Other long-term liabilities   | 42,701                              | 41,939                  |
| <b>Total liabilities</b>  | <b>878,354</b>                      | <b>935,540</b>          |
| Minority interest   | 2,263                               | 2,058                   |
| Stockholders' equity (deficit):   |                                     |                         |
| Preferred stock: \$0.01 par value; 10,000 shares authorized at January 31, 2009 and October 31, 2008; zero shares issued and outstanding as of January 31, 2009 and October 31, 2008            |                                     |                         |
| Common stock: \$0.01 par value; 200,000 shares authorized at January 31, 2009 and October 31, 2008; 84,456 and 84,443 shares issued and outstanding as of January 31, 2009 and October 31, 2008 |                                     |                         |
|   | 845                                 | 845                     |

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|  |                 |                |
|--|-----------------|----------------|
| Additional paid-in capital                           | 664,538         | 655,974        |
| Accumulated deficit                                  | (686,162)       | (504,173)      |
| Accumulated other comprehensive loss                 | (19,506)        | (10,492)       |
| <b>Total stockholders' equity (deficit)</b>          | <b>(40,285)</b> | <b>142,154</b> |
| Total liabilities and stockholders' equity (deficit) | \$ 840,332      | \$ 1,079,752   |

(1) Amounts as of October 31, 2008 were derived from the October 31, 2008 audited Consolidated Balance Sheets.  
The accompanying Notes to Condensed Consolidated Financial Statements

are an integral part of these financial statements.

**Table of Contents****VERIFONE HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | <b>Three Months Ended January 31,</b> |                |
|--|---------------------------------------|----------------|
|  | <b>2009</b>                           | <b>2008</b>    |
|  | <b>(Unaudited)</b>                    |                |
|  | <b>(In thousands)</b>                 |                |
| <b>Cash flows from operating activities</b>  |                                       |                |
| Net loss   | \$ (181,989)                          | \$ (33,498)    |
| Adjustments to reconcile net loss to net cash provided by operating activities:              |                                       |                |
| Amortization of purchased intangible assets  | 11,039                                | 14,065         |
| Depreciation and amortization of property, plant, and equipment                              | 3,245                                 | 3,027          |
| Amortization of capitalized software   | 790                                   | 471            |
| Impairment of goodwill   | 178,257                               |                |
| Write-off of capitalized software  | 494                                   | 2,700          |
| Loss on disposal of property, plant, and equipment   | 156                                   |                |
| Amortization of debt issuance costs  | 698                                   | 616            |
| Stock-based compensation   | 8,557                                 | 5,470          |
| Other non cash items   | 213                                   | (227)          |
| <b>Net cash provided by (used in) operating activities before changes in working capital</b> | <b>21,460</b>                         | <b>(7,376)</b> |
| Changes in operating assets and liabilities:   |                                       |                |
| Accounts receivable, net   | 11,795                                | 11,703         |
| Inventories  | 28,695                                | (9,543)        |
| Deferred tax assets  | (152)                                 | 5,707          |
| Prepaid expenses and other current assets  | (2,761)                               | (16,421)       |
| Other assets   | 989                                   | (11,370)       |
| Accounts payable   | (31,655)                              | (4,605)        |
| Income taxes payable   | 2,473                                 | 8,179          |
| Tax benefit from stock-based compensation  | (1)                                   | (957)          |
| Accrued compensation   | (203)                                 | 934            |
| Accrued warranty   | (106)                                 | (758)          |
| Deferred revenue, net  | (1,899)                               | 17,225         |
| Deferred tax liabilities   | (5,614)                               | 3,930          |
| Accrued expenses and other liabilities   | (15,922)                              | 5,373          |
| <b>Net cash provided by operating activities</b>   | <b>7,099</b>                          | <b>2,021</b>   |
| <b>Cash flows from investing activities</b>  |                                       |                |
| Purchases of property, plant, and equipment  | (4,674)                               | (5,383)        |
| Software development costs capitalized   | (283)                                 | (662)          |
| Acquisition of businesses, net of cash and cash equivalents acquired                         | (536)                                 | (2,858)        |
| <b>Net cash used in investing activities</b>   | <b>(5,493)</b>                        | <b>(8,903)</b> |
| <b>Cash flows from financing activities</b>  |                                       |                |
| Proceeds from debt, net of costs   |                                       | 439            |
| Repayment of debt  | (1,417)                               | (1,250)        |
| Payment of debt amendment fees   |                                       | (740)          |
| Proceeds from exercises of stock options   | 19                                    | 1,704          |
| Tax benefit of stock-based compensation  | 1                                     | 957            |
| Other  | (21)                                  | (31)           |
| <b>Net cash provided by (used in) financing activities</b>                                   | <b>(1,418)</b>                        | <b>1,079</b>   |
| Effect of foreign currency exchange rate changes on cash and cash equivalents                | (2,273)                               | 112            |



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|  |            |            |
|--|------------|------------|
| Net decrease in cash and cash equivalents                | (2,085)    | (5,691)    |
| Cash and cash equivalents, beginning of period           | 157,160    | 215,001    |
| Cash and cash equivalents, end of period                 | \$ 155,075 | \$ 209,310 |
| <b>Supplemental disclosures of cash flow information</b> |            |            |
| Cash paid for interest                                   | \$ 7,844   | \$ 6,238   |
| Cash paid (received) for income taxes                    | \$ (1,953) | \$ 2,232   |

The accompanying Notes to Condensed Consolidated Financial Statements

are an integral part of these financial statements.

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**VERIFONE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1. Principles of Consolidation and Summary of Significant Accounting Policies**

***Business Description***

VeriFone Holdings, Inc. ( VeriFone or the Company ) was incorporated in the state of Delaware on June 13, 2002. VeriFone designs, markets, and services electronic payment solutions that enable secure electronic payments among consumers, merchants, and financial institutions.

***Principles of Consolidation***

The accompanying consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated and amounts pertaining to the non-controlling ownership interest held by third parties in the operating results and financial position of the Company s majority-owned subsidiaries are reported as minority interest.

***Unaudited Interim Financial Statements***

The accompanying condensed consolidated financial statements as of January 31, 2009 and for the three months ended January 31, 2009 and 2008 are unaudited. These unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information and the rules and regulations of the Securities and Exchange Commission ( SEC ), for reports on Form 10-Q and, therefore, do not include all information and notes normally provided in audited financial statements prepared under GAAP. In the opinion of the Company s management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and include all adjustments of a normal recurring nature necessary for the fair presentation of the Company s financial position as of January 31, 2009, its results of operations for the three months ended January 31, 2009 and 2008 and cash flows for the three months ended January 31, 2009 and 2008. The condensed consolidated balance sheet at October 31, 2008 has been derived from audited consolidated financial statements, but does not include all disclosures required by GAAP. These unaudited interim condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended October 31, 2008 filed with the Securities and Exchange Commission.

***Use of Estimates***

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates, and such differences may be material to the condensed consolidated financial statements.

***Summary of Significant Accounting Policies***

The Company adopted the Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements*, effective November 1, 2008, for all financial assets and liabilities recognized or disclosed at fair value in the financial statements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies to other pronouncements that require or permit fair value measurements; it does not require any new fair value measurements. In accordance

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with FSP No. 157-2, *Effective Date of FASB Statement No. 157*, the Company has delayed the implementation of SFAS No. 157 provisions on the fair value of goodwill, other intangible assets and nonfinancial long-lived assets until the beginning of fiscal year 2010. The adoption of FAS No. 157 did not have any material impact on the Company's consolidated financial statements. See *Note 5. Fair Value Measurements* for additional information relating to the adoption of SFAS No. 157.

Effective November 1, 2008, the Company also adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an Amendment of FASB Statement No. 115*, which allows an entity to choose to measure certain financial assets and liabilities at fair value on a instrument-by-instrument basis. Subsequent fair value measurement for the financial assets and liabilities an entity elects to measure will be recognized in earnings. The Company has not elected fair value option for any eligible assets and liabilities.

Other than these changes, there have been no changes in the Company's significant accounting policies during the three months ended January 31, 2009 as compared to the significant accounting policies described in the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2008.

***Concentrations of Credit Risk***

For the three months ended January 31, 2009, one customer accounted for 10% of the Company's net revenues and 14% of the Company's outstanding accounts receivable as of January 31, 2009. No other customer accounted for more than 10% of the Company's net revenues or outstanding accounts receivable balances for other periods presented.

***Recent Accounting Pronouncements***

In December 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 141(R), *Business Combinations*. SFAS No. 141(R) will change the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for pre-acquisition gain and loss contingencies, the recognition of capitalized in-process research and development as an indefinite-lived intangible asset until approved or discontinued rather than as an immediate expense, expensing restructuring costs in connection with an acquisition rather than considering them a liability assumed in the acquisition, the treatment of acquisition-related transaction costs, including the fair value of contingent consideration at the date of an acquisition, the recognition of changes in the acquirer's income tax valuation allowance, and accounting for partial and/or step acquisitions. SFAS No. 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies under SFAS No. 109, *Accounting for Income Taxes*. Early adoption is not permitted. When SFAS No. 141(R) becomes effective, which, for the Company, will be in the first quarter of fiscal year 2010, any adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of SFAS No. 141(R) will be recorded through income tax expense, whereas currently the accounting treatment would require any adjustment to be recognized through the purchase price. The Company is currently evaluating SFAS No. 141(R) and has not yet determined the impact, if any, its adoption will have on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*. SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. In conjunction with SFAS No. 141(R), discussed below, SFAS No. 160 will significantly change the accounting for partial and/or step acquisitions. SFAS No. 160 will be effective for the Company in the beginning of fiscal year 2010. Early adoption is not permitted. The Company is currently evaluating SFAS No. 160 and has not yet determined the impact, if any, its adoption will have on the Company's consolidated financial statements.

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In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, to provide an enhanced understanding of an entity's use of derivative instruments, how they are accounted for under SFAS No. 133 and a tabular disclosure of the effects of such instruments and related hedged items on the entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company will be required to adopt SFAS No. 161 in the second quarter of fiscal 2009, which begins on February 1, 2009. The adoption of SFAS No. 161 will not have any material impact on the Company's consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position ( FSP ) No. 142-3, *Determination of the Useful Life of Intangible Assets*. FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumption used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP No. 142-3 will be effective in the first quarter of fiscal year 2010. The Company is currently evaluating the impact of the adoption of FSP No. 142-3 and has not yet determined the impact, if any, its adoption will have on the Company's consolidated financial statements.

In May 2008, the FASB issued FSPAPB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP APB 14-1 requires the issuer of a convertible debt instrument with cash settlement features to account separately for the liability and equity components of the instrument. The debt would be recognized at the present value of its cash flows discounted using an entity specific nonconvertible debt borrowing rate at the time of issuance. The equity component would be recognized as the difference between the proceeds from the issuance of the note and the fair value of the liability. FSP APB 14-1 also requires accretion of the resultant debt discount over the expected life of the debt. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. Entities are required to apply FSP APB 14-1 retrospectively for all periods presented. The Company is currently evaluating FSP APB 14-1 and has not yet determined the impact its adoption will have on the Company's consolidated financial statements. However, the impact of this new accounting treatment will be significant and will result in a significant increase to non-cash interest expense beginning in fiscal year 2010 for financial statements covering past and future periods.

**Note 2. Goodwill and Purchased Intangible Assets**

The Company performed its annual impairment test of goodwill as of August 1, 2008 in accordance with SFAS No. 142 which did not result in an impairment of goodwill. However, in light of the Company's fourth quarter operating results, the Company reduced its projected future cash flow significantly, which resulted in an indicator of possible impairment of goodwill and long-lived assets as defined under SFAS No. 142 and SFAS No. 144, requiring the Company to perform an impairment test as of October 15, 2008. Following the impairment test, the Company recorded impairment charges of \$262.5 million for goodwill and \$26.6 million for developed and core technology intangible assets in the fourth quarter of fiscal year 2008.

During November 2008, the macroeconomic environment worldwide continued to weaken. This was caused by the illiquidity of the credit markets, difficulties in the banking and financial services sectors, falling consumer confidence and rising unemployment rates. The Company's stock price and market capitalization declined significantly which was considered an indicator of possible impairment of goodwill and long-lived assets triggering the necessity of an additional impairment test as of December 1, 2008.

As a result of the goodwill impairment test, the Company concluded that the carrying amount of the North America and Asia reporting units exceeded their implied fair values and recorded an estimated impairment charge of \$178.3 million in the Corporate segment during the first quarter of fiscal year 2009. The net carrying value of goodwill in North America and International segments was reduced by \$65.6 million and \$112.7 million, respectively. See *Note 13. Segments and Geographic Information* for additional information on segment information.

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The Company determined the fair value of the North America and Asia reporting units using the income approach, which requires estimates of future operating results and discounted cash flows. This goodwill impairment charge is an estimate, as the valuations necessary to complete the required evaluation of the Company's goodwill remain in process as of the date of this report. The Company will finalize this evaluation in the second quarter of fiscal year 2009 and will update the impairment charge for goodwill, if necessary.

The long-lived assets impairment tests did not result in additional impairment charges.

**Goodwill**

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

|  | <b>Three Months<br/>Ended<br/>January 31,<br/>2009</b> | <b>Year Ended<br/>October 31,<br/>2008</b> |
|--|--|--|
| Balance, beginning of period   | \$ 321,903   | \$ 611,977                                 |
| Additions related to acquisitions  |  | 4,564                                      |
| Resolution of tax contingencies, adjustments to tax reserves and valuation allowances established in purchase accounting, and tax benefits from exercise of vested stock options assumed |  | 139  |
| Goodwill impairment  | (178,257)  | (262,462)                                  |
| Currency translation adjustments   | (8,166)  | (32,315)                                   |
| Balance, end of period   | \$ 135,480   | \$ 321,903                                 |

**Purchased Intangible Assets**

Purchased intangible assets subject to amortization consisted of the following (in thousands):

|                               | <b>January 31, 2009</b>              |                                     |            | <b>October 31, 2008</b>              |                                     |            |
|-------------------------------|--------------------------------------|-------------------------------------|------------|--------------------------------------|-------------------------------------|------------|
|                               | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b> |
| Developed and core technology | \$ 157,857                           | \$ (114,522)                        | \$ 43,335  | \$ 158,432                           | \$ (109,991)                        | \$ 48,441  |
| Trade name                    | 24,917                               | (22,382)                            | 2,535      | 24,917                               | (22,315)                            | 2,602      |
| Internal use software         | 4,876                                | (1,823)                             | 3,053      | 5,155                                | (1,629)                             | 3,526      |
| Customer relationships        | 93,088                               | (60,891)                            | 32,197     | 94,003                               | (55,935)                            | 38,068     |
|                               | \$ 280,738                           | \$ (199,618)                        | \$ 81,120  | \$ 282,507                           | \$ (189,870)                        | \$ 92,637  |

Amortization of purchased intangible assets for the three months ended January 31, 2009 and 2008 was allocated as follows (in thousands):

|                                  | <b>Three Months<br/>Ended<br/>January 31,<br/>2009</b> |          | <b>2008</b> |  |
|----------------------------------|--|----------|-------------|--|
| Included in cost of net revenues | \$ 5,168   | \$ 8,175 |             |  |
| Included in operating expenses   | 5,871  | 5,890    |             |  |



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Estimated future amortization expense of intangible assets recorded as of January 31, 2009 is as follows (in thousands):

|                           | Cost of<br>Net Revenues | Operating<br>Expenses | Total     |
|---------------------------|-------------------------|-----------------------|-----------|
| 2009 (remaining 9 months) | \$ 15,115               | \$ 14,433             | \$ 29,548 |
| 2010                      | 15,827                  | 12,056                | 27,883    |
| 2011                      | 10,647                  | 3,657                 | 14,304    |
| 2012                      | 952                     | 1,211                 | 2,163     |
| 2013                      | 163                     | 727                   | 890       |
| Thereafter                | 763                     | 5,569                 | 6,332     |
|                           | \$ 43,467               | \$ 37,653             | \$ 81,120 |

**Note 3. Balance Sheet Details*****Inventories***

Inventories consisted of the following (in thousands):

|                 | January 31,<br>2009 | October 31,<br>2008 |
|-----------------|---------------------|---------------------|
| Raw materials   | \$ 42,998           | \$ 52,152           |
| Work-in-process | 5,575               | 6,416               |
| Finished goods  | 91,197              | 109,792             |
|                 | \$ 139,770          | \$ 168,360          |

***Prepaid Expenses and Other Current Assets***

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

|                      | January 31,<br>2009 | October 31,<br>2008 |
|----------------------|---------------------|---------------------|
| Prepaid taxes        | \$ 29,724           | \$ 31,554           |
| Prepaid expenses     | 11,803              | 13,489              |
| Other receivables    | 11,843              | 5,267               |
| Other current assets | 7,022               | 7,321               |
|                      | \$ 60,392           | \$ 57,631           |

***Restricted Cash***

The Company had \$1.9 million of restricted cash as of January 31, 2009 and October 31, 2008. The restricted cash balances were comprised mainly of pledged deposits for bank guarantees to customers. The restricted cash was included in Other assets in the Condensed Consolidated Balance Sheets.





**Table of Contents****Accrued Warranty**

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

|  | <b>Three Months<br/>Ended<br/>January 31,<br/>2009</b> | <b>Year Ended<br/>October 31,<br/>2008</b> |
|--|--|--|
| Balance at beginning of period               | \$ 10,017  | \$ 11,667                                  |
| Warranty charged to cost of net revenues     | 809  | 7,289                                      |
| Utilization of warranty                      | (1,139)  | (10,877)                                   |
| Change in estimates                          | 224  | 1,889                                      |
| Warranty liabilities assumed in acquisitions |  | 49   |
| Balance at end of period                     | 9,911  | 10,017                                     |
| Less current portion                         | (8,221)  | (8,527)                                    |
| Long-term portion                            | \$ 1,690   | \$ 1,490                                   |

**Deferred Revenue, net**

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

|                          | <b>January 31,<br/>2009</b> | <b>October 31,<br/>2008</b> |
|--------------------------|-----------------------------|-----------------------------|
| Deferred revenue         | \$ 69,235                   | \$ 73,263                   |
| Deferred cost of revenue | (10,154)                    | (12,284)                    |
|                          | 59,081                      | 60,979                      |
| Less current portion     | (47,049)                    | (47,687)                    |
| Long-term portion        | \$ 12,032                   | \$ 13,292                   |

**Other Current Liabilities**

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

|                                   | <b>January 31,<br/>2009</b> | <b>October 31,<br/>2008</b> |
|-----------------------------------|-----------------------------|-----------------------------|
| Other tax liabilities (1)         | \$ 35,063                   | \$ 35,542                   |
| Accrued interest                  | 586                         | 4,448                       |
| Accounts payable related accruals | 16,875                      | 23,217                      |
| Accrued legal and audit fees      | 7,465                       | 10,885                      |
| Other                             | 12,109                      | 17,076                      |
| Total other current liabilities   | \$ 72,098                   | \$ 91,168                   |

- (1) Two of the Company's Brazilian subsidiaries that were acquired as part of the Lipman acquisition have been notified of assessments regarding Brazilian customs penalties that relate to alleged infractions in the importation of goods. The Company has accrued 38.0 million Brazilian reais or \$16.6 million and 37.1 million Brazilian reais or \$17.7 million as of January 31, 2009 and October 31, 2008, respectively, related to these assessments. See *Note 10. Commitments and Contingencies* for additional information related to these tax assessments.

