ALLIANCE DATA SYSTEMS CORP
Form 10-Q
November 09, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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: 001-15749

ALLIANCE DATA SYSTEMS CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware	**31-1429215**
(State or Other Jurisdiction of	*(I.R.S. Employer*
Incorporation or Organization)	*Identification No.)*

7500 Dallas Parkway, Suite 700

Plano, Texas 75024

(Address of Principal Executive Office, Including Zip Code)

(214) 494-3000

(Registrant s Telephone Number, Including Area Code)

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

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

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

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

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

As of November 3, 2010, 51,995,538 shares of common stock were outstanding.

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PART I

Item 1. Financial Statements.

ALLIANCE DATA SYSTEMS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2010	December 31, 2009
	(In thousands)	
ASSETS		
Cash and cash equivalents	$ 391,226	$ 213,378
Trade receivables, less allowance for doubtful accounts ($5,256 and $6,736 at September 30, 2010 and December 31, 2009, respectively)	234,570	225,212
Seller s interest		297,108
Credit card receivables:		
Credit card receivables restricted for securitization investors	4,406,664	
Other credit card receivables	539,227	671,182
Total credit card receivables	4,945,891	671,182
Allowance for loan loss	(514,296)	(54,884)
Credit card receivables, net	4,431,595	616,298
Deferred tax asset, net	340,208	197,455
Other current assets	112,437	201,427
Redemption settlement assets, restricted	495,499	574,004
Assets of discontinued operations	18,028	34,623
Total current assets	6,023,563	2,359,505
Property and equipment, net	162,758	165,012
Due from securitizations		775,570
Cash collateral, restricted	205,359	216,953
Intangible assets, net	332,033	316,597
Goodwill	1,214,569	1,166,275
Other non-current assets	192,214	225,755
Total assets	$ 8,130,496	$ 5,225,667
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	$ 124,040	$ 103,891
Accrued expenses	132,105	128,012
Certificates of deposit	452,400	772,500
Asset-backed securities debt owed to securitization investors	885,509	
Current debt	262,751	51,963
Other current liabilities	92,345	88,716
Deferred revenue	1,013,116	984,930
Total current liabilities	2,962,266	2,130,012
Deferred revenue	167,733	161,216

Deferred tax liability, net	106,804	140,712
Certificates of deposit	514,400	692,500
Asset-backed securities debt owed to securitization investors	2,476,315	
Long-term and other debt	1,666,881	1,730,389
Other liabilities	190,330	98,062
Total liabilities	8,084,729	4,952,891
Stockholders equity:		
Common stock, $0.01 par value; authorized 200,000 shares; issued 92,746 shares and 91,121 shares at September 30, 2010 and December 31, 2009, respectively	927	911
Additional paid-in capital	1,302,604	1,235,669
Treasury stock, at cost (40,277 and 38,922 shares at September 30, 2010 and December 31, 2009, respectively)	(2,007,844)	(1,931,102)
Retained earnings	769,014	1,033,039
Accumulated other comprehensive loss	(18,934)	(65,741)
Total stockholders equity	45,767	272,776
Total liabilities and stockholders equity	$ 8,130,496	$ 5,225,667

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
	(In thousands, except per share amounts)			
Revenues				
Transaction	$ 68,150	$ 90,505	$ 214,092	$ 279,638
Redemption	120,424	120,779	386,810	346,935
Securitization income		98,723		315,345
Finance charges, net	327,677	16,268	953,303	45,278
Database marketing fees and direct marketing services	167,083	129,317	427,246	364,605
Other revenue	19,109	25,839	54,247	66,620
Total revenue	702,443	481,431	2,035,698	1,418,421
Operating expenses				
Cost of operations	384,301	326,578	1,102,128	974,438
General and administrative	19,767	30,143	63,440	77,176
Provision for loan loss	90,459		275,044	
Depreciation and other amortization	17,196	15,364	50,101	45,715
Amortization of purchased intangibles	20,711	15,770	56,398	45,833
Merger costs (reimbursements)		30		(486)
Total operating expenses	532,434	387,885	1,547,111	1,142,676
Operating income	170,009	93,546	488,587	275,745
Interest expense:				
Securitization funding costs	43,026		128,251	
Interest expense on certificates of deposit	7,317	6,616	23,519	19,800
Interest expense on long-term and other debt, net	33,776	31,947	98,903	84,157
Total interest expense, net	84,119	38,563	250,673	103,957
Income from continuing operations before income taxes	85,890	54,983	237,914	171,788
Provision for income taxes	32,831	9,666	90,881	55,035
Income from continuing operations	53,059	45,317	147,033	116,753
Income (loss) from discontinued operations, net of taxes		479		(13,666)
Net income	$ 53,059	$ 45,796	$ 147,033	$ 103,087
Basic income (loss) per share:				
Income from continuing operations	$ 1.01	$ 0.86	$ 2.79	$ 2.05
Income (loss) from discontinued operations		0.01		(0.24)
Net income per share	$ 1.01	$ 0.87	$ 2.79	$ 1.81
Diluted income (loss) per share:				
Income from continuing operations	$ 0.96	$ 0.82	$ 2.63	$ 2.01

Income (loss) from discontinued operations		0.01		(0.23)
Net income per share	$ 0.96	$ 0.83	$ 2.63	$ 1.78
Weighted average shares:				
Basic	52,584	52,841	52,743	56,946
Diluted	55,218	55,136	55,820	57,959

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2010	2009
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 147,033	$ 103,087
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	106,499	91,649
Deferred income taxes	24,044	48,168
Provision for loan loss	275,044	44,252
Non-cash stock compensation	33,996	43,353
Fair value loss on interest-only strip		2,207
Fair value loss on interest rate derivatives	5,443	
Amortization of discount on convertible senior notes	48,914	37,243
Loss on the sale of assets		18,018
Change in operating assets and liabilities, net of acquisitions:		
Change in trade accounts receivable	(20,927)	13,231
Change in merchant settlement activity		(18,907)
Change in other assets	36,975	(22,683)
Change in accounts payable and accrued expenses	33,220	(68,583)
Change in deferred revenue	9,079	(2,731)
Change in other liabilities	13,551	(20,526)
Proceeds from the sale of credit card receivable portfolios to the securitization trusts		53,240
Excess tax benefits from stock-based compensation	(12,713)	(7,425)
Other	(6,654)	(7,471)
Net cash provided by operating activities	693,504	306,122
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in redemption settlement assets	21,964	29,744
Change in seller s interest		(21,337)
Change in credit card receivables	273,925	(221,473)
Change in cash collateral, restricted	12,530	85,068
Change in restricted cash	24,064	(64,810)
Change in due from securitizations		(158,823)
Capital expenditures	(48,296)	(39,706)
Payments for acquired businesses, net of cash	(117,000)	
Proceeds from the sale of assets		8,013
Other	(3,032)	4,399
Net cash provided by (used in) investing activities	164,155	(378,925)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under debt agreements	1,205,000	2,396,000
Repayment of borrowings	(1,089,549)	(2,327,926)
Proceeds from issuance of convertible senior notes due 2014		345,000
Issuances of certificates of deposit	94,000	1,100,400
Repayments of certificates of deposit	(592,200)	(609,400)
Proceeds from asset-backed securities	833,126	
Maturities of asset-backed securities	(1,157,235)	
Payment of capital lease obligations	(17,272)	(15,718)
Payment of deferred financing costs	(3,025)	(21,407)
Excess tax benefits from stock-based compensation	12,713	7,425
Proceeds from issuance of common stock	31,848	23,780
Proceeds from issuance of warrants		30,050
Payments for convertible note hedges		(80,765)

Payments for prepaid forward contracts				(74,872)
Purchase of treasury shares		(76,742)		(417,774)
Net cash (used in) provided by financing activities		(759,336)		354,793
Effect of exchange rate changes on cash and cash equivalents		(2,028)		10,720
Change in cash and cash equivalents		96,295		292,710
Cash effect on adoption of ASC 860 and ASC 810		81,553		
Cash and cash equivalents at beginning of period		213,378		156,911
Cash and cash equivalents at end of period	$	391,226	$	449,621
SUPPLEMENTAL CASH FLOW INFORMATION:				
Interest paid	$	176,335	$	58,579
Income taxes paid, net	$	26,497	$	53,890

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements included herein have been prepared by Alliance Data Systems Corporation (ADSC or, including its wholly owned subsidiaries and its consolidated variable interest entities, the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report filed on Form 10-K for the year ended December 31, 2009, filed with the SEC on March 1, 2010.

The unaudited condensed consolidated financial statements included herein reflect all adjustments (consisting of normal, recurring adjustments) which are, in the opinion of management, necessary to state fairly the results for the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for the fiscal year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect (1) the reported amounts of assets; (2) liabilities and disclosure of contingent assets and liabilities at the date of the financial statements; and (3) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. For purposes of comparability, certain prior period amounts have been reclassified to conform to the current year presentation. See Note 2, Change in Accounting Principle, for information on the adoption of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 860, Transfers and Servicing, and ASC 810, Consolidation.

In the first quarter of 2010, the Company reorganized its segments with Private Label Services and Private Label Credit reflected as one segment. All prior year segment information has been restated to conform to the current presentation. In addition, the Company renamed its other two segments from Epsilon Marketing Services and Loyalty Services to Epsilon and LoyaltyOne, respectively.

In February 2009, the Company sold the remainder of its utility services division, which was reflected as a discontinued operation. In November 2009, the Company terminated operations of its credit program for web and catalog retailer VENUE. Prior period information has been restated to reflect the termination of VENUE as a discontinued operation.

2. CHANGE IN ACCOUNTING PRINCIPLE

In June 2009, the FASB issued guidance codified in ASC 860 related to accounting for transfers of financial assets and ASC 810 related to the consolidation of variable interest entities (VIEs). ASC 860 removed the concept of qualifying special purpose entity (QSPE) and eliminated the consolidation exemption that was then available for QSPEs. ASC 810 requires an initial evaluation as well as an ongoing assessment of the Company s involvement in the activities of World Financial Network Credit Card Master Trust (Master Trust), World Financial Network Credit Card Master Note Trust (Master Trust I), World Financial Network Credit Card Master Note Trust II (Master Trust II) and World Financial Network Credit Card Master Trust III (Master Trust III) (collectively, the WFN Trusts), and World Financial Capital Credit Card Master Note Trust (the WFC Trust) and the Company s rights or obligations to receive benefits or absorb losses of the trusts that could be potentially significant in order to determine whether those VIEs are required to be consolidated on the balance

ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

sheets of World Financial Network National Bank (WFNNB), World Financial Capital Bank (WFCB) or their affiliates, including ADSC.

On January 1, 2010, the Company adopted ASC 860 and ASC 810 on a prospective basis, resulting in the consolidation of the WFN Trusts and the WFC Trust. Based on the carrying amounts of the WFN Trusts and the WFC Trust s assets and liabilities as prescribed by ASC 810, the Company recorded an increase in assets of approximately $3.4 billion, including $0.5 billion to loan loss reserves, an increase in liabilities of approximately $3.7 billion and a $0.4 billion decrease in stockholders equity.

After adoption, the Company s consolidated statements of income no longer reflect securitization income, but instead reflect finance charges and certain other income associated with the securitized credit card receivables. Net charge-offs associated with credit card receivables impact the Company s provision for loan loss reflected in the Company s total operating expenses. Interest expense associated with debt issued from the WFN Trusts and the WFC Trust to third-party investors is reported in securitization funding costs. Additionally, the Company no longer records initial gains on new securitization activity since securitized credit card loans no longer receive sale accounting treatment, nor are there any gains or losses on the revaluation of the interest-only strip receivable, as that asset is not recognized in a transaction accounted for as a secured borrowing. Since the Company s securitization transactions are accounted for under the new accounting rules as secured borrowings rather than asset sales, the cash flows from these transactions are presented as cash flows from financing activities rather than cash flows from operating or investing activities.

The assets of the consolidated VIEs include certain credit card receivables, which are restricted to settle the obligations of those entities and are not expected to be available to the Company or its creditors. The liabilities of the consolidated VIEs include asset-backed secured borrowings and other liabilities for which creditors or beneficial interest holders do not have recourse to the general credit of the Company.

3. RECENT ACCOUNTING PRONOUNCEMENTS

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, Multiple-Deliverable Revenue Arrangements, which supersedes certain guidance in ASC 605-25, Revenue Recognition Multiple-Element Arrangements, and requires an entity to allocate arrangement consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices (the relative-selling-price method). ASU 2009-13 eliminates the use of the residual method of allocation in which the undelivered element is measured at its estimated selling price and the delivered element is measured as the residual of the arrangement consideration, and requires the relative-selling-price method in all circumstances in which an entity recognizes revenue for an arrangement with multiple deliverables subject to ASU 2009-13. ASU 2009-13 will be effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. If the Company elects early adoption and the adoption is during an interim period, the Company will be required to apply this ASU retrospectively from the beginning of the Company s fiscal year. The Company can also elect to apply this ASU retrospectively for all periods presented. The Company is currently evaluating the impact that the adoption of ASU 2009-13 will have on its consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, Fair Value Measurements and Disclosures, which amends ASC 820, Fair Value Measurements and Disclosures, to add separate disclosures about purchases, sales, issuances and settlements related to Level 3 measurements. The requirement to provide the Level 3 disclosures about purchases, sales, issuances and settlements will be effective for interim and annual periods beginning after December 15, 2010. The adoption of ASU 2010-06 for the separate Level 3 disclosures will only impact disclosures and will not have a material impact on the Company s consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In July 2010, the FASB issued ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which amends ASC 310, Receivables, to require further disaggregated disclosures that improve financial statement users understanding of (1) the nature of an entity s credit risk associated with its financing receivables and (2) the entity s assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes. The new and amended disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The adoption of ASU 2010-20 will only impact disclosures and will not have a material impact on the Company s consolidated financial statements.

4. SHARES USED IN COMPUTING NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share for the periods indicated:

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
	(In thousands, except per share amounts)			
Numerator				
Income from continuing operations	$ 53,059	$ 45,317	$ 147,033	$ 116,753
Income (loss) from discontinued operations, net of taxes		479		(13,666)
Net income	$ 53,059	$ 45,796	$ 147,033	$ 103,087
Denominator				
Weighted average shares, basic	52,584	52,841	52,743	56,946
Weighted average effect of dilutive securities:				
Shares from assumed conversion of convertible senior notes	1,454	788	1,785	
Net effect of dilutive stock options and unvested restricted stock	1,180	1,507	1,292	1,013
Denominator for diluted calculation	55,218	55,136	55,820	57,959
Basic				
Income from continuing operations per share	$ 1.01	$ 0.86	$ 2.79	$ 2.05
Income (loss) from discontinued operations per share		0.01		(0.24)
Net income per share	$ 1.01	$ 0.87	$ 2.79	$ 1.81
Diluted				
Income from continuing operations per share	$ 0.96	$ 0.82	$ 2.63	$ 2.01
Income (loss) from discontinued operations per share		0.01		(0.23)
Net income per share	$ 0.96	$ 0.83	$ 2.63	$ 1.78

The Company calculates the effect of its convertible senior notes, which can be settled in cash or shares of common stock, on diluted net income per share as if they will be settled in cash as the Company has the intent to settle the convertible senior notes in cash. For the three and nine months ended September 30, 2010 and 2009, the Company excluded, in each case, 17.5 million warrants from the calculation of net income per share as the effect was anti-dilutive.

During the second quarter of 2009, the Company entered into prepaid forward contracts to purchase 1,857,400 shares of its common stock for $74.9 million that are to be delivered over a settlement period in 2014. The number of shares to be delivered under the prepaid forward contracts is used to reduce weighted average basic and diluted shares outstanding.

ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. ACQUISITION

On July 1, 2010, the acquisition date, the Company completed the acquisition of the Direct Marketing Services and Database Marketing divisions of Equifax, Inc., (collectively, DMS). The total purchase price was $117.0 million. DMS provides proprietary data-driven, integrated marketing solutions through two complementary offers: database marketing and hosting, and data services, including U.S. consumer demographic information.

The results of operations for DMS have been included since the date of acquisition and are reflected in the Company s Epsilon segment. The goodwill resulting from the acquisition will be deductible for tax purposes.