**Table of Contents****Note 4. Financings**

The Company's financing as of January 31, 2009 and October 31, 2008 consisted of the following (in thousands):

|                                       | January 31,<br>2009 | October 31,<br>2008 |
|---------------------------------------|---------------------|---------------------|
| Term B Loan                           | \$ 230,000          | \$ 231,250          |
| Senior convertible notes              | 316,250             | 316,250             |
| Capital lease and other notes payable | 689                 | 879                 |
| Total                                 | 546,939             | 548,379             |
| Less current portion                  | (5,013)             | (5,022)             |
| Long-term portion                     | \$ 541,926          | \$ 543,357          |

**Secured Credit Facility**

On October 31, 2006, the Company's principal subsidiary, VeriFone Inc., entered into a credit agreement (the "Credit Facility") consisting of a Term B Loan facility of \$500.0 million and a revolving loan permitting borrowings of up to \$40.0 million. The proceeds from the Term B loan were used to repay all outstanding amounts relating to a previous credit facility, pay certain transaction costs, and partially fund the cash consideration in connection with the acquisition of Lipman Electronic Engineering Ltd. ("Lipman") on November 1, 2006. Through January 31, 2009, the Company had repaid an aggregate of \$270.0 million, leaving a Term B Loan balance of \$230.0 million at January 31, 2009. The Credit Facility is guaranteed by the Company and certain of its subsidiaries and is secured by collateral including substantially all of the Company's assets and stock of the Company's subsidiaries.

Lehman Commercial Paper, Inc. ("Lehman CP"), a lender in the revolving loan, declared bankruptcy in October 2008. Under the terms of the Credit Facility, the Company declared Lehman CP a defaulting lender and removed Lehman CP as a lender in the revolving loan. Therefore, as of January 31, 2009 and October 31, 2008, \$25.0 million was available to the Company under the revolving loan.

The Company pays a commitment fee on the unused portion of the revolving loan credit facility at a rate that varies depending upon its consolidated total leverage ratio. The Company was paying a commitment fee at a rate of 0.425% per annum as of January 31, 2009 and October 31, 2008.

The maturity dates on the components of the Credit Facility are October 31, 2012 for the revolving loan and October 31, 2013 for the Term B Loan. Principal payments on the Term B Loan are due in equal quarterly installments of \$1.3 million over the seven-year term on the last business day of each calendar quarter with the balance due on maturity.

At the Company's option, the Term B loan and the revolving loan can be Base Rate or Eurodollar Rate loans. Base Rate loans bear interest at a per annum rate equal to a margin over the greater of the Federal Funds rate plus 0.50% or the JP Morgan prime rate. For the Base Rate Term B loan, the margin was 1.75% as of January 31, 2009 and October 31, 2008. For the Base Rate revolving loan, the margin varies depending upon the Company's consolidated leverage ratio and was 1.00% as of January 31, 2009 and October 31, 2008.

At the Company's option, Eurodollar Rate loans bear interest at a margin over the one-, two-, three- or six-month LIBOR rate. The margin for the Eurodollar Rate Term B loan was 2.75% as of January 31, 2009 and October 31, 2008. The margin for the Eurodollar Rate revolving loan varies depending upon the Company's consolidated leverage ratio and was 2.00% as of January 31, 2009 and October 31, 2008.

As of January 31, 2009, the Term B loan bore interest at 2.75% over the one-month LIBOR rate of 0.41% for a total of 3.16%. As of October 31, 2008, the Term B loan bore interest at 2.75% over the one-month LIBOR

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rate of 3.12% for a total of 5.87%. As of January 31, 2009 and October 31, 2008, no amounts were outstanding under the revolving loan.

The terms of the Credit Facility require the Company to comply with financial covenants, including maintaining leverage and fixed charge coverage ratios at the end of each fiscal quarter. As of January 31, 2009, the Company was required to maintain a total leverage ratio of not greater than 3.5 to 1.0 and a fixed charge coverage ratio of at least 2.0 to 1.0. Total leverage ratio is equal to total debt less cash as of the end of a reporting fiscal quarter divided by consolidated EBITDA, as adjusted, for the most recent four consecutive fiscal quarters. Fixed charge coverage ratio is, all for the most recent four consecutive fiscal quarters, the ratio of (a) consolidated EBITDA, as adjusted, less capital expenditures, as adjusted, and cash tax payments, over (b) the sum of cash interest expense and scheduled debt payments. Some of the financial covenants become more restrictive over the term of the Credit Facility. Noncompliance with any of the financial covenants without cure or waiver would constitute an event of default under the Credit Facility. An event of default resulting from a breach of a financial covenant may result, at the option of lenders holding a majority of the loans, in an acceleration of repayment of the principal and interest outstanding and a termination of the revolving loan. The Credit Facility also contains non-financial covenants that restrict some of the Company's activities, including its ability to dispose of assets, incur additional debt, pay dividends, create liens, make investments, make capital expenditures, and engage in specified transactions with affiliates. The terms of the Credit Facility permit prepayments of principal and require prepayments of principal upon the occurrence of certain events including among others, the receipt of proceeds from the sale of assets, the receipt of excess cash flow as defined, and the receipt of proceeds of certain debt issues. The Credit Facility also contains customary events of default, including defaults based on events of bankruptcy and insolvency; nonpayment of principal, interest, or fees when due, subject to specified grace periods; breach of specified covenants; change in control; and material inaccuracy of representations and warranties. In addition, if the Company's leverage exceeds a certain level set out in its Credit Facility, a portion of the Company's excess cash flows must be used to pay down its outstanding debt. The Company was in compliance with its financial and non-financial covenants as of January 31, 2009.

***1.375% Senior Convertible Notes***

On June 22, 2007, the Company issued and sold \$316.2 million aggregate principal amount of 1.375% Senior Convertible Notes due 2012 (the Notes) in an offering through Lehman Brothers and JP Morgan Securities Inc. (together initial purchasers) to qualified institutional buyers pursuant to Section 4(2) and Rule 144A under the Securities Act. The net proceeds from the offering, after deducting transaction costs, were approximately \$307.9 million. The Company incurred approximately \$8.3 million of debt issuance costs. The transaction costs, consisting of the initial purchasers' discounts and offering expenses, were primarily recorded in debt issuance costs, net and are being amortized to interest expense using the effective interest method over five years. The Company will pay 1.375% interest per annum on the principal amount of the Notes, payable semi-annually in arrears in cash on June 15 and December 15 of each year, commencing on December 15, 2007, subject to increase in certain circumstances as described below. The fair value of the Notes was \$151.8 million as of January 31, 2009 based on the trading price at the end of the day.

The Notes were issued under an Indenture between the Company and U.S. Bank National Association, as trustee. Each \$1,000 of principal of the Notes will initially be convertible into 22.719 shares of VeriFone common stock, which is equivalent to a conversion price of approximately \$44.02 per share, subject to adjustment upon the occurrence of specified events. Holders of the Notes may convert their Notes prior to maturity during specified periods as follows: (1) on any date during any fiscal quarter beginning after October 31, 2007 (and only during such fiscal quarter) if the closing sale price of the Company's common stock was more than 130% of the then current conversion price for at least 20 trading days in the period of the 30 consecutive trading days ending on the last trading day of the previous fiscal quarter; (2) at any time on or after March 15, 2012; (3) if the Company distributes, to all holders of its common stock, rights or warrants (other than pursuant to a rights plan) entitling them to purchase, for a period of 45 calendar days or less, shares of the Company's common stock at a price less than the average closing sale price for the ten trading days preceding

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the declaration date for such distribution; (4) if the Company distributes, to all holders of its common stock, cash or other assets, debt securities, or rights to purchase the Company's securities (other than pursuant to a rights plan), which distribution has a per share value exceeding 10% of the closing sale price of the Company's common stock on the trading day preceding the declaration date for such distribution; (5) during a specified period if certain types of fundamental changes occur; or (6) during the five business-day period following any five consecutive trading-day period in which the trading price for the Notes was less than 98% of the average of the closing sale price of the Company's common stock for each day during such five trading-day period multiplied by the then current conversion rate. Upon conversion, the Company would pay the holder the cash value of the applicable number of shares of the Company's common stock, up to the principal amount of the note. Amounts in excess of the principal amount, if any, will be paid in stock.

As of January 31, 2009, none of the conditions allowing holders of the Notes to convert had been met. If a fundamental change, as defined in the Indenture, occurs prior to the maturity date, holders of the Notes may require the Company to repurchase all or a portion of their Notes for cash at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest (including additional interest, if any) up to, but excluding, the repurchase date.

The Notes are senior unsecured obligations and rank equal in right of payment with all of the Company's existing and future senior unsecured indebtedness. The Notes are effectively subordinated to any secured indebtedness to the extent of the value of the related collateral and structurally subordinated to indebtedness and other liabilities of the Company's subsidiaries including any secured indebtedness of such subsidiaries.

In connection with the sale of the Notes, the Company entered into a registration rights agreement, dated as of June 22, 2007, with the initial purchasers of the Notes (the "Registration Rights Agreement"). Under the Registration Rights Agreement, the Company has agreed to use reasonable best efforts to file a shelf registration statement regarding the Notes within 180 days after the original issuance of the Notes and cause the shelf registration statement to be effective until the earliest of (i) the date when the holders of transfer restricted Notes and shares of common stock issued upon conversion of the Notes are able to sell all such securities immediately without restriction under Rule 144(k) under the Securities Act of 1933, as amended (the "Securities Act"), (ii) the date when all transfer-restricted Notes and shares of common stock issued upon conversion of the Notes are registered under the registration statement and sold pursuant thereto and (iii) the date when all transfer-restricted Notes and shares of common stock issued upon conversion of the Notes have ceased to be outstanding. Due to the delay in the filing of the Company's Annual Report on Form 10-K for the year ended October 31, 2007, the Company was not able to register the Notes and the shares underlying the Notes until December 11, 2008. Accordingly, the interest rate on the Notes increased by 0.25% per annum on December 20, 2007 and by an additional 0.25% per annum on March 19, 2008 relating to the Company's obligations under the Registration Rights Agreement. Such additional interest ceased to accrue on December 10, 2008, the day prior to the date the registration statement covering the Notes became effective. The Company incurred \$1.3 million in interest expense related to the registration default of which \$0.7 million remained accrued as of October 31, 2008. This accrued interest penalty was fully paid during the first quarter of fiscal year 2009.

In connection with the offering of the Notes, the Company entered into note hedge transactions with affiliates of the initial purchasers (the "counterparties"), consisting of Lehman Brothers OTC Derivatives ("Lehman Derivatives") and JPMorgan Chase Bank, National Association, London Branch, whereby the Company has the option to purchase up to 7.2 million shares of its common stock at a price of approximately \$44.02 per share. The note hedge transactions expire the earlier of the last day on which any Notes remain outstanding and June 14, 2012. The cost to the Company of the note hedge transactions was approximately \$80.2 million. The note hedge transactions are intended to mitigate the potential dilution upon conversion of the Notes in the event that the volume weighted average price of the Company's common stock on each trading day of the relevant conversion period or other relevant valuation period is greater than the applicable strike price of the convertible note hedge transactions, which initially corresponds to the conversion price of the Notes and is subject, with certain exceptions, to the adjustments applicable to the conversion price of the Notes. The note

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hedge transaction with Lehman Derivatives, which benefited from a guarantee by Lehman Brothers, covers 50% of the shares of the Company's common stock potentially issuable upon conversion of the Notes. The filing by Lehman Brothers of a voluntary Chapter 11 bankruptcy petition in September 2008 constituted an event of default under the note hedge transaction with Lehman Derivatives, giving the Company the immediate right to terminate the transaction and entitling the Company to claim reimbursement for the loss incurred in terminating and closing out the transaction. On September 21, 2008, the Company delivered a notice of termination to Lehman Derivatives and claimed reimbursement for the loss incurred in termination and close-out of the transaction.

In addition, the Company sold warrants to the counterparties whereby they have the option to purchase up to approximately 7.2 million shares of VeriFone common stock at a price of \$62.356 per share. The Company received approximately \$31.2 million in cash proceeds from the sale of these warrants. The warrants expire progressively from December 19, 2013 to February 3, 2014. If the volume weighted average price of the Company's common stock on each trading day of the measurement period at maturity of the warrants exceeds the applicable strike price of the warrants, there would be dilution to the extent that such volume weighted average price of the Company's common stock exceeds the applicable strike price of the warrants.

The cost incurred in connection with the note hedge transactions, net of the related tax benefit and the proceeds from the sale of the warrants, is included as a net reduction in additional paid-in capital in the accompanying Condensed Consolidated Balance Sheets as of January 31, 2009 and October 31, 2008, in accordance with the guidance in Emerging Issues Task Force (EITF) Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*.

In accordance with SFAS No. 128, *Earnings per Share*, the Notes will have no impact on diluted earnings per share, or EPS, until the price of the Company's common stock exceeds the conversion price of \$44.02 per share because the principal amount of the Notes will be settled in cash upon conversion. Prior to conversion the Company will include the effect of the additional shares that may be issued if its common stock price exceeds \$44.02 per share, using the treasury stock method. If the price of the Company's common stock exceeds \$62.356 per share, it will also include the effect of the additional potential shares that may be issued related to the warrants, using the treasury stock method. Prior to conversion, the note hedge transactions are not considered for purposes of the EPS calculation as their effect would be anti-dilutive.

**Principal Payments**

Principal payments, including capital leases, due for financings over the next five years and thereafter are as follows (in thousands):

| <b>Fiscal Years ending October 31:</b> |                   |
|--|-------------------|
| 2009 (remaining 9 months)              | \$ 3,763          |
| 2010                                   | 5,676             |
| 2011                                   | 5,000             |
| 2012                                   | 321,250           |
| 2013                                   | 211,250           |
|  | <b>\$ 546,939</b> |

**Note 5. Fair Value Measurements**

Effective November 1, 2008, the Company adopted SFAS No. 157, except as it applies to the nonfinancial assets and nonfinancial liabilities subject to FSP No. 157-2. SFAS No. 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be

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determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, SFAS No. 157 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. In accordance with SFAS No. 157, the Company measures its cash equivalents, Israeli severance pay funds and foreign currency derivative contracts at fair value. The cash equivalents are classified as Level 1 or Level 2 because they are either valued primarily using quoted market prices or based on alternative pricing sources utilizing observable inputs from active markets. The Israeli severance pay funds are classified as Level 1 because the funds are valued using quoted market prices. Our foreign currency derivative contracts are classified as Level 2 because the valuation inputs are based on quoted prices and market observable data of similar instruments in active markets.

The following table presents the Company's assets and liabilities that were measured at fair value on a regular basis as of January 31, 2009, classified by the level within the fair value hierarchy (in thousands):

|                                    | Level 1          | Level 2         | Level 3   |
|------------------------------------|------------------|-----------------|-----------|
| Money market funds                 | \$ 44,052        | \$              | \$        |
| Israeli severance funds            | 2,347            |                 |           |
| Corporate and government bonds     |                  | 4,576           |           |
| Foreign exchange derivative assets |                  | 249             |           |
| <b>Total assets at fair value</b>  | <b>\$ 46,399</b> | <b>\$ 4,825</b> | <b>\$</b> |

**Note 6. Other Income (Expense), net and Other Comprehensive Income (Loss)****Other Income (Expense)**

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

|  | Three Months Ended<br>January 31, |            |
|--|-----------------------------------|------------|
|  | 2009                              | 2008       |
| Foreign currency transaction gains (losses), net | \$ 4,455                          | \$ (5,363) |
| Foreign currency contract gains (losses), net    | (1,101)                           | 642        |
| Other, net                                       | 860                               | 201        |
|  | \$ 4,214                          | \$ (4,520) |

**Table of Contents****Comprehensive Income (Loss)**

The components of comprehensive income (loss) were as follows (in thousands):

|  | Three Months Ended<br>January 31, |                    |
|--|-----------------------------------|--------------------|
|  | 2009                              | 2008               |
| Net loss   | \$ (181,989)                      | \$ (33,498)        |
| Other comprehensive income (loss):                 |                                   |                    |
| Foreign currency translation adjustments           | (9,014)                           | (3,466)            |
| Unrealized gain on interest rate hedge, net of tax |                                   | 7                  |
| <b>Comprehensive loss</b>                          | <b>\$ (191,003)</b>               | <b>\$ (36,957)</b> |

**Note 7. Income Taxes**

The Company recorded a benefit from income taxes of \$1.3 million for the three months ended January 31, 2009 compared to a provision for income taxes of \$2.9 million for the three months ended January 31, 2008. The \$1.3 million benefit from income taxes for the three months ended January 31, 2009 is primarily related to discrete items, including a combination of a decrease of deferred tax liability due to goodwill impairment for GAAP purposes, offset by unfavorable tax provision impacts from an increase in the U.S. valuation allowance, and interest accruals associated with uncertain tax positions under FIN 48.

The decrease in income tax provision for the three months ended January 31, 2009, compared to the three months ended January 31, 2008, is due to the fact that the Company provided tax for the three months ended January 31, 2008 notwithstanding an expected loss for the full fiscal year. For the three months ended January 31, 2009, the estimated goodwill impairment provided a tax benefit of approximately \$2.4 million offset by the other discrete items noted above.

As of January 31, 2009, the Company remains in a net deferred tax liability position. The realization of the deferred tax assets is primarily dependent on the Company generating sufficient U.S. and foreign taxable income in future periods. Management has determined that it is not more likely than not the deferred tax assets in the U.S. and certain foreign jurisdictions will be realized and as such the Company continues to record a full valuation allowance against these assets as of January 31, 2009. The amount of deferred tax assets considered realizable may increase or decrease in subsequent quarters when the Company reevaluates the underlying basis for its estimates of future domestic and certain foreign taxable income.

The Company is currently under audit by the Internal Revenue Service ( IRS ) for its fiscal years 2003 to 2004. Although the Company believes it has correctly provided income taxes for the years subject to audit, the IRS may adopt different interpretations. The Company has not yet received any final determinations with respect to this audit although certain adjustments have been agreed with the IRS. The liability associated with the agreed adjustments had been accrued in previous periods. Subsidiaries of the Company are also under audit by the Israeli tax authorities for calendar years 2004 to 2006 and the Brazilian federal government for all periods subsequent to January 1, 2003. With few exceptions, the Company is no longer subjected to tax examination outside of the U.S. for periods prior to 2000.

**Note 8. Stockholders Equity**

The Company grants stock options and restricted stock units ( RSUs ) pursuant to stockholder approved stock option plans. The Company maintains certain equity incentive plans, as described in detail in Note 8. *Stockholders Equity* of Notes to Consolidated Financial Statements in its Annual Report on Form 10-K for the fiscal year ended October 31, 2008. All stock options and RSUs granted during the three months ended January 31, 2009 were granted under the 2006 Equity Incentive Plan.



**Table of Contents****Stock-Based Compensation**

The Company follows SFAS No. 123(R), *Share-Based Payment*, which requires the measurement of compensation cost for all outstanding unvested share-based awards at fair value and recognizes compensation over the requisite service period for awards expected to vest. The following table summarizes stock-based compensation expense by classification recorded under SFAS No. 123(R) for the three months ended January 31, 2009 and 2008 (in thousands):

|                                       | <b>Three Months Ended<br/>January 31,</b> |                 |
|---------------------------------------|---|-----------------|
|                                       | <b>2009</b>                               | <b>2008</b>     |
| Cost of net revenues                  | \$ 504                                    | \$ 626          |
| Research and development              | 1,366                                     | 1,496           |
| Sales and marketing                   | 1,859                                     | 1,803           |
| General and administrative            | 4,828                                     | 1,545           |
| <b>Total stock-based compensation</b> | <b>\$ 8,557</b>                           | <b>\$ 5,470</b> |

In the first quarter of fiscal year 2009, as a result of the cancellation of certain stock option grants voluntarily surrendered by an employee, the Company expensed all previously unrecognized compensation cost of such stock option grants amounting to \$3.6 million as of the cancellation date.

**Valuation Assumptions**

The Company estimates the grant-date fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of SFAS No. 123(R) and Staff Accounting Bulletin No. 107, *Share-Based Payment*, using the weighted-average assumptions noted in the following table.

|   | <b>Three Months Ended<br/>January 31,</b> |             |
|---|---|-------------|
|   | <b>2009</b>                               | <b>2008</b> |
| Expected term of the options (in years) | 4.0                                       | 3.0         |
| Risk-free interest rate                 | 2.2%                                      | 2.9%        |
| Expected stock price volatility         | 59.4%                                     | 40.6%       |
| Expected dividend rate                  | 0.0%                                      | 0.0%        |

The expected term represents the period of time that options granted are expected to be outstanding. The expected term of options granted is derived from the historical actual term of option grants and an estimate of future exercises during the remaining contractual period of the option.

The average risk-free interest rate is based on the U.S. Treasury zero-coupon issues with a remaining term equal to the expected term of the options used in the Black-Scholes valuation model.

Expected volatility of the stock is based on a blend of the Company's peer group in the industry in which it does business and the Company's historical volatility for its own stock.

Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive equity awards, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by the Company under SFAS No. 123(R). The fair value of each RSU is equal to the market value of the Company's common stock on the date of grant.

The Company estimates forfeitures of options and RSUs based on historical experience and records compensation expense only for those awards that are expected to vest.



**Table of Contents****Performance Restricted Stock Units for the Company's CEO**

In January 2007, the Company made an award of up to 900,000 RSUs to the Company's CEO. These RSUs may vest in three tranches of up to 300,000 RSUs each over a four-year period based upon annual growth in the Company's net income, as adjusted, per share and its share price. Two-thirds of the RSUs are performance units that will vest based on achievement of net income, as adjusted, targets, and one-third of the RSUs are market units that will vest based on achievement of net income, as adjusted, targets and specified targets for the share price of the Company's stock. Each year's RSUs will not vest until the end of the fiscal year following the year for which the specified target is met.

The performance targets for 2007 and 2008 were not achieved; hence 400,000 performance units and 200,000 market units have been cancelled.

The measurement of the fiscal 2009 tranche occurred in January 2009, the measurement date for that tranche. Up to 200,000 performance units will vest if the fiscal year 2009 performance targets are achieved. Up to 100,000 market units will vest if the fiscal 2009 performance targets are achieved and the volume-weighted average price of the Company's stock exceeds \$62.20 per share during the 10-day trading period beginning with the second full trading day following the Company's announcement of the financial results for the fiscal year ending October 31, 2009. Because these shares are contingently issuable, they are excluded from the earnings per share calculation.

**Equity Award Activity**

Stock option activity for the three months ended January 31, 2009, was as follows:

|  | Number of<br>Shares<br>(in thousands) | Weighted<br>Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(in years) | Aggregate<br>Intrinsic<br>Value<br>(in thousands) |
|--|---------------------------------------|---------------------------------------|---|---|
| Balance at November 1, 2008                    | 8,707                                 | \$ 26.20                              |   |   |
| Granted  | 2,734                                 | 6.59                                  |   |   |
| Exercised                                      | (5)                                   | 3.73                                  |   |   |
| Cancelled                                      | (974)                                 | 22.58                                 |   |   |
| Balance at January 31, 2009                    | 10,462                                | \$ 21.42                              | 5.1   | \$ 209  |
| Vested or expected to vest at January 31, 2009 | 9,629                                 | \$ 21.94                              | 5.0   | \$ 208  |
| Exercisable at January 31, 2009                | 3,914                                 | \$ 25.96                              | 3.6   | \$ 176  |

The weighted average fair value of options granted during the three months ended January 31, 2009 and 2008 was \$3.09 and \$6.07, respectively. The total intrinsic value of options exercised was \$0.01 million and \$3.3 million during the three months ended January 31, 2009 and 2008, respectively.

Restricted stock unit activity for the three months ended January 31, 2009, was as follows (in thousands):

|                             | Number of<br>Shares<br>(in thousands) | Aggregate<br>Intrinsic<br>Value<br>(in thousands) |
|-----------------------------|---------------------------------------|---|
| Balance at November 1, 2008 | 385                                   |   |
| Granted                     | 10                                    |   |

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|  |      |    |     |
|--|------|----|-----|
| Vested   | (10) |    |     |
| Cancelled                                      | (3)  |    |     |
| Balance at January 31, 2009                    | 382  | \$ | 381 |
| Vested or expected to vest at January 31, 2009 | 314  | \$ | 282 |

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The weighted average fair value of RSUs granted during the three months ended January 31, 2009 and 2008 was \$5.30 and \$19.81, respectively. The total fair value of RSUs vested during the three months ended January 31, 2009 and 2008 was \$0.05 million and \$0.2 million, respectively.

Net cash proceeds from the exercise of stock options were \$0.02 million and \$0.9 million for the three months ended January 31, 2009 and 2008, respectively.

As of January 31, 2009, total compensation cost related to unvested options and RSUs expected to vest but not yet recognized was \$37.0 million and \$2.2 million, respectively, and was expected to be recognized over a weighted-average period of 3.0 years for options and 1.9 years for RSUs.

**Note 9. Net Income (Loss) Per Share**

Basic net loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net loss per common share is computed using the weighted average number of common shares outstanding plus the effect of common stock equivalents, unless the common stock equivalents are anti-dilutive. The potential dilutive shares of the Company's common stock resulting from the assumed exercise of outstanding stock options and equivalents, the assumed exercise of the warrants and the dilutive effect of the convertible senior notes are determined using the treasury stock method.

The following details the computation of the loss per common share (in thousands, except per share data):

|  | <b>Three Months Ended<br/>January 31,<br/>2009                      2008</b> |             |
|--|--|-------------|
| <b>Basic and diluted net loss per share:</b>                                   |  |             |
| Numerator:   |  |             |
| Net loss   | \$ (181,989)   | \$ (33,498) |
| Denominator:   |  |             |
| Weighted-average shares outstanding used in computing basic net loss per share | 84,487   | 84,153      |
| Add dilutive securities:   |  |             |
| Stock options and restricted stock units                                       |  |             |
| Weighted-average shares used in computing diluted net loss per share           | 84,487   | 84,153      |
| Net loss per share:  |  |             |
| Basic  | \$ (2.15)  | \$ (0.40)   |
| Diluted  | \$ (2.15)  | \$ (0.40)   |

As of January 31, 2009 and 2008, options and RSUs to purchase 10.9 million and 8.8 million, respectively, of Common Stock were excluded from the calculation of weighted average shares for diluted net loss per share as they were anti-dilutive.

The Notes are considered to be Instrument C securities as defined by EITF No. 90-19, *Convertible Bonds with Issuer Option to Settle for Cash upon Conversion* ( EITF 90-19 ); therefore, only the conversion spread relating to the Notes is included in the Company's diluted earnings per share calculation, if dilutive. The potential dilutive shares of the Company's common stock resulting from the assumed settlement of the conversion spread of the Notes are determined under the method set forth in EITF 90-19. Under such method, the settlement of the conversion spread of the Notes has a dilutive effect when the average share price of the Company's common stock during the period exceeds \$44.02. The average share price of the Company's common stock during the three months ended January 31, 2009 and 2008 did not exceed \$44.02.

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Warrants to purchase 7.2 million shares of the Company's common stock were outstanding at January 31, 2009, but were not included in the computation of diluted earnings per share because the warrants' exercise price was greater than the average market price of the Company's common stock during the three months ended January 31, 2009; therefore, their effect was anti-dilutive.

**Note 10. Commitments and Contingencies*****Commitments***

The Company leases certain facilities under non-cancelable operating leases that contain free rent periods and/or rent escalation clauses. Rent expense under these leases has been recorded on a straight-line basis over the lease term. The difference between amounts paid and rent expense is recorded as deferred rent and the short-term and long-term portions are included in other current liabilities and other long-term liabilities, respectively, in the Condensed Consolidated Balance Sheets. Additionally, the Company subleases certain real property to third parties. Future minimum lease payments and sublease rental income under these leases as of January 31, 2009, were as follows (in thousands):

| <b>Fiscal Years Ending October 31:</b> | <b>Minimum<br/>Lease Payments</b> | <b>Sublease<br/>Rental Income</b> | <b>Net Minimum<br/>Lease Payments</b> |
|--|-----------------------------------|-----------------------------------|---------------------------------------|
| 2009 (remaining 9 months)              | \$ 9,268                          | \$ (54)                           | \$ 9,214                              |
| 2010                                   | 10,891                            | (4)                               | 10,887                                |
| 2011                                   | 8,882                             |                                   | 8,882                                 |
| 2012                                   | 7,464                             |                                   | 7,464                                 |
| 2013                                   | 6,010                             |                                   | 6,010                                 |
| Thereafter                             | 7,611                             |                                   | 7,611                                 |
| <b>Total</b>                           | <b>\$ 50,126</b>                  | <b>\$ (58)</b>                    | <b>\$ 50,068</b>                      |

***Contingencies******Manufacturing Agreements***

The Company works on a purchase order basis with third-party contract manufacturers and component suppliers with facilities in China, Singapore, Israel and Brazil to supply a majority of the Company's finished goods inventories. The Company provides each contract manufacturer with a purchase order to cover the manufacturing requirements, which constitutes a binding commitment by the Company to purchase materials produced by the manufacturer as specified in the purchase order. The total amount of purchase commitments as of January 31, 2009 was approximately \$27.9 million, and are generally paid within one year. Of this amount, \$3.7 million has been recorded in Other current liabilities in the accompanying Condensed Consolidated Balance Sheets as of January 31, 2009 because these commitments are not expected to have future value to the Company.

***Legal Proceedings******Brazilian State Tax Assessments******State Value Added Tax***

One of the Company's Brazilian subsidiaries has been notified of a tax assessment regarding Brazilian state value added tax ( VAT ), for the periods from January 2000 to December 2001 that relates to products supplied to the Company by a contract manufacturer. The assessment relates to an asserted deficiency of 4.7 million Brazilian reais (approximately \$2.1 million) excluding interest. The tax assessment was based on a clerical error in which the Company's Brazilian subsidiary omitted the required tax exemption number on its invoices. Management does not expect that the Company will ultimately incur a material liability in respect of this assessment, because they believe, based in part on advice of the Company's Brazilian tax counsel, that the

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Company is likely to prevail in the proceedings relating to this assessment. On May 25, 2005, the Company had an administrative hearing with respect to this audit. The Company's management expects to receive the decision of the administrative body sometime in 2009. In the event the Company receives an adverse ruling from the administrative body, the Company will decide whether or not to appeal and would reexamine the determination as to whether an accrual is necessary. It is currently uncertain what impact this state tax examination may have with respect to the Company's use of a corresponding exemption to reduce the Brazilian federal VAT.

***Importation of Goods Assessments***

Two of the Company's Brazilian subsidiaries that were acquired as a part of the Lipman acquisition have been notified of assessments regarding Brazilian customs penalties that relate to alleged infractions in the importation of goods. The assessments were issued by the Federal Revenue Department in the City of Vitória, the City of São Paulo, and the City of Itajai. The assessments relate to asserted deficiencies totaling 26.9 million Brazilian reais (approximately \$11.7 million) excluding interest. The tax authorities allege that the structure used for the importation of goods was simulated with the objective of evading taxes levied on the importation by under-invoicing the imported goods; the tax authorities allege that the simulation was created through a fraudulent interposition of parties, where the real sellers and buyers of the imported goods were hidden.

In the Vitória tax assessment, the fines were reduced from 4.7 million Brazilian reais (approximately \$2.0 million) to 1.5 million Brazilian reais (approximately \$0.6 million) on a first level administrative decision on January 26, 2007. The proceeding has been remitted to the Taxpayers Council to adjudicate the appeal of the first level administrative decision filed by the tax authorities. The Company also appealed the first level administrative decision on February 26, 2007. In this appeal, the Company argued that the tax authorities did not have enough evidence to determine that the import transactions were indeed fraudulent and that, even if there were some irregularities in such importations, they could not be deemed to be the Company's responsibility since all the transactions were performed by the third-party importer of the goods. On February 27, 2008, the Taxpayers Council rendered its decision to investigate the first level administrative decision for further analysis of the matter. The Company expects to receive the decision of the Taxpayers Council sometime in 2009. In the event the Company receives an adverse ruling from the Taxpayers Council, the Company will decide whether or not to appeal to the judicial level. Based on the Company's current understanding of the underlying facts, the Company believes that it is probable that its Brazilian subsidiary will be required to pay some amount of fines. At January 31, 2009, the Company has accrued 4.7 million Brazilian reais (approximately \$2.0 million), excluding interest, which it believes is the probable payment.

On July 12, 2007, the Company was notified of a first administrative level decision rendered in the São Paulo tax assessment, which maintained the total fine of 20.2 million Brazilian reais (approximately \$8.8 million) imposed. On August 10, 2007, the Company appealed the first administrative level decision to the Taxpayers Council. A hearing was held on August 12, 2008 before the Taxpayers Council, and on October 14, 2008, the Taxpayers Council granted the Company's appeal and dismissed the Sao Paulo assessment. However, the Taxpayers Council has not issued its written opinion concerning the legal basis for such dismissal, and the Brazilian tax authorities have informed the Company that it will file a revised assessment in this matter. Based on the Company's current understanding of the underlying facts, the Company believes that it is probable that its Brazilian subsidiary will be required to pay some amount of fines. Accordingly, at January 31, 2009, the Company has accrued 20.2 million Brazilian reais (approximately \$8.8 million), excluding interest.

On May 22, 2008, the Company was notified of a first administrative level decision rendered in the Itajai assessment, which maintained the total fine of 2.0 million Brazilian reais (approximately \$0.9 million) imposed, excluding interest. On May 27, 2008, the Company appealed the first level administrative level decision to the Taxpayers Council. Based on the Company's current understanding of the underlying facts, the Company believes that it is probable that its Brazilian subsidiary will be required to pay some amount of fines. Accordingly, at January 31, 2009, the Company has accrued 2.0 million Brazilian reais (approximately \$0.9 million), excluding interest.

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***Patent Infringement and Commercial Litigation******SPA Syspatronic AG v. VeriFone Holdings, Inc., VeriFone, Inc., et al.***

On September 18, 2007, SPA Syspatronic AG ( SPA ) commenced this action in the United States District Court for the Eastern District of Texas, Marshall Division, against the Company and others, alleging infringement of U.S. Patent No. 5,093,862 purportedly owned by SPA. SPA is seeking a judgment of infringement, an injunction against further infringement, damages, interest and attorneys' fees. The Company filed an answer and counterclaims on November 8, 2007, and intends to vigorously defend this litigation. On January 28, 2008, the Company requested that the U.S. Patent and Trademark Office (the PTO ) perform a re-examination of the patent. The PTO granted the request on April 4, 2008. The Company then filed a motion to stay the proceedings with the Court and on April 25, 2008, the Court agreed to stay the proceedings pending the re-examination. On December 19, 2008, the PTO rejected all claims of the subject patent on the same basis as was identified in the Company's request for re-examination. The case is still in the preliminary stages, and it is not possible to quantify the extent of the Company's potential liability, if any. An unfavorable outcome could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flow.

***Cardsoft, Inc. et al v. VeriFone Holdings, Inc., VeriFone, Inc., et al.***

On March 6, 2008, Cardsoft, Inc. and Cardsoft (Assignment for the Benefit of Creditors), LLC ( Cardsoft ) commenced this action in the United States District Court for the Eastern District of Texas, Marshall Division, against the Company and others, alleging infringement of U.S. Patents No. 6,934,945 and No. 7,302,683 purportedly owned by Cardsoft. Cardsoft is seeking a judgment of infringement, an injunction against further infringement, damages, interest and attorneys' fees. The Company intends to vigorously defend this litigation. The case is still in the preliminary stages, and it is not possible to quantify the extent of the Company's potential liability, if any. An unfavorable outcome could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flow.

***Communication Transaction Solutions, Inc. v. VeriFone Holdings, Inc., VeriFone, Inc., et al.***

The Company was a defendant in this action initiated in the California Superior Court in Santa Clara County on August 30, 2006, in which the plaintiff alleged among other things misappropriation of trade secrets in connection with the Company's development of its wireless pay-at-the-table system. These allegations followed the Company's decision in October 2005 to terminate discussions regarding a possible acquisition of the plaintiff's business. The plaintiff sought damages, interest and attorneys' fees. The parties argued summary judgment motions on September 4, 2008 and on September 11, 2008, the Court dismissed certain of the plaintiffs' claims. In January 2009, without admitting any misappropriation of trade secrets, wrongdoing or violation of law and to avoid the distraction and expense of continued litigation, the Company agreed to settle the litigation. In exchange for a payment of \$3.0 million by the Company, all asserted claims will be dismissed and the Company will receive a perpetual, fully paid-up license to all plaintiff intellectual property and trade secrets asserted in the lawsuit.

***Class Action and Derivative Lawsuits***

On or after December 4, 2007, several securities class action claims were filed against the Company and certain of the Company's officers, former officers, and a former director. These lawsuits have been consolidated in the U.S. District Court for the Northern District of California as *In re VeriFone Holdings, Inc. Securities Litigation*, C 07-6140 MHP. The original actions were: *Eichenholtz v. VeriFone Holdings, Inc. et al.*, C 07-6140 MHP; *Lien v. VeriFone Holdings, Inc. et al.*, C 07-6195 JSW; *Vaughn et al. v. VeriFone Holdings, Inc. et al.*, C 07-6197 VRW (Plaintiffs voluntarily dismissed this complaint on March 7, 2008); *Feldman et al. v. VeriFone Holdings, Inc. et al.*, C 07-6218 MMC; *Cerini v. VeriFone Holdings, Inc. et al.*, C 07-6228 SC; *Westend Capital Management LLC v. VeriFone Holdings, Inc. et al.*, C 07-6237 MMC; *Hill v. VeriFone Holdings, Inc. et al.*,



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C 07-6238 MHP; *Offutt v. VeriFone Holdings, Inc. et al.*, C 07-6241 JSW; *Feitel v. VeriFone Holdings, Inc., et al.*, C 08-0118 CW. On August 22, 2008, the Court appointed plaintiff National Elevator Fund lead plaintiff and its attorneys lead counsel. Plaintiff filed its consolidated amended class action complaint on October 31, 2008, and the Company filed its motion to dismiss on December 31, 2008. The consolidated amended complaint asserts claims under the Securities Exchange Act Sections 10(b), 20(a), and 20A and Securities and Exchange Commission Rule 10b-5 for securities fraud and control person liability against the Company and certain of the Company's current and former officers and directors, based on allegations that the Company and the individual defendants made false or misleading public statements regarding the Company's business and operations during the putative class periods and seeks unspecified monetary damages and other relief. Discovery has not yet commenced and is not expected to do so until after a ruling on the Company's motion to dismiss. At this time, the Company has not recorded any liabilities as the Company is unable to estimate any potential liability.