The following table summarizes the fair values of the assets acquired and liabilities assumed in the DMS acquisition as of the date of purchase:

	As of July 1, 2010 (In thousands)
Other current assets	$ 893
Property and equipment	2,290
Capitalized software	4,800
Identifiable intangible assets	67,600
Goodwill	43,874
Non-current assets	165
Total assets acquired	119,622
Current liabilities	2,622
Total liabilities assumed	2,622
Net assets acquired	$ 117,000

6. CREDIT CARD RECEIVABLES

Beginning January 1, 2010, the Company s credit card securitization trusts, the WFN Trusts and the WFC Trust, were consolidated on the balance sheets of WFNNB, WFCB or their affiliates, including ADSC, under ASC 860 and ASC 810. The WFN Trusts and the WFC Trust s credit card receivables are reported in credit card receivables restricted for securitization investors.

The tables below present quantitative information about the components of total credit card receivables and delinquencies:

	September 30, 2010	December 31, 2009
	(In millions)	
Principal receivables	$ 4,705.4	$ 5,332.8

Billed and accrued finance charges	203.0	155.7
Other receivables	37.5	21.0
Total credit card receivables	4,945.9	5,509.5
Less credit card receivables restricted for securitization investors	4,406.7	4,838.3
Other credit card receivables	$ 539.2	$ 671.2
Principal amount of credit card receivables 90 days or more past due	$ 130.5	$ 157.4

ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Allowance for Loan Loss

The Company maintains an allowance for loan losses at a level that is adequate to absorb probable losses inherent in credit card receivables. In estimating the inherent loan losses for the credit card portfolio, management utilizes a migration analysis of delinquent and current credit card receivables. Migration analysis is a technique used to estimate the likelihood that a credit card receivable will progress through the various stages of delinquency and to charge-off. The migration analysis considers uncollectible principal, interest and fees reflected in credit card receivables. In determining the proper level of the allowance for loan loss, management also considers factors that may impact loan loss experience, including seasoning, loan volume and amounts, payment rates and forecasting uncertainties.

The allowance for loan loss is evaluated monthly for adequacy and is maintained through an adjustment to the provision for loan loss. Additions to the allowance are made through charges to the provision for loan loss or when reserves are acquired as part of a business or portfolio acquisition. When credit card receivables are charged off, principal amounts of credit card receivables outstanding are deducted from the allowance and subsequent recoveries of such amounts increase the allowance. The Company considers uncollectible interest and fees in assessing the adequacy of the allowance for loan loss; however, unpaid interest and fees are reversed against finance charges, net.

Changes in the allowance for loan loss on credit card receivables for the nine months ended September 30, 2010 and the year ended December 31, 2009 were as follows:

	September 30, 2010	December 31, 2009
	(In thousands)	
Balance at beginning of period	$ 54,884	$ 38,124
Adoption of ASC 860 and ASC 810	523,950	
Provision for loan loss	272,259	52,259
Principal charge-offs, net of recoveries	(336,797)	(35,499)
Balance at end of period	$ 514,296	$ 54,884

The provision for loan loss expense was $90.5 million and $275.0 million for the three and nine months ended September 30, 2010, respectively, which includes $0.9 million and $2.8 million of credit card fraud losses, respectively. The provision for loan loss expense was $16.4 million and $35.9 million for the three and nine months ended September 30, 2009, respectively, for the Company s on-balance sheet credit card receivables. These amounts were netted against securitization income in 2009.

Net charge-offs of principal receivables were $102.1 million and $99.6 million for the three months ended September 30, 2010 and 2009, respectively, and $336.8 million and $297.2 million for the nine months ended September 30, 2010 and 2009, respectively.

Securitized Credit Card Receivables

The Company regularly securitizes its credit card receivables to the WFN Trusts and the WFC Trust. The Company continues to own and service the accounts that generate credit card receivables held by the WFN Trusts and the WFC Trust. In its capacity as a servicer, each of the respective banks earns a fee from the WFN Trusts and the WFC Trust to service and administer the credit receivables, collect payments, and charge-off uncollectible receivables.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The tables below present quantitative information about the components of total securitized credit card receivables, delinquencies and net charge-offs:

	September 30, 2010	December 31, 2009
	(In millions)	
Total credit card receivables restricted for securitization investors	$ 4,406.7	$ 4,838.3
Principal amount of credit card receivables restricted for securitization investors, 90 days or more past due	$ 117.6	$ 148.2

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
	(In millions)			
Net charge-offs of securitized principal	$ 91.5	$ 89.9	$ 297.5	$ 270.8

During the initial phase of a securitization reinvestment period, the Company generally retains principal collections in exchange for the transfer of additional credit card receivables into the securitized pool of assets. During the amortization or accumulation period of a securitization, the investors share of principal collections (in certain cases, up to a maximum specified amount each month) is either distributed to the investors or held in an account until it accumulates to the total amount due, at which time it is paid to the investors in a lump sum.

The table below summarizes certain cash flows received from and paid to the securitization trusts when transfers of credit card receivables to the securitization trusts were treated as sales prior to the adoption of ASC 860 and ASC 810:

	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2009
	(In millions)	
Proceeds from collections reinvested in previous credit card securitizations	$ 849.2	$ 3,133.4
Proceeds from new securitizations	1,081.4	2,150.0
Proceeds from collections reinvested in revolving period transfers	1,491.6	4,672.2
Servicing fees received[1]	17.3	53.6

(1) Upon adoption of ASC 860, these fees were eliminated with the consolidation of the WFN Trusts and the WFC Trust, and therefore not reflected in the unaudited condensed consolidated statements of income as of September 30, 2010.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. REDEMPTION SETTLEMENT ASSETS

Redemption settlement assets consist of cash and cash equivalents and securities available-for-sale and are designated for settling redemptions by collectors of the AIR MILES® Reward Program in Canada under certain contractual relationships with sponsors of the AIR MILES Reward Program. These assets are primarily denominated in Canadian dollars. Realized gains and losses from the sale of investment securities were not material. The principal components of redemption settlement assets, which are carried at fair value, are as follows:

	September 30, 2010				December 31, 2009			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)							
Cash and cash equivalents	$ 34,502	$	$	$ 34,502	$ 71,641	$	$	$ 71,641
Government bonds	35,084	1,016	(7)	36,093	41,026	1,205		42,231
Corporate bonds[(1)]	417,740	7,545	(381)	424,904	453,447	8,473	(1,788)	460,132
Total	$ 487,326	$ 8,561	$ (388)	$ 495,499	$ 566,114	$ 9,678	$ (1,788)	$ 574,004

(1) Included in corporate bonds at December 31, 2009 is an investment in retained interests in the WFN Trusts with a fair value of $73.9 million. Upon adoption of ASC 860, these amounts were eliminated with the consolidation of the WFN Trusts, and therefore not reflected in the unaudited condensed consolidated balance sheet as of September 30, 2010.

The following tables show the gross unrealized losses and fair value for those investments that were in an unrealized loss position as of September 30, 2010 and December 31, 2009, aggregated by investment category and the length of time that individual securities have been in a continuous loss position:

	September 30, 2010					
	Less than 12 months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Government bonds	$ 9,780	$ (7)	$	$	$ 9,780	$ (7)
Corporate bonds	53,792	(381)			53,792	(381)
Total	$ 63,572	$ (388)	$	$	$ 63,572	$ (388)

	December 31, 2009					
	Less than 12 months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

			(In thousands)			
Corporate bonds	$ 98,448	$ (1,646)	$ 7,705	$ (142)	$ 106,153	$ (1,788)
Total	$ 98,448	$ (1,646)	$ 7,705	$ (142)	$ 106,153	$ (1,788)

Market values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and extent to which fair value has been below cost basis, the financial condition of the security s issuer, and the Company s intent to sell the security and whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. The Company typically invests in highly-rated securities with low probabilities of default and has the ability to hold the investments until maturity. As of September 30, 2010, the Company does not consider the investments to be other-than-temporarily impaired.

The net carrying value and estimated fair value of the securities at September 30, 2010 by contractual maturity are as follows:

	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	$ 160,888	$ 161,738
Due after one year through five years	326,438	333,761
Total	$ 487,326	$ 495,499

8. INTANGIBLE ASSETS AND GOODWILL

Intangible Assets

Intangible assets consist of the following:

	September 30, 2010			
	Gross Assets	Accumulated Amortization	Net	Amortization Life and Method
	(In thousands)			
Finite Lived Assets				
Customer contracts and lists	$ 236,228	$ (142,022)	$ 94,206	5-10 years straight line
Premium on purchased credit card portfolios	151,431	(58,162)	93,269	3-10 years straight line, accelerated
Collector database	68,024	(58,809)	9,215	30 years 15% declining balance
Customer database	175,430	(70,930)	104,500	4-10 years straight line
Noncompete agreements	2,839	(2,351)	488	2-5 years straight line
Tradenames	14,156	(4,711)	9,445	4-10 years straight line
Purchased data lists	19,824	(11,264)	8,560	1-5 years straight line, accelerated
	$ 667,932	$ (348,249)	$ 319,683	
Indefinite Lived Assets				
Tradenames	12,350		12,350	Indefinite life
Total intangible assets	$ 680,282	$ (348,249)	$ 332,033	

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2009			
	Gross Assets	Accumulated Amortization (In thousands)	Net	Amortization Life and Method
Finite Lived Assets				
Customer contracts and lists	$ 186,428	$ (121,540)	$ 64,888	5-10 years straight line
Premium on purchased credit card portfolios	155,227	(46,936)	108,291	3-10 years straight line, accelerated
Collector database	66,541	(56,316)	10,225	30 years 15% declining balance
Customer database	160,564	(57,043)	103,521	4-10 years straight line
Noncompete agreements	2,522	(1,986)	536	3-5 years straight line
Tradenames	11,658	(3,674)	7,984	4-10 years straight line
Purchased data lists	17,178	(8,376)	8,802	1-5 years straight line, accelerated
	$ 600,118	$ (295,871)	$ 304,247	
Indefinite Lived Assets				
Tradenames	12,350		12,350	Indefinite life
Total intangible assets	$ 612,468	$ (295,871)	$ 316,597	

With the acquisition of DMS, the Company acquired $67.6 million of intangible assets. These assets included $49.8 million of customer relationships, $15.0 million of customer databases, $2.5 million of trade names and $0.3 million for noncompete agreements. These assets are being amortized over a weighted average life of 7.7 years, 4.0 years, 10.0 years and 2.0 years, respectively. See Note 5, Acquisition, for more information on DMS.

Goodwill

The changes in the carrying amount of goodwill for the nine months ended September 30, 2010 are as follows:

	LoyaltyOne	Epsilon	Private Label Services and Credit (In thousands)	Corporate/ Other	Total
December 31, 2009	$ 234,613	$ 669,930	$ 261,732	$	$ 1,166,275
Effects of foreign currency translation	4,979	(559)			4,420
Goodwill acquired during the year		43,874			43,874
September 30, 2010	$ 239,592	$ 713,245	$ 261,732	$	$ 1,214,569

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. DEBT

Debt consists of the following:

Description	September 30, 2010	December 31, 2009	Maturity	Interest Rate
			(In thousands)	
Long-term and other debt:				
Credit facility	$ 370,000	$ 487,000	March 2012	(1)
Senior notes	250,000	250,000	May 2011	6.14%
2009 Term loan	161,000	161,000	March 2012	(2)
2010 Term loan	236,000		March 2012	(3)
Convertible senior notes due 2013	647,111	612,058	August 2013	1.75%
Convertible senior notes due 2014	252,730	238,869	May 2014	4.75%
Capital lease obligations and other debt	12,791	33,425	Various Oct 2010 Jul 2013[4]	5.20% to 8.10%[4]
	1,929,632	1,782,352		
Less: current portion	(262,751)	(51,963)		
Long-term portion	$ 1,666,881	$ 1,730,389		
Certificates of deposit:				
Certificates of deposit	$ 966,800	$ 1,465,000	One year to five years	0.50% to 5.25%
Less: current portion	(452,400)	(772,500)		
Long-term portion	$ 514,400	$ 692,500		
Asset-backed securities debt owed to securitization investors:[5]				
Fixed rate asset-backed term note securities	$ 1,772,815	$	Various Nov 2011 Jun 2015	3.79% to 7.00%
Floating rate asset-backed term note securities	1,153,500		Various Sept 2011 Apr 2013	0.39% to 2.76%[6]
Conduit asset-backed securities	435,509		Various Jun 2011 Sept 2011	1.85% to 2.66%
Total asset-backed securities owed to securitization investors	3,361,824			
Less: current portion	(885,509)			
Long-term portion	$ 2,476,315	$		

(1) The Company maintains a $750.0 million unsecured revolving credit facility (the Credit Facility,) where advances are in the form of either base rate loans or Eurodollar loans and may be denominated in Canadian dollars, subject to a sublimit, or U.S. dollars. The interest rate for

base loans is the higher of (a) the Bank of Montreal s prime rate, (b) the Federal funds rate plus 0.5%, and (c) the quoted London Interbank Offered Rate (LIBOR) as defined in the credit agreement plus 1.0%. The interest rate for Eurodollar loans denominated in U.S. or Canadian dollars fluctuates based on the rate at which deposits of U.S. dollars or Canadian dollars, respectively, in the London interbank market are quoted plus a margin of 0.4% to 0.8% based upon the Company s senior leverage ratio as defined in the Credit Facility. Total availability under the Credit Facility at September 30, 2010 was $380.0 million. At September 30, 2010, the weighted average interest rate was 0.76%.

(2) Advances under the term loan agreement, dated May 15, 2009 (the 2009 Term Loan), are in the form of either base rate loans or Eurodollar loans. The interest rate for base rate loans fluctuates and is equal to the highest of (a) Bank of Montreal s prime rate; (b) the Federal funds rate plus 0.5%; and (c) the quoted

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

LIBOR as defined in the 2009 Term Loan agreement plus 1.0%, in each case plus a margin of 2.0% to 3.0% based upon the Company s senior leverage ratio as defined in the 2009 Term Loan agreement. The interest rate of Eurodollar loans fluctuates based on the rate at which deposits of U.S. dollars in the London interbank market are quoted plus a margin of 3.0% to 4.0% based on the Company s senior leverage ratio as defined in the 2009 Term Loan. At September 30, 2010, the weighted average interest rate was 3.26%.

(3) Advances under the term loan agreement, dated August 6, 2010 (the 2010 Term Loan), are in the form of either base rate loans or Eurodollar loans. The interest rate for base rate loans fluctuates and is equal to the highest of (a) Bank of Montreal s prime rate; (b) the Federal funds rate plus 0.5%; and (c) the quoted LIBOR as defined in the 2010 Term Loan agreement plus 1.0%, in each case plus a margin of 1.5% to 2.5% based upon the Company s senior leverage ratio as defined in the 2010 Term Loan agreement. The interest rate of Eurodollar loans fluctuates based on the rate at which deposits of U.S. dollars in the London interbank market are quoted plus a margin of 2.5% to 3.5% based on the Company s senior leverage ratio as defined in the 2010 Term Loan. At September 30, 2010, the weighted average interest rate was 2.76%.

(4) The Company has other minor borrowings, primarily capital leases, with varying interest rates and maturities.

(5) Upon adoption of ASC 860 and ASC 810, the Company consolidated the WFN Trusts and the WFC Trust and the related asset-backed securities debt. See Note 2, Change in Accounting Principle, for more information on the adoption of ASC 860 and ASC 810.

(6) Interest rates include those for certain of the Company s asset-backed securities owed to securitization investors where floating rate debt is fixed through interest rate swap agreements. The weighted average interest rate of the fixed rate achieved through interest rate swap agreements is 4.45% at September 30, 2010.

As of September 30, 2010, the Company was in compliance with its financial covenants.

Credit Facility

In June 2010, the Company amended its Credit Facility to clarify the application of ASC 860 and ASC 810 with respect to the calculation of covenant compliance.

2009 Term Loan

In June 2010, the Company amended its 2009 Term Loan to clarify the application of ASC 860 and ASC 810 with respect to the calculation of covenant compliance. In addition, the amendment removed the prepayments that were required beginning June 30, 2010 and now provides that principal payments be paid at maturity, March 30, 2012.

2010 Term Loan

On August 6, 2010, the Company, as borrower, and ADS Alliance Data Systems, Inc., ADS Foreign Holdings, Inc., Alliance Data Foreign Holdings, Inc., Epsilon Marketing Services, LLC and Epsilon Data Management, LLC, as guarantors, entered into a term loan agreement with Bank of Montreal, as administrative agent, and various other agents and banks. The 2010 Term Loan is unsecured. Amounts borrowed under the 2010 Term Loan are scheduled to mature on March 30, 2012.