Beginning on December 13, 2007, several actions were also filed against certain current and former directors and officers derivatively on the Company's behalf. These derivative lawsuits were filed in: (1) the U.S. District Court for the Northern District of California, as *In re VeriFone Holdings, Inc. Shareholder Derivative Litigation*, Lead Case No. C 07-6347, which consolidates *King v. Bergeron, et al.* (Case No. 07-CV-6347), *Hilborn v. VeriFone Holdings, Inc., et al.* (Case No. 08-CV-1132), *Patel v. Bergeron, et al.* (Case No. 08-CV-1133), and *Lemmond, et al. v. VeriFone Holdings, Inc., et al.* (Case No. 08-CV-1301); and (2) California Superior Court, Santa Clara County, as *In re VeriFone Holdings, Inc. Derivative Litigation*, Lead Case No. 1-07-CV-100980, which consolidates *Catholic Medical Mission Board v. Bergeron, et al.* (Case No. 1-07-CV-100980), and *Carpel v. Bergeron, et al.* (Case No. 1-07-CV-101449). On May 15, 2008, the Court in the federal derivative action appointed Charles R. King as lead plaintiff and his attorneys as lead counsel. On October 31, 2008, plaintiffs in the federal action filed their consolidated amended derivative complaint, which names the Company as a nominal defendant and brings claims for insider selling, breach of fiduciary duty, unjust enrichment, waste of corporate assets and aiding and abetting breach of fiduciary duty against the Company and certain of the Company's current and former officers and directors. On December 15, 2008, the Company and the other defendants filed a motion to dismiss. The parties have agreed by stipulation that briefing on this motion will relate only to the issue of plaintiffs' failure to make a pre-suit demand on the Company's Board of Directors.

On October 31, 2008, the derivative plaintiffs in California Superior Court for the County of Santa Clara filed their consolidated derivative complaint, naming the Company as a nominal defendant and brings claims for insider selling, breach of fiduciary duty, unjust enrichment, waste of corporate assets and aiding and abetting breach of fiduciary duty against certain of the Company's current and former officers and directors and the Company's largest shareholder, GTCR Golder Rauner. On November 10, 2008, the Company filed a motion to stay the state court action pending resolution of the parallel federal actions, and the parties have agreed by stipulation to delay briefing on the motion to stay until after the issue of demand futility is resolved in the federal derivative case.

On January 27, 2008, a class action complaint was filed against the Company in the Central District Court in Tel Aviv, Israel on behalf of purchasers of the Company's stock on the Tel Aviv Stock Exchange. The complaint seeks compensation for damages allegedly incurred by the class of plaintiffs due to the publication of erroneous financial reports. The Company filed a motion to stay the action, in light of the proceedings already filed in the United States, on March 31, 2008. A hearing on the motion was held on May 25, 2008. Further briefing in support of the stay motion, specifically with regard to the threshold issue of applicable law, was submitted on June 24, 2008. On September 11, 2008, the Israeli District Court ruled in the Company's favor, holding that U.S. law would apply in determining the Company's liability. On October 7, 2008, plaintiffs filed a motion for leave to appeal the District Court's ruling to the Israeli Supreme Court. The Company's response to plaintiffs' appeal motion was filed on January 18, 2009. Because the Company's motion to stay will depend upon the Supreme Court's ruling, the District Court has stayed its proceedings until the Supreme Court rules on plaintiffs' motion for leave to appeal. At this time, the Company has not recorded any liabilities as the Company is unable to estimate any potential liability.

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The foregoing cases are still in the preliminary stages, and the Company is not able to quantify the extent of its potential liability, if any. An unfavorable outcome in any of these matters could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flows. In addition, defending this litigation is likely to be costly and may divert management's attention from the day-to-day operations of the Company's business.

*Regulatory Actions*

The Company has responded to inquiries and provided information and documents related to the restatement of its fiscal year 2007 interim financial statements to the Securities and Exchange Commission, the Department of Justice, the New York Stock Exchange and the Chicago Board Options Exchange. The SEC has interviewed several current and former officers and employees. The Company is continuing to cooperate with the SEC in responding to the SEC's requests for information.

On February 18, 2009, the Company received a Wells Notice from the SEC in connection with the investigation by the staff of the SEC's Division of Enforcement (the Staff) related to the restatement. The Wells Notice provides the Company with notification that the Staff intends to recommend that the SEC bring a civil injunctive action against the Company, alleging violations of the federal securities laws arising from the restatement of the Company's fiscal year 2007 interim financial statements. Under the process established by the SEC, recipients of a Wells Notice have the opportunity to respond before the Staff makes a recommendation to the SEC regarding what action, if any, should be brought by the SEC. In connection with this contemplated action, the Staff may seek a civil injunction and civil penalties.

*Other Litigation*

The Company is subject to various other legal proceedings related to commercial, customer, and employment matters that have arisen during the ordinary course of business. Although there can be no assurance as to the ultimate disposition of these matters, the Company's management has determined, based upon the information available at the date of these financial statements, that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

**Note 11. Restructuring Charges**

In the first quarter of 2009, in light of the macroeconomic conditions, management approved several actions worldwide as part of a restructuring plan designed to improve financial results. The Company expensed \$1.8 million of employee restructuring expense and \$0.1 million of facilities restructuring expense in the Corporate segment for these actions for the three months ended January 31, 2009. In addition, the Company expensed \$0.7 million of facilities restructuring expense in the Corporate segment for the 2008 restructuring plan.

The following table summarizes restructuring expenses for the three months ended January 31, 2009 and 2008 (in thousands):

|                                  | <b>Three Months Ended</b> |                 |
|----------------------------------|---------------------------|-----------------|
|                                  | <b>January 31,</b>        |                 |
|                                  | <b>2009</b>               | <b>2008</b>     |
| Cost of net revenues             | \$ 195                    | \$ 166          |
| Sales and marketing              | 874                       | 399             |
| Research and development         | 591                       | 752             |
| General and administrative       | 960                       | 787             |
| <b>Total restructuring costs</b> | <b>\$ 2,620</b>           | <b>\$ 2,104</b> |

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Restructuring activity for the three months ended January 31, 2009 was as follows (in thousands):

|                                    | <b>Employee Severance<br/>and Benefit<br/>Arrangement</b> | <b>Facilities<br/>Related Costs</b> | <b>Total</b>    |
|------------------------------------|---|-------------------------------------|-----------------|
| Balance at November 1, 2008        | \$ 1,332  | \$ 1,992                            | \$ 3,324        |
| First quarter charges              | 1,784   | 836                                 | 2,620           |
| Other adjustments                  | (41)  | (173)                               | (214)           |
| Cash payments                      | (810)   | (303)                               | (1,113)         |
| <b>Balance at January 31, 2009</b> | <b>\$ 2,265</b>   | <b>\$ 2,352</b>                     | <b>\$ 4,617</b> |

The Company may incur additional restructuring charges in the future for additional employee severance and benefit arrangements, and facility-related activities.

**Note 12. Related-Party Transactions**

For the three months ended January 31, 2009, the Company recorded \$1.4 million of sales to affiliates of one of the members of the Company's Board of Directors which were included in System Solutions net revenues in the accompanying Condensed Consolidated Statements of Operations. For the three months ended January 31, 2008, the Company did not record any sales to affiliated parties.

**Note 13. Segment and Geographic Information****Segment Information**

The Company operates in two business segments: North America and International. The Company defines North America as the United States and Canada, and International as the other countries from which it derives revenues. Total assets and long-lived assets by segment are based on the physical location of the assets.

Net revenues and operating income (loss) of each business segment reflect net revenues generated within the segment, standard cost of System Solutions net revenues, actual cost of Services net revenues, and expenses that directly benefit only that segment. Corporate net revenues and operating income (loss) reflect non-cash acquisition charges, including amortization of purchased core and developed technology assets and step-down in deferred revenue, impairment of goodwill and other Corporate charges, including inventory obsolescence and scrap at corporate distribution centers, rework, specific warranty provisions, non-standard freight, over-and-under absorption of materials management and supply chain engineering overhead.

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In 2008, the Company revised the methodology for business segment operating loss reporting. Distribution center costs and certain warranty and royalty costs, which were previously allocated to the Corporate segment were reallocated based on ship-to locations. Restructuring costs which was previously allocated to the International and North America segments were reallocated to the Corporate segment. The following table sets forth net revenues and operating income (loss), as revised, for the Company's segments (in thousands):

|                                 | <b>Three Months Ended<br/>January 31,</b> |                    |
|---------------------------------|---|--------------------|
|                                 | <b>2009</b>                               | <b>2008</b>        |
| <b>Net revenues:</b>            |   |                    |
| International                   | \$ 130,263                                | \$ 118,019         |
| North America                   | 83,900                                    | 67,720             |
| Corporate                       | (140)                                     | (218)              |
| <b>Total net revenues</b>       | <b>\$ 214,023</b>                         | <b>\$ 185,521</b>  |
| <b>Operating income (loss):</b> |   |                    |
| International                   | \$ 33,621                                 | \$ 21,047          |
| North America                   | 27,927                                    | 19,970             |
| Corporate                       | (244,381)                                 | (62,714)           |
| <b>Total operating loss</b>     | <b>\$ (182,833)</b>                       | <b>\$ (21,697)</b> |

The Company's goodwill by segment were as follows (in thousands):

|               | <b>January 31,<br/>2009</b> | <b>October 31,<br/>2008</b> |
|---------------|-----------------------------|-----------------------------|
| International | \$ 131,999                  | \$ 252,869                  |
| North America | 3,481                       | 69,034                      |
| <b>Total</b>  | <b>\$ 135,480</b>           | <b>\$ 321,903</b>           |

The Company's total assets by segment were as follows (in thousands):

|               | <b>January 31,<br/>2009</b> | <b>October 31,<br/>2008</b> |
|---------------|-----------------------------|-----------------------------|
| International | \$ 589,853                  | \$ 735,991                  |
| North America | 250,479                     | 343,761                     |
| <b>Total</b>  | <b>\$ 840,332</b>           | <b>\$ 1,079,752</b>         |

**Geographic Information**

The net revenues by geographic areas were as follows (in thousands):

**Three Months Ended  
January 31,**

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|                        | <b>2009</b>    | <b>2008</b>    |
|------------------------|----------------|----------------|
| Europe                 | \$ 66,141      | \$ 57,683      |
| Latin America          | 43,608         | 44,609         |
| Asia                   | 20,514         | 15,727         |
| United States          | 75,051         | 60,530         |
| Canada                 | 8,709          | 6,972          |
| <br>Total net revenues | <br>\$ 214,023 | <br>\$ 185,521 |

Revenues are allocated to the geographic areas based on the shipping destination of customer orders. Corporate revenues are included in the United States geographic area revenues.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. In some cases, forward-looking statements can be identified by words such as anticipates, expects, believes, plans, predicts, and similar terms. Such forward-looking statements are based on current expectations, estimates, and projections about our industry, management's beliefs, and assumptions made by management. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A Risk Factors below and in Item 1A of our Annual Report on Form 10-K for the year ended October 31, 2008 filed with the SEC. The following discussion should be read in conjunction with our consolidated financial statements and related notes included in our 2008 Annual Report on Form 10-K and the Condensed Consolidated Financial Statements and Notes thereto included elsewhere in this Quarterly Report on Form 10-Q. Unless required by law, we expressly disclaim any obligation to update publicly any forward-looking statements, whether as result of new information, future events, or otherwise.*

When we use the terms VeriFone, we, us, and our in this item, we mean VeriFone Holdings, Inc., a Delaware corporation, and its consolidated subsidiaries.

**Overview**

We are a global leader in secure electronic payment solutions. We provide expertise, solutions, and services that add value to the point of sale with merchant-operated, consumer-facing, and self-service payment systems for the financial, retail, hospitality, petroleum, government, transportation and healthcare vertical markets. We have one of the leading electronic payment solutions brands and are one of the largest providers of electronic payment systems worldwide. We believe that we benefit from a number of competitive advantages gained through our 27-year history and success in our industry. These advantages include our globally trusted brand name, large installed base, significant involvement in the development of industry standards, global operating scale, customizable platforms, and investment in research and development. We believe that these advantages position us well to capitalize on the continuing global shift toward electronic payment transactions.

Our industry's long-term growth continues to be driven by the long-term shift towards electronic payment transactions and away from cash and checks in addition to an improvement in security standards that require more advanced electronic payment systems. Internationally, growth rates have been higher because of the relatively lower penetration rates of electronic payment transactions in many countries as well as governmental efforts to modernize their economies and use electronic payments as a means of improving collection of value-added tax ( VAT ) and sales tax. Recently, additional factors have driven growth, including the shift from dial up to internet protocol ( IP ) based and wireless communications, personal identification number ( PIN ) based debit transactions, and advances in computing technology which enable vertical solutions and non-payment applications to reside at the point of sale.

Revenues recognized in our fiscal quarters have tended to be back-end loaded as we receive sales orders and deliver our System Solutions towards the end of each fiscal quarter. This back-end loading may adversely affect our results of operations in a number of ways. First, if we expect to receive sales orders that do not materialize at the end of the fiscal quarter or if we do not receive them with sufficient time to deliver our System Solutions and recognize revenue in that fiscal quarter, our revenues and profitability may be adversely affected. In addition, the manufacturing processes at our internal manufacturing facility could become concentrated in a shorter time period which could increase labor and other manufacturing costs as well as delivery costs and negatively impact our gross margins. If, on the other hand, we were to hold higher inventory levels to counteract this effect, we would be subject to an enhanced risk of inventory obsolescence. The concentration of orders may also make it difficult to accurately forecast component requirements and, as a result, we could experience a shortage of the components needed for production, possibly delaying shipments and causing lost orders. This could cause us to

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fail to meet our revenue and operating profit expectations for a particular quarter and could increase the fluctuation of our quarterly results if shipments are delayed from one fiscal quarter to the next or orders are cancelled by customers.

Security has become a driving factor in our business as our customers endeavor to meet ever escalating governmental requirements related to the prevention of identity theft as well as operating safeguards imposed by the credit and debit card associations, members of which include Visa International ( Visa ) MasterCard Worldwide ( MasterCard ), American Express, Discover Financial Services, and JCB Co., Ltd. In September 2006, these card associations established the Payment Card Industry Security Standards Council to oversee and unify industry standards in the areas of credit card data security, referred to as the PCI-PED standard which consists of PIN-entry device security and the PCI Data Security Standard ( PCI-DSS ) for enterprise data security, and the Payment Application Data Security Standard for payment application data security. We are a leader in providing systems and software solutions that meet these standards and have upgraded or launched next generation system solutions that span our product portfolio ahead of mandated deadlines.

We operate in two business segments: North America and International. We define North America as the United States and Canada, and International as all other countries from which we derive revenues.

We have continued to experience lower than expected revenue levels and softer demand globally due to weakened markets and adverse economic conditions. We believe that demand for wireless, IP-enabled, PIN-based debit and enhanced security systems will continue to be adversely affected by lower North American demand as retailers plan to close redundant or underperforming locations and the purchasing power of certain International customers diminishes due to unfavorable foreign currency exchange rate movements, and as customers opt for lower-priced products which would negatively impact our revenues and gross margins. However, over the long-term we expect demand in emerging economies to continue to grow faster relative to our mature markets as these economies develop and seek to enhance VAT collection. We continue to devote research and development ( R&D ) resources to address these market needs.

**Results of Operations****Net Revenues**

We generate net revenues through the sale of our electronic payment systems and solutions that enable electronic transactions, which we identify as System Solutions, and to a lesser extent, warranty and support services, field deployment, installation and upgrade services, and customer specific application development, which we identify as Services.

Net revenues, which include System Solutions and Services, are summarized in the following table (in thousands, except percentages):

|                   | <b>Three Months Ended January 31,</b> |                   |                       |                              |
|-------------------|---------------------------------------|-------------------|-----------------------|------------------------------|
|                   | <b>2009</b>                           | <b>2008</b>       | <b>Net<br/>Change</b> | <b>Percentage<br/>Change</b> |
| Systems Solutions | \$ 185,841                            | \$ 155,601        | \$ 30,240             | 19.4%                        |
| Services          | 28,182                                | 29,920            | (1,738)               | -5.8%                        |
| <b>Total</b>      | <b>\$ 214,023</b>                     | <b>\$ 185,521</b> | <b>\$ 28,502</b>      | <b>15.4%</b>                 |

**System Solutions**

System Solutions net revenues increased \$30.2 million, or 19.4%, to \$185.8 million for the three months ended January 31, 2009 from \$155.6 million for the three months ended January 31, 2008. System Solutions net revenues comprised 86.8% of total net revenues for the three months ended January 31, 2009 as compared to 83.9% for the three months ended January 31, 2008.

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International System Solutions net revenues for the three months ended January 31, 2009 increased \$11.7 million, or 11.3%, to \$115.5 million compared to the three months ended January 31, 2008. This increase was predominately attributable to a \$7.6 million, or 15.2% increase in European revenues and a \$4.3 million, or 29.2%, increase in Asian revenues. In Europe, the increase in System Solutions revenues were primarily driven by increased Turkey revenues, as a result of increased vertical solution revenues to non-banking customers and improved sales execution in Continental Europe. China was the primary contributor to the increase in Asian System Solutions revenues, due to a continuing favorable macroeconomic climate relative to other countries in the region. System Solutions revenues in Latin America declined \$0.2 million, or 0.4%, to \$38.7 million, compared to the three months ended January 31, 2008 primarily as a result of reduced demand in light of the implicit price increases of VeriFone product occurring under significant currency devaluations, a poorer economic climate, and increased pricing competition from a new entrant in our Brazilian market.

North America System Solutions net revenues for the three months ended January 31, 2009 increased \$18.5 million, or 35.7%, to \$70.3 million compared to the three months ended January 31, 2008, largely attributable to the non recurrence of a \$23.4 million revenue deferral in the first quarter of fiscal year 2008 because all of the revenue recognition criteria were not met. Our U.S. Financial business continued to be constrained by adverse economic conditions which slowed retail store openings. Petroleum Solutions sales were relatively flat as gas station owners are deferring decisions to upgrade their systems. Multilane net revenues grew, reflecting continued demand of large retailers to deploy solutions which address the enhanced PCI-DSS requirements.

We are unable to predict the likely duration and severity of the current disruption in the financial markets and adverse economic conditions in the U.S. and other countries and such conditions, if they persist, will continue to adversely impact our business, operating results, and financial condition.

*Services Revenues*

Services net revenues decreased \$1.7 million, or 5.8%, to \$28.2 million for the three months ended January 31, 2009 from \$29.9 million for three months ended January 31, 2008. The majority of the decline was due to lower North American Petroleum deployment services, timing of the completion of Petroleum software services and unfavorable currency impacts for Brazilian reais denominated service revenues.

*Gross Profit*

The following table shows the gross profit for System Solutions and Services (in thousands, except percentages):

|                   | Three Months Ended January 31, 2009 |              | Three Months Ended January 31, 2008 |              |
|-------------------|-------------------------------------|--------------|-------------------------------------|--------------|
|                   | Amounts                             | %            | Amounts                             | %            |
| Systems Solutions | \$ 57,730                           | 31.1%        | \$ 45,997                           | 29.6%        |
| Services          | 11,572                              | 41.1%        | 11,367                              | 38.0%        |
| <b>Total</b>      | <b>\$ 69,302</b>                    | <b>32.4%</b> | <b>\$ 57,364</b>                    | <b>30.9%</b> |

Gross profit on System Solutions increased \$11.7 million, or 25.5%, to \$57.7 million for the three months ended January 31, 2009 from \$46.0 million for the three months ended January 31, 2008. Gross profit on System Solutions represented 31.1% of System Solutions net revenues for the three months ended January 31, 2009 and 29.6% for the three months ended January 31, 2008. The increase in gross profit percentage in the three months ended January 31, 2009 compared to the three months ended January 31, 2008 was primarily due to improvements in International gross profit percentages, as described below, and decreases in Corporate costs as a percentage of System Solutions net revenues. These increases were partially offset by a decline in the gross profit percentage of the North America segment.



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International gross profit percentage improved in Europe for the three months ended January 31, 2009 primarily as a result of additional Corporate management oversight and changes in personnel, which resulted in stronger commercial practices and pricing discipline. A secondary factor in the improvement of International gross profit percentage was lower relative revenue contribution from Brazil and Mexico, countries which generally carry below average gross profit percentages.

North America gross profit percentage for the three months ended January 31, 2009 was adversely impacted by product mix as sales shifted away from wireless and Petroleum solutions, which typically have higher than average gross profit percentages, towards Mutilane solutions, which typically carry lower than average gross profit percentages.

Corporate costs increased on an absolute level but decreased as a percentage of System Solutions net revenues. Corporate costs are comprised of non-cash acquisition charges, including amortization of purchased core and developed technology assets, step-down in deferred revenue, and other Corporate charges, including inventory obsolescence and scrap at corporate distribution centers, rework, specific warranty provisions, non-standard freight, over-and-under absorption of materials management and supply chain engineering overhead. Since these costs are generally incurred on a company-wide basis, it is impractical to allocate them to either the North America or International segment. Corporate costs decreased as a result of \$5.2 million in reduced spending from greater than planned use of ocean freight as compared to air freight, improved efficiencies in our Tel Aviv manufacturing facilities, favorable foreign currency exchange rates and a \$3.0 million decrease in amortization of purchased core and developed technology assets due to the impairment charges in fiscal year 2008. These decreases were partially offset by an increase of \$10.1 million in excess, obsolescence and scrap due to the deteriorating macroeconomic environment and a desire to not dilute customer perceptions of the value of VeriFone solutions by selling slow moving inventory at deep discounts.

**Research and Development Expenses**

Research and development ( R&D ) expenses are summarized in the following table (in thousands, except percentages):

|                            | Three Months Ended January 31, |           |               |                      |
|----------------------------|--------------------------------|-----------|---------------|----------------------|
|                            | 2009                           | 2008      | Net<br>Change | Percentage<br>Change |
| Research and development   | \$ 17,872                      | \$ 22,462 | \$ (4,590)    | -20.4%               |
| Percentage of net revenues | 8.4%                           | 12.1%     |               |                      |

R&D expenses for the three months ended January 31, 2009 decreased \$4.6 million, or 20.4%, compared to the three months ended January 31, 2008, primarily driven by the non-recurrence of a \$2.7 million write-off of capitalized software during the first quarter of 2008, a \$2.2 million decrease in personnel costs due to cost reduction and favorable foreign currency exchange rates.

We expect R&D expenses over the next few quarters to be relatively flat or slightly lower in absolute amounts as we adjust to the weaker macroeconomic environment.

**Sales and Marketing Expenses**

Sales and marketing expenses are summarized in the following table (in thousands, except percentages):

|                            | Three Months Ended January 31, |           |               |                      |
|----------------------------|--------------------------------|-----------|---------------|----------------------|
|                            | 2009                           | 2008      | Net<br>Change | Percentage<br>Change |
| Sales and marketing        | \$ 19,407                      | \$ 24,643 | \$ (5,236)    | -21.2%               |
| Percentage of net revenues | 9.1%                           | 13.3%     |               |                      |

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Sales and marketing expenses decreased \$5.2 million, or 21.2%, for the three months ended January 31, 2009, compared to the three months ended January 31, 2008 primarily due to a \$2.1 million decrease in personnel costs, a \$1.7 million decrease in internal meetings, trade shows and marketing communications related expenses and a \$0.9 million decrease in consulting and outside services costs as a result of our cost reduction efforts and favorable foreign currency exchange rates.

We expect sales and marketing expenses to be flat or slightly lower in absolute terms as we adjust to the weaker macroeconomic environment.

**General and Administrative Expenses**

General and administrative expenses are summarized in the following table (in thousands, except percentages):

|                            | Three Months Ended January 31, |           |               |                      |
|----------------------------|--------------------------------|-----------|---------------|----------------------|
|                            | 2009                           | 2008      | Net<br>Change | Percentage<br>Change |
| General and administrative | \$ 30,728                      | \$ 26,066 | \$ 4,662      | 17.9%                |
| Percentage of net revenues | 14.4%                          | 14.1%     |               |                      |

General and administrative expenses in the three months ended January 31, 2009 increased \$4.7 million, or 17.9%, compared to the three months ended January 31, 2008 primarily due to a \$3.3 million increase in stock-based compensation mainly as a result of the surrender of certain option grants, a \$5.5 million increase in professional services mainly due to increased activity levels in tax accounting and internal audit functional areas as a result of remediation related activities, \$1.0 million in a legal settlement charge, and \$0.6 million in costs for acquisition related compensation milestone payouts. Partially offsetting these increases was a \$5.0 million decrease in restatement costs related to the restatement of 2007 interim financial results in the first quarter of fiscal year 2008.

We expect general and administrative expenses, excluding costs related to independent investigation and 2007 quarterly restatement costs incurred in fiscal year 2008, to be flat or slightly lower as we adjust to the weaker macroeconomic environment.

**Impairment of Goodwill and Intangible Assets**

We performed our annual impairment test of goodwill as of August 1, 2008 in accordance with SFAS No. 142 which did not result in an impairment of goodwill. However, in light of our fourth quarter operating results, we reduced our projected future cash flow significantly, which resulted in an indicator of possible impairment of goodwill and long-lived assets as defined under SFAS No. 142 and SFAS No. 144, requiring us to perform an impairment test as of October 15, 2008. Following the impairment test, we recorded impairment charges of \$262.5 million for goodwill and \$26.6 million for developed and core technology intangible assets in the fourth quarter of fiscal year 2008.

During November 2008, the macroeconomic environment worldwide continued to weaken. This was caused by the illiquidity of the credit markets, difficulties in the banking and financial services sectors, falling consumer confidence and a rising unemployment rate. Our stock price and market capitalization declined significantly which was considered an indicator of possible impairment of goodwill and long-lived assets, triggering the necessity of an additional impairment test as of December 1, 2008.

As a result of the goodwill impairment test, we concluded that the carrying amount of the North America and Asia reporting units exceeded their implied fair values and recorded an estimated impairment charge of \$178.3 million in the Corporate segment in the first quarter of fiscal year 2009. The net carrying value of goodwill in the North America and International segments was reduced by \$65.6 million and \$112.7 million, respectively.

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We determined the fair value of the North America and Asia reporting units using the income approach, which requires estimates of future operating results and discounted cash flows. This goodwill impairment charge is an estimate, as valuations necessary to complete the required evaluation of the goodwill remain in process as of the date of this report. We will finalize this evaluation in the second quarter of fiscal year 2009 and will update the impairment charge for goodwill, if necessary.

The long-lived assets impairment tests did not result in additional impairment charges.

We will continue to evaluate the carrying value of our remaining goodwill and intangible assets and if we determine in the future that there is a potential further impairment in any of our reporting units, we may be required to record additional charges to earnings which could adversely affect our financial results.

### ***Interest Expense***

Interest expense decreased \$1.1 million, or 16.8%, in the three months ended January 31, 2009 compared to the three months ended January 31, 2008. This decrease in interest expense for the three months ended January 31, 2009 was mostly attributable to the decrease in the effective interest rates on our Term-B loan as LIBOR rates declined from 3.12% on October 31, 2008 to 0.41 % on January 31, 2009.

In May 2008, the FASB issued FASB Staff Position ( FSP ) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP APB 14-1 will require us to account separately for the liability and equity components of our convertible debt. The debt would be recognized at the present value of its cash flows discounted using our nonconvertible debt borrowing rate at the time of issuance. The equity component would be recognized as the difference between the proceeds from the issuance of the note and the fair value of the liability. FSP APB 14-1 also requires accretion of the resultant debt discount over the expected life of the debt. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. Entities are required to apply FSP APB 14-1 retrospectively for all periods presented. We are currently evaluating FSP APB 14-1 and have not yet determined the impact its adoption will have on our consolidated financial statements. However, the impact of this new accounting treatment may be significant and may result in a significant increase to non-cash interest expense beginning in fiscal year 2010 for financial statements covering past and future periods.

### ***Interest Income***

Interest income decreased \$1.4 million in the three months ended January 31, 2009 compared to the three months ended January 31, 2008. This decrease was attributable to the lower effective interest rates during the three months ended January 31, 2009 as compared to the three months ended January 31, 2008.

### ***Other Income (Expense), Net***

Other income was \$4.2 million during the three months ended January 31, 2009 primarily resulting from \$3.4 million of net foreign currency exchange gain. Other expense was \$4.5 million for the three months ended January 31, 2008 primarily due to \$4.7 million net foreign currency exchange loss.

### ***Provision for Income Tax***

We recorded a benefit from income taxes of \$1.3 million for the three months ended January 31, 2009 compared to a provision for income taxes of \$2.9 million for the three months ended January 31, 2008. The \$1.3 million benefit from income taxes for the three months ended January 31, 2009 is primarily related to discrete items, including a combination of a decrease of deferred tax liability due to goodwill impairment for GAAP purposes, offset by unfavorable tax provision impacts from an increase in the US valuation allowance, and interest accruals associated with uncertain tax positions under FIN 48.

The decrease in income tax provision for the three months ended January 31, 2009, compared to the three months ended January 31, 2008 is due to the fact that we provided tax for the three months ended January 31, 2008 notwithstanding an expected loss for the full fiscal year. For the three months ended January 31, 2009, the

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estimated goodwill impairment provided a tax benefit of approximately \$2.4 million offset by the other discrete items noted above.

As of January 31, 2009, we remain in a net deferred tax liability position. The realization of the deferred tax assets is primarily dependent on our ability to generating sufficient U.S. and foreign taxable income in future periods. We have determined that it is not more likely than not the deferred tax assets in the U.S. and certain foreign jurisdictions will be realized and as such we continue to record a full valuation allowance against these assets as of January 31, 2009. The amount of deferred tax assets considered realizable may increase or decrease in subsequent periods when we reevaluate the underlying basis for our estimates of future domestic and certain foreign taxable income.

We are currently under audit by the Internal Revenue Service ( IRS ) for our fiscal years 2003 and 2004. Although we believe we have correctly provided income taxes for the years subject to audit, the IRS may adopt different interpretations. We have not yet received any final determinations with respect to this audit although certain adjustments have been agreed with the IRS. The liability associated with the agreed adjustments had been accrued in previous periods. Our subsidiaries are also under audit by the Israeli tax authorities for 2004 to 2006 and the Brazilian federal government for the periods between January 31, 2003 through the current date. With few exceptions, we are no longer subjected to tax examination outside of the U.S. for periods prior to 2000.

**Segment Information**

We operate in two business segments: North America and International. We define North America as the United States and Canada, and International as the other countries from which we derive revenues.

Net revenues and operating income (loss) of each business segment reflect net revenues generated within the segment, supply chain standard inventory cost of System Solutions net revenues, actual cost of Services net revenues, and expenses that directly benefit only that segment, including distribution center costs, royalty and warranty expense. Corporate net revenues and operating income (loss) reflect non-cash acquisition charges, including amortization of purchased core and developed technology assets, step-down in deferred revenue, impairment and other Corporate charges, including inventory obsolescence and scrap at corporate distribution centers, rework, specific warranty provisions, non-standard freight and over-and-under absorption of materials management overhead.

In fiscal year 2008, we revised the methodology for business segment operating loss reporting. Distribution center costs and certain warranty and royalty costs, which were previously allocated to the Corporate segment, were reallocated based on ship-to locations. Restructuring costs which was previously allocated to the International and North America segments were reallocated to the Corporate segment. The following table reconciles net revenues and operating income (loss) for our segments for the three months ended January 31, 2009 and 2008 (in thousands):

|                                 | <b>Three Months Ended</b> |                    |
|---------------------------------|---------------------------|--------------------|
|                                 | <b>January 31,</b>        |                    |
|                                 | <b>2009</b>               | <b>2008</b>        |
| <b>Net revenues:</b>            |                           |                    |
| International                   | \$ 130,263                | \$ 118,019         |
| North America                   | 83,900                    | 67,720             |
| Corporate                       | (140)                     | (218)              |
| <b>Total net revenues</b>       | <b>\$ 214,023</b>         | <b>\$ 185,521</b>  |
| <b>Operating income (loss):</b> |                           |                    |
| International                   | \$ 33,621                 | \$ 21,047          |
| North America                   | 27,927                    | 19,970             |
| Corporate                       | (244,381)                 | (62,714)           |
| <b>Total operating loss</b>     | <b>\$ (182,833)</b>       | <b>\$ (21,697)</b> |

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Net revenues increased \$12.2 million in International for the three months ended January 31, 2009 as compared to the same period in 2008 primarily driven by a \$11.6 million increase in System Solutions net revenues and \$0.6 million increase in Services net revenues. See *Results of Operations - Net Revenues*.

Net revenues increased \$16.2 million in North America for the three months ended January 31, 2009 as compared to the three months ended January 31, 2008 primarily due to a \$18.6 million increase in Systems Solutions net revenues partially offset by a \$2.4 million decrease in Services net revenues. See *Results of Operations - Net Revenues*.

The increase in International operating income for the three months ended January 31, 2009 compared to the three months ended January 31, 2008 was mainly due to increased net revenues and gross profit percentages, and decreased operating expenses.

The increase in North America operating income for the three months ended January 31, 2009 compared to the three months ended January 31, 2008 was mainly due to increase in net revenues and decrease in operating expenses partially offset by decrease in gross margin percentages.

The increase in Corporate operating loss for the three months ended January 31, 2009 was primarily due to the \$178.3 million estimated impairment charge for goodwill as described above, \$5.2 million in reduced spending from greater than planned use of ocean freight rather than air freight, improved efficiencies in our Tel Aviv manufacturing facilities and favorable foreign currency exchange rates; a \$3.3 million increase in stock-based compensation due to the surrender of certain option grants; a \$3.0 million reduction in amortization of purchased core and developed technology assets; \$2.3 million of increased tax accounting professional services; and, \$1.0 million in a legal settlement charge. These increases were partially offset by an increase of \$10.1 million in excess, obsolescence and scrap due to the deteriorating macroeconomic environment and a desire to not dilute customer perceptions of the value of VeriFone solutions by selling slow moving inventory at deep discounts, and \$2.6 million of spending reductions relating to internal sales meetings, conferences, trade shows, marketing communications and personnel.

**Liquidity and Capital Resources**

|  | <b>Three Months Ended<br/>January 31,</b> |             |
|--|---|-------------|
|  | <b>2009</b>                               | <b>2008</b> |
| Net cash provided by (used in):                                  |   |             |
| Operating activities   | \$ 7,099                                  | \$ 2,021    |
| Investing activities   | (5,493)                                   | (8,903)     |
| Financing activities   | (1,418)                                   | 1,079       |
| Effect of exchange rate fluctuation on cash and cash equivalents | (2,273)                                   | 112         |
| Net decrease in cash and cash equivalents                        | \$ (2,085)                                | \$ (5,691)  |

Our primary liquidity and capital resource needs are to service our debt, finance working capital, and to make capital expenditures and investments. At January 31, 2009, our primary sources of liquidity were cash and cash equivalents of \$155.1 million and \$25.0 million available balance on our revolving credit facility.

We believe that we have the financial resources to meet our business requirements for the next twelve months, including capital expenditures, working capital requirements, and future strategic investments, and to comply with our financial covenants.

**Operating Activities**

Cash flow from operating activities was \$7.1 million for the three months ended January 31, 2009.

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Cash provided by operations before changes in working capital amounted to \$21.5 million for the three months ended January 31, 2009 and consisted of \$182.0 million net loss adjusted for \$203.5 million of non-cash items such as impairment of goodwill, amortization of purchased intangible assets, stock-based compensation expense, depreciation and amortization of property, plant, and equipment, amortization and write-off of capitalized software and amortization of debt issuance costs.

Changes in working capital resulted in a \$14.4 million decrease in cash and cash equivalents during the three months ended January 31, 2009. The main drivers were as follows:

A \$47.6 million decrease in accounts payable and accrued expenses and other liabilities primarily due to the decrease in inventory purchases, a reduction in general and administrative expenses and payments of accrued interest and vendor invoices;

A \$5.6 million decrease in deferred tax liabilities;

A \$2.8 million increase in prepaid expenses and other current assets primarily due to an increase in bankers' acceptances; and

A \$1.9 million decrease in deferred revenues due to the recognition of certain previously deferred revenues.

Offset by:

A \$28.7 million decrease in inventories due to usage of inventory on hand after the fiscal 2008 year-end ramp up, reduction in inventory purchases and increase in charges for excess, obsolescence and scrap;

A \$11.8 million decrease in accounts receivable due to lower billing in the first quarter of fiscal year 2009; and

A \$2.5 million increase in income taxes payable.

**Investing Activities**

Cash used in investing activities was \$5.5 million in the three months ended January 31, 2009, and primarily consisted of \$4.7 million in purchases of property, plant and equipment and \$0.5 million used in business acquisitions.

**Financing Activities**

The \$1.4 million of cash used in financing activities in the three months ended January 31, 2009 primarily consisted of repayment of debt.

**Contractual Obligations**

The following table summarizes our contractual obligations as of January 31, 2009 (in thousands):

|   | Total      | Less Than<br>1 Year | 1 to<br>3 Years | 3 to<br>5 Years | More Than<br>5 Years |
|---|------------|---------------------|-----------------|-----------------|----------------------|
| Term B Loan (including interest)(1)           | \$ 263,249 | \$ 9,241            | \$ 24,190       | \$ 229,818      | \$                   |
| Senior convertible notes (including interest) | 331,482    | 2,174               | 8,709           | 320,599         |                      |
| Capital lease obligations                     | 79         | 31                  | 48              |                 |                      |

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|                              |            |           |           |            |          |
|------------------------------|------------|-----------|-----------|------------|----------|
| Operating leases             | 50,126     | 9,268     | 19,773    | 13,474     | 7,611    |
| Minimum purchase obligations | 27,913     | 27,913    |           |            |          |
|                              | \$ 672,849 | \$ 48,627 | \$ 52,720 | \$ 563,891 | \$ 7,611 |

(1) Interest in the above table has been calculated using the rate in effect at January 31, 2009.