The 2010 Term Loan contains usual and customary negative covenants, which are subject to certain specified exceptions. The 2010 Term Loan also requires the Company to satisfy certain financial covenants, including maximum ratios of total leverage and senior leverage and a minimum ratio of consolidated operating EBITDA to consolidated interest expense, each as determined in accordance with the 2010 Term Loan.

As of September 30, 2010, total borrowings under the 2010 Term Loan were $236.0 million.

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Convertible Senior Notes

The table below summarizes the carrying value of the components of the convertible senior notes:

	September 30, 2010	December 31, 2009
	(In thousands)	
Carrying amount of equity component	$ 368,678	$ 368,678
Principal amount of liability component	$ 1,150,000	$ 1,150,000
Unamortized discount	(250,159)	(299,073)
Net carrying value of liability component	$ 899,841	$ 850,927
If-converted value of common stock	$ 1,142,583	$ 1,130,852

The discount on the liability component will be amortized as interest expense over the remaining life of the convertible senior notes which is a weighted average period of 3.1 years.

Interest expense on the convertible senior notes recognized in the Company s unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2010 and 2009 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Interest expense calculated on contractual interest rate	$ 7,619	$ 7,619	$ 22,856	$ 15,937
Amortization of discount on liability component	16,752	15,019	48,914	37,243
Total interest expense on convertible senior notes	$ 24,371	$ 22,638	$ 71,770	$ 53,180
Effective interest rate (annualized)	11.0%	11.0%	11.0%	11.0%

Asset-backed Securities Owed to Securitization Investors

An asset-backed security is a security whose value and income payments are derived from and collateralized (or backed) by a specified pool of underlying assets. The sale of the pool of underlying assets to general investors is accomplished through a securitization process.

The Company regularly sells its credit card receivables to its securitization trusts, the WFN Trusts and the WFC Trust. Beginning January 1, 2010, the WFN Trusts and the WFC Trust were consolidated on the balance sheets of the Company, under ASC 860 and ASC 810. See Note 2, Change in Accounting Principle, for more information on the adoption of ASC 860 and ASC 810. The liabilities of the consolidated VIEs include asset-backed securities for which creditors or beneficial interest holders do not have recourse to the general credit of the Company.

Asset-backed Term Notes

In March 2010, Master Trust II issued $100.8 million of term asset-backed securities to investors. The offering consisted of $65.0 million of Class A Series 2010-1 asset-backed notes that have a fixed interest rate of 4.2% per year, $9.8 million of Class M Series 2010-1 asset-backed notes that have a fixed interest rate of

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5.3% per year, $6.6 million of Class B Series 2010-1 asset-backed notes that have a fixed interest rate of 6.3% per year, $11.6 million of Class C Series 2010-1 asset-backed notes that have a fixed interest rate of 7.0% per year and $7.8 million of Class D Series 2010-1 zero-coupon notes which were retained by the Company. The Class A notes will mature in November 2012, the Class M notes will mature in December 2012, the Class B notes will mature in January 2013, the Class C notes will mature in February 2013 and the Class D notes will mature in March 2013. With the consolidation of the WFN Trusts, the Class D Series 2010-1 notes are eliminated from the unaudited condensed consolidated financial statements.

On July 8, 2010, Master Trust I issued $450.0 million of term asset-backed securities to investors in a public offering. The offering consisted of $355.5 million of Class A Series 2010-A asset-backed notes that have a fixed interest rate of 3.96% per year, $16.9 million of Class M Series 2010-A asset-backed notes that have a fixed interest rate of 5.2% per year, $21.4 million of Class B Series 2010-A asset-backed notes that have a fixed interest rate of 6.75% per year and $56.2 million of Class C Series 2010-A asset-backed notes that have a fixed interest rate of 5.0% per year. The Class A, Class M, Class B and Class C notes will all mature in June 2015. The Class C Series 2010-A notes were retained by the Company. With the consolidation of the WFN Trusts, the Class C Series 2010-A notes are eliminated from the unaudited condensed consolidated financial statements.

Conduit Facilities

During the first quarter of 2010, the Company renewed its $550.0 million 2009-VFC1 conduit facility under Master Trust III, extending the maturity to September 30, 2011.

During the second quarter of 2010, the Company renewed its $1.2 billion 2009-VFN conduit facility under Master Trust I, extending the maturity to June 23, 2011, and its $275.0 million 2009-VFN conduit facility under the WFC Trust, extending the maturity to June 3, 2011.

Derivative Financial Instruments

As part of its interest rate risk management program, the Company may enter into derivative financial instruments with institutions that are established dealers and manage its exposure to changes in fair value of certain obligations attributable to changes in LIBOR.

The credit card securitization trusts have entered into derivative financial instruments, which include both interest rate swaps and an interest rate cap, to mitigate their interest rate risk on a related financial instrument or to lock the interest rate on a portion of their variable asset-backed securities debt.

Effective January 1, 2010, the derivative financial instruments of the credit card securitization trusts were consolidated on the Company s balance sheets under ASC 860 and ASC 810. These interest rate contracts involve the receipt of fixed rate amounts from counterparties in exchange for the Company making variable rate payments over the life of the agreement without the exchange of the underlying notional amount. These interest rate contracts are not designated as hedges. Such contracts are not speculative and are used to manage interest rate risk, but do not meet the specific hedge accounting requirements of ASC 815, Derivatives and Hedging.

The following tables identify the notional amount, fair value and classification of the Company s outstanding interest rate contracts at September 30, 2010 in the unaudited condensed consolidated balance sheets:

	Notional Amount (in thousands)	Weighted Average Years to Maturity
Interest rate contracts not designated as hedging instruments	$ 1,153,500	1.98

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Balance Sheet Location	Fair Value (in thousands)
Interest rate contracts not designated as hedging instruments	Other current liabilities	$ 6,624
Interest rate contracts not designated as hedging instruments	Other liabilities	$ 77,375

The following tables identify the classification of the Company s outstanding interest rate contracts for the three and nine months ended September 30, 2010 in the unaudited condensed consolidated statements of income:

For the three months ended September 30, 2010	Income Statement Location	Loss on Derivative Contracts (in thousands)
Interest rate contracts not designated as hedging instruments	Securitization funding costs	$ 59

For the nine months ended September 30, 2010	Income Statement Location	Loss on Derivative Contracts (in thousands)
Interest rate contracts not designated as hedging instruments	Securitization funding costs	$ 5,443

The Company limits its exposure on derivatives by entering into contracts with institutions that are established dealers and maintain certain minimum credit criteria established by the Company. At September 30, 2010, the Company does not maintain any derivative contracts subject to master agreements that would require the Company to post collateral or that contain any credit-risk related contingent features. The Company has provisions in certain of the master agreements that require counterparties to post collateral to the Company when their credit ratings fall below certain thresholds. At September 30, 2010, these thresholds were not breached and no amounts were held as collateral by the Company.

10. DEFERRED REVENUE

Because management has determined that the earnings process is not complete at the time an AIR MILES reward mile is issued, the recognition of revenue on all fees received at issuance is deferred. The Company allocates the proceeds from the issuance of AIR MILES reward miles into two components as follows:

Redemption element. The redemption element is the larger of the two components. Revenue related to the redemption element is based on the estimated fair value. For this component, revenue is recognized at the time an AIR MILES reward mile is redeemed, or for those AIR MILES reward miles that are estimated to go unredeemed by the collector base, known as breakage, over the estimated life of an AIR MILES reward mile.

Service element. The service element consists of marketing and administrative services provided to sponsors. Revenue related to the service element is determined using the residual method in accordance with ASC 605-25. It is initially deferred and then amortized pro rata over the estimated life of an AIR MILES reward mile.

Under certain of the Company s contracts, a portion of the proceeds is paid to the Company upon the issuance of an AIR MILES reward mile and a portion is paid at the time of redemption and therefore, the Company does not have a redemption obligation related to these contracts. Revenue is recognized at the time of redemption and is not reflected in the reconciliation of the redemption obligation detailed below. Under such contracts, the proceeds received at issuance are initially deferred as service revenue and revenue is recognized pro rata over the estimated life of an AIR MILES reward mile. Amounts for revenue related to the redemption element and service element are recorded in redemption revenue and transaction revenue, respectively, in the unaudited condensed consolidated statements of income.

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A reconciliation of deferred revenue for the AIR MILES Reward Program is as follows:

	Service	Deferred Revenue Redemption	Total
		(In thousands)	
December 31, 2009	$ 306,336	$ 839,810	$ 1,146,146
Cash proceeds	136,088	359,749	495,837
Revenue recognized	(126,637)	(364,684)	(491,321)
Other		4,564	4,564
Effects of foreign currency translation	6,898	18,725	25,623
September 30, 2010	$ 322,685	$ 858,164	$ 1,180,849
Amounts recognized in the unaudited condensed consolidated balance sheets:			
Current liabilities	$ 154,952	$ 858,164	$ 1,013,116
Non-current liabilities	$ 167,733	$	$ 167,733

11. STOCKHOLDERS EQUITY

Stock Repurchase Programs

On January 27, 2010, the Company s Board of Directors authorized a stock repurchase program (Prior Repurchase Program) to acquire up to $275.1 million of the Company s common stock through December 31, 2010. On September 13, 2010, the Company s Board of Directors authorized a new stock repurchase program, replacing the Prior Repurchase Program, to acquire up to $400.0 million of the Company s common stock through December 31, 2011, subject to any restrictions pursuant to the terms of the Company s credit agreements or otherwise.

For the three and nine months ended September 30, 2010, the Company acquired a total of 897,986 shares and 1,354,486 shares, respectively, of its common stock for $50.9 million and $76.7 million, respectively. All shares were acquired prior to September 13, 2010 and under the Prior Repurchase Program.

Stock Compensation Plans

On March 31, 2005, the Company s Board of Directors adopted the 2005 long-term incentive plan, which was subsequently approved by the Company s stockholders on June 7, 2005 and became effective July 1, 2005. This plan reserved 4,750,000 shares of common stock for grants of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units and other performance-based awards to selected officers, employees, non-employee directors and consultants performing services for the Company or its affiliates. On September 24, 2009, the Company s Board of Directors amended the 2005 long term incentive plan to provide that, in addition to settlement in shares of the Company s common stock or other securities, equity awards may be settled in cash. No more grants may be made from the 2005 long-term incentive plan, which expired on June 30, 2010.

On March 25, 2010, the Company s Board of Directors adopted the 2010 Omnibus Incentive Plan, which was subsequently approved by the Company s stockholders on June 8, 2010, became effective July 1, 2010 and expires on June 30, 2015. This plan reserves 3,000,000 shares of common stock for grants of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units, performance share awards, cash incentive awards, deferred stock units, and other stock-based and cash-based awards to

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selected officers, employees, non-employee directors and consultants performing services for the Company or its affiliates, with only employees being eligible to receive incentive stock options.

Stock Compensation Expense

Total stock-based compensation expense recognized in the Company s unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2010 and 2009 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Cost of operations	$ 6,598	$ 7,315	$ 18,801	$ 23,466
General and administrative	4,377	7,293	15,195	19,799
Total	$ 10,975	$ 14,608	$ 33,996	$ 43,265

There was no stock-based compensation expense related to discontinued operations for the three and nine months ended September 30, 2010 and for the three months ended September 30, 2009. For the nine months ended September 30, 2009, stock-based compensation expense for the Company s discontinued operations was approximately $0.1 million. This amount is included in the loss from discontinued operations in the unaudited condensed consolidated statements of income.

During the nine months ended September 30, 2010, the Company awarded 477,329 performance-based restricted stock units with a weighted average grant date fair value per share of $57.15 as determined on the date of grant. The performance restriction on the awards will lapse upon determination by the Board of Directors or the Compensation Committee of the Board of Directors that the Company s core earnings per share growth for the period from January 1, 2010 to December 31, 2010 met certain pre-defined vesting criteria that permit a range from 50% to 150% of such performance-based restricted stock units to vest. Upon such determination, the restrictions will lapse with respect to 33% of the award on February 22, 2011, an additional 33% of the award on February 22, 2012 and the final 34% of the award on February 22, 2013, provided that the participant is employed by the Company on each such vesting date.

During the nine months ended September 30, 2010, the Company awarded 201,639 service-based restricted stock units with a weighted average grant date fair value per share of $60.37 as determined on the date of grant. Service-based restricted stock units typically vest ratably over three years provided that the participant meets the service condition on each such vesting date.

In March 2009, the Company determined that it was no longer probable that the specified performance measures associated with certain performance-based restricted stock units would be achieved. As a result, 1,242,098 performance-based restricted stock units granted during 2008 and in January 2009, having a weighted-average grant date fair value of $56.43 per share, are not expected to vest. The Company has not recognized stock-based compensation expense related to those awards no longer expected to vest.

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12. COMPREHENSIVE INCOME

The components of comprehensive income, net of tax effect, are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Net income	$ 53,059	$ 45,796	$ 147,033	$ 103,087
Adoption of ASC 860 and ASC 810[1]			55,881	
Unrealized loss on securities available-for-sale	(1,535)	(5,678)	(3,283)	(35,126)
Foreign currency translation adjustments[2]	(3,909)	(2,908)	(5,791)	6,217
Total comprehensive income, net of tax	$ 47,615	$ 37,210	$ 193,840	$ 74,178

(1) These amounts related to unrealized losses associated with retained interests in the WFN Trusts and the WFC Trust, which were classified as available-for-sale. These amounts were previously reflected in accumulated other comprehensive income. Effective January 1, 2010, upon the adoption of ASC 860 and ASC 810, these interests and related accumulated other comprehensive income have been reclassified, derecognized or eliminated upon consolidation of the WFN Trusts and the WFC Trust.

(2) Primarily related to the impact of changes in the Canadian currency exchange rate.

13. FINANCIAL INSTRUMENTS

In accordance with ASC 825, Financial Instruments, the Company is required to disclose the fair value of financial instruments for which it is practical to estimate fair value. To obtain fair values, observable market prices are used if available. In some instances, observable market prices are not readily available and fair value is determined using present value or other techniques appropriate for a particular financial instrument. These techniques involve judgment and as a result are not necessarily indicative of the amounts the Company would realize in a current market exchange. The use of different assumptions or estimation techniques may have a material effect on the estimated fair value amounts.

Fair Value of Financial Instruments The estimated fair values of the Company s financial instruments are as follows:

	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Financial assets				
Cash and cash equivalents	$ 391,226	$ 391,226	$ 213,378	$ 213,378
Trade receivables, net	234,570	234,570	225,212	225,212
Seller s interest			297,108	297,108
Credit card receivables, net	4,431,595	4,431,595	616,298	616,298
Redemption settlement assets, restricted	495,499	495,499	574,004	574,004
Due from securitizations			775,570	775,570

Cash collateral, restricted	205,359	205,359	216,953	216,953
Financial liabilities				
Accounts payable	124,040	124,040	103,891	103,891
Asset-backed securities debt owed to securitization investors	3,361,824	3,427,074		
Debt, including certificates of deposit	2,896,432	3,073,214	3,247,352	3,408,039
Derivative financial instruments	83,999	83,999		

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Value of Assets and Liabilities Held at September 30, 2010

The following techniques and assumptions were used by the Company in estimating fair values of financial instruments as disclosed herein:

Cash and cash equivalents, trade receivables, net and accounts payable The carrying amount approximates fair value due to the short maturity.

Credit card receivables, net The carrying amount of credit card receivables, net approximates fair value due to the short maturity, and the average interest rates approximate current market origination rates.

Redemption settlement assets, restricted Fair value for securities is based on quoted market prices for the same or similar securities.

Cash collateral, restricted The spread deposits are recorded at their fair value based on discounted cash flow models. The carrying amount of excess funding deposits approximates its fair value due to the relatively short maturity period and average interest rates, which approximate current market rates.

Asset-backed securities debt owed to securitization investors The fair value is estimated based on the current rates available to the Company for similar debt instruments with similar remaining maturities.

Debt, including certificates of deposit The fair value is estimated based on the current rates available to the Company for similar debt instruments with similar remaining maturities.

Derivative financial instruments The valuation of these instruments is determined using a discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and option volatility.

Fair Value of Assets and Liabilities Held at December 31, 2009

The following techniques and assumptions were used by the Company in estimating fair values of financial instruments which were subsequently reclassified, derecognized or eliminated upon consolidation of the WFN Trusts and the WFC Trust as a result of the adoption of ASC 860 and ASC 810 as disclosed herein:

Seller s interest Seller s interest was carried at an allocated carrying amount based on their fair value. The Company determined the fair value of its seller s interest through discounted cash flow models. The estimated cash flows used included assumptions related to rates of payments and defaults, which reflected economic and other relevant conditions. The discount rate used was based on an interest rate curve that was observable in the market place plus an unobservable credit spread. With the consolidation of the WFN Trusts and the WFC Trust on January 1, 2010, seller s interest has been eliminated.