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### **Off-Balance Sheet Arrangements**

Our only off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of the SEC's Regulation S-K, consist of forward foreign currency exchange agreements described under Quantitative and Qualitative Disclosures about Market Risk. See Item 3.

### **Recent Accounting Pronouncements**

Information with respect to our recent accounting pronouncements may be found in Note 1. *Principles of Consolidation and Summary of Significant Accounting Policies* in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, which section is incorporated herein by reference.

### **Critical Accounting Policies and Estimates**

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

On an ongoing basis, we evaluate our critical accounting policies and estimates, including those related to revenue recognition, inventory valuation, product returns reserve and allowance for doubtful accounts, contingencies and litigation, income taxes, and accounting for long-lived assets. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

For further information on our critical accounting policies, see the discussion of critical accounting policies in our Annual Report on Form 10-K for the fiscal year ended October 31, 2008.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. To mitigate some of these risks, we utilize derivative financial instruments to hedge these exposures. We do not use derivative financial instruments for speculative or trading purposes nor do we issue or hold leveraged derivative financial instruments.

#### **Interest Rates**

We are exposed to interest rate risk related to our borrowings under the credit agreement we entered into on October 31, 2006. These borrowings generally bear interest upon the three-month LIBOR rate. As of January 31, 2009, a 50 basis point increase in interest rates on our borrowings subject to variable interest rate fluctuations would increase our interest expense by approximately \$1.2 million annually. We generally invest most of our cash in overnight and short-term instruments, which would earn more interest income if market interest rates rise and less interest income if market interest rates fall.

#### **Foreign Currency Risk**

A majority of our business consists of sales made to customers outside the United States. A substantial portion of the net revenues we generate from such sales is denominated in currencies other than the U.S. dollar.



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Additionally, portions of our cost of net revenues and other operating expenses are incurred by our international operations and are denominated in local currencies ( P&L Exposures ). Our balance sheet includes non-U.S. dollar denominated assets and liabilities which can be adversely affected by fluctuations in currency exchange rates ( Balance Sheet Exposures ). Fluctuations in currency exchange rates can adversely affect our P&L Exposures and Balance Sheet Exposures and generate foreign currency transaction gains and losses which are included in other income (expense), net in the Condensed Consolidated Statements of Operations.

Historically, we have not sought to mitigate the risk of P&L Exposures with hedging activities; however, we have sought to mitigate the risk of Balance Sheet Exposures by entering into foreign currency forward contracts. The objective of these contracts is to neutralize the impact of currency exchange rate movements on our operating results by offsetting gains and losses on the forward contracts with increases or decreases in foreign currency transactions. Forward contracts are included in Prepaid expenses and other current assets and Other current liabilities in the Condensed Consolidated Balance Sheets. The contracts are marked-to-market on a monthly basis with gains and losses included in other income (expense), net in the Condensed Consolidated Statements of Operations. In some instances, we seek to hedge transactions that are expected to become Balance Sheet Exposures in the very short-term, generally within one month. We do not use foreign currency contracts for speculative or trading purposes.

Our outstanding forward contracts as of January 31, 2009 are presented in the table below. All forward contracts are representative of the expected payments to be made under these instruments. The fair market value of the contracts represents the difference between the spot currency rate at January 31, 2009 and the contracted rate. All of these forward contracts mature within 95 days of January 31, 2009 (in thousands):

|                              | Currency | Local<br>Currency<br>Contract<br>Amount | Currency | Contracted<br>Amount | Fair Market<br>Value at<br>January 31,<br>2009<br>Gain<br>(Loss) |
|------------------------------|----------|---|----------|----------------------|--|
| <b>Contracts to buy USD</b>  |          |   |          |                      |  |
| Argentine pesos              | ARS      | (3,000)                                 | USD      | \$ 838               | \$ (7)   |
| Australian dollar            | AUD      | (6,800)                                 | USD      | 4,541                | 114  |
| Brazilian real               | BRL      | (26,000)                                | USD      | 11,125               | (121)  |
| British pound                | GBP      | (3,200)                                 | USD      | 4,576                | (2)  |
| Chinese yuan                 | CNY      | (120,000)                               | USD      | 17,436               | (62)   |
| Euro                         | EUR      | (13,950)                                | USD      | 18,484               | 405  |
| India rupee                  | INR      | (200,000)                               | USD      | 4,068                | (25)   |
| Mexican peso                 | MXN      | (20,000)                                | USD      | 1,404                | 1  |
| Turkish lira                 | TRY      | (1,600)                                 | USD      | 976                  | 6  |
|                              |          |   |          |                      | \$ 309   |
| <b>Contracts to sell USD</b> |          |   |          |                      |  |
| Israeli shekel               | ILS      | 16,400                                  | USD      | (4,099)              | \$ (60)  |
|                              |          |   |          |                      | \$ 249   |

As of January 31, 2009 our Balance Sheet Exposures amounted to \$82.2 million and were offset by forward contracts with a notional amount of \$67.4 million. Based on our net exposures as of January 31, 2009, a 10% movement of currency rate would result in a gain or loss of \$1.5 million.

Hedging of our Balance Sheet Exposures may not always be effective to protect us against currency exchange rate fluctuations, particularly in the event of imprecise forecasts of non-U.S. denominated assets and liabilities. In addition, at times we have not fully hedged our Balance Sheet Exposures, leaving us at risk to foreign exchange gains and losses on the unhedged amounts. Furthermore, historically we have not hedged our P&L Exposures. Accordingly, if there were an adverse movement in exchange rates, we might suffer significant

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losses. For instance, for the three months ended January 31, 2009 and 2008, we recorded a \$3.4 million net foreign currency gain and \$4.7 million net foreign currency loss, respectively, despite our hedging activities.

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**Equity Price Risk**

In June 2007, we sold \$316.2 million aggregate principal amount of 1.375% Senior Convertible Notes due 2012 (the Notes). Holders may convert their Notes prior to maturity upon the occurrence of certain circumstances. Upon conversion, we would pay the holder the cash value of the applicable number of shares of VeriFone common stock, up to the principal amount of the Notes. Amounts in excess of the principal amount, if any may be paid in cash or in stock at our option. Concurrently with the issuance of the Notes, we entered into note hedge transactions and separately, warrant transactions, to reduce the potential dilution from the conversion of the Notes and to mitigate any negative effect such conversion may have on the price of our common stock.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

VeriFone maintains disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management is responsible for establishing and maintaining our disclosure controls and procedures. Our Chief Executive Officer and Chief Financial Officer participated with our management in evaluating the effectiveness of our disclosure controls and procedures as of January 31, 2009.

Based on our management's evaluation (with the participation of our Chief Executive Officer and our Chief Financial Officer), our Chief Executive Officer and Chief Financial Officer have concluded that, as of January 31, 2009, in light of the material weaknesses described below, our disclosure controls and procedures were not effective to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Notwithstanding the material weaknesses described below, we have performed additional analyses and other procedures to enable management to conclude that our condensed consolidated financial statements included in this report were prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Based in part on these additional efforts, our Chief Executive Officer and Chief Financial Officer have included their certifications as exhibits to this Form 10-Q.

A material weakness is a control deficiency, or combination of control deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. Management's assessment identified the following material weaknesses in our internal control over financial reporting as of January 31, 2009.

An entity-level material weakness in control activities related to the design and operation of our supervision, monitoring, and monthly financial statement review processes. This material weakness contributed to adjustments in several accounts during the fiscal year ended October 31, 2008. The accounts most affected included capitalized software development costs, inventories, accounts payable and cost of net revenues; however, this material weakness could impact all financial statement accounts.

A transaction-level material weakness in the design and operating effectiveness of controls related to income taxes. Specifically, our processes and procedures were not designed to provide for adequate

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and timely identification, documentation and review of various income tax calculations, reconciliations and related supporting documentation required to apply our accounting policy for income taxes in accordance with U.S. GAAP. This material weakness impacted our ability to timely report financial information related to income tax accounts and resulted in adjustments to income tax expense, income taxes payable, deferred tax assets and liabilities, and goodwill accounts during the fiscal year ended October 31, 2008.

An entity-level material weakness in the control environment related to our period-end financial reporting process due to an insufficient number of qualified personnel with the required proficiency to apply our accounting policies in accordance with U.S. GAAP. This material weakness contributed to adjustments in several accounts during the fiscal year ended October 31, 2008. The accounts most affected included capitalized software development costs, inventories, accounts payable and cost of net revenues; however, this material weakness could impact all financial statement accounts, with a higher likelihood for accounts subject to non-routine or estimation processes, such as inventory reserves and income taxes.

As a result of the identified material weaknesses, our management concluded that, as of January 31, 2009, our internal control over financial reporting was not effective.

### **Management's Remediation Initiatives**

In response to the material weaknesses discussed above, we plan to continue the efforts already underway to review and make necessary changes to improve our internal control over financial reporting, including:

We have added and expect to continue to add qualified accounting and finance personnel having sufficient knowledge and experience in generally accepted accounting principles, cost accounting, tax, and management of financial systems. We hired a Vice President of Tax during the first quarter of fiscal year 2009 to enhance the timeliness and accuracy of accounting for tax activity;

We continue to enhance our review process over the monthly financial results by requiring additional documentation and analysis to be provided that will then be reviewed by appropriate key senior personnel from both finance and non-finance areas;

We expect to enhance the segregation of duties between the financial planning and the accounting and control functions; and

We intend to enhance our governance and compliance functions to improve control consciousness and prevention of errors in financial reporting, as well as to improve tone, communication, education, and training for employees involved in the financial reporting process.

### **Changes in Internal Control over Financial Reporting**

Other than the remedial measures discussed above, which are ongoing, there were no changes in our internal control over financial reporting during the three months ended January 31, 2009 that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Information with respect to this Item may be found in Note 10. *Commitments and Contingencies* of Notes to Condensed Consolidated Financial Statements in this Form 10-Q, which is incorporated into this Item 1 by reference.

**ITEM 1A. RISK FACTORS**

**Risks Related to Our Business**

*Our internal processes and controls and our disclosure controls have been inadequate; if the processes and controls we have implemented and continue to implement are inadequate, we may not be able to comply with our financial statement certification requirements under applicable SEC rules, or prevent future errors in our financial reporting.*

As described under *Item 4 Controls and Procedures* in this Quarterly Report on Form 10-Q, we have identified material weaknesses in our internal control over financial reporting and have determined that our disclosure controls and procedures were not effective. These weaknesses, such as weakness in control activities related to income taxes and financial statement review processes and having insufficient number of qualified finance personnel, contributed to our need to restate previously reported interim financial information for each of the first three quarters of our fiscal year ended October 31, 2007, and to the delays in the filing of our Annual Report on Form 10-K for fiscal year 2007. We also were unable to file our quarterly reports on Form 10-Q for our fiscal quarters ended January 31, 2008 and April 30, 2008 on a timely basis. We have implemented and intend to continue to implement a number of additional and enhanced processes and controls to improve our internal control over financial reporting. However, if we are unsuccessful in adequately implementing these processes and controls, we may be unable to comply with Exchange Act Rules 13a-15 and 15d-15, which specify the processes and controls that public companies are required to have in place, and we may be unable to provide the executive certificates required by Exchange Act Rules 13a-15 and 15d-15 in our quarterly and annual reports. Even if we implement such controls, there can be no assurance that these controls will be sufficient to detect or prevent future errors in financial reporting. We have devoted additional resources to our financial control and reporting requirements, including hiring additional qualified employees in these areas. We expect to hire additional employees and may also engage additional consultants in these areas. Competition for qualified financial control and accounting professionals in the geographic areas in which we operate is keen and there can be no assurance that we will be able to hire and retain these individuals.

*We have been named as a party to several class action and derivative action lawsuits arising from the restatements, and we may be named in additional litigation, all of which are likely to require significant management time and attention and expenses and may result in an unfavorable outcome which could have a material adverse effect on our business, financial condition, and results of operations.*

In connection with the restatements of our historical interim financial statements for fiscal year 2007, a number of securities class action complaints were filed against us and certain of our officers, and a number of purported derivative actions have also been filed against certain of our current and former directors and officers. See *Part II Item 1 Legal Proceedings* of this Quarterly Report on Form 10-Q.

The amount of time and resources required to resolve these lawsuits is unpredictable, and defending ourselves is likely to divert management's attention from the day-to-day operations of our business, which could adversely affect our business, financial condition, and results of operations. In addition, an unfavorable outcome in such litigation or a decision by us to settle such lawsuits to avoid the distraction and expense of continued litigation even if we deem the claims to be without merit would have a material adverse effect on our business, financial condition, and results of operations.

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Our insurance may not be sufficient to cover our costs for defending these actions or paying any damages in the event of an unfavorable outcome. In addition, we may be obligated to indemnify (and advance legal expenses to) both current and former officers, employees and directors in connection with these actions. We currently hold insurance policies for the benefit of our directors and officers, although our insurance coverage may not be sufficient in some or all of these matters. Furthermore, our insurance carriers may seek to deny coverage in some or all of these matters, in which case we may have to fund the indemnification amounts owed to such directors and officers ourselves.

We are subject to the risk of additional litigation and regulatory proceedings or actions in connection with the restatement. We have responded to inquiries and provided information and documents related to the restatement to the SEC, the U.S. Department of Justice, the New York Stock Exchange, and the Chicago Board Options Exchange. The SEC also has interviewed several current and former VeriFone officers and employees, and we are continuing to cooperate with the SEC in responding to the SEC's requests for information. On February 18, 2009, we received a Wells Notice from the SEC stating that the Staff intends to recommend that the SEC bring a civil injunctive action against the Company, alleging violations of the federal securities laws arising from the restatement. In connection with this contemplated action, the Staff may seek a civil injunction and other civil penalties. Additional regulatory inquiries may also be commenced by other U.S. federal, state or foreign regulatory agencies. In addition, we may in the future be subject to additional litigation or other proceedings or actions arising in relation to the restatement of our historical interim financial statements. Litigation and any potential regulatory proceeding or action may be time consuming, expensive and distracting from the conduct of our business. The adverse resolution of any specific lawsuit or any potential regulatory proceeding or action could have a material adverse effect on our business, financial condition, and results of operations.

Our restatement and related litigation could result in substantial additional costs and expenses and adversely affect our cash flows, and may adversely affect our business, financial condition, and results of operations. We have incurred substantial expenses for legal, accounting, tax and other professional services in connection with the investigation by the audit committee of our board of directors, our internal review of our historical financial statements, the preparation of the restated financial statements, inquiries from government agencies, the related litigation, and the amendments to our credit agreement as a result of our failure to timely file our Exchange Act reports with the SEC. We expect to continue to incur significant expenses in connection with these matters.

Many members of our senior management team and our Board of Directors have been and will be required to devote a significant amount of time on remedial efforts and litigation related to the restatement. In addition, certain of these individuals are named defendants in the litigation related to the restatement. Defending these actions may require significant time and attention from them. If our senior management is unable to devote sufficient time in the future developing and pursuing our strategic business initiatives and running ongoing business operations, there may be a material adverse effect on our business, financial condition and results of operations.

***If current macroeconomic conditions persist or worsen, our business and results of operations could be further adversely affected.***

The U.S. and international economy and financial markets have experienced significant slowdown and volatility due to uncertainties related to energy prices, availability of credit, difficulties in the banking and financial services sectors, softness in the housing market, severely diminished market liquidity, geopolitical conflicts, falling consumer confidence and rising unemployment rates. This slowdown has and could further lead to reduced demand for our products if customers decide to delay or reduce deployment of electronic payment systems, which in turn would reduce our revenues and adversely affect our business, financial condition and results of operations. In particular, the slowdown and volatility in the global markets have resulted in softer demand in the financial and retail sectors and more conservative purchasing decisions by customers, including a tendency toward lower-priced products, which could negatively impact our revenues, gross margins and results of operations. In addition to a reduction in sales, our profitability may decrease during downturns because we may not be able to reduce costs at the same rate as our sales decline. Given the current unfavorable economic

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environment, our customers may have difficulties obtaining capital at adequate or historical levels to finance their ongoing business and operations, which could impair their ability to make timely payments to us. We are unable to predict the likely duration and severity of the current disruption in the financial markets and adverse economic conditions in the U.S. and other countries and such conditions, if they persist or worsen, will further adversely impact our business, operating results, and financial condition.

***Fluctuations in currency exchange rates may adversely affect our results of operations.***

A substantial portion of our business consists of sales made to customers outside the United States. A portion of the net revenues we receive from such sales is denominated in currencies other than the U.S. dollar. Additionally, portions of our cost of net revenues and our other operating expenses are incurred by our International operations and denominated in local currencies. Fluctuations in the value of these net revenues, costs and expenses as measured in U.S. dollars have affected our results of operations historically, and adverse currency exchange rate fluctuations may have a material impact in the future. Further, changes in exchange rates that strengthen the U.S. dollar could increase the price of our products in the local currencies of the foreign markets we serve. This would result in making our products relatively more expensive than products that are denominated in local currencies, leading to a reduction in sales and profitability in those foreign markets. In addition, our balance sheet reflects non-U.S. dollar denominated assets and liabilities, primarily intercompany balances, which can be adversely affected by fluctuations in currency exchange rates and cause gains and losses that are included in other income (expense), net in our Condensed Consolidated Statement of Operations. We have entered into foreign currency forward contracts and other arrangements intended to hedge our balance sheet exposure to adverse fluctuations in exchange rates. We have also effectively priced our System Solutions in U.S. dollars in certain countries. Nevertheless, these hedging arrangements may not always be effective, particularly in the event of imprecise forecasts of non-U.S. denominated assets and liabilities. Additionally, our efforts to effectively price products in U.S. dollars may have disadvantages since it may affect demand for our products if the local currency strengthens relative to the U.S. dollar. On the other hand, we could be adversely affected where the U.S. dollar strengthens relative to the local currency between the time of a sale and the time we receive payment, which would be collected in the devalued local currency. Accordingly, if there is an adverse movement in exchange rates, we might suffer significant losses and our results of operations may otherwise be adversely affected. Additionally, hedging programs expose us to risks that could adversely affect our operating results, including the following:

we may be unable to hedge currency risk for some transactions because of a high level of uncertainty or the inability to reasonably estimate our foreign exchange exposures; and

we may be unable to acquire foreign exchange hedging instruments in some of the geographic areas where we do business, or, where these derivatives are available, we may not be able to acquire enough of them to fully offset our exposure.

***A significant percentage of our business is executed towards the end of our fiscal quarters. This could negatively impact our business and results of operations.***

Revenues recognized in our fiscal quarters tend to be back-end loaded. This means that sales orders are received, product is shipped, and revenue is recognized increasingly towards the end of each fiscal quarter. This back-end loading, particularly if it becomes more pronounced, could adversely affect our business and results of operations due to a number of factors including the following:

the manufacturing processes at our internal manufacturing facility could become concentrated in a shorter time period. This concentration of manufacturing could increase labor and other manufacturing costs and negatively impact gross margins. The risk of inventory write-offs could also increase if we were to hold higher inventory levels to counteract this effect;

the higher concentration of orders may make it difficult to accurately forecast component requirements and, as a result, we could experience a shortage of the components needed for production, possibly delaying shipments and causing lost orders;

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if we are unable to fill orders at the end of a quarter, shipments may be delayed. This could cause us to fail to meet our revenue and operating profit expectations for a particular quarter and could increase the fluctuation of quarterly results if shipments are delayed from one fiscal quarter to the next or orders are cancelled by customers; and

in order to fulfill orders at the end of a quarter, we may be forced to deliver our products using air freight which results in increased distribution costs.