Due from securitizations The retained interest and interest-only strips were recorded at their fair value. The Company used a valuation model that calculated the present value of estimated future cash flows for each asset which incorporated the Company s own estimates of assumptions market participants used in determining fair value, including estimates of payment rates, defaults, net charge-offs, discount rates and contractual interest and fees. With the consolidation of the WFN Trusts and the WFC Trust on January 1, 2010, due from securitizations has been derecognized or eliminated.

Assets and Liabilities Measured on a Recurring Basis

ASC 825 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

Level 1, defined as observable inputs such as quoted prices in active markets;

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and

Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The use of different techniques to determine fair value of these financial instruments could result in different estimates of fair value at the reporting date.

The following tables provide the assets carried at fair value measured on a recurring basis as of September 30, 2010 and December 31, 2009:

	Balance at September 30, 2010	Fair Value Measurements at September 30, 2010 Using		
		Level 1	Level 2	Level 3
		(In thousands)		
Government bonds[1]	$ 36,093	$	$ 36,093	$
Corporate bonds[1]	424,904	210,367	214,537	
Other available-for-sale securities[2]	83,758	64,746	19,012	
Cash collateral, restricted	205,359		37,530	167,829
Total assets measured at fair value	$ 750,114	$ 275,113	$ 307,172	$ 167,829
Derivative financial instruments[3]	$ 83,999	$	$ 83,999	$
Total liabilities measured at fair value	$ 83,999	$	$ 83,999	$

	Balance at December 31, 2009	Fair Value Measurements at December 31, 2009 Using		
		Level 1	Level 2	Level 3
		(In thousands)		
Government bonds[1]	$ 42,231	$ 16,676	$ 25,555	$
Corporate bonds[1]	460,132	308,668	77,598	73,866
Other available-for-sale securities[2]	105,064	95,300	9,764	
Seller s interest	297,108			297,108
Due from securitizations	775,570			775,570
Cash collateral, restricted	216,953		10,275	206,678
Total assets measured at fair value	$ 1,897,058	$ 420,644	$ 123,192	$ 1,353,222

(1) Amounts are included in redemption settlement assets in the unaudited condensed consolidated balance sheets.

(2) Amounts are included in other current and non-current assets in the unaudited condensed consolidated balance sheets.

(3) Amounts are included in other current liabilities and other liabilities in the unaudited condensed consolidated balance sheets.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables summarize the changes in fair value of the Company s assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 825 as of September 30, 2010 and 2009:

	Corporate Bonds	Seller s Interest	Due from Securitizations	Cash Collateral, Restricted
		(In thousands)		
June 30, 2010	$	$	$	$ 171,790
Total gains (realized or unrealized)				
Included in earnings				473
Included in other comprehensive income				
Purchases, sales, issuances and settlements				(4,434)
Transfers in or out of Level 3				
September 30, 2010	$	$	$	$ 167,829
Gains for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2010	$	$	$	$ 473

	Corporate Bonds	Seller s Interest	Due from Securitizations	Cash Collateral, Restricted
		(In thousands)		
December 31, 2009	$ 73,866	$ 297,108	$ 775,570	$ 206,678
Adoption of ASC 860 and ASC 810	(73,866)	(297,108)	(775,570)	
Total gains (realized or unrealized)				
Included in earnings				143
Included in other comprehensive income				
Purchases, sales, issuances and settlements				(38,992)
Transfers in or out of Level 3				
September 30, 2010	$	$	$	$ 167,829
Gains for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2010	$	$	$	$ 143

	Corporate Bonds	Seller s Interest	Due from Securitizations	Cash Collateral, Restricted
		(In thousands)		
June 30, 2009	$ 83,559	$ 183,673	$ 531,386	$ 189,668
Total (losses) gains (realized or unrealized)				

Included in earnings		(816)	1,427	85
Included in other comprehensive income	14,129		(23,838)	
Purchases, sales, issuances and settlements		28,635	23,553	(4,222)
Transfers in or out of Level 3				
September 30, 2009	$ 97,688	$ 211,492	$ 532,528	$ 185,531
Losses for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2009	$	$	$ (3,578)	$

ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Corporate Bonds	Seller s Interest	Due from Securitizations	Cash Collateral, Restricted
		(In thousands)		
December 31, 2008	$ 28,625	$ 182,428	$ 428,853	$ 175,384
Total (losses) gains (realized or unrealized)				
Included in earnings		7,727	(9,149)	556
Included in other comprehensive income	4,506		(54,125)	
Purchases, sales, issuances and settlements	64,557	21,337	166,949	9,591
Transfers in or out of Level 3				
September 30, 2009	$ 97,688	$ 211,492	$ 532,528	$ 185,531
Losses for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2009	$	$	$ (8,868)	$

For the three and nine months ended September 30, 2010 and 2009, gains included in earnings attributable to cash collateral, restricted were included in revenue under finance charges, net in the unaudited condensed consolidated statements of income. For the three and nine months ended September 30, 2009, gains and losses included in earnings for seller s interest and due from securitizations were included in securitization income in the unaudited condensed consolidated statements of income.

Assets and Liabilities Measured on a Non-Recurring Basis

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include those associated with acquired businesses, including goodwill and other intangible assets. For these assets, measurement at fair value in periods subsequent to their initial recognition is applicable if one or more is determined to be impaired. During the three and nine months ended September 30, 2010, the Company had no impairments related to these assets.

14. INCOME TAXES

For the three and nine months ended September 30, 2010, the Company utilized an effective tax rate of 38.2% to calculate its provision for income taxes. In accordance with ASC 740-270, Income taxes Interim Reporting, the Company s expected annual effective tax rate for calendar year 2010 based on all known variables is 38.2%.

For the three and nine months ended September 30, 2009, the Company s effective tax rate was 17.6% and 32.0%, respectively. During the third quarter of 2009, the Company recognized an $11.7 million tax benefit related to previously established tax reserves to cover various uncertain tax positions, which were no longer necessary due to a United States Tax Court decision, statute of limitations expirations and other factors. The Company s 2009 effective tax rate without regard to the $11.7 million tax benefit remained 38.8%.

On January 1, 2010, the Company s deferred tax asset increased by approximately $197.2 million as a result of the adoption of ASC 860 and ASC 810.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. SEGMENT INFORMATION

In the first quarter of 2010, the Company reorganized its segments with Private Label Services and Private Label Credit reflected as one segment. All prior year segment information has been restated to conform to the current presentation. In addition, the Company renamed its other two segments from Epsilon Marketing Services and Loyalty Services to Epsilon and LoyaltyOne, respectively.

The Company operates in three reportable segments: LoyaltyOne, Epsilon and Private Label Services and Credit.

LoyaltyOne includes the Company s Canadian AIR MILES Reward Program;

Epsilon provides integrated direct marketing solutions that combine database marketing technology and analytics with a broad range of direct marketing services; and

Private Label Services and Credit provides risk management solutions, account origination, funding, transaction processing, customer care and collections services for the Company s private label retail credit card programs.

Additionally, corporate and all other immaterial businesses are reported collectively as an all other category labeled Corporate/Other. Total interest expense, net and income taxes are not allocated to the segments in the computation of segment operating profit for internal evaluation purposes and have also been included in Corporate/Other. Total assets are not allocated to the segments. The Company s utility services business and a terminated credit program have been classified as discontinued operations. See Note 16, Discontinued Operations, for additional information.

Three Months Ended September 30, 2010	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Eliminations	Total
			(In thousands)			
Revenues	$ 184,411	$ 170,468	$ 349,642	$ 357	$ (2,435)	$ 702,443
Adjusted EBITDA(1)	46,478	44,091	143,894	(13,988)	(1,584)	218,891
Depreciation and amortization	5,827	21,473	8,892	1,715		37,907
Stock compensation expense	2,514	2,305	1,779	4,377		10,975
Operating income (loss)	38,137	20,313	133,223	(20,080)	(1,584)	170,009
Interest expense, net				84,119		84,119
Income (loss) from continuing operations before income taxes	38,137	20,313	133,223	(104,199)	(1,584)	85,890

Three Months Ended September 30, 2009	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Eliminations	Total
			(In thousands)			
Revenues	$ 177,008	$ 131,926	$ 166,982	$ 5,515	$	$ 481,431
Adjusted EBITDA(1)	53,186	35,196	67,845	(16,061)		140,166

Depreciation and amortization	5,966	18,003	5,809	1,356	31,134
Stock compensation expense	3,847	1,705	1,763	7,293	14,608
Merger and other costs(2)				878	878
Operating income (loss)	43,373	15,488	60,273	(25,588)	93,546
Interest expense, net				38,563	38,563
Income (loss) from continuing operations before income taxes	43,373	15,488	60,273	(64,151)	54,983

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine Months Ended September 30, 2010	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Eliminations	Total
			(In thousands)			
Revenues	$ 575,612	$ 433,799	$ 1,032,106	$ 1,510	$ (7,329)	$ 2,035,698
Adjusted EBITDA[1]	158,731	102,654	416,878	(44,171)	(5,010)	629,082
Depreciation and amortization	18,111	57,565	25,913	4,910		106,499
Stock compensation expense	7,042	6,441	5,318	15,195		33,996
Operating income (loss)	133,578	38,648	385,647	(64,276)	(5,010)	488,587
Interest expense, net				250,673		250,673
Income (loss) from continuing operations before income taxes	133,578	38,648	385,647	(314,949)	(5,010)	237,914

Nine Months Ended September 30, 2009	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Eliminations	Total
			(In thousands)			
Revenues	$ 504,985	$ 372,495	$ 512,960	$ 27,981	$	$ 1,418,421
Adjusted EBITDA[1]	146,419	87,717	216,314	(36,002)		414,448
Depreciation and amortization	15,877	51,835	17,740	6,096		91,548
Stock compensation expense	10,128	6,930	6,394	19,813		43,265
Merger and other costs[2]				3,890		3,890
Operating income (loss)	120,414	28,952	192,180	(65,801)		275,745
Interest expense, net				103,957		103,957
Income (loss) from continuing operations before income taxes	120,414	28,952	192,180	(169,758)		171,788

(1) Adjusted EBITDA is a non-GAAP financial measure equal to income from continuing operations, the most directly comparable GAAP financial measure, plus stock compensation expense, provision for income taxes, interest expense, net, depreciation and amortization, merger and other costs. Adjusted EBITDA is presented in accordance with ASC 280, Segment Reporting, as it is the primary performance metric by which senior management is evaluated.

(2) Merger and other costs are not allocated to the segments in the computation of segment operating profit for internal evaluation purposes. Merger costs represent investment banking, legal and accounting costs directly associated with the proposed merger with an affiliate of The Blackstone Group. Other costs represent compensation charges related to the departure of certain employees resulting from cost saving initiatives and other non-routine costs associated with the disposition of certain businesses.

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ALLIANCE DATA SYSTEMS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. DISCONTINUED OPERATIONS

In February 2009, the Company completed the sale of the remainder of its utility services business, including the termination of a services agreement and the resolution of certain contractual disputes, to a former utility client. In November 2009, the Company terminated operations of its credit program for web and catalog retailer VENUE. These have been treated as discontinued operations under ASC 205-20, Presentation of Financial Statements Discontinued Operations. The underlying assets of the discontinued operations for the periods presented in the unaudited condensed consolidated balance sheets are as follows:

	September 30, 2010	December 31, 2009
	(In thousands)	
Assets:		
Credit card receivables, net	$ 18,028	$ 34,623
Assets of discontinued operations	$ 18,028	$ 34,623

The following table summarizes the operating results of the discontinued operations:

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
	(In thousands)			
Revenue	$	$ 1,755	$	$ 10,089
Income (loss) before provision for income taxes		744		(20,898)
(Provision) benefit from income taxes		(265)		7,232
Income (loss) from discontinued operations	$	$ 479	$	$ (13,666)

17. REGULATORY MATTERS

On July 15, 2010, the Office of the Comptroller of the Currency (OCC) approved an application filed by the Company s credit card services bank subsidiary, WFNNB, to change the location of the bank to Wilmington, Delaware through the merger of the bank with an interim banking association organized under the laws of the United States and located in Wilmington, Delaware. WFNNB is a national banking association and a limited purpose credit card bank and is regulated, supervised, and examined by the OCC, its primary regulator. WFNNB is also subject to regulation by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation. Neither the name of the bank nor any of its assets, liabilities or contemplated business purposes will change as a result of the merger. The merger was completed in August 2010.

18. NON-CASH FINANCING AND INVESTING ACTIVITIES

On January 1, 2010, the Company adopted ASC 860 and ASC 810 resulting in the consolidation of the WFN Trusts and the WFC Trust. Based on the carrying amounts of the WFN Trusts and the WFC Trust s assets and liabilities as prescribed by ASC 810, the consolidation of the trusts had the following non-cash impact to the financing and investing activities for the nine months ended September 30, 2010 as follows:

- elimination of $74 million in redemption settlement assets for those interests retained in the WFN Trusts,

- elimination of $775 million in retained interests classified in due from securitizations,

- consolidation of $4.1 billion in credit card receivables, and

- consolidation of $3.7 billion in asset-backed securities.

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes thereto presented in this quarterly report and the consolidated financial statements and related notes thereto included in our Annual Report filed on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission, or SEC, on March 1, 2010.

In the first quarter of 2010, we reorganized our segments with Private Label Services and Private Label Credit reflected as one segment. All prior year segment information has been restated to conform to the current presentation. In addition, we renamed our other two segments from Epsilon Marketing Services and Loyalty Services to Epsilon and LoyaltyOne, respectively.

Year in Review Highlights

Our results for the first nine months of 2010 included the following new and renewed agreements:

In January 2010, we announced the signing of a multi-year expansion agreement with New York & Company, a specialty retail apparel chain, to provide a comprehensive database marketing solution that includes customer data management, campaign management, reporting and strategic consulting and analytics services.

In February 2010, we announced the signing of multi-year agreements with Kraft Foods Inc. to provide a comprehensive direct-to-consumer marketing solution, including database and data management, consumer data integration, permission-based email marketing services, multi-channel campaign management and interactive web services.

In February 2010, we announced that Budgetcar, Inc., a subsidiary of Avis Budget Group, Inc. and an AIR MILES® Reward Program sponsor and rewards supplier since 2007, had signed a multi-year renewal agreement.

In February 2010, we announced the signing of a new multi-year agreement with Dallas-based La Quinta to provide permission-based email marketing services. In addition, La Quinta also renewed its existing agreement for Epsilon s ongoing support and management of La Quinta s frequent guest program.

In March 2010, we announced that Vision Electronics, an AIR MILES Reward Program sponsor since 2007, had signed a multi-year renewal agreement.

In March 2010, our private label credit card banking subsidiary, World Financial Network National Bank, or WFNNB, issued $100.8 million of asset-backed securities to investors.

In March 2010, WFNNB completed the renewal of its $550.0 million conduit facility.

In April 2010, we announced the signing of a new 5-year contract with the Liquor Control Board of Ontario, a top-10 AIR MILES Reward Program sponsor and a sponsor since 1998.

In May 2010, we announced that Pharmasave Atlantic, an Atlantic Canadian pharmacy retailer and an AIR MILES Reward Program sponsor since 1995, signed a multi-year renewal agreement.

In May 2010, we announced the signing of a multi-year agreement with Whirlpool Canada LP, one of Canada s leading marketers and supplier of home appliances, as a sponsor in our AIR MILES Reward Program.

In June 2010, we announced that Washington, D.C.-based AARP has signed a multi-year renewal agreement to provide data and database marketing services in support of AARP s member acquisition program.

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In June 2010, we announced a new sponsor agreement coinciding with an innovative energy conversation campaign with the Ontario Power Authority, representing an expansion of the AIR MILES Reward Program in the energy sector.

In June 2010, WFNNB completed the renewal of its $1.2 billion conduit facility, and our industrial bank subsidiary, World Financial Capital Bank, or WFCB, completed the renewal of its $275.0 million conduit facility, resulting in an increase of $175.0 million in overall conduit capacity.

In July 2010, we completed the acquisition of the Direct Marketing Services and Database Marketing divisions of Equifax, Inc., collectively DMS. DMS provides proprietary data-driven, integrated marketing solutions and has been integrated in our Epsilon segment.

In July 2010, we announced the signing of a multi-year renewal agreement with New York, N.Y.-based JPMorgan Chase, providing digital marketing services in support of JPMorgan Chase s Credit Card Services group.

In July 2010, WFNNB issued $450.0 million of asset-backed securities to investors.

In July 2010, we announced that Dell Inc. signed a multi-year expansion agreement, supporting its strategic email marketing program.

In August 2010, we announced that the Manitoba Liquor Control Commission, an AIR MILES Reward Program sponsor since 1998, signed a multi-year renewal agreement.

In August 2010, we entered into a new term loan agreement with Bank of Montreal and various other agents. At closing, we borrowed $221.0 million. In September 2010, we exercised the option to increase and borrowed an additional $15.0 million.

In August 2010, WFNNB completed its charter relocation from Columbus, Ohio to Wilmington, Delaware, providing additional flexibility in the management of our credit card programs going forward.

In August 2010, we announced the signing of a multi-year expansion agreement with Unilever, a large consumer products company, to provide database management and multichannel marketing services.

In August 2010, we announced the signing of a multi-year agreement with David s Bridal, Inc., parent company of Priscilla of Boston and a leading retailer of bridal and special occasion attire, to provide private label credit card services.

In September 2010, we announced the signing of a new agreement with AAA Northern California Nevada and Utah, the second-largest club in the national AAA federation, to provide marketing services.

In September 2010, we announced the signing of a new multi-year agreement with MyPoints.com, an online loyalty marketing service, to provide co-brand credit card services.

In September 2010, our Board of Directors approved a new stock repurchase program to acquire up to $400.0 million of our outstanding common stock through December 31, 2011, subject to any restrictions pursuant to the terms of our credit agreements or otherwise.

In September 2010, we announced the signing of an expansion agreement with leading specialty retailer Chico s to provide data overlay services.

Critical Accounting Policies and Estimates

There have been no material changes, other than those noted below with the adoption of Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, 860, Transfers and Servicing, and ASC 810, Consolidation, to our critical accounting policies and estimates from the information provided in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, included in our 10-K for the fiscal year ended December 31, 2009.

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Effective January 1, 2010, our seller s interest, interest-only strips and retained interest, which were recorded at estimated fair value, have been reclassified, derecognized or eliminated upon adoption of ASC 860 and ASC 810. Additionally, with the consolidation of World Financial Network Credit Card Master Trust, or Master Trust, World Financial Network Credit Card Master Note Trust, or Master Trust I, World Financial Network Credit Card Master Note Trust II, or Master Trust II, and World Financial Network Credit Card Master Trust III, or Master Trust III, or collectively, the WFN Trusts, and the World Financial Capital Credit Card Master Note Trust, or the WFC Trust, the estimate for the allowance for loan loss has become a critical accounting estimate.

Management evaluates its allowance for loan loss monthly for adequacy. The allowance is maintained through an adjustment to the provision for loan loss. In estimating the inherent loan losses in the credit card portfolio, we utilize a migration analysis of delinquent and current credit card receivables. Migration analysis is a technique used to estimate the likelihood that a credit card receivable will progress through the various stages of delinquency and to charge-off. The migration analysis considers uncollectible principal, interest and fees reflected in credit card receivables. In determining the proper level of the allowance for loan loss, management also considers factors that may impact loan loss experience, including seasoning, loan volume and amounts, payment rates and forecasting uncertainties.

Recent Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Update, or ASU, 2009-13, Multiple-Deliverable Revenue Arrangements, which supersedes certain guidance in ASC 605-25, Revenue Recognition Multiple-Element Arrangements, and requires an entity to allocate arrangement consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices (the relative-selling-price method). ASU 2009-13 eliminates the use of the residual method of allocation in which the undelivered element is measured at its estimated selling price and the delivered element is measured as the residual of the arrangement consideration, and requires the relative-selling-price method in all circumstances in which an entity recognizes revenue for an arrangement with multiple deliverables subject to ASU 2009-13. ASU 2009-13 will be effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. If we elect early adoption and the adoption is during an interim period, we will be required to apply this ASU retrospectively from the beginning of our fiscal year. We can also elect to apply this ASU retrospectively for all periods presented. We are currently evaluating the impact that the adoption of ASU 2009-13 will have on our consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, Fair Value Measurements and Disclosures, which amends ASC 820, Fair Value Measurements and Disclosures, to add separate disclosures about purchases, sales, issuances and settlements related to Level 3 measurements. The requirement to provide the Level 3 disclosures about purchases, sales, issuances and settlements will be effective for interim and annual periods beginning after December 15, 2010. The adoption of ASU 2010-06 for the separate Level 3 disclosures will only impact disclosures and will not have a material impact on our consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which amends ASC 310, Receivables, to require further disaggregated disclosures that improve financial statement users understanding of (1) the nature of an entity s credit risk associated with its financing receivables and (2) the entity s assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes. The new and amended disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The adoption of ASU 2010-20 will only impact disclosures and will not have a material impact on our consolidated financial statements.

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Accounting Treatment for Securitizations

We have consolidated the credit card securitization trusts used in our securitization transactions, as the WFN Trusts and the WFC Trust were no longer exempt from consolidation effective January 1, 2010, upon our adoption of ASC 860 and ASC 810.

At adoption, we added approximately $3.4 billion of assets, including a $0.5 billion addition to loan loss reserves, and approximately $3.7 billion of liabilities to our unaudited condensed consolidated balance sheets. The impact of the new accounting is a reduction to stockholders equity of $0.4 billion. The adoption required a full consolidation of the securitization trusts in accordance with accounting principles generally accepted in the United States of America, or GAAP.

Subsequent to January 1, 2010, our unaudited condensed consolidated statements of income no longer reflect securitization income, but instead reflect finance charges and certain other income associated with the securitized credit card receivables. Net charge-offs associated with credit card receivables impact our provision for loan loss reflected in our total operating expenses. Interest expense associated with debt issued from the trusts to third-party investors is reported in securitization funding costs. Additionally, we no longer record initial gains on new securitization activity since securitized credit card loans no longer receive sale accounting treatment, nor are there any gains or losses on the revaluation of the interest-only strip receivable, as that asset is not recognized in a transaction accounted for as a secured borrowing. Since our securitization transactions are accounted for under the new accounting rules as secured borrowings rather than asset sales, the cash flows from these transactions are presented as cash flows from financing activities rather than cash flows from operating or investing activities.

Regulatory Matters

The new Federal Reserve Board guidelines on late fees that can be charged by financial institutions became effective on August 22, 2010. In anticipation of the late fee guidelines, we modified cardholder terms to offset the impact of any decline in average late fees charged. The final guidelines had less impact than initially expected as they provide for: (1) a $25 maximum late fee compared to our original expectation of $20, and (2) late fees to be charged in excess of the $25 maximum for repeat offenses within a six month period. In response to the final guidelines, we have changed minimum payments and modified late fee structures effective for billing cycles beginning in November 2010.

On July 15, 2010, the Office of the Comptroller of the Currency, or OCC, approved an application filed by our credit card services bank subsidiary, WFNNB, to change the location of the bank to Wilmington, Delaware through the merger of the bank with an interim banking association organized under the laws of the United States and located in Wilmington, Delaware. WFNNB is a national banking association and a limited purpose credit card bank and is regulated, supervised and examined by the OCC, its primary regulator. WFNNB is also subject to regulation by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation. Neither the name of the bank nor any of its assets, liabilities or contemplated business purposes will change as a result of the merger. The merger was completed in August 2010.

On September 27, 2010, the Board of the Federal Deposit Insurance Corporation adopted new safe harbors relating to the treatment of securitizations in receivership or conservatorship. The new safe harbor rules include a grandfathering provision that we believe will allow the credit card securitization trusts used in our securitization program to continue to benefit from the protections under the safe harbor to the same extent as prior securitizations issued by those trusts. Therefore we do not expect the adoption of the new rule to adversely affect our ability to securitize our receivables. However, because the new safe harbors were recently adopted, participants in the securitization market, including investors in asset-backed securities and the rating agencies that rate our asset-backed securities, are continuing to evaluate the effect of the new safe harbors.

Outlook

We expect double-digit growth in both consolidated revenue and consolidated adjusted EBITDA for the fourth quarter. Private Label Services and Credit and Epsilon are expected to provide positive revenue growth and adjusted EBITDA growth, while LoyaltyOne is expected to provide positive revenue growth but a decline in adjusted EBITDA.

LoyaltyOne

LoyaltyOne is expected to report a decline in adjusted EBITDA primarily due to the run-off of deferred revenue related to the conversion of a certain split fee to non-split fee program that began in May 2008. In conjunction with this conversion, we changed our estimate of breakage from one-third to 28%. The change in estimate had no impact on the total redemption liability, but reduced the amount of deferred breakage within the redemption liability that is expected to be recognized over the expected life of the mile.

The deferred revenue associated with the conversion of a split fee sponsor to a non-split fee sponsor was recognized as AIR MILES reward miles were redeemed and was fully amortized in the third quarter of 2010. Comparatively, revenue associated with breakage is recognized ratably over the estimated life of a mile. Although our deferred breakage element continues to build, the growth rate has been impacted by weak AIR MILES reward miles issuance in the later part of 2009 and 2010. We believe this will negatively impact our redemption revenue. Based on AIR MILES reward miles issuance forecasts, the negative impact of this timing issue should moderate by mid-2011.

While we believe that the AIR MILES Reward Program tends to be resilient during economic swings, macroeconomic factors, such as the overall health of the Canadian economy, may impact collector behavior. Therefore, we could experience an impact to our sponsor mix resulting in lower-priced miles being issued, which could impact our operating margins. In the latter part of 2008 and 2009, we started to see a shift in the sponsor mix, and given the deferred nature of our revenue recognition, this impact is expected to be reflected in our results of operations for the second half of 2010. In 2010, we have seen a slight positive shift in sponsor mix.

AIR MILES reward miles issued during the third quarter of 2010 decreased 3.9% compared to the third quarter of 2009 due to reduced promotional activity in the grocer sector and generally flat consumer credit card spending compared to the prior corresponding quarter. Growth in credit card spending was sluggish as a result of less buoyant consumer spending brought on by the slowing the economic recovery in Canada.

LoyaltyOne also has a partnership interest in an entity operating a Brazilian coalition loyalty program. The initial phase is currently in progress and a further planned investment of up to $15.0 million in the initiative is dependent on the success of the initial phase and the timing of the phased program rollout. The program is in the process of securing long-term agreements with select major sponsors, while preparing for a national rollout with them in early 2011.

Epsilon

We believe that the outlook for Epsilon s business remains strong as the major offerings continue to demonstrate positive momentum, with expected growth of 20% in revenue and adjusted EBITDA in the fourth quarter of 2010 as compared to the fourth quarter of 2009. Specifically, the database/digital businesses continue to benefit from strong new client wins, producing a solid implementation stream throughout 2010. We also believe that Abacus continued growth demonstrates a return to stability in retail and catalog marketing budgets. This trend suggests a positive economic outlook from these key verticals, which we expect will reinforce the value of data-driven ROI-based marketing strategies in the overall marketing mix.

Finally, the DMS acquisition has been integrated into our Epsilon segment. DMS provides proprietary data-driven, integrated marketing solutions through two complementary offerings: database marketing and hosting, and data services, including U.S. consumer demographic information. The DMS acquisition is not expected to materially benefit earnings in 2010, but is expected to be accretive to earnings in 2011.

Private Label Services and Credit

For the third quarter of 2010, credit trends were positive with principal charge-offs at 8.3% of average total receivables, improving from 9.4% for the third quarter of 2009. Charge-off rates continue to trend lower as, due to the length of severity of the economic downturn, there is no longer a direct correlation between loan loss rates and unemployment levels. Delinquency rates, a good predictor of future losses, improved slightly to 6.1% of principal receivables at September 30, 2010 from 6.2% at September 30, 2009. Delinquency rates continue to trend downward on a seasonally adjusted basis. However, the September 2010 delinquency rate was 10 to 20 basis points higher than predicted by normal seasonality. We believe that the changes incorporated in cardholder terms during 2010, including raising annual percentage rates in March and increasing minimum payments from $10 to $20 in June, have resulted in two small increases that are working their way through the delinquency rate. Finally, cardholder spending has slowed from the first half of 2010. For the third quarter of 2010, credit sales increased 7.2%, driven primarily by new credit card portfolios.

For the fourth quarter of 2010, average receivable balances are expected to be flat year-over-year as new programs anniversary. The provision for loan loss will increase during the fourth quarter from the third quarter of 2010 due to the seasonal buildup in credit card receivables and will exceed actual loan loss charge-offs.

Use of Non-GAAP Financial Measures

Adjusted EBITDA is a non-GAAP financial measure equal to income from continuing operations, the most directly comparable GAAP financial measure, plus stock compensation expense, provision for income taxes, interest expense, net, merger and other costs, depreciation and other amortization and amortization of purchased intangibles.

We use adjusted EBITDA as an integral part of our internal reporting to measure the performance of our reportable segments and to evaluate the performance of our senior management. Adjusted EBITDA is considered an important indicator of the operational strength of our businesses. Adjusted EBITDA eliminates the uneven effect across all business segments of considerable amounts of non-cash depreciation of tangible assets and amortization of certain intangible assets that were recognized in business combinations. A limitation of this measure, however, is that it does not reflect the periodic costs of certain capitalized tangible and intangible assets used in generating revenues in our businesses. Management evaluates the costs of such tangible and intangible assets, the impact of related impairments, as well as asset sales through other financial measures, such as capital expenditures, investment spending and return on capital and therefore the effects are excluded from adjusted EBITDA. Adjusted EBITDA also eliminates the non-cash effect of stock compensation expense. Stock compensation expense is not included in the measurement of segment adjusted EBITDA provided to the chief operating decision maker for purposes of assessing segment performance and decision making with respect to resource allocations. Therefore, we believe that adjusted EBITDA provides useful information to our investors regarding our performance and overall results of operations. Adjusted EBITDA is not intended to be a performance measure that should be regarded as an alternative to, or more meaningful than, either operating income or net income as an indicator of operating performance or to cash flows from operating activities as a measure of liquidity. In addition, adjusted EBITDA is not intended to represent funds available for dividends, reinvestment or other discretionary uses, and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP.

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The adjusted EBITDA measures presented in this Quarterly Report on Form 10-Q may not be comparable to similarly titled measures presented by other companies, and may not be identical to corresponding measures used in our various agreements.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Income from continuing operations	$ 53,059	$ 45,317	$ 147,033	$ 116,753
Stock compensation expense	10,975	14,608	33,996	43,265
Provision for income taxes	32,831	9,666	90,881	55,035
Interest expense, net	84,119	38,563	250,673	103,957
Merger and other costs(1)		878		3,890
Depreciation and other amortization	17,196	15,364	50,101	45,715
Amortization of purchased intangibles	20,711	15,770	56,398	45,833
Adjusted EBITDA	$ 218,891	$ 140,166	$ 629,082	$ 414,448

(1) Represents investment banking, legal and accounting costs directly associated with the proposed merger with an affiliate of The Blackstone Group. Other costs represent compensation charges related to the departure of certain employees resulting from cost saving initiatives and other non-routine costs associated with the disposition of certain businesses.