***We depend on a limited number of customers, including distributors and resellers, for a large percentage of our System Solutions sales. If we do not effectively manage our relationships with them, our net revenues and operating results will suffer.***

A significant percentage of our net revenues are attributable to a limited number of customers, including distributors and ISOs. For the first quarter of 2009, our ten largest customers accounted for approximately 31% of our net revenues, and one of our customers accounted for 10% of our net revenues in that period. If any of our large customers significantly reduces or delays purchases from us or if we are required to sell products to them at reduced prices or on other terms less favorable to us, our revenues and income could be materially adversely affected.

We sell a significant portion of our solutions through third parties such as independent distributors, independent sales organizations, or ISOs, value-added resellers, and payment processors. We depend on their active marketing and sales efforts. These third parties also provide after-sales support and related services to end user customers. When we introduce new applications and solutions, they also provide critical support for developing and porting the custom software applications to run on our various electronic payment systems and, internationally, in obtaining requisite certifications in the markets in which they are active. Accordingly, the pace at which we are able to introduce new solutions in markets in which these parties are active depends on the resources they dedicate to these tasks. Moreover, our arrangements with these third parties typically do not prevent them from selling products of other companies, including our competitors, and they may elect to market our competitors products and services in preference to our system solutions. If one or more of our major resellers terminates or otherwise adversely changes its relationship with us, we may be unsuccessful in replacing it. The loss of one of our major resellers could impair our ability to sell our solutions and result in lower revenues and income. It could also be time consuming and expensive to replicate, either directly or through other resellers, the certifications and the custom applications owned by these third parties.

***We are exposed to credit risk of some of our customers and to credit exposures in weakened markets, which could result in material losses.***

A significant portion of our sales are on an open credit basis, with typical payment terms of up to 60 days in the United States and, because of local customs or conditions, longer in some international markets. In the past, there have been bankruptcies among our customer base. Although credit losses have not been material to date, future losses, if incurred, could harm our business and have a material adverse effect on our operating results and financial condition. Additionally, to the degree that the recent turmoil in the credit markets makes it more difficult for some customers to obtain financing, our customers' ability to pay could be adversely impacted, which in turn could have a material adverse impact on our business, operating results and financial condition.

***We depend upon third parties to manufacture many of our systems and to supply the components necessary to manufacture our products.***

Prior to the Lipman acquisition, we did not directly manufacture the physical systems we design which form part of our System Solutions. In addition, Lipman did not manufacture systems it sold in Brazil or a majority of the systems designed by its Dione subsidiary. We arrange for a limited number of third parties to manufacture these systems under contract and pursuant to our specifications. Components such as application specific



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integrated circuits, or ASICs, payment processors, wireless modules, modems, and printer mechanisms that are necessary to manufacture and assemble our systems are sourced either directly by us or on our behalf by our contract manufacturers from a variety of component suppliers selected by us. If our suppliers are unable to deliver the quantities that we require, we would be faced with a shortage of critical components. We also experience from time to time an increase in the lead time for delivery of some of our key components. We may not be able to find alternative sources in a timely manner if suppliers of our key components become unwilling or unable to provide us with adequate supplies of these key components when we need them or if they increase their prices. If we are unable to obtain sufficient key required components, or to develop alternative sources if and as required in the future, or to replace our component and factory tooling for our products in a timely manner if they are damaged or destroyed, we could experience delays or reductions in product shipments. This could harm our relationships with our customers and cause our revenues to decline. Even if we are able to secure alternative sources or replace our tooling in a timely manner, our costs could increase.

***The government tax benefits that our Israeli subsidiary currently receives require it to meet several conditions and may be terminated or reduced in the future, which could require us to pay increased taxes or refund tax benefits received in the past.***

Our principal subsidiary in Israel (formerly Lipman) has received tax benefits under Israeli law for capital investments that are designated as Approved Enterprises. We received such tax benefits of approximately \$8.0 million in 2008 and \$0.1 million in 2007. To maintain our eligibility for these tax benefits, we must continue to meet conditions, including making specified investments in property, plant, and equipment, and continuing to manufacture in Israel. If we do not comply with these conditions in the future, the benefits received could be cancelled or reduced and we could be required to pay increased taxes or refund the amounts of the tax benefits Lipman received in the past, together with interest and penalties. Also, an increase in our assembly of products outside of Israel may be construed as a failure to comply with these conditions. These tax benefits may not continue in the future at the current levels or at all. The termination or reduction of these tax benefits, or our inability to qualify for new programs, could adversely affect our results of operations. Our principal subsidiary in Israel has undistributed earnings of approximately \$206.0 million, the vast majority of which are attributable to Lipman's Approved Enterprise programs. As such, these earnings were not subject to Israeli statutory corporate tax at the time they were generated. To the extent that these earnings are distributed to the United States in the future, our Israeli subsidiary would be required to pay corporate tax at the rate ordinarily applicable to such earnings (currently between 10% and 25%) along with a 15% withholding tax. As of January 31, 2009, we have accrued approximately \$48.4 million for taxes associated with future distributions of Israeli earnings.

***We have significant operations in Israel and therefore our results of operations may be adversely affected by political or economic instability or military operations in or around Israel.***

We have offices and a manufacturing facility in Israel and many of our suppliers are located in Israel. Therefore, political, economic, and military conditions in Israel directly affect our operations. The future of peace efforts between Israel and its Arab neighbors remains uncertain. Any armed conflicts or further political instability in the region is likely to negatively affect business conditions and adversely affect our results of operations. Furthermore, several countries continue to restrict or ban business with Israel and Israeli companies. These restrictive laws and policies may seriously limit our ability to make sales in those countries.

In addition, many employees in Israel are obligated to perform at least 30 days and up to 40 days, depending on rank and position, of military reserve duty annually and are subject to being called for active duty under emergency circumstances. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations in Israel could be disrupted by the absence for a significant period of one or more key employees or a significant number of other employees due to military service. Any disruption in our operations in Israel could materially adversely affect our business.

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***We depend on our manufacturing and warehouse facility in Israel. If operations at this facility are interrupted for any reason, there could be a material adverse effect on our results of operations.***

We currently assemble and test a majority of our NURIT products and some of our Dione products at our manufacturing facility located in Israel. Component and limited finished product inventories are also stored at this facility. Disruption of the manufacturing process at this facility or damage to it, whether as a result of fire, natural disaster, act of war, terrorist attack, or otherwise, could materially affect our ability to deliver products on a timely basis and could materially adversely affect our results of operations. We also assemble some of our NURIT products in Brazil. To the extent products are manufactured by third parties in additional countries, we may become more dependent on third-party manufacturers to produce and deliver products sold in these markets on a timely basis and at an acceptable cost.

***We have experienced rapid growth, and if we cannot adequately manage our growth, our results of operations will suffer.***

We have experienced rapid growth in our operations, both internally and from acquisitions. We cannot be sure that we have made adequate allowances for the costs and risks associated with our expansion, or that our systems, procedures, and managerial controls will be adequate to support further expansion in our operations. Any delay in implementing, or transitioning to, new or enhanced systems, procedures, or controls may adversely affect our ability to manage our product inventory and record and report financial and management information on a timely and accurate basis. If we are unable to successfully manage expansion, our results of operations may be adversely affected.

***A majority of our net revenues is generated outside of the United States and we intend to continue to expand our operations internationally. Our results of operations could suffer if we are unable to manage our international expansion and operations effectively.***

During the fiscal year ended October 31, 2008, and the three months ended January 31, 2009, 65.2% and 64.9%, respectively, of our net revenues were generated outside of the United States. We expect our percentage of net revenues generated outside of the United States to increase in the coming years. Part of our strategy is to expand our penetration in existing foreign markets and to enter new foreign markets. Our ability to penetrate some international markets may be limited due to different technical standards, protocols or product requirements. Expansion of our international business will require significant management attention and financial resources. Our international net revenues will depend on our continued success in the following areas:

securing commercial relationships to help establish our presence in new international markets;

hiring and training personnel capable of marketing, installing and integrating our solutions, supporting customers, and managing operations in foreign countries;

localizing our solutions to target the specific needs and preferences of foreign customers, which may differ from our traditional customer base in the market we currently serve;

building our brand name and awareness of our services among foreign customers in new international markets; and

implementing new systems, procedures, and controls to monitor our operations in new international markets.

In addition, we are subject to risks associated with operating in foreign countries, including:

multiple, changing, and often inconsistent enforcement of laws and regulations;

satisfying local regulatory or industry imposed security or other certification requirements;

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competition from existing market participants that may have a longer history in and greater familiarity with the international markets we enter;

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tariffs and trade barriers;

laws and business practices that may favor local competitors;

fluctuations in currency exchange rates;

extended payment terms and the ability to collect accounts receivable;

economic and political instability in certain foreign countries;

imposition of limitations on conversion of foreign currencies into U.S. dollars or remittance of dividends and other payments by foreign subsidiaries;

changes in a specific country's or region's political or economic conditions; and

greater difficulty in safeguarding intellectual property in areas such as China, Russia, and Latin America.

Many of these factors typically become more prevalent during periods of economic stress; therefore, current global economic differences may exacerbate certain of these risks. In addition, compliance with foreign and U.S. laws and regulations that are applicable to our international operations is complex and may increase our cost of doing business in international jurisdictions and our international operations could expose us to fines and penalties if we fail to comply with these regulations. These laws and regulations include import and export requirements, U.S. laws such as the Foreign Corrupt Practices Act, and local laws prohibiting corrupt payments to governmental officials. Although we have implemented policies and procedures designed to ensure compliance with these laws, there can be no assurance that our employees, contractors, and agents will not take actions in violation of our policies, particularly as we expand our operations through organic growth and acquisitions. Any such violations could subject us to civil or criminal penalties, including substantial fines or prohibitions on our ability to offer our products and services to one or more countries, and could also materially damage our reputation, our brand, our international expansion efforts, our business, and our operating results. In addition, if we fail to address the challenges and risks associated with international expansion and acquisition strategy, we may encounter difficulties implementing our strategy, which could impede our growth or harm our operating results.

***Our quarterly operating results may fluctuate significantly as a result of factors outside of our control, which could cause the market price of our common stock to decline.***

We expect our revenues and operating results to vary from quarter to quarter. As a consequence, our operating results in any single quarter may not meet the expectations of securities analysts and investors, which could cause the price of our common stock to decline. Factors that may affect our operating results include:

the type, timing, and size of orders and shipments;

demand for and acceptance of our new product offerings;

customers' willingness to maintain inventories;

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delays in the implementation and delivery of our products and services, which may impact the timing of our recognition of revenues;

variations in product mix and cost during any period;

development of new relationships and maintenance and enhancement of existing relationships with customers and strategic partners;

component supply, manufacturing, or distribution difficulties;

deferral of customer contracts in anticipation of product or service enhancements;

timing of commencement, implementation, or completion of major implementation projects;

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timing of governmental, statutory and industry association requirements;

the relative mix of North America and International net revenues;

fluctuations in currency exchange rates;

the fixed nature of many of our expenses; and

industry and economic conditions, including competitive pressures and inventory obsolescence.

In particular, differences in relative growth rates between our businesses in North America and internationally may have a significant effect on our operating results, particularly our reported gross profit percentage, in any individual quarter, with International sales carrying lower margins.

In addition, we have in the past and may continue to experience periodic variations in sales to our key vertical and international markets. These periodic variations occur throughout the year and may lead to fluctuations in our quarterly operating results depending on the impact of any given market during that quarter and could lead to volatility in our stock price.

***We may be subject to additional impairment charges due to potential declines in the fair value of our assets.***

As a result of our acquisitions, particularly that of Lipman, we have significant goodwill and intangible assets on our balance sheet. We test goodwill and intangible assets for impairment on a periodic basis as required, and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The events or changes that could require us to test our goodwill and intangible assets for impairment include a reduction in our stock price and market capitalization and changes in our estimated future cash flows, as well as changes in rates of growth in our industry or in any of our reporting units. In the fourth quarter of 2008, we recorded an impairment charge of \$289.1 million for goodwill and developed technology intangible assets due to lower revenue expectations in light of current operating performance and future operating expectations. In the first quarter of 2009, we recorded an additional estimated impairment charge of \$178.3 million. This goodwill impairment charge is an estimate, as the valuations necessary to complete the required evaluation of the our goodwill remain in process as of the date of this report. We will finalize this evaluation in the second quarter of fiscal year 2009 and will update the impairment charge for goodwill, if necessary.

We will continue to evaluate the carrying value of our remaining goodwill and intangible assets and if we determine in the future that there is a potential further impairment in any of our reporting units, we may be required to record additional charges to earnings which could materially adversely affect our financial results and could also materially adversely affect our business. See *Note 2. Goodwill and Purchased Intangible Assets* in the Notes to the Condensed Consolidated Financial Statements for additional information related to impairment of goodwill and intangible assets.

***Our North American and International operations are not equally profitable, which may promote volatility in our earnings and may adversely impact future growth in our earnings.***

Our International sales of System Solutions have tended to carry lower average selling prices and therefore have lower gross margins than our sales in North America. As a result, if we successfully expand our International sales, any improvement in our results of operations will likely not be as favorable as an expansion of similar magnitude in the United States and Canada. In addition, we are unable to predict for any future period our proportion of revenues that will result from International sales versus sales in North America. Variations in this proportion from period to period may lead to volatility in our results of operations which, in turn, may depress the trading price of our common stock.

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***Security is vital to our customers and end users and therefore breaches in the security of our solutions could adversely affect our reputation and results of operations.***

Protection against fraud is of key importance to the purchasers and end users of our solutions. We incorporate security features, such as encryption software and secure hardware, into our solutions to protect against fraud in electronic payment transactions and to ensure the privacy and integrity of consumer data. Our solutions may be vulnerable to breaches in security due to defects in the security mechanisms, the operating system and applications, or the hardware platform. Security vulnerabilities could jeopardize the security of information transmitted or stored using our solutions. We also provide our customers with repair, encryption key loading and helpdesk services, and have in the past and may in the future also experience security breaches or fraudulent activities related to unauthorized access to sensitive customer information. In general, liability associated with security breaches of a certified electronic payment system belongs to the institution that acquires the financial transaction. However, if the security of our solutions is compromised, our reputation and marketplace acceptance of our solutions will be adversely affected, which would cause our business to suffer, and we may become subject to damages claims.

***Our solutions may have defects that could result in sales delays, delays in our collection of receivables, and claims against us.***

We offer complex solutions that are susceptible to undetected hardware and software errors or failures. Solutions may experience failures when first introduced, as new versions are released, or at any time during their lifecycle. Defects may also arise from third party components that we incorporate into our products, such as hardware modules, chipsets or battery cells. Any product recalls as a result of errors or failures could result in the loss of or delays in market acceptance of our solutions and adversely affect our business and reputation. Any significant returns or warranty claims could result in significant additional costs to us and could adversely affect our results of operations. Our customers may also run third-party software applications on our electronic payment systems. Errors in third-party applications could adversely affect the performance of our solutions.

The existence of defects and delays in correcting them could result in negative consequences, including the following: harm to our brand; delays in shipping system solutions; loss of market acceptance for our system solutions; additional warranty expenses; diversion of resources from product development; and loss of credibility with distributors and customers. Correcting defects can be time consuming and in some circumstances extremely difficult. Software errors may take several months to correct, and hardware defects may take even longer to correct.

***We may accumulate excess or obsolete inventory that could result in unanticipated price reductions and write-downs and adversely affect our financial condition.***

In formulating our solutions, we have focused our efforts on providing to our customers solutions with higher levels of functionality, which requires us to develop and incorporate cutting edge and evolving technologies. This approach tends to increase the risk of obsolescence for products and components we hold in inventory and may compound the difficulties posed by other factors that affect our inventory levels, including the following:

the need to maintain significant inventory of components that are in limited supply;

buying components in bulk for the best pricing;

responding to the unpredictable demand for products;

cancellation of customer orders; and

responding to customer requests for quick delivery schedules.

The accumulation of excess or obsolete inventory may result in price reductions and inventory write-downs, which could adversely affect our business and financial condition. We incurred an obsolescence cost of





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\$11.8 million for obsolete inventory, scrap, and purchase commitments for excess components at contract manufacturers during each of the first quarter of 2009 and the fiscal year ended October 31, 2008. In the fiscal year ended October 31, 2007, we incurred an obsolescence charge of \$16.6 million primarily due to the implementation of PCI security standards which significantly reduced the markets in which non-PCI compliant finished goods and related accessories could be sold.

***If we do not accurately forecast customer demand and effectively manage our product mix and inventory levels, we may lose sales from having too few or the wrong mix of products or incur costs associated with excess inventory.***

If we improperly forecast demand for our products we could end up with too many products and be unable to sell the excess inventory in a timely manner, if at all, or, alternatively we could end up with too few products and not be able to satisfy demand. This problem is exacerbated because we attempt to closely match inventory levels with product demand leaving limited margin for error, and we generally receive a significant volume of customer orders towards the end of each fiscal quarter which leave us little room to adjust inventory mix to match demand. Also, during the transition from an existing product to a new replacement product, we must accurately predict the demand for the existing and the new product. Our inability to properly manage our inventory levels could cause us to incur increased expenses associated with writing off excessive or obsolete inventory or lose sales or have to ship products by air freight to meet immediate demand incurring incremental freight costs above sea freight costs, a preferred method, and suffering a corresponding decline in gross margins. If we do not accurately predict demand, we could also incur increased expenses associated with binding commitments to certain third party contract manufacturers. See Note 10. *Commitment and Contingencies* of Notes to our Condensed Consolidated Financial Statements in this Form 10-Q.

***Our proprietary technology is difficult to protect and unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively.***

We may not be able to protect our proprietary technology, which could enable competitors to develop services that compete with our own. We rely on copyright, trademark, and trade secret laws, as well as confidentiality, licensing and other contractual arrangements to establish and protect the proprietary aspects of our solutions. We do not have patent protection for certain important aspects of our current solutions. The laws of some countries in which we sell our solutions and services may not protect software and intellectual property rights to the same extent as the laws in the United States. If we are unable to prevent misappropriation of our technology, competitors may be able to use and adapt our technology. Our failure to protect our technology could diminish our competitive advantage and cause us to lose customers to competitors.

***Our business may suffer if we are sued for infringing the intellectual property rights of third parties, or if we are unable to obtain rights to third-party intellectual property on which we depend.***

Third parties have in the past asserted and may in the future assert claims that our system solutions infringe their proprietary rights. Such infringement claims, even if meritless, may cause us to incur significant costs in defending those claims. We may be required to discontinue using and selling any infringing technology and services, to expend resources to develop non-infringing technology or to purchase licenses or pay royalties for other technology. Similarly, we depend on our ability to license intellectual property from third parties. These or other third parties may become unwilling to license to us on acceptable terms intellectual property that is necessary to our business. In either case, we may be unable to acquire licenses for other technology on reasonable commercial terms or at all. As a result, we may find that we are unable to continue to offer the solutions and services upon which our business depends.