Results of Continuing Operations

Three months ended September 30, 2010 compared to the three months ended September 30, 2009

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Change $	Change %
	(In thousands, except percentages)			
Revenue:				
LoyaltyOne	$ 184,411	$ 177,008	$ 7,403	4.2%
Epsilon	170,468	131,926	38,542	29.2
Private Label Services and Credit	349,642	166,982	182,660	109.4
Corporate/Other	357	5,515	(5,158)	(93.5)
Eliminations	(2,435)		(2,435)	NM*
Total	$ 702,443	$ 481,431	$ 221,012	45.9%
Adjusted EBITDA[(1)]:				
LoyaltyOne	$ 46,478	$ 53,186	$ (6,708)	(12.6)%
Epsilon	44,091	35,196	8,895	25.3
Private Label Services and Credit	143,894	67,845	76,049	112.1
Corporate/Other	(13,988)	(16,061)	2,073	(12.9)
Eliminations	(1,584)		(1,584)	NM*
Total	$ 218,891	$ 140,166	$ 78,725	56.2%
Stock compensation expense:				
LoyaltyOne	$ 2,514	$ 3,847	$ (1,333)	(34.7)%
Epsilon	2,305	1,705	600	35.2
Private Label Services and Credit	1,779	1,763	16	0.9
Corporate/Other	4,377	7,293	(2,916)	(40.0)
Total	$ 10,975	$ 14,608	$ (3,633)	(24.9)%
Depreciation and amortization:				
LoyaltyOne	$ 5,827	$ 5,966	$ (139)	(2.3)%
Epsilon	21,473	18,003	3,470	19.3
Private Label Services and Credit	8,892	5,809	3,083	53.1
Corporate/Other	1,715	1,356	359	26.5
Total	$ 37,907	$ 31,134	$ 6,773	21.8%
Operating income from continuing operations:				
LoyaltyOne	$ 38,137	$ 43,373	$ (5,236)	(12.1)%
Epsilon	20,313	15,488	4,825	31.2
Private Label Services and Credit	133,223	60,273	72,950	121.0
Corporate/Other	(20,080)	(25,588)	5,508	(21.5)
Eliminations	(1,584)		(1,584)	NM*
Total	$ 170,009	$ 93,546	$ 76,463	81.7%
Adjusted EBITDA margin[(2)]:				
LoyaltyOne	25.2%	30.0%	(4.8)%	
Epsilon	25.9	26.7	(0.8)	
Private Label Services and Credit	41.2	40.6	0.6	

Total	31.2%	29.1%	2.1%	
Segment operating data:				
Private Label statements generated	34,827	31,064	3,763	12.1%
Credit sales	$ 2,046,490	$ 1,909,165	$ 137,325	7.2%
Average credit card receivables	$ 4,909,977	$ 4,217,159	$ 692,818	16.4%
AIR MILES reward miles issued	1,124,363	1,169,492	(45,129)	(3.9)%
AIR MILES reward miles redeemed	844,509	777,422	67,087	8.6%

(1) Adjusted EBITDA is equal to income from continuing operations, plus stock compensation expense, provision for income taxes, interest expense, net, merger and other costs, depreciation and amortization. For a reconciliation of adjusted EBITDA to income from continuing operations, the most directly comparable GAAP financial measure, see Use of Non-GAAP Financial Measures included in this report.

(2) Adjusted EBITDA margin is adjusted EBITDA divided by revenue. Management uses adjusted EBITDA margin to analyze the operating performance of the segments and the impact revenue growth has on operating expenses.

* Not Meaningful

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Consolidated Operating Results:

Revenue. Total revenue increased $221.0 million, or 45.9%, to $702.4 million for the three months ended September 30, 2010 from $481.4 million for the comparable period in 2009. The increase was due to the following:

Transaction. Revenue decreased $22.4 million, or 24.7%, to $68.2 million for the three months ended September 30, 2010 due to several factors:

elimination of servicing fees of $17.3 million from the credit card securitization trusts, as a result of the adoption of ASC 860 and ASC 810. In its capacity as a servicer, each of our respective banks earns a fee from the credit card securitization trusts to service and administer its receivables, collect payments, and charge-off uncollectible receivables. Upon consolidation of the credit card securitization trusts, this fee was eliminated; and

a decline in merchant fees, which are transaction fees charged to the retailer, of $15.5 million attributable to increases in royalty payments to our retail clients, as well as a decline in fees earned from our deferred programs.

These declines were offset in part by increased AIR MILES reward miles issuance fees of $5.4 million due in part to a favorable foreign currency exchange rate. The average foreign currency exchange rate for the current year period increased to $0.96 as compared to $0.91 in the prior year period. Issuance fees in local currency (Canadian dollars) increased CAD $3.5 million due to growth in the number of AIR MILES reward miles issued in the prior periods. Our issuance fees, which consist of fees for marketing and administrative services provided to sponsors, are recognized pro rata over the estimated life of an AIR MILES reward mile. Additionally, debt cancellation premiums paid by our credit card holders increased $5.4 million due to higher volumes.

Redemption. Revenue decreased $0.4 million, or 0.3%, to $120.4 million for the three months ended September 30, 2010. Redemption revenue in local currency (Canadian dollars) decreased approximately CAD $7.4 million. Redemption revenue was negatively impacted by a decline in the run-off of deferred revenue related to the conversion of a certain split-fee to non-split fee program of CAD $18.4 million. This decrease was offset by an increase in redemption revenue of CAD $11.0 million, consistent with the increase in AIR MILES reward miles redeemed of 8.6%.

Securitization income. Securitization income decreased $98.7 million. Upon adoption of ASC 860 and ASC 810 and the consolidation of the credit card securitization trusts, securitization income is no longer reflected. Amounts that were previously included in this financial statement line item are now reflected in finance charges, net in our unaudited condensed consolidated statements of income.

Finance charges, net. Revenue increased $311.4 million to $327.7 million for the three months ended September 30, 2010. On a conformed presentation, adjusting 2009 securitization income for securitization funding costs and credit losses, revenue increased $78.2 million. The increase was a result of continued positive trends in average receivable balances of 16.4% and an increase in our gross yield of approximately 200 basis points from the comparable period.

Database marketing fees and direct marketing. Revenue increased $37.8 million, or 29.2%, to $167.1 million for the three months ended September 30, 2010. The database/digital businesses continue to build from recent client signings and expansion of services to existing clients, increasing 23.3% for the three months ended September 30, 2010. The positive trends in our catalog business are continuing as our large catalog coalition database, Abacus, achieved solid revenue growth of 10.7% during the third quarter of 2010 as the data sector continued to show positive momentum. Additionally, the recent DMS acquisition added $12.6 million in revenue.

Other revenue. Revenue decreased $6.7 million, or 26.0%, to $19.1 million for the three months ended September 30, 2010. Included in the third quarter of 2009 was revenue from the sale of certain licenses in conjunction with an outsourcing agreement. Additionally, investment revenue of $1.6 million from investments held by LoyaltyOne in the credit card securitization trusts was eliminated due to their consolidation in 2010 upon adoption of ASC 860 and ASC 810. These decreases were offset in part by additional consulting revenue at LoyaltyOne.

Cost of operations. Cost of operations increased $57.7 million, or 17.7%, to $384.3 million for the three months ended September 30, 2010. The increase was driven by the following:

- higher payroll and benefit costs at Epsilon of $16.2 million and Private Label Services and Credit of $6.7 million, respectively, due to the DMS acquisition, the addition of a customer call center with the Charming Shoppes acquisition, and to support overall growth;
- increased data processing costs at Epsilon of $5.8 million from new database builds coming online and the assumption of expenses related to the DMS acquisition;
- increases in the cost of redemptions for the AIR MILES Reward Program of $6.4 million, driven by the increase in average foreign currency exchange rates. The cost of redemptions for the AIR MILES Reward Program in local currency increased CAD $1.6 million, in part from increased redemptions; and
- credit card related expenses such as marketing, stationary and supplies and postage rose $8.2 million in the current period as compared to the prior year period due to higher volumes and changes in cardholder terms.

General and administrative. General and administrative expenses decreased $10.4 million, or 34.4%, to $19.8 million for the three months ended September 30, 2010. The decrease was driven by costs associated with the sale of certain licenses incurred in the third quarter of 2009 along with a decrease in medical and benefit costs.

Provision for loan loss. Provision for loan loss was $90.5 million for the three months ended September 30, 2010. In 2009, net losses were netted against securitization income. On a conformed presentation, provision for loan loss decreased $9.1 million as compared to the prior year period net losses of $99.6 million. The decrease was a result of continued declines in the loss rate.

Depreciation and other amortization. Depreciation and other amortization increased $1.8 million, or 11.9%, to $17.2 million for the three months ended September 30, 2010 due to additional capital expenditures placed in service.

Amortization of purchased intangibles. Amortization of purchased intangibles increased $4.9 million, or 31.3%, to $20.7 million for the three months ended September 30, 2010. The increase was primarily related to the amortization of $2.1 million associated with the intangible assets acquired in the Charming Shoppes acquisition in October 2009 and $2.7 million associated with the intangible assets acquired in the DMS acquisition in July 2010.

Interest expense. Total interest expense, net increased $45.5 million, or 118.1%, to $84.1 million for the three months ended September 30, 2010 from $38.6 million for the comparable period in 2009. The increase was due to the following:

- *Securitization funding costs.* Securitization funding costs were $43.0 million for the three months ended September 30, 2010. In 2009, these costs were netted against securitization income and totaled $34.9 million. In 2010, with the consolidation of the WFN Trusts and the WFC Trust, amounts are now reflected as an expense. The increase in these costs from 2009 relates to increased borrowings due to the growth in the portfolio and the amortization of securitization fees.
- *Interest expense on certificates of deposit.* Interest expense on certificates of deposit increased $0.7 million to $7.3 million for the three months ended September 30, 2010 from $6.6 million for the comparable period in 2009 due to an increase in the average balance offset by a decline in the interest rate.

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Interest expense on long-term and other debt, net. Interest expense on long-term and other debt, net increased $1.9 million, to $33.8 million for the three months ended September 30, 2010 from $31.9 million for the comparable period in 2009. The increase in interest expense is related to an increase in the amortization of the discount associated with our convertible senior notes.

Merger costs (reimbursements). In 2010, there were no merger costs or reimbursements. During the three months ended September 30, 2009, we incurred minimal legal costs associated with our proposed merger with an affiliate of The Blackstone Group. We do not expect any future costs associated with the proposed merger.

Taxes. Income tax expense increased $23.1 million to $32.8 million for the three months ended September 30, 2010 from $9.7 million for the comparable period in 2009. In 2009, we recognized an $11.7 million tax benefit related to previously established tax reserves to cover various uncertain tax positions, which were no longer necessary during the period ended September 30, 2009. The remaining increase was due in part to an increase in taxable income, offset by a decline in our effective tax rate to 38.2% as compared to 38.8%, exclusive of the tax benefit recognized.

Income (loss) from discontinued operations. In 2010, there were no gains or losses associated with discontinued operations. Income from discontinued operations, net of taxes, of $0.5 million in the three months ended September 30, 2009 related to the terminated operations of our credit program for web and catalog retailer VENUE.

***Segment Revenue and Adjusted EBITDA*:**

Revenue. Total revenue increased $221.0 million, or 45.9%, to $702.4 million for the three months ended September 30, 2010 from $481.4 million for the comparable period in 2009. The increase was due to the following:

LoyaltyOne. Revenue increased $7.4 million, or 4.2%, to $184.4 million for the three months ended September 30, 2010 due to a favorable foreign currency exchange rate. In local currency (Canadian), revenue declined CAD $4.6 million, as increases in issuance revenue of CAD $3.5 million were offset by declines in redemption revenue of CAD $7.4 million. Although redemptions increased 8.6%, increasing redemption revenue by CAD $11.0 million in total, redemption revenue decreased as a result of a decline in the run-off of deferred revenue of CAD $18.4 million related to the conversion of a certain split-fee to non-split fee program.

Epsilon. Revenue increased $38.5 million, or 29.2%, to $170.5 million for the three months ended September 30, 2010. The database/digital businesses continued their trend of double-digit revenue growth increasing 23.3%. These businesses have benefited from the number of signings in 2009 which has continued into 2010. The remaining portion of Epsilon consists primarily of its data business, which includes the large catalog coalition database, Abacus. Abacus achieved solid revenue growth of 10.7% during the third quarter of 2010 continuing the positive trend from the first half of 2010. Additionally, the data business was enhanced by the DMS acquisition, as it added $12.6 million in revenue.

Private Label Services and Credit. Revenue increased $182.7 million, or 109.4%, to $349.6 million for the three months ended September 30, 2010. On a conformed presentation, adjusting 2009 revenue for securitization funding costs and credit losses, revenue increased $48.1 million, or 16.0% due to growth in our average receivable balances which increased 16.4%, and an increase in gross yield of approximately 200 basis points. This was offset in part by a reduction in transaction revenue, attributable to increases in royalty payments to our retail clients, as well as a decline in fees earned from our deferred programs.

Corporate/Other. Revenue decreased $5.2 million to $0.4 million for the three months ended September 30, 2010 resulting primarily from the third quarter 2009 sale of certain licenses in conjunction with an outsourcing agreement.

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Adjusted EBITDA. For purposes of the discussion below, adjusted EBITDA is equal to income from continuing operations plus stock compensation expense, provision for income taxes, interest expense, net, merger and other costs, depreciation and amortization. Adjusted EBITDA increased $78.7 million, or 56.2%, to $218.9 million for the three months ended September 30, 2010 from $140.2 million for the comparable period in 2009. The increase was due to the following:

LoyaltyOne. Adjusted EBITDA decreased $6.7 million, or 12.6%, to $46.5 million and adjusted EBITDA margin decreased to 25.2% for the three months ended September 30, 2010 compared to 30.0% in the same period in 2009. The decrease in 2010 was primarily due to the run-off of deferred revenue associated with the conversion of a split-fee sponsor to a non-split fee sponsor which was offset in part by increased margins on cost of AIR MILES reward miles redeemed.

Epsilon. Adjusted EBITDA increased $8.9 million, or 25.3%, to $44.1 million, but adjusted EBITDA margin decreased to 25.9% for the three months ended September 30, 2010 compared to 26.7% in the same period in 2009. This was driven by double digit revenue growth offset by increases in payroll costs to support this growth, as well as expenses assumed with the DMS acquisition.

Private Label Services and Credit. Adjusted EBITDA increased $76.0 million, or 112.1%, to $143.9 million for the three months ended September 30, 2010 while adjusted EBITDA margin increased to 41.2% for the three months ended September 30, 2010 compared to 40.6% in the same period in 2009. On a conformed presentation, adjusting 2009 for securitization funding costs, adjusted EBITDA increased $41.1 million, or 40.0%, and adjusted EBITDA margin increased to 41.2% from 34.1%. Adjusted EBITDA and adjusted EBITDA margin were positively impacted due to growth in our average receivable balances which increased 16.4% from 2009, improvement in our gross yield, and an improvement in credit losses as compared to the prior year.

Corporate/Other. Adjusted EBITDA increased $2.1 million to a loss of $14.0 million for the three months ended September 30, 2010, primarily related to a decline in payroll and benefits and a general reduction of overall expenses.

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Results of Continuing Operations

Nine months ended September 30, 2010 compared to the nine months ended September 30, 2009

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009	Change $	Change %
	(In thousands, except percentages)			
Revenue:				
LoyaltyOne	$ 575,612	$ 504,985	$ 70,627	14.0%
Epsilon	433,799	372,495	61,304	16.5
Private Label Services and Credit	1,032,106	512,960	519,146	101.2
Corporate/Other	1,510	27,981	(26,471)	(94.6)
Eliminations	(7,329)		(7,329)	NM*
Total	$ 2,035,698	$ 1,418,421	$ 617,277	43.5%
Adjusted EBITDA[(1)]:				
LoyaltyOne	$ 158,731	$ 146,419	$ 12,312	8.4%
Epsilon	102,654	87,717	14,937	17.0
Private Label Services and Credit	416,878	216,314	200,564	92.7
Corporate/Other	(44,171)	(36,002)	(8,169)	22.7
Eliminations	(5,010)		(5,010)	NM*
Total	$ 629,082	$ 414,448	$ 214,634	51.8%
Stock compensation expense:				
LoyaltyOne	$ 7,042	$ 10,128	$ (3,086)	(30.5)%
Epsilon	6,441	6,930	(489)	(7.1)
Private Label Services and Credit	5,318	6,394	(1,076)	(16.8)
Corporate/Other	15,195	19,813	(4,618)	(23.3)
Total	$ 33,996	$ 43,265	$ (9,269)	(21.4)%
Depreciation and amortization:				
LoyaltyOne	$ 18,111	$ 15,877	$ 2,234	14.1%
Epsilon	57,565	51,835	5,730	11.1
Private Label Services and Credit	25,913	17,740	8,173	46.1
Corporate/Other	4,910	6,096	(1,186)	(19.5)
Total	$ 106,499	$ 91,548	$ 14,951	16.3%
Operating income from continuing operations:				
LoyaltyOne	$ 133,578	$ 120,414	$ 13,164	10.9%
Epsilon	38,648	28,952	9,696	33.5
Private Label Services and Credit	385,647	192,180	193,467	100.7
Corporate/Other	(64,276)	(65,801)	1,525	(2.3)
Eliminations	(5,010)		(5,010)	NM*
Total	$ 488,587	$ 275,745	$ 212,842	77.2%
Adjusted EBITDA margin[(2)]:				
LoyaltyOne	27.6%	29.0%	(1.4)%	
Epsilon	23.7	23.5	0.2	
Private Label Services and Credit	40.4	42.2	(1.8)	

Total	30.9%	29.2%	1.7%	
Segment operating data:				
Private Label statements generated	106,627	94,086	12,541	13.3%
Credit sales	$ 6,119,733	$ 5,401,527	$ 718,206	13.3%
Average credit card receivables	$ 5,029,052	$ 4,197,426	$ 831,626	19.8%
AIR MILES reward miles issued	3,327,131	3,278,290	48,841	1.5%
AIR MILES reward miles redeemed	2,538,773	2,321,387	217,386	9.4%

(1) Adjusted EBITDA is equal to income from continuing operations, plus stock compensation expense, provision for income taxes, interest expense, net, merger and other costs, depreciation and amortization. For a reconciliation of adjusted EBITDA to income from continuing operations, the most directly comparable GAAP financial measure, see Use of Non-GAAP Financial Measures included in this report.

(2) Adjusted EBITDA margin is adjusted EBITDA divided by revenue. Management uses adjusted EBITDA margin to analyze the operating performance of the segments and the impact revenue growth has on operating expenses.

* Not Meaningful

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Consolidated Operating Results:

Revenue. Total revenue increased $617.3 million, or 43.5%, to $2.04 billion for the nine months ended September 30, 2010 from $1.42 billion for the comparable period in 2009. The increase was due to the following:

Transaction. Revenue decreased $65.5 million, or 23.4%, to $214.1 million for the nine months ended September 30, 2010 due to the following factors:

- elimination of servicing fees of $53.6 million from the credit card securitization trusts, as a result of the adoption of ASC 860 and ASC 810. In its capacity as a servicer, each of our respective banks earns a fee from the credit card securitization trusts, to service and administer its receivables, collect payments, and charge-off uncollectible receivables. Upon consolidation of the credit card securitization trusts, this fee was eliminated;

- a decrease in merchant fees, which are transaction fees charged to the retailer, of $29.9 million attributable to increases in royalty payments to our retail clients, as well as a decline in fees earned from our deferred programs; and

- a decline in transition services revenue of $19.1 million from agreements associated with the acquirers of our merchant services and utility services businesses, which were no longer in place in 2010.

These decreases were offset in part by increased AIR MILES reward miles issuance fees of $22.5 million due to a favorable foreign currency exchange rate and growth in our AIR MILES reward miles issued. Our issuance fees, which consist of marketing and administrative services provided to sponsors, are recognized pro rata over the estimated life of an AIR MILES reward mile. The average foreign currency exchange rate for the current year period increased to $0.96 as compared to $0.86 in the prior year period. Debt cancellation premiums received from our credit card holders increased $13.2 million due to higher volumes.

Redemption. Revenue increased $40.0 million, or 11.5%, to $386.8 million for the nine months ended September 30, 2010, which was impacted by a favorable foreign currency rate. Redemption revenue in local currency (Canadian dollars) decreased approximately CAD $4.0 million. Redemption revenue was negatively impacted by a decline in the run-off deferred revenue related to the conversion of a certain split-fee to non-split fee program of CAD $32.8 million. This decrease was offset by an increase in redemption revenue of CAD $28.8 million, consistent with the increase in AIR MILES reward miles redeemed of 9.4%.

Securitization income. Securitization income decreased $315.3 million. Upon adoption of ASC 860 and ASC 810 and the consolidation of the credit card securitization trusts, securitization income is no longer reflected. Amounts that were previously included in this financial statement line item are now reflected in finance charges, net in our unaudited condensed consolidated statements of income.

Finance charges, net. Revenue increased $908.0 million to $953.3 million for the nine months ended September 30, 2010. On a conformed presentation, adjusting 2009 securitization income for securitization funding costs and credit losses, revenue increased $192.2 million. The increase was a result of average receivable balances of 19.8%, credit sales growth of 13.3% and an increase in our gross yield from the prior year period.

Database marketing fees and direct marketing. Revenue increased $62.6 million, or 17.2%, to $427.2 million for the nine months ended September 30, 2010. The database/digital businesses continue to build from recent client signings and expansion of services to existing clients, increasing 16.0% for the nine months ended September 30, 2010. Our catalog business has shown positive trends for the current year as compared to the prior year with our large catalog coalition database, Abacus, achieving solid revenue growth of 12.6%. The data sector continued to show positive momentum. Additionally, the recent DMS acquisition added $12.6 million in revenue for the nine months ended September 30, 2010.

Other revenue. Revenue decreased $12.4 million, or 18.6%, to $54.2 million for the nine months ended September 30, 2010 due to (1) the inclusion in 2009 of revenue from the sale of our MasterCard Incorporated class B stock, (2) the elimination of investment revenue of $5.0 million from investments held by LoyaltyOne in the credit card securitization trusts due to their consolidation in 2010 upon adoption of ASC 860 and ASC 810, and (3) the inclusion in 2009 of revenue from the sale of certain licenses. These decreases were offset in part by additional consulting revenue at LoyaltyOne.

Cost of operations. Cost of operations increased $127.7 million, or 13.1%, to $1.10 billion for the nine months ended September 30, 2010. The increase was driven by the following:

higher payroll and benefit costs at Epsilon of $29.3 million and Private Label Services and Credit of $22.6 million, respectively, due to the DMS acquisition, the addition of a customer call center with the Charming Shoppes acquisition, and to support overall growth;

increased data processing costs at Epsilon of $7.5 million from new database builds coming online and the assumption of expenses related to the DMS acquisition;

increases in the cost of redemptions for the AIR MILES Reward Program of $43.6 million, driven by the increase in average foreign currency exchange rates and an increase in redemptions. The cost of redemptions for the AIR MILES Reward Program in local currency increased CAD $14.0 million, or 4.9%, due to an increase in miles redeemed; and

credit card related expenses such as marketing, stationary and supplies, credit bureau and postage rose $22.8 million in the current period as compared to the prior year period due to higher volumes and changes in cardholder terms.

General and administrative. General and administrative expenses decreased $13.7 million, or 17.8%, to $63.4 million for the nine months ended September 30, 2010. The decrease was driven by a decline in medical and benefit costs for the nine months ended September 30, 2010 as compared to the prior year comparable period, and costs associated with the sale of certain licenses incurred in the third quarter of 2009.

Provision for loan loss. Provision for loan loss was $275.0 million for the nine months ended September 30, 2010. In 2009, net losses were netted against securitization income. On a conformed presentation, provision for loan loss decreased $22.2 million, or 7.5%, as compared to the prior year comparable period provision for loan loss of $297.2 million. The decrease was a result of continued declines in the loss rate.

Depreciation and other amortization. Depreciation and other amortization increased $4.4 million, or 9.6%, to $50.1 million for the nine months ended September 30, 2010 due to additional capital expenditures including internally developed software projects placed in service during the second half of 2009 and the first nine months of 2010.

Amortization of purchased intangibles. Amortization of purchased intangibles increased $10.6 million, or 23.1%, to $56.4 million for the nine months ended September 30, 2010. The increase was primarily related to the amortization of $6.4 million associated with the intangible assets acquired in the Charming Shoppes acquisition in October 2009 and $2.7 million associated with the intangible assets acquired in the DMS acquisition in July 2010.

Interest expense. Total interest expense, net increased $146.7 million, or 141.1%, to $250.7 million for the nine months ended September 30, 2010 from $104.0 million for the comparable period in 2009. The increase was due to the following:

Securitization funding costs. Securitization funding costs were $128.3 million for the nine months ended September 30, 2010. In 2009, these costs were netted against securitization income and totaled $103.3 million. In 2010, with the consolidation of the WFN Trusts and the WFC Trust, amounts are now reflected as an expense. The increase in these costs from 2009 relates to increased borrowings due to growth in the portfolio and the amortization of securitized fees.

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Interest expense on certificates of deposit. Interest expense on certificates of deposit increased $3.7 million to $23.5 million for the nine months ended September 30, 2010 from $19.8 million for the comparable period in 2009 due to an increase in the average balance offset in part by a decline in interest rates.

Interest expense on long-term and other debt, net. Interest expense on long-term and other debt, net increased $14.7 million, or 17.5%, to $98.9 million for the nine months ended September 30, 2010 from $84.2 million for the comparable period in 2009. The increase in interest expense resulted from an $11.7 million increase in the amortization of the discount associated with our convertible senior notes, an increase of $1.3 million for our credit facilities due to higher average balances and the amortization of debt issuance costs of $1.3 million.

Merger costs (reimbursements). In 2010, there were no merger costs or reimbursements. During the nine months ended September 30, 2009, we received a reimbursement of $0.5 million from costs associated with our proposed merger with an affiliate of The Blackstone Group. We do not anticipate any future costs associated with the proposed merger.

Taxes. Income tax expense increased $35.9 million to $90.9 million for the nine months ended September 30, 2010 from $55.0 million for the comparable period in 2009. In 2009, we recognized an $11.7 million tax benefit related to previously established tax reserves to cover various uncertain tax positions, which were no longer necessary during the period ended September 30, 2009. The remaining increase was due in part to an increase in taxable income, offset by a decline in our effective tax rate to 38.2% as compared to 38.8%, exclusive of the tax benefit recognized.

Income (Loss) from discontinued operations. In 2010, there were no gains or losses associated with discontinued operations. Loss from discontinued operations, net of taxes, of $13.7 million in the nine months ended September 30, 2009 related to the sale of the remaining portion of our utility services business, offset by income from the terminated operations of our credit program for web and catalog retailer VENUE.

***Segment Revenue and Adjusted EBITDA*:**

Revenue. Total revenue increased $617.3 million, or 43.5%, to $2.04 billion for the nine months ended September 30, 2010 from $1.42 billion for the comparable period in 2009. The increase was due to the following:

LoyaltyOne. Revenue increased $70.6 million, or 14.0%, to $575.6 million for the nine months ended September 30, 2010 due to a favorable foreign currency exchange rate. The average foreign currency exchange rate for the current year period increased to $0.96 as compared to $0.86 in the prior period. In local currency (Canadian), revenue increased by CAD $2.5 million, as increases in issuance revenue of CAD $9.9 million driven by AIR MILES reward miles issuance growth of 1.5% were offset by declines in redemption revenue of CAD $4.0 million. Although redemptions increased 9.4%, increasing redemption revenue by CAD $28.8 million in total, redemption revenue declined as a result of a CAD $32.8 million decline in the run-off of deferred revenue related to the conversion of a certain split-fee to non-split fee program. Revenue was also negatively impacted by approximately CAD $3.0 million due to a decrease in investment revenue resulting from a decline in our rate of return and lower average balance of redemption settlement assets.

Epsilon. Revenue increased $61.3 million, or 16.5%, to $433.8 million for the nine months ended September 30, 2010. The database/digital businesses continued their trend of double-digit revenue growth increasing 16.0%. Momentum in this group continues to build as, increasingly, large multi-national companies are directing a portion of their marketing spend to Epsilon. These businesses have benefited from the number of client signings in 2009 which has continued into 2010. Our large catalog coalition database, Abacus, achieved solid revenue growth of 12.6% during the nine months ended September 30, 2010, continuing the positive trend from the first half of 2010. The data sector continues to show positive momentum, signifying the demand that marketers have for rich insight to drive

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targeted marketing initiatives. Additionally, the data business was enhanced by the DMS acquisition, as it added $12.6 million in revenue.

Private Label Services and Credit. Revenue increased $519.1 million, or 101.2%, to $1.03 billion for the nine months ended September 30, 2010. On a conformed presentation, adjusting 2009 revenue for securitization funding costs and credit losses, revenue increased $118.7 million, or 13.0%. The increase was a result of continued positive trends in average receivable growth of 19.8%, credit sales growth of 13.3%, and an increase in gross yield of approximately 150 basis points. The increase was offset in part by a reduction in transaction revenue, attributable to increases in royalty payments to our retail clients, as well as a decline in fees earned from our deferred programs.

Corporate/Other. Revenue decreased $26.5 million to $1.5 million for the nine months ended September 30, 2010 due primarily to a decline of $19.1 million in transition services revenue from agreements associated with the acquirers of our merchant services and utility services businesses, which were no longer in place in 2010, and the third quarter of 2009 sale of certain licenses in conjunction with an outsourcing agreement.

Adjusted EBITDA. For purposes of the discussion below, adjusted EBITDA is equal to income from continuing operations plus stock compensation expense, provision for income taxes, interest expense, net, merger and other costs, depreciation and amortization. Adjusted EBITDA increased $214.6 million, or 51.8%, to $629.1 million for the nine months ended September 30, 2010 from $414.4 million for the comparable period in 2009. The increase was due to the following:

LoyaltyOne. Adjusted EBITDA increased $12.3 million, or 8.4%, to $158.7 million and adjusted EBITDA margin decreased to 27.6% for the nine months ended September 30, 2010 compared to 29.0% in the same period in 2009. Adjusted EBITDA was impacted by a favorable exchange rate as well as a decline in realized foreign currency exchange losses. In the second quarter of 2009, LoyaltyOne recognized an exchange loss of $15.9 million related to certain U.S investments held. Excluding the impact of these items, adjusted EBITDA decreased CAD $21.1 million. The decline in adjusted EBITDA margin is largely due to the run-off of deferred revenue associated with the conversion of a split-fee sponsor to a non-split fee sponsor, offset in part by increased margins on cost of AIR MILES reward miles redeemed.

Epsilon. Adjusted EBITDA increased $14.9 million, or 17.0%, to $102.7 million and adjusted EBITDA margin increased to 23.7% for the nine months ended September 30, 2010 compared to 23.5% in the same period in 2009. This was driven by double digit revenue growth offset by increases in payroll costs to support this growth, as well as expenses assumed with the DMS acquisition.

Private Label Services and Credit. Adjusted EBITDA increased $200.6 million, or 92.7%, to $416.9 million for the nine months ended September 30, 2010 while adjusted EBITDA margin decreased to 40.4% for the nine months ended September 30, 2010 compared to 42.2% in the same period in 2009. On a conformed presentation, adjusting 2009 for securitization funding costs, adjusted EBITDA increased $97.2 million, or 30.4%, and adjusted EBITDA margin increased to 40.4% from 35.0%. Adjusted EBITDA and adjusted EBITDA margin were positively impacted by the growth in our average receivable balances, which increased 19.8% from 2009, increases in our credit sales, which increased 13.3% from 2009, improvement in our gross yield and an improvement in credit losses as compared to the prior year.

Corporate/Other. Adjusted EBITDA decreased $8.2 million to a loss of $44.2 million for the nine months ended September 30, 2010 related to an increase in severance costs and an increase in incentive compensation as compared to the prior year period. Additionally, 2009 was impacted by a $2.6 million non-income based tax benefit which did not recur in 2010.

Asset Quality

Our delinquency and net charge-off rates reflect, among other factors, the credit risk of our private label credit card receivables, the average age of our various private label credit card account portfolios, the success of our collection and recovery efforts, and general economic conditions.

Delinquencies. A credit card account is contractually delinquent if we do not receive the minimum payment by the specified due date on the cardholder s statement. When an account becomes delinquent, we print a message on the cardholder s billing statement requesting payment. After an account becomes 30 days past due, a proprietary collection scoring algorithm automatically scores the risk of the account rolling to a more delinquent status. The collection system then recommends a collection strategy for the past due account based on the collection score and account balance and dictates the contact schedule and collections priority for the account. If we are unable to make a collection after exhausting all in-house efforts, we engage collection agencies and outside attorneys to continue those efforts.

The following table presents the delinquency trends of our credit card portfolio:

	September 30, 2010	% of total	December 31, 2009	% of total
	(In thousands, except percentages)			
Receivables outstanding principal	$ 4,705,361	100%	$ 5,332,777	100%
Principal receivables balances contractually delinquent:				
31 to 60 days	93,027	2.0	97,024	1.8
61 to 90 days	64,641	1.3	70,423	1.3
91 or more days	130,547	2.8	157,449	3.0
Total	$ 288,215	6.1%	$ 324,896	6.1%

Net Charge-Offs. Our net charge-offs include the principal amount of losses from cardholders unwilling or unable to pay their account balances, as well as bankrupt and deceased cardholders, less recoveries and exclude charged-off interest and fees and fraud losses. Charged-off interest and fees are recorded in finance charges, net while fraud losses are recorded as an expense. Credit card receivables are charged off at the end of the month during which an account becomes 180 days contractually past due, except in the case of customer bankruptcies. Customer bankruptcies are charged off at the end of the month, 60 days following the receipt of notification of the bankruptcy or death but not later than the 180-day contractual time frame.