We have received, and have currently pending, third-party claims and may receive additional notices of such claims of infringement in the future. Infringement claims may cause us to incur significant costs in defending those claims or to settle claims to avoid costly or protracted litigation even if we deem those claims to be without

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merit. For example, in September 2007, SPA Syspatronic AG commenced an infringement action against us and others and in March 2008, Cardsoft, Inc. and Cardsoft (Assignment for the Benefit of Creditors), LLC commenced an infringement action against us and others. Infringement claims are expensive and time consuming to defend, regardless of the merits or ultimate outcome. Similar claims may result in additional protracted and costly litigation. There can be no assurance that we will continue to prevail in any such actions or that any license required under any such patent or other intellectual property would be made available on commercially acceptable terms, if at all. See Note 10.

*Commitments and Contingencies* in the Notes to the Condensed Consolidated Financial Statements

***We face litigation and tax assessment risks that could force us to incur substantial defense costs and could result in damages awards against us that would negatively impact our business.***

As described in Note 10. *Commitments and Contingencies* in the Notes to the Condensed Consolidated Financial Statements, there are a number of pending litigation and tax assessment matters each of which may be time-consuming to resolve, expensive to defend, and disruptive to normal business operations. The outcome of litigation and tax assessments are inherently difficult to predict. An unfavorable resolution of any specific lawsuit or tax assessment could have a material adverse effect on our business, results of operations and financial condition.

***We may not be able to attract, integrate, manage, and retain qualified personnel.***

Our success depends to a significant degree upon the continued contributions of our key senior management, engineering, sales and marketing, and manufacturing personnel, many of whom would be difficult to replace. In addition, our future success also depends on our ability to attract, integrate, manage, and retain highly skilled employees throughout our businesses. Competition for some of these personnel is intense, and in the past, we have had difficulty hiring employees in our desired time frame, particularly qualified finance and accounting professionals. We may be unsuccessful in attracting and retaining personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel in the future, or delays in hiring required personnel, particularly engineers and sales personnel, could make it difficult for us to manage our business and meet key objectives, such as timely product introductions.

In fiscal year 2008 and in the first quarter of 2009, we implemented work force reduction plans reducing the number of employees and contractors. These reductions have also required that we reassign certain employee duties. Workforce reductions and job reassignments could negatively affect employee morale, and make it difficult to motivate and retain our remaining employees and contractors, which would affect our ability to deliver our products in a timely fashion and otherwise negatively affect our business.

In addition, the restatement of our historical interim financial statements has adversely impacted our ability to attract and retain qualified personnel and may also have affected the morale and productivity of our workforce, including as a result of the uncertainties inherent in the restatement process, as well as our inability to provide equity-based compensation or permit the exercise of outstanding stock options from the time we announced that we would be restating our interim financial statements to August 2008, when we filed the required reports with the SEC. Moreover, the restatement process has adversely affected the market for our shares making our equity compensation program potentially less attractive for current or prospective employees.

***Shipments of electronic payment systems may be delayed by factors outside of our control, which can harm our reputation and our relationships with our customers.***

The shipment of payment systems requires us or our manufacturers, distributors, or other agents to obtain customs or other government certifications and approvals, and, on occasion, to submit to physical inspection of our systems in transit. Failure to satisfy these requirements, and the very process of trying to satisfy them, can lead to lengthy delays in the delivery of our solutions to our direct or indirect customers. Delays and unreliable delivery by us may harm our reputation in the industry and our relationships with our customers.

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***Force majeure events, such as terrorist attacks, other acts of violence or war, political instability, and health epidemics may adversely affect us.***

Terrorist attacks, war and international political instability, along with health epidemics may disrupt our ability to generate revenues. Such events may negatively affect our ability to maintain sales revenues and to develop new business relationships. Because a substantial and growing part of our revenues is derived from sales and services to customers outside of the United States and we have our electronic payment systems manufactured outside the U.S., terrorist attacks, war and international political instability anywhere may decrease international demand for our products and inhibit customer development opportunities abroad, disrupt our supply chain and impair our ability to deliver our electronic payment systems, which could materially adversely affect our net revenues or results of operations. Any of these events may also disrupt global financial markets and precipitate a decline in the price of our common stock.

***Natural or manmade disasters, business interruptions and health epidemics could delay our ability to receive or ship our products, or otherwise disrupt our business.***

Our worldwide operations could be subject to earthquakes, power shortages, telecommunications failures, water shortages, tsunamis, floods, hurricanes, typhoons, fires, extreme weather conditions, health epidemics and other natural or manmade disasters or business interruptions. The occurrence of any of these business disruptions could seriously harm our revenue and financial condition and increase our costs and expenses. Our corporate headquarters, and a portion of our research and development activities, are located in California, and other critical business operations and some of our suppliers are located in California and Asia, near major earthquake faults. If our manufacturers or warehousing facilities are disrupted or destroyed, we would be unable to distribute our products on a timely basis, which could harm our business. Moreover, if our computer information systems or communication systems, or those of our vendors or customers, are subject to hacker attacks or other disruptions, our business could suffer. We have not established a formal disaster recovery plan. Our back-up operations may be inadequate and our business interruption insurance may not be enough to compensate us for any losses that may occur. A significant business interruption could result in losses or damages and harm our business. For example, much of our order fulfillment process is automated and the order information is stored on our servers. If our computer systems and servers go down even for a short period at the end of a fiscal quarter, our ability to recognize revenue would be delayed until we were again able to process and ship our orders, which could harm our revenues for that quarter and cause our stock price to decline significantly.

***While we believe we comply with environmental laws and regulations, we are still exposed to potential risks associated with environmental laws and regulations.***

We are subject to other legal and regulatory requirements, including a European Union directive that places restrictions on the use of hazardous substances (RoHS) in electronic equipment, a European Union directive on Waste Electrical and Electronic Equipment (WEEE), and the environmental regulations promulgated by China's Ministry of Information Industry (China RoHS). RoHS sets a framework for producers obligations in relation to manufacturing (including the amounts of named hazardous substances contained in products sold) and WEEE sets a framework for treatment, labeling, recovery, and recycling of electronic products in the European Union which may require us to alter the manufacturing of the physical devices that include our solutions and/or require active steps to promote recycling of materials and components. In addition, similar legislation could be enacted in other jurisdictions, including in the United States. If we do not comply with the RoHS directives, WEEE directives and China RoHS, we may suffer a loss of revenue, be unable to sell in certain markets or countries, be subject to penalties and enforced fees, and/or suffer a competitive disadvantage. Furthermore, the costs to comply with RoHS and WEEE and China RoHS, or with current and future environmental and worker health and safety laws may have a material adverse effect on our results of operation, expenses and financial condition.

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*We may pursue complementary acquisitions and strategic investments, which will involve numerous risks. We may not be able to address these risks without substantial expense, delay or other operational or financial problems.*

We may seek to acquire or make investments in related businesses, technologies, or products in the future. Acquisitions or investments involve various risks, such as:

the difficulty of integrating the technologies, operations, and personnel of the acquired business, technology or product;

the potential disruption of our ongoing business, including the diversion of management attention;

the possible inability to obtain the desired financial and strategic benefits from the acquisition or investment;

loss of customers;

the risk that increasing complexity inherent in operating a larger business may impact the effectiveness of our internal controls and adversely affect our financial reporting processes;

assumption of unanticipated liabilities;

the loss of key employees of an acquired business; and

the possibility of our entering markets in which we have limited prior experience.

Future acquisitions and investments could also result in substantial cash expenditures, potentially dilutive issuance of our equity securities and incurrence of additional debt, contingent liabilities and amortization expenses related to other intangible assets that could adversely affect our business, operating results, and financial condition. We depend on the retention and performance of existing management and employees of acquired businesses for the day-to-day management and future operating results of these businesses.

## **Risks Related to Our Industry**

*Our markets are highly competitive and subject to price erosion.*

The markets for our system solutions and services are highly competitive, and we have been subject to price pressures. Competition from manufacturers, distributors, or providers of products similar to or competitive with our system solutions or services could result in price reductions, reduced margins, and a loss of market share or could render our solutions obsolete. For example, First Data Corporation, a leading provider of payments processing services, and formerly our largest customer, has developed and continues to develop a series of proprietary electronic payment systems for the U.S. market.

We expect to continue to experience significant and increasing levels of competition in the future. We compete with suppliers of cash registers that provide built in electronic payment capabilities and producers of software that facilitates electronic payment over the internet, as well as other manufacturers or distributors of electronic payment systems. We must also compete with smaller companies that have been able to develop strong local or regional customer bases. In certain foreign countries, some competitors are more established, benefit from greater name recognition and have greater resources within those countries than we do.

*We must adhere to industry and government regulations and standards and therefore sales will suffer if we cannot comply with them.*

## Edgar Filing: VeriFone Holdings, Inc. - Form 10-Q

Our system solutions must meet industry standards imposed by EMVCo LLC, Visa, MasterCard, and other credit card associations and standard setting organizations. New standards are continually being adopted or proposed as a result of worldwide anti-fraud initiatives, the increasing need for system compatibility and

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technology developments such as wireless and wireline IP communication. Our solutions also must comply with government regulations, including those imposed by telecommunications authorities and independent standards groups worldwide regarding emissions, radiation, and connections with telecommunications and radio networks. We cannot be sure that we will be able to design our solutions to comply with future standards or regulations on a timely basis, if at all. Compliance with these standards could increase the cost of developing or producing our solutions. New products designed to meet any new standards need to be introduced to the market and ordinarily need to be certified by the credit card associations and our customers before being purchased. The certification process is costly and time consuming and increases the amount of time it takes to sell our products. Our business and financial condition could be adversely affected if we cannot comply with new or existing industry standards, or obtain or retain necessary regulatory approval or certifications in a timely fashion, or if compliance results in increasing the cost of our products. Selling products that are non-compliant may result in fines against us or our customers, which we may be liable to pay.

*If we do not continually enhance our existing solutions and develop and market new solutions and enhancements, our net revenues and income will be adversely affected.*

The market for electronic payment systems is characterized by:

rapid technological change;

frequent product introductions and enhancements;

evolving industry and government performance and security standards; and

changes in customer and end-user requirements.

Because of these factors, we must continually enhance our existing solutions and develop and market new solutions. These efforts require significant investment in research and development as well as increased costs of manufacturing and distributing our system solutions, and we may not necessarily be able to increase or maintain prices to account for these costs.

We cannot be sure that we will successfully complete the development and introduction of new solutions or enhancements or that our new solutions will be accepted in the marketplace. We may also fail to develop and deploy new solutions and enhancements on a timely basis. In either case, we may lose market share to our competitors, and our net revenues and results of operations could suffer.

### **Risks Related to Our Capital Structure**

*Our secured credit facility contains restrictive and financial covenants and, if we are unable to comply with these covenants, we will be in default. A default could result in the acceleration of our outstanding indebtedness, which would have an adverse effect on our business and stock price.*

On October 31, 2006, our principal subsidiary, VeriFone, Inc., entered into a secured credit agreement consisting of a Term B Loan facility of \$500.0 million and a revolving credit facility permitting borrowings of up to \$40.0 million (the "Credit Facility"). The proceeds from the Term B loan were used to repay all outstanding amounts relating to an existing senior secured credit agreement, pay certain transaction costs, and partially fund the cash consideration in connection with the acquisition of Lipman on November 1, 2006. Through January 31, 2009, we had repaid an aggregate of \$270.0 million, leaving a Term B Loan balance of \$230.0 million at January 31, 2009.

Our Credit Facility contains customary covenants that require our subsidiaries to maintain certain specified financial ratios and restrict their ability to make certain distributions with respect to their capital stock, prepay other debt, encumber their assets, incur additional indebtedness, make capital expenditures above specified levels, engage in certain business combinations, or undertake various other corporate activities. Therefore, as a practical matter, these covenants restrict our ability to engage in or benefit from such activities. In addition, we

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have, in order to secure repayment of our Credit Facility, pledged substantially all of our assets and properties. This pledge may reduce our operating flexibility because it restricts our ability to dispose of these assets or engage in other transactions that may be beneficial to us.

If we are unable to comply with the covenants in our Credit Facility, we will be in default, which could result in the acceleration of our outstanding indebtedness. In addition, if our leverage exceeds a certain level set out in our Credit Facility, a portion of our excess cash flows must be used to pay down our outstanding debt. If acceleration occurs, we may not be able to repay our debt and we may not be able to borrow sufficient additional funds to refinance our debt. The U.S. credit markets are currently experiencing a significant contraction as a result of which we may not be able to obtain additional financing on acceptable terms, or at all. If we were to default in performance under the Credit Facility we may pursue an amendment or waiver of the Credit Facility with our existing lenders, but there can be no assurance that the lenders would grant another amendment and waiver and, in light of current credit market conditions, any such amendment or waiver requested is likely to be on terms, including additional fees, as well as increased interest rates and other more stringent terms and conditions that would be materially disadvantageous to us. For example, as a result of the delay in our financial reports for the 2007 fiscal year and the first two fiscal quarters of 2008, we were required to obtain amendments to our Credit Facility that resulted in an increase in the interest rate payable on our term loan and revolving commitments, as well as increases in the commitment fee for unused revolving commitments and letter of credit fees. We also paid the consenting lenders amendment fees in connection with the amendments. We expect that in light of current market conditions any lender's fees or other terms and conditions for a covenant waiver or amendment would be substantially more costly to us today than the cost we incurred for credit agreement amendments in 2008.

***The conditions of the U.S. and international capital markets may adversely affect our ability to draw on our revolving credit facility as well as have an adverse effect on other financial transactions.***

Lehman Commercial Paper, Inc. ( Lehman CP ) was a lender under our revolving credit facility with a commitment of \$15 million out of the \$40 million facility. As a result of Lehman CP's filing of a voluntary Chapter 11 bankruptcy petition in October 2008, we reduced the revolving credit facility by its commitment.

In addition, the filing by Lehman Brothers Holdings Inc. ( Lehman Brothers ) of a voluntary Chapter 11 bankruptcy petition constituted an event of default under our convertible note hedge transaction with Lehman Brothers OTC Derivatives Inc. ( Lehman Derivatives ), giving us the immediate right to terminate the transaction and entitling us to claim reimbursement for the loss incurred in terminating and closing out the transaction. On September 21, 2008, we delivered a notice of termination to Lehman Derivatives and claimed reimbursement for the loss incurred in termination and close out of the transaction. We could incur significant costs to replace this hedge transaction if we elect to do so. These replacement costs may not be fully offset by any proceeds recoverable from Lehman Brothers and Lehman Derivatives (which has also filed a voluntary Chapter 11 bankruptcy petition) following our termination of the convertible note hedge transaction with Lehman Derivatives.

If other financial institutions that have extended credit commitments to us or have entered into hedge, insurance or similar transactions with us are adversely affected by the conditions of the U.S. and international capital markets, they may become unable to fund borrowings under their credit commitments to us or otherwise fulfill their obligations under the relevant transactions, which could have a material and adverse impact on our financial condition and our ability to borrow additional funds, if needed, for working capital, capital expenditures, acquisitions and other corporate purposes.

***Our indebtedness and debt service obligations under our Credit Facility may adversely affect our cash flow, cash position, and stock price.***

We intend to fulfill our debt service obligations under our Credit Facility from existing cash, investments and operations. In the future, if we are unable to generate or raise additional cash sufficient to meet these

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obligations and need to use more of our existing cash than planned or to liquidate investments in order to fund these obligations, we may have to delay or curtail the development and/or the sales and marketing of new payment systems.

Our indebtedness could have significant additional negative consequences, including, without limitation:

requiring the dedication of a significant portion of our expected cash flow to service the indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures;

increasing our vulnerability to general adverse economic conditions;

limiting our ability to obtain additional financing; and

placing us at a possible competitive disadvantage to less leveraged competitors and competitors that have better access to capital resources.

Additionally, if we are required to refinance or raise additional cash to settle our existing indebtedness on or prior to its maturity, our ability to successfully achieve such objective is dependent on a number of factors, including but not limited to our business outlook, projected financial performance, general availability of corporate credit, and market demand for our securities offerings.

***Any modification of the accounting guidelines for convertible debt could result in higher interest expense related to our convertible debt, which could materially impact our results of operations and earnings per share.***

In May 2008, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP APB 14-1 requires the issuer of convertible debt instruments with cash settlement features to account separately for the liability and equity components of the instrument. The debt would be recognized at the present value of its cash flows discounted using the issuer's nonconvertible debt borrowing rate at the time of issuance. The equity component would be recognized as the difference between the proceeds from the issuance of the note and the fair value of the liability. The FSP also requires accretion of the resultant debt discount over the expected life of the debt. The FSP is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. Entities are required to apply the FSP retrospectively for all periods presented. We are currently evaluating FSP APB 14-1 and have not yet determined the impact its adoption will have on our consolidated financial statements. However, the impact of this new accounting treatment will be significant and will result in a significant increase to non-cash interest expense beginning in fiscal year 2010 for financial statements covering past and future periods.

***Some provisions of our certificate of incorporation and bylaws may delay or prevent transactions that many stockholders may favor.***

Some provisions of our certificate of incorporation and bylaws may have the effect of delaying, discouraging or preventing a merger or acquisition that our stockholders may consider favorable, including transactions in which stockholders might receive a premium for their shares. These provisions include:

authorization of the issuance of blank check preferred stock without the need for action by stockholders;

the removal of directors or amendment of our organizational documents only by the affirmative vote of the holders of two-thirds of the shares of our capital stock entitled to vote;

provision that any vacancy on the board of directors, however occurring, including a vacancy resulting from an enlargement of the board, may only be filled by vote of the directors then in office;





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inability of stockholders to call special meetings of stockholders, although stockholders are permitted to act by written consent; and

advance notice requirements for board nominations and proposing matters to be acted on by stockholders at stockholder meetings.

*Our share price has been volatile and we expect that the price of our common stock may continue to fluctuate substantially.*

Our stock price has fluctuated substantially since our initial public offering and more recently since the announcement of our anticipated restatement in December 2007 and during the recent turmoil in the worldwide financial markets. In addition to fluctuations related to Company-specific factors, broad market and industry factors may adversely affect the market price of our common stock, regardless of our actual operating performance. Factors that could cause fluctuations in our stock price may include, among other things:

actual or anticipated variations in quarterly operating results;

changes in financial estimates by us or by any securities analysts who might cover our stock, or our failure to meet the estimates made by securities analysts;

changes in the market valuations of other companies operating in our industry;

announcements by us or our competitors of significant acquisitions, strategic partnerships or divestitures;

additions or departures of key personnel; and

sales or purchases of our common stock, including sales or purchases of our common stock by our directors and officers or by our principal stockholders.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

The following documents are filed as Exhibits to this report:

**Exhibit**

| <b>Number</b> | <b>Description</b>   |
|---------------|--|
| 31.1          | Certification of the Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.                                |
| 31.2          | Certification of the Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.                                |
| 32.1          | Certification of the Chief Executive Officer and the Chief Financial Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002. |

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VERIFONE HOLDINGS, INC

By: /s/ DOUGLAS G. BERGERON  
**Douglas G. Bergeron**  
**Chief Executive Officer**

By: /s/ ROBERT DYKES  
**Robert Dykes**  
**Senior Vice President and Chief Financial Officer**

Date: March 6, 2009

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**EXHIBIT INDEX**

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