The net charge-off rate is calculated by dividing net charge-offs for the period by the average credit card receivables for the period. Average credit card receivables represent the average balance of the cardholder receivables at the beginning of each month in the periods indicated. The following table presents our net charge-offs for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Average credit card receivables	$ 4,909,977	$ 4,217,159	$ 5,029,052	$ 4,197,426
Net charge-offs of principal receivables	102,108	99,614	336,797	297,161
Net charge-offs as a percentage of average credit card receivables (annualized)	8.3%	9.4%	8.9%	9.4%

Liquidity and Capital Resources

Operating Activities. We have historically generated cash flows from operations, although that amount may vary based on fluctuations in working capital. Our operating cash flow is seasonal, with cash utilization peaking at the end of December due to increased activity in our Private Label Services and Credit segment related to holiday retail sales.

We generated cash flow from operating activities of $693.5 million and $306.1 million for the nine months ended September 30, 2010 and 2009, respectively. The increase in operating cash flows was due to increased profitability, including non-cash charges to income such as an increase of $275.0 million in the provision for loan loss as a result of the consolidation of the credit card securitization trusts. We also generated positive operating cash flow of $71.9 million from increases in working capital, including the timing of payments for other assets. Also impacting cash flow from operations was amounts due from the credit card securitization trusts. In 2009, the amounts due from the credit card securitization trusts were included in other assets and resulted in a use of cash as amounts increased during the period. In 2010, with the consolidation of the credit card securitization trusts upon the adoption of ASC 860 and ASC 810, amounts due from the credit card securitization trusts were eliminated. We utilize our cash flow from operations for ongoing business operations, acquisitions and capital expenditures.

Investing Activities. Cash provided by investing activities was $164.2 million for the nine months ended September 30, 2010. Cash used by investing activities was $378.9 million for the nine months ended September 30, 2009. Significant components of investing activities are as follows:

- *Credit Card Receivables Funding.* Cash increased $273.9 million due to a decline in receivables from the seasonal pay down of our credit card receivables.

- *Acquisition.* Cash decreased $117.0 million as a result of the DMS acquisition completed on July 1, 2010.

- *Capital Expenditures.* Our capital expenditures for the nine months ended September 30, 2010 were $48.3 million compared to $39.7 million for the comparable period in 2009. We anticipate capital expenditures to be approximately 3% of annual revenue for the foreseeable future.

Financing Activities. Cash used in financing activities was $759.3 million for the nine months ended September 30, 2010 as compared to cash provided by financing activities of $354.8 million for the nine months ended September 30, 2009. Our financing activities during the nine months ended September 30, 2010 relate primarily to borrowings and repayments of debt, including certificates of deposit and asset-backed securities debt, and repurchases of common stock.

Adoption of ASC 860 and ASC 810. The consolidation of the WFN Trusts and the WFC Trust resulted in $81.6 million in cash and cash equivalents as of January 1, 2010, which is shown separately from operating, financing and investing activities.

Liquidity Sources. In addition to cash generated from operating activities, our primary sources of liquidity include our securitization program, certificates of deposit issued by WFNNB, WFCB, our credit facility and issuances of equity securities.

In addition to our efforts to renew and expand our current facilities, we continue to seek new sources of liquidity. We have also expanded our brokered certificates of deposit to supplement liquidity for our credit card receivables.

We believe that internally generated funds and other sources of liquidity discussed above will be sufficient to meet working capital needs, capital expenditures, and other business requirements for at least the next 12 months.

Securitization Program. Since January 1996, we have sold a majority of the credit card receivables originated by WFNNB to WFN Credit Company, LLC and WFN Funding Company II, LLC, which in turn sold them to the WFN Trusts as part of our securitization program. In September 2008, we initiated a securitization program for the credit card receivables originated by WFCB, selling them to World Financial Capital Credit Company, LLC which in turn sold them to the WFC Trust. These securitization programs are the primary vehicle through which we finance WFNNB s and WFCB s credit card receivables.

Historically, we have used both public and private asset-backed securities term transactions as well as private conduit facilities as sources of funding for our credit card receivables. Private conduit facilities have been used to accommodate seasonality needs and to bridge to completion of asset-backed securitization transactions.

We have secured and continue to secure the necessary commitments to fund our portfolio of securitized credit card receivables originated by WFNNB and WFCB. However, certain of these commitments are short-term in nature and subject to renewal. There is not a guarantee that these funding sources, when they mature, will be renewed on similar terms or at all based on recent unsuitable volumes and pricing levels in the asset-backed securitization markets.

As of September 30, 2010, the WFN Trusts and the WFC Trust had approximately $4.4 billion of securitized credit card receivables. Securitizations require credit enhancements in the form of cash, spread deposits and additional receivables. The credit enhancement is principally based on the outstanding balances of the series issued by the WFN Trusts and the WFC Trust and by the performance of the private label credit cards in these securitization trusts.

In March 2010, Master Trust II issued $100.8 million of term asset-backed securities to investors. The offering consisted of $65.0 million of Class A Series 2010-1 asset-backed notes that have a fixed interest rate of 4.2% per year, $9.8 million of Class M Series 2010-1 asset-backed notes that have a fixed interest rate of 5.3% per year, $6.6 million of Class B Series 2010-1 asset-backed notes that have a fixed interest rate of 6.3% per year, $11.6 million of Class C Series 2010-1 asset-backed notes that have a fixed interest rate of 7.0% per year and $7.8 million of Class D Series 2010-1 zero-coupon notes which were retained by us. The Class A notes will mature in November 2012, the Class M notes will mature in December 2012, the Class B notes will mature in January 2013, the Class C notes will mature in February 2013 and the Class D notes will mature in March 2013. With the consolidation of the WFN Trusts, the Class D Series 2010-1 notes are eliminated from the unaudited condensed consolidated financial statements.

In July 2010, Master Trust I issued $450.0 million of term asset-backed securities to investors in a public offering. The offering consisted of $355.5 million of Class A Series 2010-A asset-backed notes that have a fixed interest rate of 3.96% per year, $16.9 million of Class M Series 2010-A asset-backed notes that have a fixed interest rate of 5.2% per year, $21.4 million of Class B Series 2010-A asset-backed notes that have a fixed interest rate of 6.75% per year and $56.2 million of Class C Series 2010-A asset-backed notes that have a fixed interest rate of 5.0% per year. The Class A, Class M, Class B and Class C notes will all mature in June 2015. The Class C Series 2010-A notes were retained by us. With the consolidation of the WFN Trusts, the Class C Series 2010-A notes are eliminated from the unaudited condensed consolidated financial statements.

At September 30, 2010, we had $3.4 billion of asset-backed securities debt owed to securitization investors, of which $885.5 million is due within the next 12 months.

During the first quarter of 2010, we renewed our $550.0 million 2009-VFC1 conduit facility under Master Trust III, extending the maturity to September 30, 2011.

During the second quarter of 2010, we renewed our $1.2 billion 2009-VFN conduit facility under Master Trust I, extending the maturity to June 23, 2011, and our $275.0 million 2009-VFN conduit facility under the WFC Trust, extending the maturity to June 3, 2011.

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The following table shows the maturities of borrowing commitments as of September 30, 2010 for the WFN Trusts and the WFC Trust by year:

	2010	2011	2012	2013	2014 & Thereafter	Total
				(In millions)		
Term notes	$	$ 1,158.9	$ 805.2	$ 925.7	$ 450.0	$ 3,339.8
Conduit facilities[1]		2,447.8				2,447.8
Total[2]	$	$ 3,606.7	$ 805.2	$ 925.7	$ 450.0	$ 5,787.6

(1) Amount represents borrowing capacity, not outstanding borrowings.

(2) As of September 30, 2010, with the consolidation of the WFN Trusts and the WFC Trust, $531.7 million of debt issued by the trusts and retained by us has been eliminated in the unaudited condensed consolidated financial statements.

Debt

On June 18, 2010, we amended our $750.0 million unsecured revolving credit facility to clarify the application of ASC 860 and ASC 810 and the calculation of covenant compliance.

On June 18, 2010, we amended our 2009 Term Loan agreement to clarify the application of ASC 860 and ASC 810 and the calculation of covenant compliance. In addition, the amendment removed the prepayments that were required beginning June 30, 2010 and now provides that principal payments be paid at maturity, March 30, 2012.

On August 6, 2010, we, as borrower, and ADS Alliance Data Systems, Inc., ADS Foreign Holdings, Inc., Alliance Data Foreign Holdings, Inc., Epsilon Marketing Services, LLC and Epsilon Data Management, LLC, as guarantors, entered into a term loan agreement, or 2010 Term Loan, with the Bank of Montreal, as administrative agent, and various other agents and banks. The 2010 Term Loan is unsecured. Amounts borrowed under the 2010 Term Loan are scheduled to mature on March 30, 2012. As of September 30, 2010, total borrowings under the 2010 Term Loan were $236.0 million.

As of September 30, 2010, we were in compliance with our financial covenants. See Note 9, Debt, of the Notes to Unaudited Condensed Consolidated Financial Statements for more information related to our debt.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. Our primary market risks include interest rate risk, credit risk, foreign currency exchange rate risk and redemption reward risk.

There has been no material change from our Annual Report on Form 10-K for the year ended December 31, 2009 related to our exposure to market risk from interest rate risk, credit risk, foreign currency exchange rate risk and redemption reward risk.

Item 4. Controls and Procedures.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

As of September 30, 2010, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of September 30, 2010 (the end of our third fiscal quarter), our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and include controls and procedures designed to ensure that information we are required to disclose in such reports is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

In July 2010, we acquired DMS for $117.0 million. Because of the timing of the acquisition, it will be excluded from our evaluation of and conclusion on the effectiveness of internal control over financial reporting as of December 31, 2010. In 2011, we will expand our evaluation of the effectiveness of the internal controls over financial reporting to include DMS.

There have been no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

FORWARD-LOOKING STATEMENTS

This Form 10-Q and the documents incorporated by reference herein contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may use words such as anticipate, believe, estimate, expect, intend, predict, project and similar expressions as they relate to us or our management. W make forward-looking statements, we are basing them on our management s beliefs and assumptions, using information currently available to us. Although we believe that the expectations reflected in the forward-looking statements are reasonable, these forward-looking statements are subject to risks, uncertainties and assumptions, including those discussed in the Risk Factors section in Item 1A. of our Annual Report on Form 10-K for the year ended December 31, 2009 and Item 1A. of Part II of this Quarterly Report.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary materially from what we projected. Any forward-looking statements contained in this quarterly report reflect our current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. We have no intention, and disclaim any obligation, to update or revise any forward-looking statements, whether as a result of new information, future results or otherwise, except as required by law.

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PART II

Item 1. Legal Proceedings.

From time to time we are involved in various claims and lawsuits arising in the ordinary course of our business that we believe will not have a material adverse effect on our business or financial condition, including claims and lawsuits alleging breaches of our contractual obligations.

Item 1A. Risk Factors.

There have been no material changes to the Risk Factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009 or our Quarterly Report on Form 10-Q for the quarters ended March 31, 2010 or June 30, 2010.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On January 27, 2010, our Board of Directors authorized a stock repurchase program, or Prior Repurchase Program, to acquire up to $275.1 million of our outstanding common stock, from February 5, 2010 through December 31, 2010. On September 13, 2010, our Board of Directors authorized a new stock repurchase program, replacing the Prior Repurchase Program, to acquire up to $400.0 million of our outstanding common stock from September 13, 2010 through December 31, 2011, subject to any restrictions pursuant to the terms of our credit agreements or otherwise.

The following table presents information with respect to those purchases of our common stock made during the three months ended September 30, 2010:

Period	Total Number of Shares Purchased[1]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs[2] (In millions)
During 2010:				
July 1-31	658,496	$ 56.53	652,000	$ 212.5
August 1-31	232,733	56.98	230,986	199.3
September 1-12	15,697	59.21	15,000	198.4
September 13-30	1,554	62.89		400.0
Total	908,480	$ 56.70	897,986	$ 400.0

(1) During the period represented by the table, 10,494 shares of our common stock were purchased by the administrator of our 401(k) and Retirement Saving Plan for the benefit of the employees who participated in that portion of the plan.

(2) On January 27, 2010, our Board of Directors authorized the Prior Repurchase Program which allowed us to acquire up to $275.1 million of our outstanding common stock, from February 5, 2010 through December 31, 2010. On September 13, 2010, our Board of Directors authorized a new stock repurchase program, replacing the Prior Repurchase Program, to acquire up to $400.0 million of our outstanding common stock, from September 13, 2010 through December 31, 2011, subject to any restrictions under the terms of our credit agreements or otherwise.

Item 3. Defaults Upon Senior Securities.

None

Item 4. (Removed and Reserved).

Item 5. Other Information.

(a) None

(b) None

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Item 6. Exhibits.

(a) *Exhibits:*

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Exhibit No.	Description
3.1	Second Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit No. 3.1 to our Registration Statement on Form S-1 filed with the SEC on March 3, 2000, File No. 333-94623).
3.2	Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.2 to our Registration Statement on Form S-1 filed with the SEC on March 3, 2000, File No. 333-94623).
3.3	First Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.3 to our Registration Statement on Form S-1 filed with the SEC on May 4, 2001, File No. 333-94623).
3.4	Second Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.4 to our Annual Report on Form 10-K, filed with the SEC on April 1, 2002, File No. 001-15749).
3.5	Third Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.2 to our Current Report on Form 8-K, filed with the SEC on February 18, 2009, File No. 001-15749).
3.6	Fourth Amendment to the Second Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit No. 3.2 to our Current Report on Form 8-K, filed with the SEC on December 11, 2009, File No. 001-15749).
4	Specimen Certificate for shares of Common Stock of the Registrant (incorporated by reference to Exhibit No. 4 to our Quarterly Report on Form 10-Q, filed with the SEC on August 8, 2003, File No. 001-15749).
10.1	Supplemental Agreement to Second Amended and Restated Pooling and Servicing Agreement, dated as of August 9, 2010, among World Financial Network National Bank, WFN Credit Company, LLC and The Bank of New York Mellon Trust Company, N.A. (incorporated by reference to Exhibit No. 4.1 to the Current Report on Form 8-K filed by WFN Credit Company, LLC and World Financial Network Credit Card Master Note Trust on August 12, 2010, File Nos. 333-60418 and 333-113669).
10.2	Supplemental Agreement to Receivables Purchase Agreement, dated as of August 9, 2010, among World Financial Network National Bank and WFN Credit Company, LLC (incorporated by reference to Exhibit No. 4.2 to the Current Report on Form 8-K filed by WFN Credit Company, LLC and World Financial Network Credit Card Master Note Trust on August 12, 2010, File Nos. 333-60418 and 333-113669).
10.3	Supplemental Agreement to Transfer and Servicing Agreement, dated as of August 9, 2010, among World Financial Network National Bank, WFN Credit Company, LLC and World Financial Network Credit Card Master Note Trust (incorporated by reference to Exhibit No. 4.3 to the Current Report on Form 8-K filed by WFN Credit Company, LLC and World Financial Network Credit Card Master Note Trust on August 12, 2010, File Nos. 333-60418 and 333-113669).

Exhibit No.	Description
10.4	Term Loan Agreement, dated as of August 6, 2010, by and among Alliance Data Systems Corporation, as borrower, and certain subsidiaries parties thereto, as guarantors, Bank of Montreal, as Administrative Agent, Co-Lead Arranger and Book Runner, and various other agents and banks (incorporated by reference to Exhibit No. 10.1 to our Current Report on Form 8-K, filed with the SEC on August 9, 2010, File No. 001-15749).
*31.1	Certification of Chief Executive Officer of Alliance Data Systems Corporation pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
*31.2	Certification of Chief Financial Officer of Alliance Data Systems Corporation pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
*32.1	Certification of Chief Executive Officer of Alliance Data Systems Corporation pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code.
*32.2	Certification of Chief Financial Officer of Alliance Data Systems Corporation pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code.
*101.INS	XBRL Instance Document
*101.SCH	XBRL Taxonomy Extension Schema Document
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
*101.LAB	XBRL Taxonomy Extension Label Linkbase Document
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith
\+ Management contract, compensatory plan or arrangement

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SIGNATURES

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

ALLIANCE DATA SYSTEMS CORPORATION

Date: November 9, 2010	By: /s/ Edward J. Heffernan **Edward J. Heffernan** ***President and Chief Executive Officer***
Date: November 9, 2010	By: /s/ Charles L. Horn **Charles L. Horn** ***Executive Vice President and Chief Financial Officer***